

Anirudha Gupta

## FOREIGN AID AND POLITICAL ECONOMY OF NEPAL

As a landlocked country, with a population of about 15 million and per capita income of \$ 160, Nepal's economy and strategy of development present an interesting subject for investigation. Its panchayat system, introduced in 1963 by the present King, Birendra, preserves a close-door, non-competitive political order; but its economic strategy envisages a free play of market forces and private enterprise. In fact in its guideline for economic development, the Nepalese government makes a special plea for support and protection to the private sector "in a more convincing and effective manner" in view of the role it plays in the industrialization of the country".<sup>1</sup>

It is the neo-classical model of import-substitution and export promotion that Nepal has adopted as basic to its development strategy. This strategy relies more on raising surplus from the country's export-import trade than from domestic revenue sources. Government finance from 1976 to 1985 shows that over 80% of its tax revenue came from custom duties, excise and sales taxes; while revenue from land taxes declined by around 11% during the same period. (See Table 1). Yet, over 90% of Nepal's population live on agriculture and contribute about 69% of Gross Domestic Product (GDP) at

1. *Nepal Press Digest* (NPD), Kathmandu, vol. 30, no. 4, p. 30. See also *The Seventh Plan 1985-1990 (A Summary)* Part I, National Planning Commission, Kathmandu, June 1985.

current market prices.<sup>2</sup> Agricultural productivity does not seem to constitute a priority area in Nepal's developmental strategy. Over the years production in agriculture declined in both subsistence and commercial sectors. Except paddy and wheat, which showed a modest growth rate between 1983-86, the yield in other food-grains stagnated or declined.<sup>3</sup> Even production of paddy suffered set-back owing

**Table 1**  
**Tax Revenue (Selected Items) (in million Rs.)\***

	1976	1982	1985
1. Custom Duty	354.1	825.2	1065.1
2. Excise Duty	121.1	303.9	483.2
3. Sales Tax	161.6	599.7	845.2
4. Land Revenue	89.0	85.5	73.0

Source: Nepal Rastra Bank

\*21.3 Rs.=US\$ 1

to a prolonged drought in the Tarai region, described as "the granary of Nepal." As a result, during the period 1976-86, Nepal's food import outstripped food-export at an average rate of 1 to 6 percent annually. Yet, next to manufactured goods food and live animals, still hold an important place in Kingdom's foreign exchange earnings.<sup>4</sup> Separate returns from commodity trade show that export of manufactured goods, classified chiefly by materials has risen at the rate of roughly 9.4% annually since 1982-83.<sup>5</sup> However, as most of these materials are imported, it is obvious that Nepal has chosen to raise trade surplus by importing materials for re-export especially to countries other than India. Because of increased export of cotton readymade garments, America has become its largest trade partner,

2. *Nepal in Figures 1987*, Central Bureau of Statistics, Kathmandu, 1987.

3. See *Seventh Plan 1985-1990*, *op. cit.*, Chapter 24.

4. *Statistical Yearbook of Nepal 1987*, Central Bureau of Statistics, Kathmandu, 1987, pp. 400-5.

5. *Ibid.*

followed by the EEC countries with an aggregate share of of 28.7 per cent. This, in short, is the "Hong Kong model" through which Nepal intends to restructure and transform the economy of a land-locked country.

Such a course has obvious implications. On the one hand, it has given rise to an export-oriented enclave benefiting mostly Kathmandu, the capital, and a few other urban centres. On the other hand, it has led to runaway trade gap which stood from Rs. 843.3 million in 1976-77 at Rs. 6240.3 million in 1985-86.<sup>6</sup> There were also demographic changes - growth of population at an average annual rate of 2.6%, plus the resultant burden on land, which forced larger migration from the rural to urban areas, and from the hills to the Tarai. In view of malaria control, clearance of forest, and the officially sponsored settlement schemes, the Tarai region attracted largest number of in-migrants from the mountains and hills.<sup>7</sup> Annually, out of five persons to migrate internally, four migrate to the Tarai and one to the urban areas.<sup>7</sup> That such demographic changes (with the mountains literally climbing down the plains) have grave social and political implications is obvious and we shall examine some of them at a latter stage. What needs to be said at this point is that parallel to the fall in agricultural productivity, great economic disparities have emerged in the rural areas. Despite having an elaborate land-reform programme since 1964 ("which is conceived more as a tenancy reform than land reform")<sup>8</sup> and expanded irrigational facilities and institutional credit arrangements, majority of the rural people have grown poorer while a handful of money-lender-cum-landlords, with extensive stakes in cash-crop production, has grown richer. The 1981 Agriculture Sample Census showed that over 2/3rd of the farm households had less than 1 hectare of land holding and cultivated less than 1/5th of the arable land.

6. *Ibid.*, p. 395.

7. See *Rural Landlessness in Nepal*, Integrated Development Systems (IDS), Kathmandu, 1985, p. 49.

8. *Ibid.*, p. 26.

Large holders with more than 5 hectares comprised 3 to 4 percent of the landowners and cultivated about one-third of the arable land.<sup>9</sup> At the same time, declining productivity pushed small and marginal farmers into the ranks of the landless.<sup>10</sup> A recent study of rural landlessness in Nepal thus arrives at the following conclusions.<sup>11</sup>

1. The pressure on land is continuously increasing and average area of land holding is declining even after additional land is brought into cultivation.
2. No major policy changes have been made during the last two decades to correct the skewed land distribution pattern.
3. Tenancy rights of many of the tillers are unsecured despite the Land Reform Act of 1964.
4. Institutional credit arrangements (banking etc.) are not benefiting the small and marginal landholders, who still depend on private sources for credit.
5. The level of wages for agricultural labour has not changed much, especially in the Tarai mainly due to oversupply of labour and under-employment.
6. The prices of agricultural output have not increased to the same extent as the prices of imported inputs and other consumer goods which is evident from the decline in terms of trade between agricultural and non-agricultural sectors.
7. All these factors cause a declining trend of per capita income of the rural (agricultural) sector resulting in the majority of marginal and small farmers getting poorer.

---

9. *Ibid.*, p. 11.

10. *Ibid.*, pp. 23-24, According to a Survey of the National Planning Commission, 37.33% of rural households and 32.89% of the rural population fall below the poverty line.

11. *Ibid.*, pp. 27-28.

## I

It is at this point one should like to know whether the aggravation of rural poverty, unemployment and disruption of traditional peasant life could generate massive social upheavals in Nepal. Indeed one may ask what has kept in check a peasant revolution in Nepal? There have been some sporadic uprisings in the rural interior, especially in the Eastern region which also explains the sprouting of several self-proclaimed Marxist-Leninist groups (called MALE), but these groups are too fragmented to organise or make full use of the peasant unrest. Another inhibiting factor may have been the tradition of patron-client relationship which still governs the social setting in the villages. As Scholz notes in his study of rural development, Nepal's traditional land system represented a coalition between the aristocracy and bureaucracy on one hand and local overlords on the other. The land-owning class needed village overlords to collect rents and control the peasantry and the village overlords needed the political backing provided by the land-owning aristocracy and bureaucracy".<sup>12</sup> Despite improved means of transport and communication, the tenant's cultural dependency on the landlord has remained unchanged.

This pattern could have come under considerable strain had not the rural poor found an easy access to migrate to India and, internally into the Tarai region to find alternative means of livelihood. The open Indo-Nepal border provides an additional incentive to the landless and marginal Nepali peasants to cross over to India in great numbers.<sup>13</sup> And, most of those who migrate to India want to raise money to pay their debts, or release their land from "giri", or simply send back enough money to save their families from starvation.<sup>14</sup> This yearly flow of Nepalis into India and a return flow of immigrants to their

12. John T. Scholz., *Policy Processes and Rural Development : A Study of Land Reform in Nepal* (Ph. D Thesis, California, Berkeley, 1974) cited in *Ibid.*, p. 6.

13. A survey data indicate that the largest number of migrants from the hills migrate outside the country, mainly to India,

14. *Rural Landlessness in Nepal*, *op. cit.*

native places keep up an appearance of occupational mobility among the rural poor and contribute to preserving the socio-economic *status quo* in the agrarian sector. No returning migrant is rich enough to become politically ambitious or restive about his place in society nor is he pressed enough by poverty to break into spontaneous or organized political action. As a parallel development, annual flow of Indian labour into Tarai from the adjoining districts of Bihar and U. P.<sup>15</sup> also help preserve the socio-economic backwardness of these areas.

A third important factor is the use a handful of rural elite has made of extensive external investment in agriculture. Foreign aid accounts for over 50% of total government investment in the agricultural sector. In irrigation alone foreign aid between 1975-84 totalled Rs. 1432.5 million. These investments made little difference in the average income of marginal and small-landholders, but they substantially raised the income of medium and large-size farms.<sup>16</sup>

This is also the case in regard to the Integrated Rural Development Projects (IRDPs) initiated and funded by a host of external agencies. In addition to agriculture, these projects include infra-structural components (e.g. road transport, schools, institutes, trading centres, etc.) but, inspite of the fact that these projects aim at the under-privileged landless and marginal farmers as "target groups" their major benefits have been reaped by the rural elite (i. e., big and medium farm landlord)

The same holds true of the institutional credit arrangements for augementing the income of the rural poor. A Rastra Bank Agricultural Credit Review Survey (1980) showed that the maximum percentage of institutional credit had been taken by large farmers (73.6%) followed by medium farmers (15.3%) while the maximum credit needs of the

---

15. Cultivation of cash crops mainly sugarcane, has rendered the rural poor on both sides of the border into a reservoir of cheap labour.

16. See, *A Survey of Employment, Income, Distribution and Consumption Pattern in Nepal*, National Planning Commission, Kathmandu, 1983, p. 97.

marginal and small farmers (over 80%) were still met by private sources i. e., the big landholders and money-lenders.<sup>17</sup>

It is clear that massive inflow of foreign funds has contributed to the accretion of financial and institutional power of a handful of rural elite. This elite has established linkages, with the local, regional and central organs of the administration to become more effective in wielding the instruments of control and coercion. Foreign aid has thus helped - and not weakened - the preservation of a highly inequitable social order in a predominantly agricultural country. It has, according to a joint study, increased "political dependence of the underclass." Secondly, "while investing infrastructural growth to facilitate the mobility of population and goods", it has enhanced linkages of the rural landowners and eased their entry into the power-structure which is location specific (urban-based). Thirdly, foreign aid has contributed to the "immense expansion and diversification of central and local state bodies". Fourthly, it has "enabled the upper class to extend its reach and make itself felt in the very far-flung and heterogeneous villages and hamlets in the country"<sup>18</sup>.

This inter-locking pattern of linkages between foreign aid and Nepal's political system under the King's over-arching leadership constitutes the main focus of our present study. What follows, therefore, is a survey of the pattern and sources of foreign aid and its general impact on Nepal's political economy. First, the pattern and the sources.

## II

Nepal started receiving aid from 1951 onwards; but the quantum of aid-inflow was quite erratic upto 1972-73. Thereafter, it showed

17. *Rural Landlessness in Nepal*, op. cit., p. 62.

18. Chaitanya Misra and Pitambar Sharma, "Foreign Aid and Social Structure" in *Foreign Aid and Development in Nepal*, IDS, Kathmandu, 1983, pp. 1-17.

not only a steady increase but also an expanding role in most sectors of the Nepalese economy. During the six periodic plans between 1956-85, average annual inflow of total foreign aid was estimated at Rs 742.2 million, or about 58% of the average annual investment in the public sector (see Table 2).<sup>19</sup>

**Table-2**  
**Foreign Assistance in Five Year Plans 1956-85<sup>20</sup>**

Figures in million Rs.

	Investment in the public sector	Foreign aid	% Share of foreign aid
Ist Plan (1956-60)	330.0	370.9	112.2
IIInd Plan (1960-65)	600.0	412.3	68.7
III Plan (1965-70)	1740.0	919.8	52.9
IV Plan (1970-75)	2570.0	1509.0	58.7
V Plan (1975-80)	8872.0	4240.0	47.8
VI Plan (1980-85)	21750.0	13050.0	60.8
<b>Total</b>	<b>38860.0</b>	<b>20502.0</b>	<b>57.2</b>

It was not only in development outlays that foreign aid became important: the entire budgetary exercise of the government concentrated on meeting deficits by raising loans from abroad. Between 1980-85, as budgetary deficits rose from Rs. 804 million in 1980-81 to an astronomical Rs.3590 million in 1985-86, the government explored all avenues to raise foreign loans to the tune of Rs. 2225 million.<sup>21</sup> This is quite an unusual feature in the context of South Asian countries. Share of foreign aid, as percentage of Nepali resources-balance totals around 90%, whereas in the case of other countries this ratio

19. See, Sriam Poudyal, "Foreign Aid in Nepal : An Analysis of Structure, Motive and Impact", *Journal of Development and Administrative Studies* (JDAS), Kathmandu, vol. 4, no. 1-2, June-December 1982, pp. 179-214.

20. Source : *Ibid.*

21. *Statistical Yearbook. op. cit.*, p. 424.



is much lower because they rely more on private capital flows and factor-incomes from abroad than on foreign aid. In the relative absence of such flows, "foreign aid has become almost the only source of meeting the savings gap in the Nepali economy".<sup>22</sup> It is for this reason that government's dependence upon foreign aid appears much more pronounced in Nepal than in other regional countries. What does this dependence signify in political terms? In the opinion of two Nepali economists, Mishra and Sharma, the government is dependent not only for the financing, but through it, "for the legitimization of power relations in favour of the upper class as well".<sup>23</sup>

But before taking this aspect, we should examine some specific features of external aid to Nepal. First, external aid has come in the form of both direct grants and loans.<sup>24</sup> Most grants have come on a bilateral basis, while an overwhelming proportion of loan is advanced by the multilateral agencies on a nominal rate of interest and on a long term basis. India, USA and China constitute principal donors of bilateral grants. India's dominating position is apparent

**Table-3**  
**Bilateral Grants Flowing into Nepal (upto 1979-80)**

Source	Percentage of Total
India	38.3
U.S.A.	23.2
China	14.3
U.K.	9.8
U.S.S.R.	2.4
Others	12.0

Source : Poudyal, *op. cit.* p. 189.

22. Devendra Raj Pandey, "Foreign Aid in Nepal's Development : An Overview" in *Foreign Aid and Development in Nepal*, *op. cit.*, p. 279.

23. *Ibid.*, p. 277.

24. Poudyal, *op. cit.*,

as it provided over 38% of the total bilateral grants till 1979-80. But if we consider the contribution of only the three major donors, India's share would account for around 50% of the total grants.<sup>25</sup>

Sectoral distribution of foreign aid shows that a major portion of it has been spent on the development of transport and communication. Incidentally, this has suited most the interests of the two major donors - India and China - as both have supported construction of road projects "to connect important regions of the Kingdom with their own borders".<sup>26</sup>

But the Government too has been equally eager to develop roads and communication to strengthen internal security. By the end of the Fourth Plan, emphasis of planning had shifted to agriculture and utilization of manpower, but aid allocation for transport and communication still continued to account for 35-40 percent of public outlays.

Quite apart from the question "whether foreign aid has contributed to Nepal's economic development or not", external aid flows have definitely made an impact on the country's socio-economic infrastructure. On an average, 186 km. of road has been built per year since 1956 - which is quite impressive in view of the difficult terrains to be negotiated and reached. This together with the improvement in other forms of communication, has facilitated administrative integration. Literacy rate too has increased, though three out of four Nepali adults still cannot read or write. Higher education and health facilities have improved and so has the average age of the Nepalis.<sup>27</sup> Foreign aid has also played a key role in the construction of several major manufacturing enterprises in the public and private sectors.

But the less tangible results of foreign aid should be searched in the socio-economic spheres. First, as we have noted, foreign aid has

25. *Ibid.*, p. 189.

26. *Ibid.* p. 192.

27. Devendra Raj Pandey, "Economic Reality", *Seminar*, New Delhi, June 1982, pp. 26-31.

strengthened a dependency-complex to the extent that Nepal's "development strategy has tended to follow aid rather than vice-versa".<sup>28</sup> Second, despite repeated exhortation to raise agricultural productivity, aid flows have failed "to unknot the problems of rural indebtedness, tenancy, landlessness, wage labour and so on".

Third, the principal beneficiary of external aid has been the government. The latter has used its external linkages to cover persistent inactivity in the socio-economic sector and paying lip service to its need-based developmental goals. Its plans, economic policies and budgets bear little relevance to the nation's economic ailments: "They are pursued with an eye on the aid donors on the one hand and the self-seeking attitudes of ruling classes on the other".<sup>30</sup> Further, linkages with foreign donors have made it possible for the government to continue with a taxation policy that has restricted collection of land revenue from annually 20% in 1969-70 to 4% in 1980-81. Similarly, receipts from income tax have gone down to about 6% after reaching a level of about 11% of tax revenue in 1977-78.<sup>31</sup>

A much graver consequence of foreign aid has been pointed out by the two scholars cited earlier. According to them, "over the last 30 years foreign aid has increasingly penetrated a wide range of economic and social sectors of the country".<sup>32</sup> And, in the context of Nepal, such aid has become "a metaphor for the maintenance and strengthening of the traditional native power structure".<sup>33</sup> In their view foreign aid has speeded up the process of monetization of the rural economy by i) favouring the subsidized urban sector, 2) contributing to the penetration of the Indian market with Nepal, and 3) aiding the transfer of capital from rural to urban areas. "The beneficiaries of

28. Pandey, *op. cit.*, p. 285.

29. Misra and Sharma, *op. cit.*, p. 8.

30. Pandey, *op. cit.*,

31. *Ibid.*

32. Misra and Sharma, *op. cit.*, p. 1,

33. *Ibid.*, p. 2.

this process have been precisely those classes which determine the content and channels of foreign aid inflow into Nepal.”<sup>34</sup>

### III

Among these classes, we must examine in particular the role of a burgeoning middle class which, until the revolution of 1951, was almost non-existent. Under the Ranas, there was a landed aristocracy with petty farmers and peasants with the landless and the untouchables below them.<sup>35</sup> The ruling aristocracy patronised a number of families, who rendered services in the military and civil jobs, or won their favour through expressions of personal loyalty and fidelity in what came to be called the *Chakri* system. But, in the post-Rana period, with money and opportunity flowing in, the non-aristocratic but relatively better-off families found new avenues for the promotion of their economic and social interests. At the same time, with the expansion of administrative services, education and other developmental programmes, a sizeable middle class emerged along with many more who shared its aspirations. This middle class “owes its birth directly to foreign assistance in diverse forms of Nepal”.<sup>36</sup>

It is the phenomenal expansion of an administrative infrastructure, pumped and aided by foreign assistance, that accounts for the rise and growth of a beneficiary middle class. Thus, to give few examples: between 1960 and 1980, the number of civil servants increased from 3,000 to 70,000. Also, according to a Planning Commission Survey, the government needs created 5,000 new jobs every year to man its administrative and developmental services. In education, too, between 1950-70, the number of students enrolled for secondary and higher education increased from about 2,000 to approximately 120,000. The

34. *Ibid.*, p. 5.

35. *Foreign Aid and Development in Nepal, op. cit.*, p. XII.

36. *Ibid.*, p. XVII.

Tribhuvan University, founded in 1959, has today 116 campus colleges to supply trained manpower to the country.<sup>37</sup>

The recruits to this new middle class comes largely from the well-to-do higher caste families. In higher education, for instance, the Newars, Brahmins and Chhetris constitute over 78% of the enrolled students. These groups dominate higher echelons of the bureaucracy and private companies. Obviously, "the fundamentally patrimonial character" of Nepal's political system has favoured most the traditional higher castes in the context of the "feudal tradition of the ruler elevating families in the caste hierarchy".<sup>38</sup> In the Panchayat structure, as Baral notes, the "hard core" of the political elite came continuously from Chhetris, Brahmins and Newars.<sup>39</sup> The traditional caste order as well as the feudal-oriented social values have thus been reinforced by the new class formations in Nepalese society.

It is this factor, perhaps, that underwrites and strengthens Nepal's partyless Panchayat system. Despite many crises, including an armed insurrection organized by the Nepali Congress from exile, the system has not only stabilized itself, but has also by allowing for direct elections to the National Panchayat on the basis of adult franchise broadened its own popular base. How has this come about? In 1960 King Mahendra banned all political parties, dissolved an elected parliament and imposed his personal rule on the country. After a time he introduced the Panchayat system which was essentially based on autocratic principles. During 1976-79, autocratic trends in Panchayat politics became more marked as a bunch of politicians took control of the administration under direct surveillance of the King.<sup>40</sup> But events took

---

37. *NPD*, p. 54.

38. B. Borgstrom, *The Patron and the Pancha: Village Values and Panchayat Democracy in Nepal*, New Delhi, 1980, p. 62.

39. See, Lok Raj Baral, *Nepal's Politics of Referendum: A Study of Groups, Perspectives and Trends*, New Delhi, 1983, p. 169.

40. *Ibid.*, Chapter I.

an unexpected turn: in May 1979, students took to the streets in Kathmandu and other towns and called for an end to the Panchayat system. Viewing the situation with alarm, King Birendra ordered a national referendum to offer a choice between the Panchayat order "with suitable reforms" and a multiparty system of government.<sup>41</sup> The referendum, held in May 1980, divided popular opinion almost by half: around 54% of the total 4.4 million voters approved the Panchayat system, but the case for competitive party politics was not wholly lost. As a consequence, Birendra amended the constitution to provide for direct election to the National Panchayat (NP) on the basis of adult franchise; appointment of a Prime Minister with the approval of at least 60% of the 140 NP members, and formation of a Council of Ministers responsible to the NP. In short, the base of Nepal's Panchayat pyramid was widened while a sort of cabinet government at the apex was theoretically conceded.<sup>42</sup>

This trend towards liberalization showed the political flexibility of Nepal's ruling classes. In place of a confrontationist policy, they opted for larger popular share in a closed political system. But even this concession helped to generate popular enthusiasm in Panchayat elections during 1981 and 1986 as seen below:

**Table - 4**  
**Elections in Nepal (1981/1986)**

	Total voters	Votes polled	% polled	No. of candidates
1981	7,793,119	4,073,836	52.2	1098
1986	9,044,712	5,456,028	60.3	1549

Source: Election Commissioner's office.

41. *Ibid.*, pp. 215-16.

42. See, Ahirudha Gupta, "Post-Election Politics in Nepal" *International Studies*, New Delhi, vol. 24, *op. cit.*, 1987, pp. 91-100.

Despite the great odds against registering voters and setting polling booths in inaccessible terrains, the list of adult voters expanded by more than 1.25 million between 1981-86. The voters turn-out also rose from 52.26% in 1981 to 60% and above in 1986. The tally of candidates for 112 elected seats in parliament went upto 1,549 as against 1,098 in 1981. These figures indicate that despite non-participation of the banned political parties, popular interest in the elections was not inconsiderable. In 1917, even the Nepali Congress acknowledged this fact and decided to participate in the elections for 188,755 seats in the village and Town Panchayats.<sup>43</sup>

Thus, if Nepal's economy is in a mess, its politics presents a story of reasonable success and stability. The panchayat system has evolved a political consensus, centering the palace and the old order and buttressed by a beneficiary middle class. In other words, the traditional autocracy and feudal elements have found a new ally in the middle class to preserve their political supremacy in Nepal. And this has been made possible by the abundant flow of aid from external donors: "the power of the purse has helped the power structure by contributing to the legitimization of the political system".<sup>44</sup>

#### IV

Over-dependence on foreign aid, concentration on export promotion as "engine of growth" and absence of domestic resource mobilization have thus achieved what an observer calls Nepal's "*status quo* of under-development."<sup>45</sup> And, it is because India's share in Nepal trade and external aid flow overshadows all others, that we have to interpret India's special relations with Nepal from an angle very different from those generally advanced by the official and non-official quarters in both the countries. Obviously, it is Nepal's geo-political situation

43. *Keesing's Contemporary Archives*, vol. 33, October, 1987.

44. Misra and Sharma, *op. cit.*, p. 8.

45. Bhavani Dhunjana, "Foreign Aid : A Free Lunch for Nepal", *JDAS*, vol. 3, no. 1-2, June-December 1981, p. 132.

that causes greatest concern to India's security and defence. On the other hand, Nepal's view of "special relations" with India stems from its commitment to a particular growth strategy based on aid and export. More than being land-locked, Nepal finds itself being "India-locked". Hence, it wants to procure liberal transit facilities from India to make its trade "the leading and sustaining force of national development".<sup>46</sup> Nepal stresses the economic aspect of "special relations" with India, while the latter views them primarily in strategic terms. The two attitudes are not complementary.

But there is also some ambivalence in the Nepali positions whereas it welcomes maximum bilateral aid from India. It wants nevertheless to diversify and increase trade relations with the overseas countries with a view to reducing its over-dependence on India.<sup>47</sup> During 1985-87, export of manufactured goods, especially ready-made garments, accounted for 40% of Nepal's overseas earnings. The indigenous content of these finished goods is, however, marginal which explains in some ways the trend towards large-scale imports. On the other hand, India's insistence on having a minimum of 90% of Nepalese or Indian and Nepalese materials in the export of manufactured goods causes great irritation to Kathmandu. This irritation is based "on the fact that on an infant economy like Nepal, 10% as the minimum permissible import content seemed to be too low a figure. On the other hand, it appeared reasonable to reduce the requirement of 90%..... to a substantially lower figure".<sup>48</sup>

46. Pashupati Shumsher JB Rana, "India and Nepal: The Political Economy of a Relationship", *Asian Survey*, Berkeley, July 1971 p. 654.

47. The three objectives Nepal has set for itself are :

1) to improve balance of payments situation by increasing export; 2) to expand and diversify international market for exportable goods; and 3) to boost national production and employment through export promotion. See *The Seventh Plan 1985-1990 (A Summary)* Part-1, National Planning Commission, June, pp. 80-81.

48. R. K. Das, "Landlocked States and the Problem of Trade Diversification: The Nepal Case", in *Some Aspects of Nepal's Economic Development*, Centre for the Study of Nepal, Banaras Hindu University, 1982, p. 48.



In March 1978, the signing of two separate treaties on trade and transit and an agreement on cooperation in controlling unauthorized trade access the borders helped relieve some of Nepal's pressing problems. The treaty on trade allowed entry of Nepal's manufactured products to India with only 80% of Nepalese and Indian raw materials. Goods manufactured in Nepal were given access to the Indian market free of custom duty and quota restrictions. The treaty of transit, on the other hand, facilitated movement of bulk cargo by both rail and road. India also agreed to open an overland route for Nepal to Bangladesh for extra-port facilities and access to the sea.<sup>49</sup>

There is however another side of the story. Nepal's free economy offers special attraction to unscrupulous Indian businessmen who have, in league with their local associates, reaped huge profits from Nepal's export of ready-made garments. Most garment factories are owned by Indians.<sup>50</sup> In other industries too, Indian capital predominates. Taking advantage of various joint collaboration programmes Indian business houses have come forward in a big way to invest in light consumer industries. Thus, of the 10 joint ventures approved by the two governments between 1977-86, five have gone into hotel, travel and rest in the manufacture of beer-bottling and cigarettes. These houses also enjoy a monopoly in these ventures in the Indian market.<sup>51</sup>

A major bulk of the gains from Nepal's export-import trade has thus flowed with the offers of the Indian business houses. Also, in view of the free movement of goods and people across an open border, an underground sub-economy has also grown up with a nucleus of smugglers and racketeers on both sides of the border. These smugglers and racketeers maintain close liaison with Nepali politicians and raise unsubstantiated scare about the state of Indo-Nepali relations solely with a view to feathering their own nests. Sometime, they raise a scare

---

49. *Ibid.*, 49-60.

50. *NPD*, vol. 30, 3 February 1986, p. 41.

51. Such as Oberoi Hotels, Motels, Mohan Meakin Ltd., and Sita World Travels.

about the discriminations the Indian citizens face in Tarai and, sometime, they launch a well-orchestrated campaign against the influx of Indians into Nepal.

India's share in the preservation of an iniquitous social order in Nepal cannot, therefore, be minimised. By providing bilateral aid, which constitutes about 40 per cent of the total aid flow into Nepal, India has contributed to the nurturing and strengthening of an autocratic power-structure which is based on an alliance of the traditional autocracy and a dependent middle class. By its excessive concentration on Nepal's strategic location, India has provided a surplus of excuses to Kathmandu to demand for larger aid-cuts while at the same time, appealing for national unity and pro-establishment sentiments to defeat its detractors and opponents at home. In the meanwhile, foreign and Indian capital have struck a profitable deal with Kathmandu's power elite to convert a land-locked famished and agriculturally backward country into a haven of free trade and investment.