

Nepal's Services Exports: Trend and Prospects

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Abstract

The purpose of this article is to review the concepts, classifications and determinants of export services and show its growth trend and prospects in the context of Nepal. The analysis is based on service export data for the year 1974/75 - 2002/03. The article examines the factors affecting production and service export. The compound growth rate of service export in Nepal during the study period has been encouraging despite its fluctuating nature in yearly growth pattern. Although there have been many challenging problems concerning the development of this sector, if efforts could be made from the government and concerned private actors and the future of this sector seems bright.

Introduction

The importance of services sector in the economic development of a country began to be recognized since the late 1970s. Trade in services is gaining its importance and becoming competitive worldwide in the present time. The revolutionary development in the information and communication technology has significantly contributed to the growth of services sector in both developed and developing countries. This tendency of the development of service sector reflects that the knowledge about how to do things, how to communicate, how to work with other people etc is becoming more and more important. As a result investment in human capital has got greater priority than investment in physical capital.

Economists have argued that the growth of services sector contribution to total GDP is the indication of the step forward in the stages of development. In other words, contribution of services sector to total GDP largely depends on the state of the economic development of the country concerned. In this regard, the sector thesis of the stages of development by Fisher (1933, 1939) and Clark (1940) may be relevant to mention here. According to their thesis, countries are assumed to start as primary producers and then, as the basic necessities of life are met, resources move into manufacturing or secondary activities. Finally, with

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rising income, more leisure and an increasing saturated market of manufactured goods, resources move into services or tertiary activities producing commodities with a high income elasticity of demand. However, countries with different levels of development may devote the same proportion of resources to the services sector (Cited from Thirwall, 1995).

After the Uruguay Round negotiations and agreements on terms and basis of international trade in services between the developed and developing countries, it has got new directions. Export of services has been one of the major sources of foreign exchange earnings for developing countries. Some of the developing countries, including Nepal, are continuously gaining from services trade. Trade in services has been growing faster than trade in goods in the world economy since the past decades (World Bank 1999/2000, UNCTAD, 1992).

Definition and Classification

A service is differentiated from a good. A good may be defined as a physical object which is appropriable and, therefore, transferable between economic units. A service may be defined as a change in conditions of a person or a good belonging to some economic unit, which is brought about as the result of the activity of some other economic unit (Lee and Naya (ed.), 1986). Services are also defined as economic goods which do not take a tangible and storable forms. Some require physical presence of the customer as in the case of hairdressing, medical treatment or live entertainment. In other cases services can be performed at a distance as in the case of legal representation, insurance etc (Black, 2002).

Services have been categorized as the services which require the physical proximity and those though, physical proximity is useful to increase the efficiency of services, but ordinarily do not require it. Transmission of live music over the wire is an example of the later category of services. Those services which require physical proximity may also be of different categories. For example mobile provider and immobile user (e.g. foreign contact on construction); mobile user and immobile provider (e.g. laboratory services); and mobile user and mobile provider (e.g. dry docking facilities to ships) (Charanilam, 1997).

Services may also be categorized as those services which are complementary to trade in goods (e.g. some form of transportation, insurance, banking and advertising). Those services which are not related to goods (e.g. banking, life insurance, professional real estate, telecommunication, data processing and information and travel). Those services that substitute for trade in goods (i.e. ranching, rental leasing and repair) (Lee and Naya, op.cit.).

Factors Affecting Production and Export of Services

There have been various factors responsible for the determination of the pattern of international trade in services. As in the case of the international trade in goods, international trade in services is also largely affected by the endowment of land, labour, capital and technology. For example, countries with relatively larger size of unskilled labour tend to export labour intensive services like temporary movements of construction crews, manning

ships and the simple processing of electronically transmitted data. Similarly, countries with relatively skilled labour tend to export services like architectural and financial services, the writing of computer software etc. Countries with beautiful geographical sites and rich socio-cultural heritage tend to export shipping services, tourism services etc. Other factors affecting services export have been economics of scale as large domestic market in law, financial expertise etc. may become the basis to take an advantage in the world market. Quality and quantity of complementary capital equipments like computer access, aircraft, ships, repair and training for such services help to increase the export of services. Saving and investment pattern in the domestic economy largely affects the resources allocation between goods producing and services producing sectors and hence, the services exports. Similarly, volume and direction of merchandise trade also affects the direction and volume of services exports. Further, the investment in R and D and level of education affects the export of services. The more the accumulation of technical know-how, the more the enhancement of the trade in services (UNCTAD, op.cit., Patrick and Sanvant (ed.), 1990).

Specifically, from both the demand supply sides, factors stimulating trade in services include - economic growth by leading companies to seek new market opportunities and individuals to travel for business and pleasure; improved transportation by making travel and freight shipments faster and easier; advances in IT by improving communication and data flows between countries; a search for efficiency and expertise leading consumers to seek best locations for performing their tasks and the growth in trade of manufactured products requiring variety of services (Lovelock, 2001).

Several factors affect the efficiency and competitiveness of services export to international market. Those factors include exporting the service concept to reach out new customers; importing customers with distinctive appeal or competence; transporting customers to new locations by opening new routes; exporting services including repair and maintenance, freight transport, cleaning warehousing etc. (ibid).

For the integrated strategy of expansion of services exports each of the 8 ps are to be globalized (ibid).

Product Elements: local needs are to be recognized and appropriate positions are to be established against local competition.

Price and User Cost: the relative affordability of the customers are to be considered.

Promotion and Education: includes well-trained salespeople and contact personnel, brochures, web site, and presentations at trade shows.

Price, cyberspace and time: includes physical facilities, building design, operating schedules in accordance with the local styles, regulations and climate.

Productivity and Quality: should be matched with the local availability of skills and attitudes.

People: is to ensure that the global corporate culture can co exist with the local national culture without causing ethical conflicts or discomfort among employees and customers.

Processes: any process offering distinctive competitive advantage is to be used worldwide.

Physical Evidence: Must be careful to create suitable variations for different climate and different cultural norms.

Barriers

There have been various barriers to international trade in services including visa requirements, investment regulations, restrictions on repatriation, marketing regulations, restriction on employment of foreigners, compulsion to use local facilities etc. Underdeveloped countries have the fear that liberalization of trade in services will lead to domination of the services sector by the multinationals from the developed countries. However, as most of the services are labour intrusive, the developing countries have scope to take advantage in such services. But there have been several constraints towards such benefits including technical, organizational, financial and legal. The immigration laws of developed countries restrict the manpower from developing countries which limits their scope of benefits. Lack of finance in the service producing industries has also been the major constraint for the developing countries. Technological backwardness has been another obstacle (ibid)

For the underdeveloped countries with numerous constraints and weak competitive strength both in goods and services trade, an alternative form of trading called the niche trade in services may be established. Niche trade involves narrow trading opportunities in which limited or no competition constitutes a natural form of market protection (UNCTAD, 1999). Such a concept is significantly important for small and landlocked countries, especially in travel and tourism services.

Importance and Size

Nepal is among the countries which are continuously gaining from the international trade in services. Services export has been the major source of foreign exchange earning. Egypt, Jordan, Nepal, Tunisia and Yemen earn 40 percent to 90 percent of their foreign exchange from services export (UNCTAD, op.cit.). As suggested by the sector thesis described above, the share of services sector in the total GDP of a country largely depends on the state of its development. Nepal has a comparatively larger services sector. The following table shows the contribution of different sectors of the economy to total GDP of Nepal over the past decades.

Table 1
Sectoral Contribution to total GDP

Fiscal Year	Percentage Share of		
	Agriculture	Industry	Services
1974/75	70	11	20
1984/85	51	15	34
1994/95	41	22	37
1999/2000	40	32	28
2000/01	41	32	27
2001/02	41	33	26
2002/03	40	35	25

Source: Economic Survey, Ministry of Finance, Various Issues.

As shown by the above table, the share of services sector in GDP over the decade of 1974/75 to 1984/85 had been the increasing trend. Fiscal year 1984/85 had been the year of highest share of services to total GDP. However, since then its share shows the declining trend but has remained above 25 percent.

The comparatively larger share of services to total GDP in Nepal has not been due to the advanced stage of economic development and high mass consumption as subsistence agriculture still dominates and manufacturing is still at infant stage contributing insignificantly. One of the studies conducted on the contribution of services to the goods sector has concluded that growth of services sector has a positive impact on the growth of goods sector of the economy. It has also been suggested that the contribution of services sector to goods sector has been higher in periods of balanced growth of the two sectors than the period of unbalanced growth of the services sector alone (Shrestha, 1998). However, this suggestion also does not justify the maturity stage of the economy. Since Nepal is a country having a dual economy comparatively more advanced urban sector is highly contributing to services production and export than the less advanced rural sector. Some doubts have been raised about Nepal's comfortable position in services trade maintaining that most of the receipts have been from transit trade related with gold smuggling (Pandey, 2000). However, such a tendency could be checked and replaced by new areas of services production and export.

Trend of Services Exports

Whatever the size of services sector to total GDP and its distribution at rural and urban sectors, Nepal has been a country with a surplus in the international trade in services. During the period of study, Nepal has been the net exporter of services. However, the yearly rate of contribution of net exports of services to total GDP has shown a wide range of fluctuation as shown in the following table. The yearly change in the percent share of net exports to GDP ranges from 544.4 to -87 which does not show any definite trend.

Table 2
Total Exports and Net Exports of Services as Percent of GDP

Fiscal Year	Total Exports of Services as percent of GDP	Net Exports of Services as percent of GDP	Yearly percent changes in Net Exports of Services as percent of GDP
1974/75	4.2	1.7	-
1975/76	4.3	1.6	-5.9
1976/77	5.4	2.9	81.3
1977/78	5.7	2.9	0
1978/79	6.5	3.5	20.7
1979/80	7.4	3.7	5.7
1980/81	7.6	4.1	10.8
1981/82	7.4	4.4	7.3
1982/83	7.5	4.8	9.0
1983/84	6.6	3.6	-25.0
1984/85	61.2	23.2	544.4
1985/86	6.5	2.8	-87.9
1986/87	7.6	3.6	28.6
1987/88	6.5	2.8	-22.2
1988/89	7.2	3.3	17.9
1989/90	6.4	2.7	-18.2
1990/91	6.6	2.2	-18.5
1991/92	8.1	2.6	18.2
1992/93	9.0	3.0	15.4
1993/94	15.7	8.8	193.3
1994/95	17.8	10.8	22.7
1995/96	15.5	8.4	-22.2
1996/97	19.5	14.0	66.7
1997/98	15.0	9.7	-30.7
1998/99	14.0	8.9	-8.2
1999/00	7.5	4.5	-49.4
2000/01	7.1	2.4	-46.7
2001/02	5.2	1.0	-58.3
2002/03	5.4	0.2	-80.0

Source: As per Table 1.

A time series analysis has been done in order to find out the compound growth rate of the net exports of services during the study period. Applying the semi-log arithmetic function the following equation has been formed.

$$\log Y_e = \log a + \log bX$$

The actual values of the net exports of services and the estimated values are shown by the following chart.

From the chart it has been observed that in most of the years, the net exports of services has nearly approached the straight line. It has shown minor cyclical fluctuations excepts the year 1984/85 when the net export of services largely increased due to the increases in investment income aboard. However, since the year 1999/2000, net exports of services continuously declined which may be due to two reasons. The first reason has been the development of conflict economy due to which adverse situation in the services production and exports arised as in other sectors of the economy. The second reason has been that the magnitude of decline enlarged due to the change in the data format in the national accounts. Some of the items related to services export in the new format has been omitted and values are underestimated. Data published from Nepal Rastra Bank and Ministry of Finance differ in some of the years.

From the time series regression equation the value of the coefficient b has been log 0.071. The compound growth rate has been derived from the value of the coefficient applying the following relationship.

$$\begin{aligned} \text{Compound Growth Rate} &= (\text{antilog } b-1) \cdot 100 \\ &= (\text{antilog } 0.071-1) \cdot 100 \\ &= (1.81-1) \cdot 100 = 0.18 \cdot 100 \\ &= 18.0 \text{ percent} \end{aligned}$$

The result shows that the net exports of services over the study period has been about 18 percent. This growth trend is encouraging for the country where adverse trade balance at the substantial level has been continuing since last several decades. Nepal has also large scope for enlarging and diversifying its production base and export of services.

Prospects and Constraints

Nepal has some specific areas of services production and export on line with comparative advantage where resources could be concentrated. Tourism is one of such sectors where various unique services could be generated. Nepal's biological and socio-cultural diversity could be utilized to make this sector attractive among the tourists from the world. To make tourism sector as an integrated part of the national economy more local jobs are to be created, use of local food and other materials are to be increased, tourism services including guidance, fooding, trekking, cultural entertainment, transportation and communication etc could be improved so that the domestic value added from this sector would increase. Recently

cultural and religious tourism has been emerged as a new concept which is greatly important for Nepal. Inventing new trekking sites and providing attractive services could make this sector competitive. The investment on R and D on food technology education would help to increase domestic value added from this sector. In addition to the existing tourism services Nepal can develop many niche activities unique than that of other countries. In the case of some landlocked and small countries, where comparative advantages are few economics of scale difficult to attain in production marketing or transport, competitiveness at the global level may be difficult and the economies may face the danger of remaining perpetually marginalized. Such LDCs nonetheless retain chances of success through alternative development options that match their disadvantage and are commonly referred to niche production (UNCTAD, 1999). And Nepal should seriously think about the development of such areas of niche character in the tourism and travel.

Nepalese tourism sector has numerous problems and challenges which should be properly addressed. To mention some of the problems being tourism promotion activities limited to a few geographical areas, limited extension of tourism infrastructure, lack of adequate exposure for tourists' attraction in the media, prevailing insurgency situation, negative publicity of Nepal in international media etc (Ministry of Finance, 2003/04). The government's efforts should be towards solving these challenging problems to develop the tourism sector in competitive manner.

In order to diversity the production base and increase the export of services the investment in education and health, information and communication technology should be increased. Recently, Nepal has gained some success in IT sector but even having enormous prospects, the education, health and financial sectors have not been developed to the desired extent. Search for new opportunity for export of health, financial and education services and increase investment in these sectors seem to be needed. In sum, instead of concentrating on the services attached to transit trade, Nepal should think about the production of services both of global and niche nature to make this sector competitive. The present comfortable position in services trade should not be deteriorated instead be further accelerated. The government's policy must be directed to create an environment for reinvestment of the services export income for the further development of this sector. The 8 Ps are to be incorporated to enter into the world market and reap benefits there.

Conclusion

The increasing pace of international trade in services has been a worldwide phenomenon. It is becoming more and more competitive in recent years. In the world different types of services are traded and strategies adopted to make this sector more competitive. Some developing countries have made good performance in this area. Nepal is also a country having surplus in services trade despite its adverse trade balance and it has been the major source of foreign exchange earning. The compound growth rate of services exports during the study period has been encouraging despite its fluctuating nature in yearly growth pattern. Although there have been many challenging problems concerning the development of this

sector, if efforts could be made from the government and concerned private actors, the future of this sector seems brighter.

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