CHAPTER 2

Reconstruction
Implication for Economic Management

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The devastating earthquakes anf aftershocks of 2015 resulted in a loss of property worth about NPR 701 billion, or one-third of national output. Following the earthquake, the economy could not expand. The Post Disaster Needs Assessment (PDNA) report has quoted the World Bank's simulations that earthquake is expected to end up pushing an additional 2.5 to 3.5 per cent of Nepali people into poverty. The earthquake seems to have disproportionately affected the poorer and rural areas. The real Gross Domestic Product (GDP) growth decelerated to less than one per cent in Fiscal Year (FY) 2015/16, against the growth of three per cent in the previous fiscal year. Its immediate effect was a slowdown in both public and private sector investments. It also lowered job creation owing to the large loss of rural work base.

The Post Disaster Recovery Framework (PDRF) prepared by the National Reconstruction Authority (NRA) estimates the cost of reconstruction to be NPR 837.74 billion. Additionally, the government's decision to provide NPR 300,000 to destroyed households will add at least another NPR 100 billion in the estimated figures taking the sum of the estimate to over NPR 950 billion.

Brunt on economy

The calamity destroyed the physical infrastructure, the brunt of which was taken by the manufacturing sector and the fledging service industries. The agriculture sector remained relatively insulated.

Agriculture sector: The impact of the earthquake on farmland was not substantial. At the time of the earthquakes, April to May, rice planting had not begun and the winter crops such as wheat had already been harvested. Hence, loss of crops was also limited. Still, the PDNA estimated impact in terms of loss of output and production on agriculture was NPR 10 billion. This is because of the effect on other resources of production like labour, machinery, stock of grains and seeds, and livestock, coupled with damages to agricultural infrastructure–such as irrigation systems and roads–that led to the loss of output and productive capacity. This loss of livestock, crops and seeds was not only a loss of consumable items but also the loss of source of income for farmers.

An impact appraisal was done to assess the effects of the earthquake on agriculture by the Government of Nepal, Food and Agriculture Organization of the United Nations (FAO), and Food Security Cluster, in August 2015. The survey conducted in six affected districts (Dhading, Dolakha, Gorkha, Nuwakot, Rasuwa, Sindhupalchok) revealed that a high percentage of households had stored rice, millet and maize in store at the time the disaster struck. The impact on stored crops and seeds was greater affecting the availability of seeds in the same summer planting season and the winter season of the following years.

The damage was also apparent on the subsequent years because of shortage of labour to undertake operations and harvesting, according to the Agricultural Livelihoods Impact Appraisal. The agriculture was further affected by the lack of labourers and increased wage rates due to reconstruction activities.

About 58 per cent of the earthquake affected people are reported to have had farming as an important source of income before the calamity, as per the Aid and Recovery Survey done by The Asia Foundation.[1] In severely affected districts, farming was a major source of income for more than 96 per cent of the respondents. Among these, 57 per cent said that their main sources of income were affected by the earthquake.

The Asia Foundation's Impact and Recovery Monitoring, Phase III survey done in September 2016 highlighted that farming was the most affected occupation with three fourth of the land-owning farmers reporting negative impact on income. It also revealed that those farming other people's land, and who were dependent on remittance, were less likely to report farm loss after the earthquake. Most of the people (70 per cent) said that they returned to farming, 14 per cent returned to business, eight per cent to daily wages and four per cent kept relying on remittances in the survey year–2016/2017. This might be attributable to people's multiple sources of income. For instance, an individual farmer might also work as a labourer for daily wage at some point in the agriculture cycle. This enabled them to shift to other forms of work to sustain their livelihood.

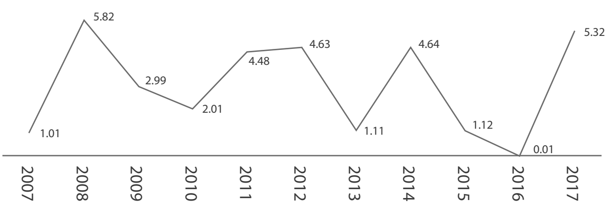
As things moved towards normalcy at micro and macro levels, in 2016/17, economic activity picked up across the board. The agriculture sector, which contributes about 29 per cent of real GDP, grew by 5.32 per cent in FY 2016/17 (Figure 2.1). The production of principal cereal crops accelerated, boosting the agricultural output, on the back of a favourable monsoon, commercialization of agriculture, expansion of irrigation and timely availability of fertilizers, not to mention contribution of normalization of supplies.

Manufacturing Industry: The districts housing Nepal's core manufacturing corridors, located at Tarai flats, were relatively unaffected by the earthquake. However, the industries in 11 districts were damaged. There was a general lack of labourers and demand for industrial goods was low. Ministry of Finance data show that this led the manufacturing sector to fall by 6.45 per cent in FY 2015/16, as against a growth of 1.42 per cent in the previous year. A field survey done by Chatterjee (2017) revealed that Kathmandu Valley suffered the greatest damage in the industrial sector–the impact was the largest on Balaju Industrial Area.

There was a fall in demand for industrial goods, because of the earthquake of 2015. Power shortage and disturbances in supply of

Figure 2.1

Growth rate of agriculture sector



Source: MoF 2007-2017

fuel and raw materials further affected the output of the industrial sector. For instance, the estimated production downtime in cement industries was reported to be between two days to two weeks. The productive capacities of the cement factories were estimated to have been reduced to 30 to 35 per cent. The overall decrease in manufacturing industry was eight per cent, in FY 2015/16. Moreover, the private sector suffered severe losses, equal to almost 76 per cent of total losses, in the productive sector.

Nepal's limited insurance products, low insurance penetration, lack of survey expertise and delays in settlement of claims, forced the companies to spend their own money in repair and reconstruction work. Even for those who did receive their claims, the amount did not even cover 20 per cent of their losses. The reason behind the low compensation was that the policies calculate the compensation amount after deducting the depreciation of the item. Since, in most cases, industries were established decades ago, the depreciation would be substantial. Only 10-20 per cent of the original value of the material was thus received by the loss bearers. The effect was more pronounced in micro, small and medium enterprises. They neither had sufficient capital cushion to reinvest nor were they compensated adequately for their losses.

The same study also revealed that 50 per cent of the surveyed industries became functional within two weeks of the quake. However, the recovery period, for the business to get into normalcy, was stated to be between six months to one year. Moreover, 61 per cent of the respondents felt the need to change their business, while almost 39 per cent felt that there was no need to bring any change in their current business.

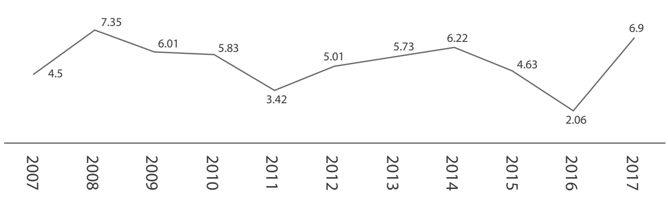
Overall, in 2017, the industrial sector, which contributes about 14 per cent of the nominal GDP, bounced back with an 11 per cent growth–the highest recorded since 2002–mainly owing to the base effect. The upward trajectory was supported by a double-digit growth of all the industrial sub-sectors. This reflected the regularization of electricity supply, availability of raw materials and an improvement in post-earthquake reconstruction activities. The lower base of the previous year also contributed to growth. Further, the overall industrial sector recovery was also fuelled by a record-high addition of hydropower capacity in the electricity subsector as well as in mining and quarrying activities prompted by the gained momentum in post-quake reconstruction.

Services sector: In a country where services account for over half of the nation's GDP, and employs 20 per cent of the total labour force, the disruption of enterprise affected the productive sector badly. The services sector grew by only 2.06 per cent in FY 2015/16, compared to the 4.63 per cent of the year before (Figure 2.2). Moreover, because of the backward and forward linkages of areas like travel, rafting, airline business, money exchange and small tourism business, their contribution to the economy is appreciable. Minimal tourist arrival, owing to the lagging effect of the earthquake, and prolonged border disruptions adversely affected hotels and restaurants, and trading activities.

The PDNA estimated revenue losses of US$450 million over the next three years in the tourism sector. For instance, in Kathmandu Valley alone, the estimated damage to tourism infrastructure was about at US$162 million. The calamity had struck at a time when the tourism sector was growing by 12 per cent. At that time, investors were planning to invest in construction of hotels in Kathmandu, Pokhara and other major tourist destinations.

Figure 2.2

Growth rate of services sector



Source: MoF 2007-2017

The quake resulted in 80 per cent of hotel bookings to be cancelled in three months. Occupancy rates stood at five per cent in the subsequent months. Nepal attracted about 32 per cent less tourists in FY 2015/16 than in the previous years. National parks reported damages to facilities and loss of revenue potentially jeopardizing conservation efforts and local livelihoods. Thousands of jobs were at risk as operators in Nepal struggled to reassure their clients that hotels and tourist infrastructure were functioning and safe. The earthquake and the slowdown in tourism revenue affected the hotel projects.

In response, the government formed a public-private Tourism Recovery Committee to work out a Tourism Recovery Plan. The plan was to generate new investments, while retaining current investments, in the tourism sector and to support jobs (minimize job losses) in the sector. The aim was to "save" the business from the adverse effects to ensure minimal job losses, not to mention recover rural livelihoods and enable them to face the upcoming winter.

Gradually, the normalization efforts of the private sector, community and government helped bring a surge in visitor arrivals. In 2017, tourist arrivals topped 940,000, a record high, indicating the sector had recovered from the rubbles of the earthquake and trade disturbances at the southern border. Hotel occupancy rates in the tourism centres, that lie in and around Kathmandu Valley, reached 90 per cent.

Both the record tourist arrival and trade normalization have favoured wholesale and retail trade, restaurant, travel and communication sub-sectors. Overall, the services sector witnessed a rebound in growth, marching above 5.5 per cent, in FY 2016/17.

Education sector: Although fleeting, the education sector was among the most affected sectors from the earthquake and its aftershocks. It was estimated that 2,472 higher secondary schools, 31,907 primary schools and 413 early childhood development (ECD) centres were affected by the disaster. Moreover, existing student vulnerabilities were exacerbated by displacement, Post Traumatic Stress Disorder, difficulties in accessing to school and impediment in their economic conditions. The percentage change in enrolment numbers dropped significantly the next year[2], mostly apparent in primary schools and ECD centres. Places like Rasuwa, Sindhuli, Dolakha, Ramechhap and Okhaldhunga experienced the fall at double digits.

However, there has been some positive development too. In three years, 3,613 educational institutions have been rebuilt and 1,719 institutions are under construction, out of the estimated 7,553 educational institutions destroyed by the earthquake. Moreover, estimates from UNICEF predict that there has been an increase in access of basic and secondary education in Nepal, especially for girls.

Labour market: The labour market was adversely affected by the loss of lives and trauma. It is estimated that 5.6 million workers were affected by the earthquake. Livelihoods were impacted and incomes decreased, compelling earthquake-affected families to be dependent on relief and rehabilitation. This entire event interrupted the smooth functioning of the labour market. Many working-class households fell deeper into absolute poverty.

Moreover, the economic activities that got squeezed out by the earthquake were labour intensive sectors, like agriculture, tourism, transport and trade and commerce. The implications for the labour market and decent work are of both short-term and long-term. This was the short-term implication. In addition, a slower economic growth caused a lower demand for labour.

The long run implication depends on how quickly the government can restore the business environment and carry out reconstruction. The expansion of labour market opportunities is directly linked with the growth of the overall economic activities and their labour intensity. Moreover, investment growth, in both the public and private sectors, is one of the major determinants of jobs creation.

The labour market effects of the recent earthquake were surveyed in four of the severely earthquake-affected districts, namely Dhading, Nuwakot, Kavrepalanchok and Sindhupalchok, in August 2015.[3] The survey revealed that labour market opportunities had not increased except in residential house construction and debris management. No new opportunities were observed in larger reconstruction activities, agriculture or tourism.

Given the rising wages in labour markets abroad and lack of lucrative domestic opportunities, labour emigration has become a trend. Labour is scarce in agriculture, construction and reconstruction. Construction wages have increased in a more pronounced manner in and after 2015. There is no labour market equilibrium even within a region. For instance, although the earthquake-hit districts are not very far from each other and are interconnected by reasonable transportation and communication, there are wage differences across districts. This shows a differentiated condition of labour availability for the same kind of work.

The country still lacks skilled labour, such as plumbers, carpenters, electricians and technicians, required for construction activities. A shortage of skilled workforce has affected the construction of earthquake resistant houses in the 14 severely affected districts. The estimated number of skilled labour is 60,000 with the Ministry of Urban Development training only 15,000 so far. Moreover, many of those trained are found to be engaged in other occupations.

Trade sector: Data from FY 2014/2015 shows that there was an immediate three-digit surge, by percentage point, in imports of materials like steel rods and sheets (235 per cent), pipe and fittings (567 per cent) and clinker. These items are mostly used in construction. Their imports had gone up by just two digits in previous years, before the earthquake. The same year witnessed a decrease in exports by 5.5 per cent, to NPR 70.98 billion.[4] Similarly, FY 2015/16 witnessed an export fall of 23.4 per cent, while imports fell by 9.9 per cent. Disruptions in trade in FY 2015/17 owed more to blockade at the southern border, thus, it is difficult to attribute conclusively the impact of earthquake on trade. The total trade deficit amounted to NPR 470 billion, a contraction of 8.2 per cent, as against the 12.9 per cent expansion of the same period of the previous fiscal year.

A four-and-a-half month long disruption of supplies due to disturbances at the southern border also led to a decrease in both export and import of goods and services. It too resulted in the narrowing down of the trade deficits. In other words, the prolonged effects of the devastating earthquake and the crippling trade disturbances in 2015 had a major impact on merchandise exports and overall trade in 2016. The reconstruction drive of 2016 coupled with shrinking industrial base, escalated imports. This worsened the trade deficit in FY 2016/17. Imports have been swelling while exports have yet to come back to normalcy after hitting its lowest level in 2015/16.

Macroeconomic implications

Inflation: Inflation in Nepal is normally influenced by structural, monetary and price situations in India. In FY 2014/15, inflation was already slowing down to 6.9 per cent before the earthquake occurred. This was a 2.5 percentage point lower than that in the corresponding period of the previous year. The slowdown in price rise was driven by several factors, including improvements in both food and non-food prices. The trend did not continue in the following FY, 2015/16, mainly because of the trade disturbances at the southern border. It was also affected by a weaker supply situation due to a substandard performance by agriculture production (Figure 2.3).

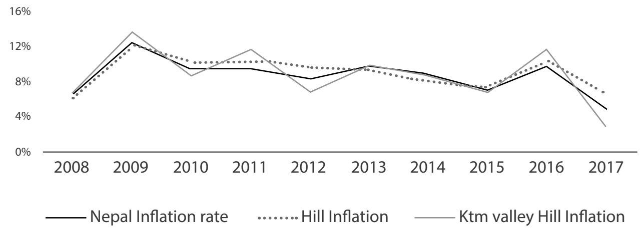
Due to the massive supply of essential materials to earthquake-affected people, through immediate relief programmes, no price pressure was seen in the affected region. However, there were some immediate spikes in local prices, but they were short lived.

Overall, there was little inflationary pressure built following the earthquake, but disruptions at the major supply centres and trade disturbances at the southern border had some impact in 2016. In last three months of FY 2014/15, national prices rose by 2.46 per cent, compared to 2.1 per cent in the same period of FY 2013/14. In the hills, where the earthquake effect was high, inflation was 2.5 per cent in the last quarter of FY 2014/15, against the 1.84 per cent of the previous year. Soaring prices in cereals grains, vegetables, fruits and the shortage of fuel, thus higher transportation costs, led inflation to edge up to 9.9 per cent in FY 2015/16. It was 7.2 per cent in the previous year. The inflationary pressure subsided and since then it has remained at less than five per cent during FY 2016/17. Moreover, in FY 2017/18, given the inflation slowdown across the border and a strong agriculture growth in the previous year, the rate of inflation is expected to remain at the lower single digit. This should completely overcome the price pressures arising from the earthquake and trade disturbances at the border.

Fiscal response: The earthquake had significant implications for public finance. It increased government expenditure and reduced domestic revenue. It increased domestic/external borrowing and substantially altering existing investment and monetary expansion. The government had to divert resources away from planned investments to meet the emergency needs- relief and rehabilitation. The required funds for the rescue and recovery were initially taken from Prime Minister's Disaster Relief Fund (PMDRF). The government allocated NPR 91 billion in the FY 2015/16 budget, following the earthquake, for recovery and reconstruction. About NPR 17 billion was allocated through sectoral ministries and other public agencies before the NRA began operations. The other NPR 74 billion was allocated for National Reconstruction

Figure 2.3

Inflation rate



Source: NRB 2017

Fund (NRF). Out of the total allocation, 67 per cent (NPR 50 billion) was for housing, four per cent (NPR three billion) for public buildings, two per cent (NPR two billion) for archaeological structures, nine per cent (NPR seven billion) for physical infrastructure and the remaining 18 per cent for production and social sector, as per Post Disaster Recovery Framework. In FY 2015/16, only 35 per cent of the planned reconstruction budget was spent.

Similarly, in FY 2016/17, about NPR 141 billion was allocated for post-earthquake reconstruction and rehabilitation. This included administrative expenses for the NRA and grants (unconditional and recurrent) to government agencies, public institutions and affected households. Funding for construction of schools and hospitals was also included in this. Foreign loan and grants formed about 88 per cent of the total reconstruction outlay for FY2016/17 (Table 2.1).

Housing reconstruction has picked up some speed lately after two years of slow progress. Of the 781,733 beneficiaries eligible for housing grants, including those in less affected districts, over 91 per cent have been enrolled in the recipient list. Many houses are under construction as beneficiaries received their first grants. However, disbursement of the second and third tranches took a while to make meaningful progress. According to NRA data, by the end of March 2018, it is reported that around 366,245 beneficiaries have received second tranche and 113,307 applicants have received the final amount. So far, 119,182 houses were completed.

Given the technical requirements of reconstruction and the lack of knowhow to abide by the earthquake resistant measures, not to mention a lack of sufficient funds,[5] the majority of those affected by the earthquake were slow to start rebuilding of their houses.

Monetary Policy Response: In an effort to provide relief to the quake survivors, Nepal Rastra Bank (NRB) immediately announced an interest free refinance facility to banks and financial institutions to enable them to provide loans to the victims of the earthquake at a subsidized interest rate of two per cent. The NRB circular also directed the financial institutions to provide concessional loan up to NPR 2.5 million for each household inside

Kathmandu Valley and up to NPR 1.5 million for those in other quake affected districts. Three years since the disaster, only 774 survivors have availed this loan to borrow total of NPR 1.33 billion.[6] Contrast this with the official data that shows over 505,000 private houses completely damaged and around 279,000 partially damaged. The apparent reason behind the low exhaustion of loans is that they were exclusively directed towards individuals with decent income, adequate collateral and those who could present evidence from their respective local bodies that they did not own any other inhabitable house. There were other technical ambiguities as well which made financial institutions reluctant to lend under this scheme. Furthermore, financial institutions are not allowed to charge such borrowers any extra amount, except the interest and

Table 2.1

Breakdown of the reconstruction budget

(NPR billion)

National reconstruction authority	**FY 2015/16**	**FY 2016/17**	**External Assistance (%)**
Recurrent Expenditure	0.1	0.16	
Capital Expenditure	0.1	0.01	
Total National Reconstruction Authority	0.2	0.17	
National Reconstruction Authority Trust			
Recurrent Expenditure		49	82
Capital Expenditure		35	90
Total National Reconstruction Authority Trust		83	85
Total National Reconstruction Fund	31	57	93
Grand Total	**32**	**141**	**88**

Source: MoF 2016

third-party payments like insurance, collateral, loan notice, and loan security. These were not very good motivating factors for the financial institutions to push the lending.

Net foreign assets and domestic credit did not show any notable change during the period. This to some extent indicates that there was no substantial spillover to the monetary system through bank financing and foreign aid. Clearly, disbursements in both the cases were dismal. The earthquake had no significant monetary implication.

Global Response: Initial international response to Gorkha Earthquake was overwhelming. There were pledges and commitments from different governments and multilateral and bilateral organizations. It is reported that the total pledge for reconstruction amounted to US$4.1 billion. The immediate relief and rehabilitation pledge from the USA (US$ 130 million) was among the highest, followed by the UK (US$ 110 million) and Australia (US$ 4.6 million). These pledges were made at an international conference on Nepal's reconstruction held on 25 June 2015. Among multilateral organizations, the Asian Development Bank pledged US$600 million, the World Bank US$600 million and International Monetary Fund US$50 million. The UN promised an initial US$15 million in emergency relief.

However, the official reconstruction process remains lagging. The government has not utilized any significant amount from the pledged US$4.1 billion. There were additional pledges from these governments later, in addition to the previously committed figures. However, their disbursements have been marginal. According to the open data, Earthquake Response Transparency Portal, almost 23 multilateral and government organizations have pledged more than US$3.01 billion cash support to the GON but have disbursed US$1.26 billion for 261 activities.

Diaspora and remittance: Immediately after the earthquake, the large Nepali diaspora began mobilizing support around the globe. Many returned home, and many others sprang up with quick response. The money transferred to the Prime Minister's relief account by Nepali diaspora, including Nepali students in universities around the world, through embassies and consulates, was approximately US$16 million. Open data sources report that there were enthusiastic commitments from Non-Resident Nepali Associations in the US, South Africa and Sweden. Such amount came close to US$4.4 million as per Earthquake Open Nepal.

Remittance from Nepali people living and working abroad reached as high as 29 per cent of GDP in the FY that ended mid-July 2015. The upturn in remittance, with respect to GDP, gained the momentum in 2016 and reached its record high at 29.6 per cent. During the last three months of FY 2014/15 (mid-May to mid-July), remittances amounting to NPR 63 billion flowed into the country every month on an average, as compared to an average inflow of NPR 47 billion in earlier months of the same year. In the FY 2016/17, Nepal received NPR 58 billion per month on an average. This flood of remittance has been attributed to migrant workers transferring money to rebuild their damaged houses and pay their household loans after the quake.

The remittance acted as a safety net for the earthquake-affected households as it was one of the most important income sources when no immediate government aid was forthcoming. Migrants were frequently sending money in large tranches, some of them borrowed from friends and others dipped deep into their savings. In addition, money transfer agencies waived their service fees charged on money sent from abroad to Nepal for the first few months of the disaster which helped increase the remittance. Independent Impacts and Recovery Monitoring conducted by The Asia Foundation had noted that farmers had insufficient harvests, which was sufficient to meet their needs only for a couple of months. The rest of their daily needs were met by using the income from remittance and other supplementary sources. In FY 2016/17, due to the looming crisis in the West Asia, particularly the labour importing countries, the remittance to GDP ratio is estimated to have fallen back to 26.8 per cent.

Fiscal space: Nepal had experienced a budget surplus in FY 2012/13, 1.8 per cent of GDP, and in FY 2013/14, 2.1 per cent of GDP. There was a small budget deficit in FY 2014/15 (one per cent of GDP). Again, in FY 2015/16, there was a fiscal surplus of 1.4 per cent of GDP due to the spending disruption from the earthquake, not to mention the addition of the reconstruction fund account and the nature of disproportionate capital spending by the government. The following year, the disaster had slightly hit on the government revenue as well. The revenue growth rate slowed down reflecting the lower level of economic activities. In FY 2016/17, the revised estimate showed that the budget deficit would be 6.4 per cent of GDP. This was because of a substantial increase in recurrent and capital spending that year.

In Nepal, there exists ample fiscal latitude to go for deficit financing. The country must resort to deficit financing simply because the capital constraints would otherwise hinder the economic growth process and aggravate the low-investment-low growth-low saving-low investment cycle. Scepticism with deficit financing is typically because of macroeconomic robustness. It is argued that scaling up public expenditure, reflected by high fiscal deficits, can jeopardize macro-economic stability. It is said that deficits lead to inflation and potential balance-of-payments problems thereby undermining growth over the long term.

Nepal's low indebtedness and concessional nature of the external borrowing indicate that the country can resort to external borrowing as well. Besides, as the government has been able to repay domestic loans in recent years, space has been created for domestic borrowing- except when the financial market remains in a tight liquidity situation. The gradual deepening of the financial market, captive investments by banks and financial institutions in government securities, adequate foreign exchange reserves and a relatively low interest rate regime (except for recent years) all indicate that there is fiscal space for the government to scale up spending in development projects (Figure 2.4). Moreover, the level of public debt has remained mellow and is gradually reaching 24.1 per cent in FY 2016/17 from 52 per cent in FY 2004/05. Also, Nepal's external debt is mostly in concessional terms and faces low distress, which calls for a fiscal policy anchored on a modest deficit[7] and driven by an optimal budget spending, if only to finance the much needed reconstruction. This should not jeopardize fiscal sustainability.

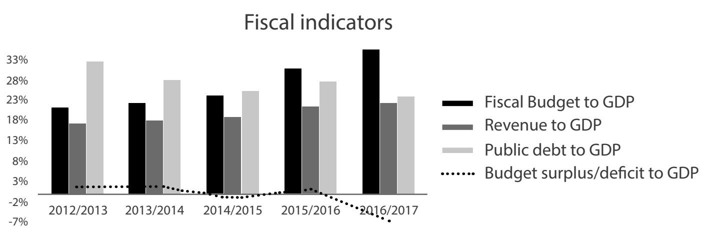
Challenges to economic management

The real challenges for post-earthquake reconstruction, therefore, are related more to structural than monetary and fiscal matters. As there is fiscal space for the deficit financing, and as inflation is moderate, the fiscal and monetary space would allow the government to expand investments in reconstruction related activities. This is not to say that structural constraints would not hinder such initiatives. Prompt and practical decisions by NRA in releasing funds, availability of technical and manual workers and willingness of household and public-sector entities to expedite construction make up such hindrances. There are some labour market related issues as well:

a) There is an acute mismatch between job opportunities available and interests or priorities of job seekers. The mismatch may have led to the scarcity of labour in agriculture, construction and reconstruction activities even while many Nepali youth is vying for low-paid foreign employment–which, compared with daily wages prevailing in Nepal, is much lower, particularly in destination countries in the Western Asia.

Figure 2.4

Fiscal space for reconstruction spending



Source: MoF 2012-2017

b) There is no labour market equilibrium even within a region inside the country. The earthquake-hit districts are not very far from each other and they are interconnected by reasonably better transportation and communication networks. Still, there are wage differences across districts prompted by the differentiated labour availability for the same kind of work.

On the monetary front, the conditions set for borrowing and the reluctance of banks to lend to the affected households remains an unresolved issue. Even the disbursement of the government's housing grant through the banking system has been a late starter. The reason was that the government was unwilling to pay the banking service charges. The slow disbursement of the public reconstruction budget is blamed on the low capacity in the Ministry of Urban Development to undertake public construction and the passive response of the line ministries.

It took a while for the disbursement of second and third tranches of housing reconstruction grants to pick up the pace. It is important to speed up the approval and disbursal momentum. As things progress, the government will have to prepare itself to meet the challenge of getting skilled and technical human resources required for carpentry and masonry works at the local level, besides ensuring a thorough supply of construction materials.

A major issue confronting the reconstruction work also pertains to a slow donor response to abide by their pledged amounts, particularly by some bilateral development partners. The government has not been serious enough to mobilize the pledged fund.

Recovery from rubble

It is evident that the earthquake is a major setback to Nepal's already weak economy. The country's tourism, investment and domestic production all suffered. The earthquake and its impact have been attributed as one of the reasons for Nepal abandoning its plan to graduate from its least developed country status by 2022.

Although it is still recovering from the rubble, Nepal needs to attain a faster economic growth by ramping up investment in sound infrastructure development, tapping into its large hydropower reserves and investing in national highways and railways. At the same time, there is a stark need to enhance the connectivity between haves and have-nots and bring about a broad based and inclusive economic growth. Basic social services need to be improved for the people. All this is complicated by additional urgencies like reconstruction of the ancient temples and archaeological treasures damaged by the earthquake.

In doing so, the government must act prudently and minimize the suboptimal level of capital spending. Nepal, with one of the lowest per capita incomes in Asia, has had continuous fiscal surpluses indicating a major challenge to its ability in capital spending. This is not ideal for a low-income country with huge investment needs, particularly for reconstruction and infrastructure development. Several tasks are listed below:

- Public spending on reconstruction on physical and social infrastructures must increase so that accelerated employment-centric and inclusive economic growth are ensured. Nonetheless, in scaling up the expenditures, due care should be taken to prevent erosion of the fiscal cushion and not exceed the economy's aggregate absorptive capacity. Close policy coordination and information sharing with the regulatory body is needed for that. Fiscal expansion should not lead to overheating so that there is room for necessary private sector credit growth.
- Most of the foreign funds pledged for post-earthquake reconstruction are in the form of loans. However, more than two-thirds of the spending will go to reconstruct individual housing. Although the social rate of return on housing investment is high, there will not be any immediate economic rate of return which would enable the state to repay the loans. Thus, efforts should be made to get the pledges renewed seeking a higher proportion of grants in the aid commitment. This would ensure that the country does not suffer from debt stress in the future.

- The government should hold another external donor meeting to guarantee pledges for necessary resources. This would also be a moment to apprise them of the progress and challenges in meeting the financing gaps.
- In addition to institutional barriers and procedural tyranny, shortage of construction materials and labour–skilled and semi-skilled–is another hurdle impacting the expenditure and execution rate of the allocated budget. The youth unemployment and labour market mismatch should be reduced by means of (1) imparting the required skill for reconstruction in the private sector, (2) setting up an attractive minimum wage for work and (3) announcement of employment schemes in public sector work. Trade unions can also be part of the skill re-matching training activities as they know the labour market from up close.
- Remittance has been an invaluable resource for post-earthquake reconstruction. Remittances are generally spent on local goods and services, especially in the recovery and rebuilding process. This means that their impact is multiplied, providing a further incentive to restore them.
- Robust policies are required to incorporate remittance as a formal means to hasten reconstruction and recovery. During natural disasters, other forms of income and means of livelihood are disrupted and recover slowly. Hence, efforts to restore remittance flows to their normal are obviously critical to the recovery of remittance receiving households.
- The government and the central bank must ease the terms and conditions for housing grant disbursement. Bank financing at a two per cent interest rate, and the central bank refinancing at zero per cent interest rate, did not work as planned since banks were uncomfortable lending at such a low rate. A revision in bank lending, at four to five per cent, would not distort the credit market for such financing.
- There is a need to involve private consulting and housing construction companies for public sector housing as well. The weak capacity of the ministries responsible for housing would

be alleviated this way. Moreover, there is a need to coordinate with local governments to expedite reconstruction. ■

The views and opinions expressed here are those of the individual authors and does not reflect those of the organizations/institutions they are involved with. The paper was submitted in January 2018

Notes

1 The Impacts and Recovery Monitoring (IRM) surveys generate data from a sample of 4,854 households across 11 earthquake- affected districts. The first round of the survey was conducted in June 2015, the second in February-March 2016, the third in September 2016, with the fourth round implemented in April 2017.

2 *Nepal Earthquake 2015: A Socio-Demographic Impact Study* revealed that reason for not attending the school were fear of aftershocks (46.1 per cent) and damage to school building (45.5 per cent). Other reasons included economic problems in the family (5.6 per cent) and falling sick or being injured due to the earthquake (2.8 per cent) .

3 Khatiwada, Y. R. 2015. *Trade Union Perspectives on the Post Disaster Needs Assessment and International Aid Programs on Reconstruction in Nepal*. Kathmandu.

4 NRB. 2015 and 2016. *Macroeconomic and financial situation of Nepal*. Kathmandu: Nepal Rastra Bank.

5 Independent Impacts and Recovery Monitoring Phase 4 "Forty-five percent of people, who said they have been declared eligible for the grant, said it would cover less than 25% of their rebuilding costs while another 35 per cent said it would cover 25-50 per cent. Only six percent said it would cover 75 per cent or more of their costs."

6 Notice issued by Nepal Rastra Bank on 12 April 2018.

7 Fiscal deficit to GDP less than five per cent.

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