

Import Substitution and Export Promotion of Horticultural Crops in Nepal

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Abstract

Import substitution and Export promotion are the widely used government policies for the protection of domestic production and specialization of product for trade competitiveness. Import substitution policies require great attention because of the huge government costs incurred in implementing the policies and might be counterproductive and not necessarily be cost effective amid increased consumer price and government subsidies while compromising the tariff revenue. On the other hand, the government may invest huge sum of money for export promotion policies because of the multiple benefits garnered from export earnings, increased balance of payments and production motivation to producers. Nepal government's import substitution policies and export promotion policies in horticultural crops were reviewed and subsequent past programs for implementation of such policies in major commodities have been reviewed in this paper. The import export data for the last six years from department of customs and production data from ministry of agricultural development have been collected and analyzed to draw the conclusion with respect to policy coherency. Only few strategic commodities should be selected for import substitution and government subsidies for increased production with levying quarantine rules for SPS and TBT are recommended than imposing tariffs as policy instrument for import substitution of potato, citrus and apple. Production and productivity enhancement programs, export incentives, custom clearance facilitation, trade diplomacy and negotiation, mutual recognition, export destination diversification and product diversification are recommended tools for export promotion.

Keywords: Tariff, SPS, TBT, Trade, Diversification

Introduction

Import substitution and export promotion policies are widely used development policies; where both intend to enhance national welfare in international trade. Having both advantages and

disadvantages in both policies; many countries try to induce both policies simultaneously though these are quite contradictory within themselves. The inward looking import substitution policy assumes that market already exists as evidenced by the imports and aim is to restrict the import to protect domestic production or industries. Another reason for IS policy by many LDCs is

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that it is easier for LDCs to protect their domestic market against foreign competition than to force developed nations to lower trade barriers against their products. As opposed to IS policies, with the outward looking export promotion policies, government encourages the specific products which have comparative advantages. The specialization in technology for economies of scale and use of labor intensive forces by the LDCs make the products competitive in international markets and enhance exports. In early developing countries, development comes into the picture via substituting the imported goods by locally produced goods (Yilmazkuday, 2003). Export promotion policy utilizes the external demand as their sources of activities. Basically, import substitution is substituting the imported goods with the locally produced goods to meet the internal demand (Bruton, 1998). For which protection is needed for locally produced goods. Key institution to make the protection is government. Thus government utilizes different tools viz tariffs, quotas, exchange rates, prices of factors of production, interest rate to implement the IS policy; which is a government intervention in economy. The government increases the tariffs for import, provides limited quotas, fixes exchange rates to devalue their currencies, fixes interest rate under the market equilibrium level to increase the domestic investment, subsidizes the different factor units and may use other protection strategies like minimum support prices. In outward oriented policies, the interest rate, inflation and exchange rates are determined by the market. It is believed that the IS policy in long run will close the country's economy to the rest of the world. Because of the high protection levels, internal and external price levels differ so much in value. Further, the absence of competition with the foreign production is tried to be remedied by the government which in turn destroys the economy further and further (Bruton, 1998).

Many literatures suggest that developing countries used IS policy initially and then shifted towards export promotion policy. Large countries having huge internal markets but

low technological intervention initially started with IS policy during 1960s, and countries who shifted towards EP developed faster than others (Srinivasan and Bhagwati, 1999). Moreover, the choice for policy also depends on the political system of the country and their priorities, production potentials, current economic indicators like balance of payments; and there are many benefits of using IS policy as well. In the second post Second World War (1939-45), many LDCs tried to reduce their reliance on imports and practiced much inward looking policies. Many Latin American countries like Brazil and Argentina followed IS policies which gained in short run; but it was believed that their economy stagnated and grew slowly which forced them to switch their policies towards more outward oriented.

When comes to agriculture sector, albeit the economic policy resembles similar to industrial sector moreover, most of the countries are still using protectionist policies in this sector. As agriculture implies a diverse sectors with many subsectors like horticulture, crops, livestock, fisheries, industrial crops; the policies differ according to the commodities. For those commodities, which have good domestic production potentials but import is increasing at huge scale; countries are compelled to use IS policy. However for the commodities having both competitive and comparative advantages the country might use EP to increase export for positive BOP. It seems none of the countries in the world use IS and EP explicitly, rather they use them simultaneously according to the nature of commodities in agriculture sector.

Nepal had followed quantitative restriction policy in order to protect the domestic industries from foreign industries, facilitate import of raw materials and intermediate inputs required for domestic production by local and output oriented industries, and conserve the foreign exchange. But this quantitative restriction policy was not favored by World Bank and IMF, and was not supportive when Nepal approached for their help in order to overcome the BOP crisis in mid 1980s, they pressured to give up

quantitative restriction policy for liberal trade policy (Shrestha, 2022). Following Nepal's accession to WTO, the trade liberalization in agriculture sector deemed indispensable and policy gradually shifted towards EP rather than IS. WB led structural adjustments program and stabilization policies; formulation of many trade liberalization policies like Trade policy 1992, Trade policy 2009, Trade policy 2015, WTO accession, FDI policy, privatization policy, NTIS 2010, NTIS 2016 clearly reflected the country's paradigm shifting from protectionist policy. However, increased import of agriculture commodities and decreasing the BOP has forced government to rethink on using IS policy; as evidenced by the lawmakers and some economists arguing for implementing the IS policy in agriculture sector.

Against this backdrop, this paper has been prepared to evaluate the trade performance of major import and export of horticulture commodities in recent days and recommend the policy makers for using appropriate economic development policies with regard to agriculture trade.

Materials and methods

This paper aims to explore differential policies that seem necessary to enhance agriculture export by protecting the domestic production with some sorts of protection for certain commodities. It is necessary to take advantage from both IS and EP; which could be used simultaneously according to the nature of commodities. The trade statistics for recent years from department of custom was used as major source of market indicator; while production statistics from ministry of agriculture and livestock development was used an indicator of production potentials. The trends of import of major horticulture commodities in recent years was evaluated against the production data for the same period and possibility of IS policy on such commodities was analyzed and recommended. Similarly the export data of major horticulture export commodities was evaluated against their production data for same

period and possible causes of weak export were explored and export promotion measures were recommended. Out of total imports, top import horticulture commodities were selected for analysis; similarly top export commodities were taken for analyzing export promotion strategies. Besides, import substitution and export promotion policies were reviewed and analyzed against import volumes and export to draw conclusion.

Results and discussion

Potato, onion, citrus and apple were top import horticulture commodities; which have high production potentials. Similarly the export of the NTIS commodities like cardamom, tea, ginger and other export potential commodities like coffee and vegetables were studied. The findings of the analysis have been discussed and the relevancies of substitution and export promotion policies in these commodities have been discussed in this chapter.

Relevancy of substitution policy

The trends of potato import and production is reflected by the figure 1 and figure 2 respectively.

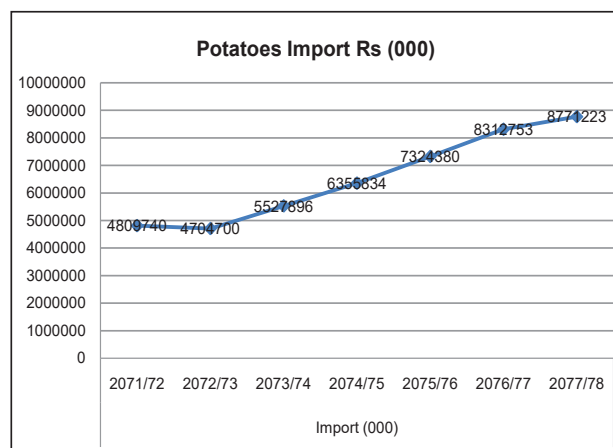


Figure 1: Import of potatoes from 2071/72 to 2077/78
Source: Department of custom, Government of Nepal 2072 to 2078

The imports of potatoes have been surging at high rate in last seven years. It has almost doubled within the period reflecting need for urgent intervention in potato import management. Contrary to this the production

data for the same period shows that there is constant growth in production of potatoes in Nepal. It is estimated that Nepal is amongst top 14 potatoes producing countries in the world. As most of the mid hills areas in Nepal are suitable for potato production in two season; it can be grown in all the geographical regions at least for one season; there seems huge production potentialities of potatoes in Nepal. The figure shows the production

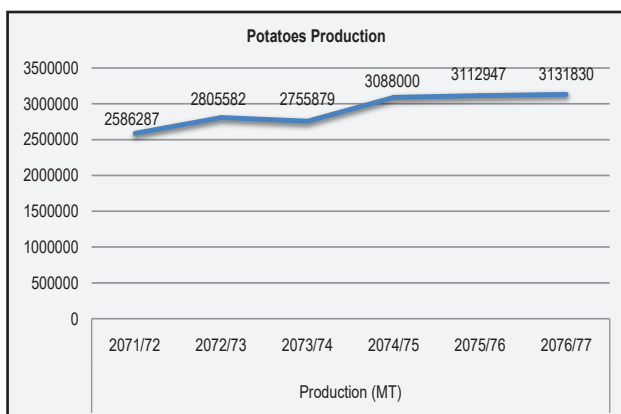


Figure 2: Production of potatoes from 2071/72 to 2077/78

Source: MoALD, Government of Nepal 2072 to 2078

of potatoes has been increasing throughout the year. As the gap between demand and supply seem increasing throughout the year despite increased production; the import could be related to the industrial purpose as raw materials. If such imports are for industrial products like chips and French fries; it should be viewed positively; however the imports could be restricted with quality production; varietal improvement and research for developing chips varieties. Provided Nepal’s huge areas could be used for potato production; it seems; the country can induce Import Substitution policy in potato only after evaluating the main reasons for increased import either for consumption or for industrial value. The policy instruments may be different for different period. Initially the input subsidy, credit subsidy may be used apart from technological support like quality seeds and varieties then other instruments like quota or tariffs may be utilized to reduce import.

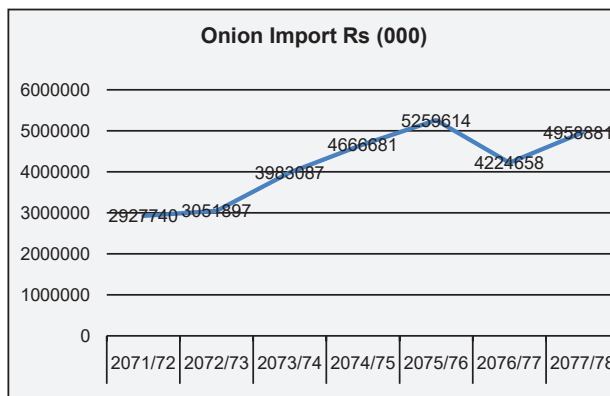


Figure 3: Import of onion from 2071/72 to 2077/78

Source: Department of custom, Government of Nepal 2072 to 2078

The import data for onion suggest high increment in onion import in recent years. Figure 3 and Figure 4 reflect the import and production situation of onion during past 7 years. Ever increasing import value of onion is huge burden to the policy makers. The figure suggests two fold increases in the import of onion in past few years. The price increment of onion during September-October is much worrying. Although, Nepal has good areas for onion production yet higher opportunity cost of onion to the vegetables and other competing commodities has discouraged farmers to grow onions in higher scale. Further difficulty of storage for more than 3 months; make this commodity almost less lucrative for farmers.

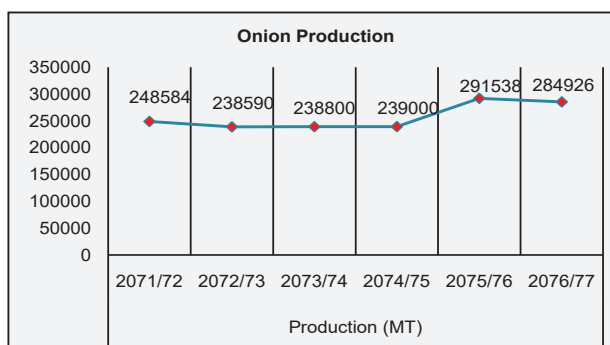


Figure 4: Production of onion from 2071/72 to 2077/78

Source: MoALD, Government of Nepal 2072 to 2078

Despite increased import data; the production is almost stagnant. Government of Nepal tried to induce Import substitution policy for onion through onion mission program during 2010s. However, such program only provided small subsidy in seeds and storage; and were not

supported by other instruments like import restriction through tariffs and other mechanisms. Lower comparative advantage with the vegetables and maize of domestic production and also onion from India and China; the mission onion program did not become successful in substituting the imports neither it was sufficient to increase the domestic production of onion in the country. Amid the situation almost similar to that period, it is not wise to implement import substitution policy in onion.

Another horticulture commodity with high import in recent years and yet good production potentials throughout the mid hills of the country and much plain terai area is the citrus.

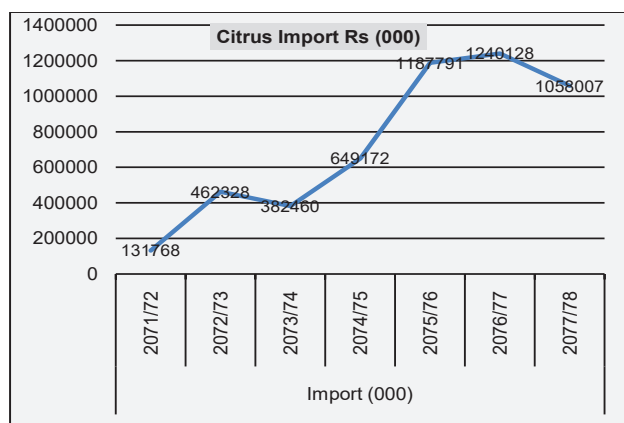


Figure 5: Import of citrus from 2071/72 to 2077/78

Source: Department of custom, Government of Nepal 2072 to 2078

The figure 5 and 6 shows the recent import and production trends of citrus in Nepal. The import of citrus has increased by 8 folds during past 6 years. It was further found that lemon constitute about 90% of the total citrus import; implying for utilizing lemon production program massively. Although there is huge scope for production of mandarin and sweet orange; which can be grown in large section of mid hills of Nepal having northern slope, the domestic production being sufficient hardly for six months and relying rest six months to imports for meeting domestic demand. Lack of good storage facilities and reduced quality in storage are the de-motivating factors to the farmers. The production data from MoALD suggest the steady growth in production of citrus during past 7 years. Such huge imports

despite growth in production implies either the use of citrus for juices and other industrial purposes which have export values as well or increasing habits of citrus consumption by Nepalese people.

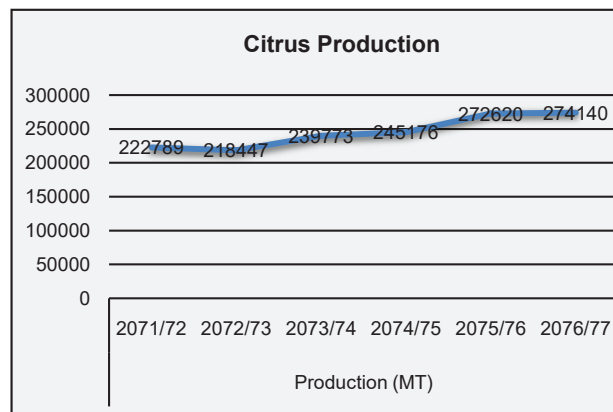


Figure 6: Production of citrus from 2071/72 to 2077/78

Source: MoALD, Government of Nepal 2072 to 2078

The lemon/lime production mission program was rightly started during 2010s but could not be continued due to lack of ownership of the program by the local and province government during early stage of restructuring of agriculture sector in federal context. However, this program was able to create positive vibes in developing lemon and lime orchards in plain regions of the country. It is believed that, the country could be self sufficient in lime/lemon after few years with continued investment for farm development from private sectors as well. The identification of new production areas for Sweet orange and mandarin is important to increase production due to recent citrus decline problem in old orchard. Likewise orchard management practices, control of diseases and pests with new technologies like area wide approach, replacement of old orchards, development of cold chains/storage facilities will be essential to motivate farmers for further production. The IS policy could be gradually applied in citrus only analyzing the industrial requirement.

Another important commodity with huge import volume in recent years is the apple. Figure 7 and 8 shows the import and production of apple in past 7 years. Like all other commodities discussed the import of the apple is increasing

at higher pace. The import value of apple has increased by 3.5 folds during the period. Mostly high hills of Gandaki and Karnali province are suitable for apple farming. Although the climate change has affected the production areas of this commodity as most of the production areas of province 1 and Bagmati province has declined. This phenomenon is also responsible for increased import. Decreasing production areas, lack of identification of new production areas, unavailability of storage facilities, difficult road transportation curtailing the supply chain development are the reasons for lower incentives for the farmers to grow apple in large quantities which make the country rely on import. As the import is increasing tremendously in one hand and decreasing trend of production has serious implications further in coming days.

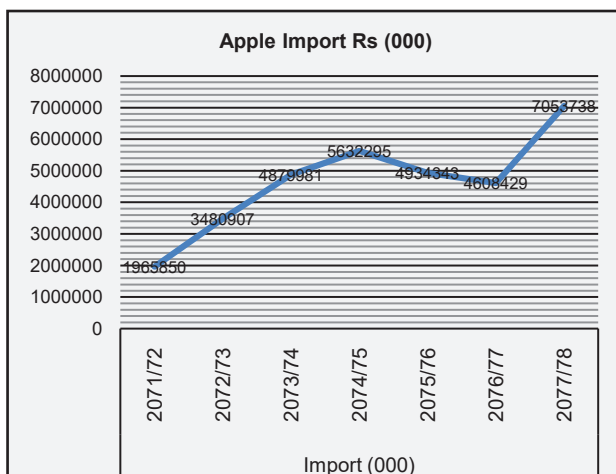


Figure 7: Import of Apple from 2071/72 to 2077/78

Source: Department of custom, Government of Nepal 2072 to 2078

Nepal have large areas for apple production, but need to replace old orchard, identify new areas for orchard development, investment on research for developing and adopting low chilling requirement varieties, exploration of scaling up and areas expansion under high density planting are some of interventions needed for increasing production. Further development of good storage and connectivity will motivate farmers. As such, it is very difficult to achieve self sufficiency in apple production amid increased demand of fruit throughout the season probably because of expanding urban

population and income level of people. The production from Nepal is hardly sufficient for 3 months and it is extremely difficult to us IS policy in apple. However, pear could be developed as replacements for apple consumption to reduce the huge import burden, but the government cannot control the consumers' choice which may in turn increase the consumer price.

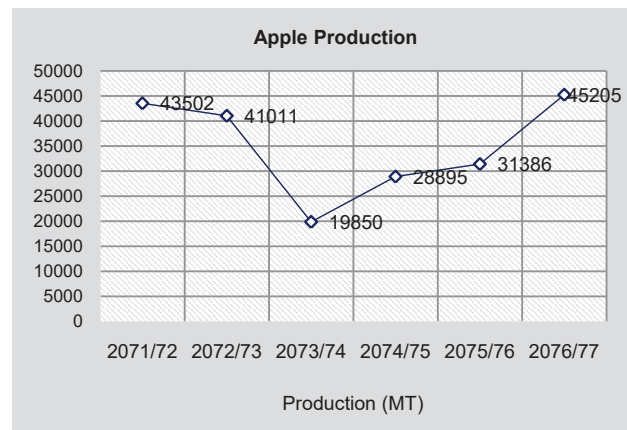


Figure 8: Production of apple from 2071/72 to 2077/78

Source: MoALD, Government of Nepal 2072 to 2078

Relative income elastic nature of horticultural crops is the main reason for such increased import of these commodities. With the increased income the food habits is gradually changing and people are preferring more protein with vegetables and fruits over the carbohydrate. More than 60% of remittances are used in consumption in Nepal and with the increased remittance flow over the periods, the demand for these commodities has increased and thus the import. Thus government needs some sorts of protection policies to reduce the import but should take account of production potentials and farmers motivation to avoid high consumer price.

Export promotion for major horticultural crops

Several export promotion policies have been drafted in Nepal. With the liberalization policies after structural adjustment the economy was shifted towards EP from traditional IS and it has a similar implication in agriculture sector. The major policies that support export promotion of horticulture crops include Trade policy 1992, Trade policy 2009, Trade policy 2015, DTIS

2004, NTIS 2010, NTIS 2016, Industrial policy, Intellectual property rights, Foreign Investment policy, multilateral (WTO, BIMSTEC, SAFTA) and bilateral trading arrangements (India, China, Bangladesh, USA), Agriculture Development Strategy and Cash incentive schemes for export (CISE). Despite number of conducive policies,

the export promotion schemes are poorly reflected in budget and plans. The performance of major export commodities over the years are is not satisfactory. The export of major exportable commodities and their production trends reflect the need for clear promotion ideas in action rather than in paper.

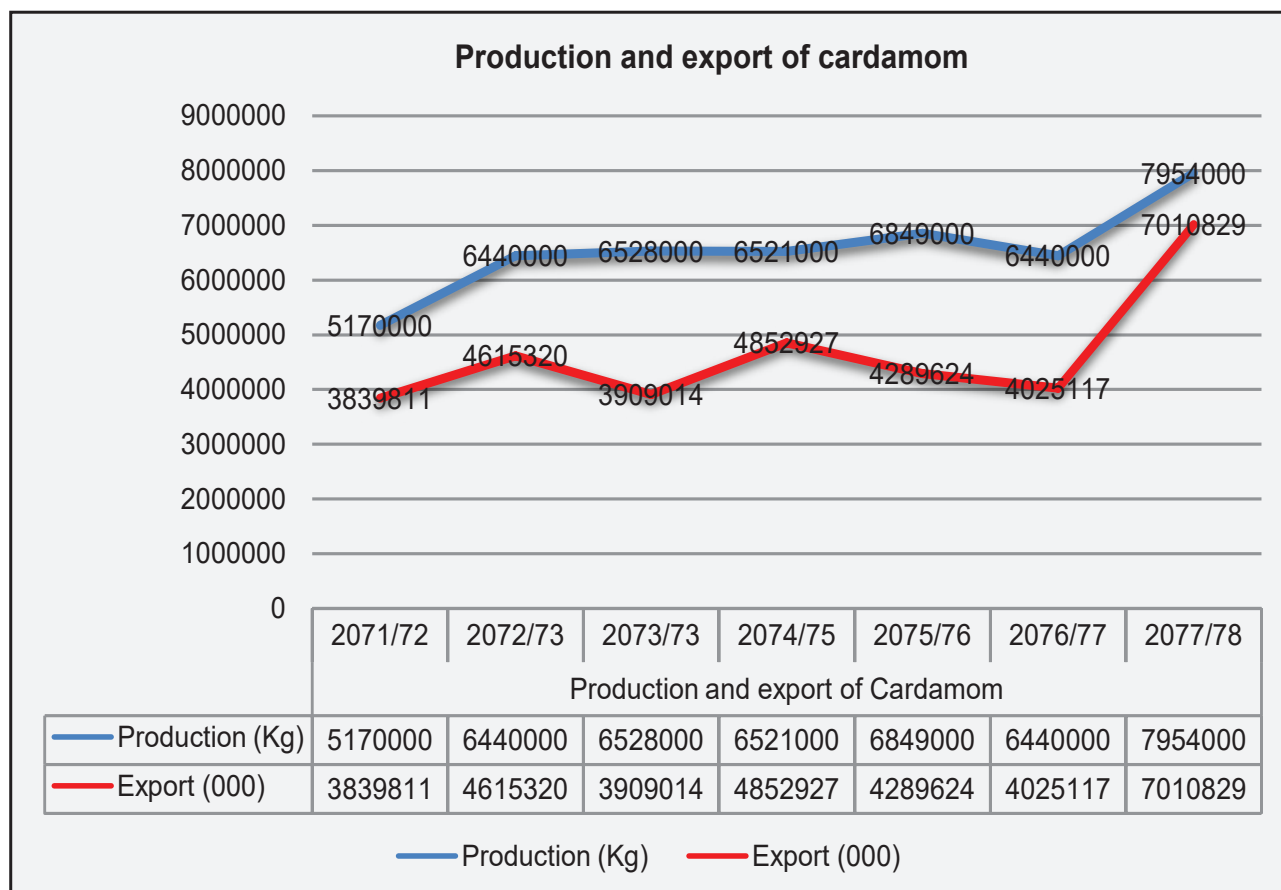


Figure 9: Production and export of citrus cardamom 2071/72 to 2077/78

Source: MoALD, Government of Nepal 2072 to 2078; Department of custom, GoN 2072 to 2078

Figure 9 shows the production and export trends of large cardamom; which is the top ranked exportable horticulture crops in Nepal. The production and export is found to be increasing throughout the study period. The production and export line show similar patterns; which reflect fewer problems with market. Though there are fluctuation of price over the periods and farmers compelling the erratic prices, however positive correlation between production and export volume signifies that more you produce more you can sell. Thus government needs production enhancement plans in cardamom to increase the exportable volume. Nepal is the largest

producer and exporter of cardamom in the world, however more than 90% of export destination is India. The Indian traders generally fix the price which makes weak bargaining power because of limited market destination. Diversification in export destination is important to harness better price and export earnings.

The production and export of another major commodity: Tea is shown in figure 10. Export was found to be fluctuating despite steady production growth. This shows the market related problems with the export. As major export is dependent on Indian market; changes in Indian government policies affect the tea price and export value.

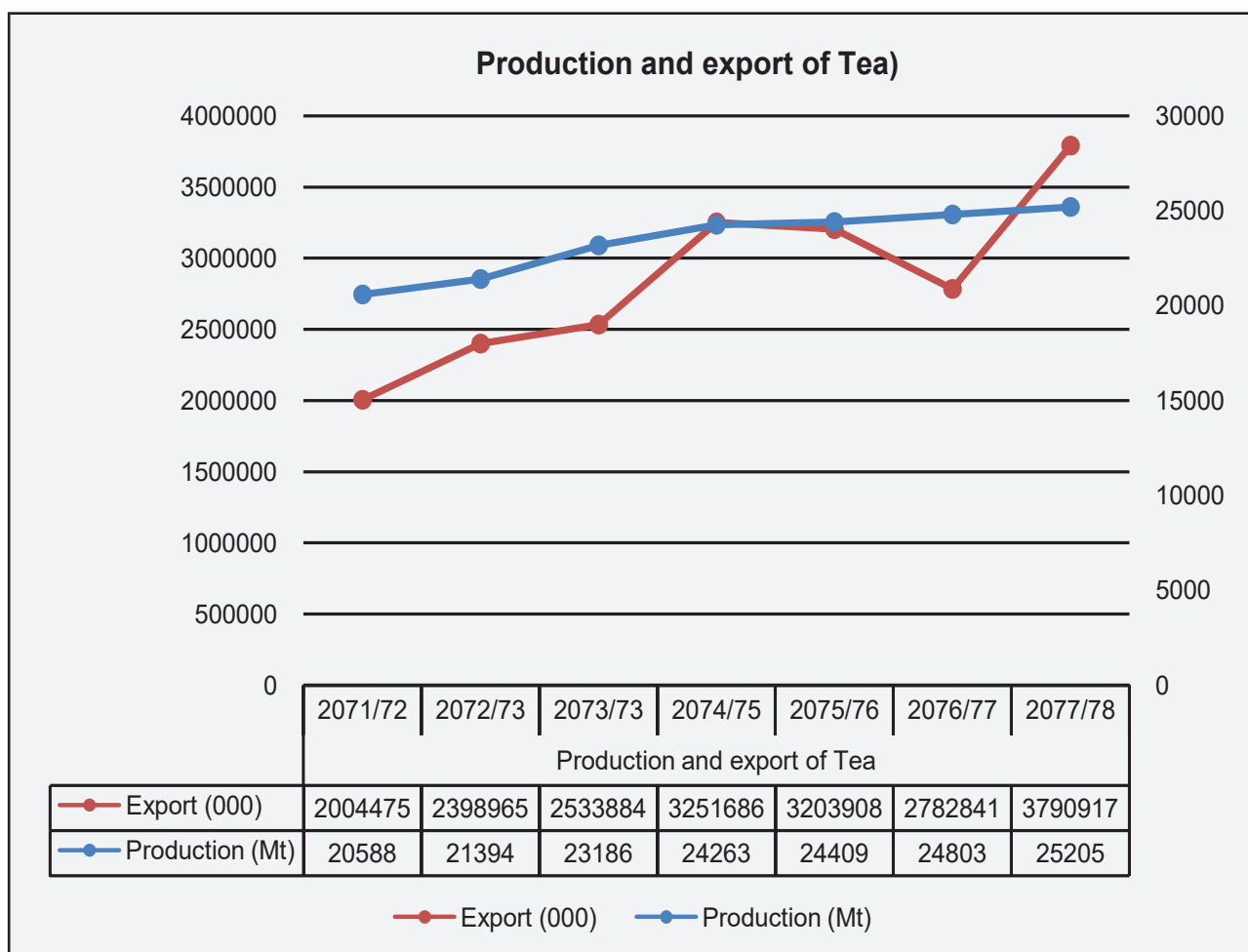


Figure 10: Production and export of Tea 2071/72 to 2077/78

Source: MoALD, Government of Nepal 2072 to 2078; Department of custom, GoN 2072 to 2078

Organic orthodox tea which has Himalayan aroma and good texture has huge demand in European markets. Nepalese orthodox tea is gaining popularity in export market in recent years. Thus government should focus on providing production supports for orthodox tea to increase the exportable volume. Trade facilitation at custom points, export diplomacy from diplomatic mission and embassies, trade fair, auction market, brand development and promotion, export incentives are some of export promotion activities for increasing tea export.

The figure 11 shows the production and export of another important commodity ginger. Although the production remains stagnant the export was found to be highly fluctuated over the years. Nepal is one of the largest producers of ginger in the world. The inconsistent policy from Indian government is hindering ginger

production and export. India is the largest buyer of Nepalese ginger and the price of ginger is affected by Indian policies at custom points. Technical barriers to trade come to play in ginger trade largely. The quality production program, product diversification and market destination diversification are important in enhancing ginger export. The organic ginger has good market demand in European market; thus organic production and certification, trade facilitation, export incentives, trade negotiation and mutual recognition of certificates are important in expanding ginger export.

The production and export of coffee is shown in figure 12. There is huge fluctuation in the export despite steady production. Like ginger; coffee has difficulty in export market. The organic coffee has good market demand, however lack of certification schemes; poor organization

of producers association and benefit sharing mechanism has discouraged small organic producer groups which affects the quality production in exportable volume. Thus organic production schemes with good certification

mechanisms need to be emphasized to develop good Nepalese brand having Himalayan aroma. Such products need to be supported from diplomatic missions as trade ambassador.

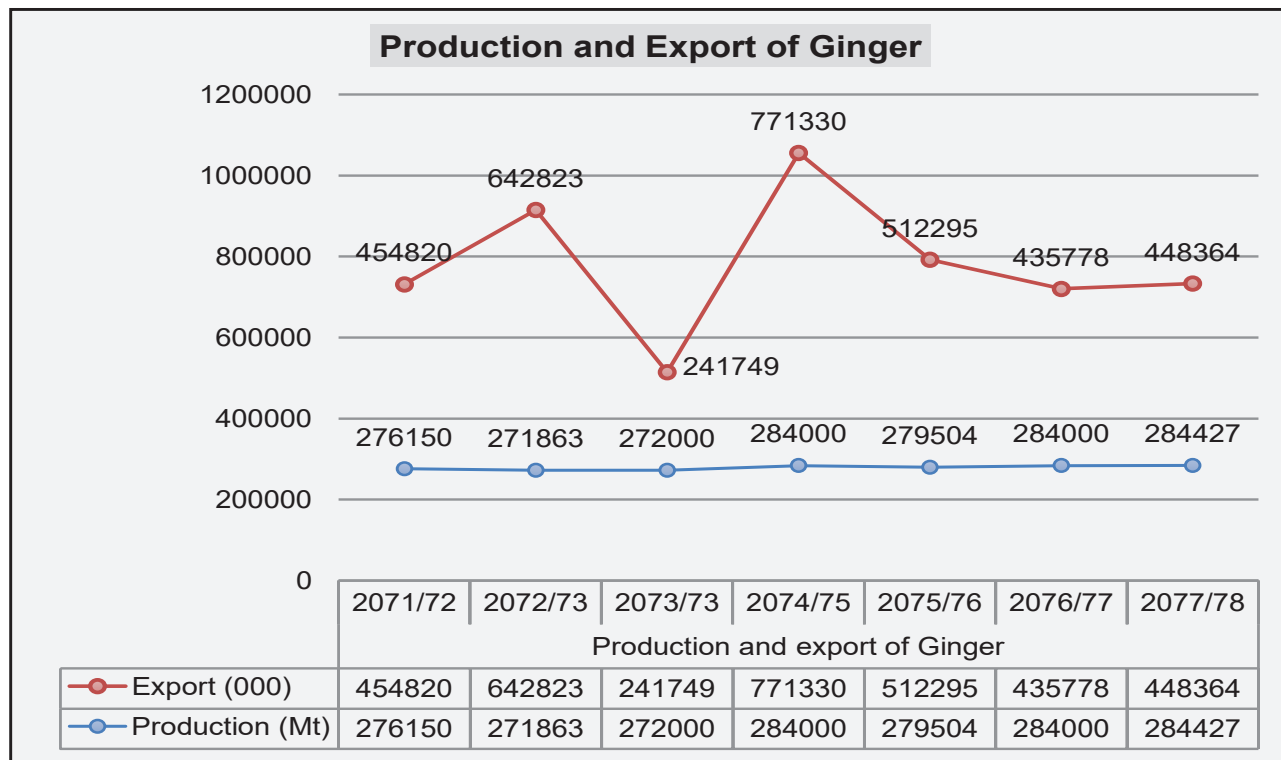


Figure 11: Production and export of Ginger 2071/72 to 2077/78

Source: MoALD, Government of Nepal 2072 to 2078; Department of custom, GoN 2072 to 2078

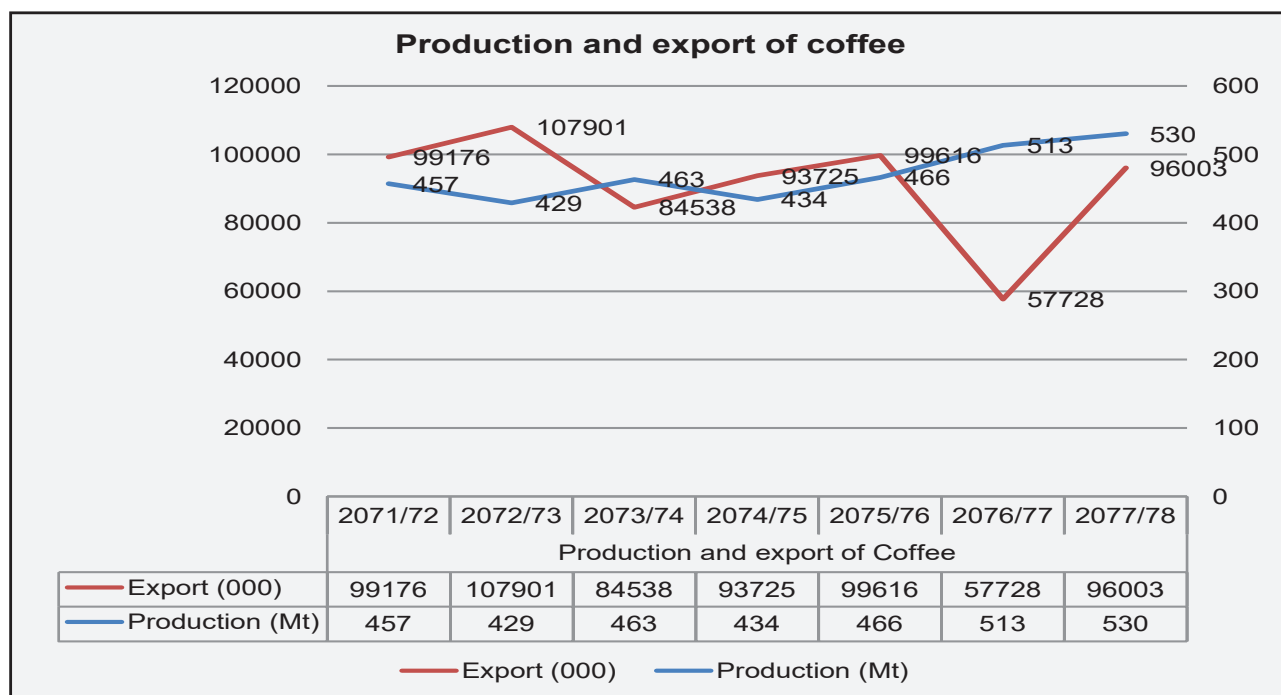


Figure 12: Production and export of Coffee 2071/72 to 2077/78

Source: MoALD, Government of Nepal 2072 to 2078; Department of custom, GoN 2072 to 2078

Conclusion

Many study findings suggest Import substitution policy as inward looking protectionist policy that reduces the economy in long run. Many LDCs have shifted from Import substitution to export promotion especially after the liberalization of world economy through World Bank, IMF and WTO. Nepal, traditionally practicing relatively government directed economy until democracy of 1990s have literally shifted towards export promotion policies. After accession to WTO and using more market economy in agriculture sector also, the country's dependency has increased at higher rate. The agriculture import is huge while export remains a small share of the total trade. Despite following export promotion policies for long time; the performance of agriculture sector in trade is discouraging. The high import of horticultural commodities having good domestic production potential is the burden for policy makers. As production cost is increasing and also due to poor technological advancements the horticulture products are becoming less competitive with foreign imports. In this scenario, the farmers are also demanding the protection schemes and policy makers and government are turning towards Import substitution policy. The import data and production data for past 7 years for major horticulture commodities suggest the need for some protection for the domestic producers especially for potatoes, citrus and fresh vegetables. However despite increasing import such IS policy might be counterproductive for the commodities like apple and onion; because the domestic production not enough to meet the ever increasing demand. Thus, government should use IS and EP policies at the same time for different commodities. The recent policy and programs of government of Nepal for 2079/80 has emphasized on using Import substitution policy in agriculture. However it requires a detail study before using the policy. The government may start with very few commodities with huge imports but production potentials to avoid implications on overall economy. While using Export promotion policies, Nepal should target high value crops

having diversified market destination. Such policies may include production promotion schemes, investment in research, production subsidy for lowering cost of production, export incentives, trade facilitation, brand promotion, trade diplomacy, trade negotiation to avoid TBT, Mutual recognition agreement, international expos, B to B facilitation and export destination diversification.

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