

Strategic Issues in the Economic Policies of His Majesty's Government of Nepal

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Introduction

When I was invited to address the Council, I remembered that I had addressed it on September 6, 1976 on the question of economic growth in Nepal, that was nine years ago. After the presentation of the paper, I remember, I was severely criticized as a pessimist and a habitual critic. I went back and read that old paper again. I want to read before you the conclusion presented in that paper which is as follows: "The problems that we face present before us are both challenges as well as opportunities. A Nepal strong and united marching ahead resolutely in the path of development all across the length and breadth of the country is the vision of the future that is in itself the most challenging as well as the noble and inspiring task facing the country. To turn this vision into a living reality is entirely within our reach and capability, provided that we strengthen and put new life and force into the economic and political institutions that have been established in the country. Participation will have to be made more meaningful and institutional autonomy within defined guidelines must be continuously strengthened. In essence, what will be needed is a new attitude to accept change, to face change and to move forward boldly with full self-confidence and dignity in meeting the historic task strengthening both the economic and political base of our free existence."

This was my assessment nine years ago. As I look back over the years including my two years as the finance minister of the country, I can point out areas where we have moved forward in nation-building; there are also areas where much work needs to be done. In many cases, perhaps, our efforts have not been adequate, or commensurate with the magnitude of the task that lies ahead. This should, however, not lead us to despair but towards greater commitment and dedication towards achieving our goals.

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Evolution of Linkage

Politically, the granting of the referendum by *His Majesty the King* was an event of historic importance for the country. It has led to the evolution of a national polity under the *Panchayat System* where the link between the people and their representatives has become much more meaningful and strong. The voter in the district doesn't request his representative; he demands that his voice be heard and raised in the National Panchayat. The pressure on the government for more resources has naturally increased. Similarly, there is a greater awareness of regional balance and allocations. More and more people-ordinary common people all over the country are learning to speak up and demand greater attention from their representatives and the government. For the government this represents a challenge as well as an opportunity. The challenge is to be able to mobilize resources and harness them to constructive uses for the fulfilment of the rising aspirations of the people. This is also an opportunity to develop new economic links and institutions in line with the goals of our System that can involve the people in raising the level of savings and investments so vital to an increase in income and output.

At the popular level, often, economic issues tend to fall within a dualistic framework. One is either a capitalist or a socialist, a conservative or a liberal and so on. Thinking in 'either-or' terms is less taxing to man's capacity for reasoning. In reality, however, strict duality is seldom the order of the day. This has been very well realized in Eastern philosophy since antiquity. Love and hate are two diametrically opposite emotions and yet they manage to co-exist in most human beings. A normal man finds a 'balance' between these emotions even though he may not be consciously aware of it. When this balance becomes difficult, he tends to develop psychic problems.

Clear Guidelines

If we look at economic systems, I don't think that there is any country in the world practising unfettered *laissez faire* any more. Even in capitalist countries, government's relative share of GDP exceeds that of the many developing countries that claim their faith in socialism. In like manner, even strong advocates of socialism are finding areas where flexibility can produce results. And yet we continue to analyse as if dualism were the order of the day.

In Nepal also I find this line of thinking characterising our discussions on economic policies. But if we look at our Constitution, I think the guidelines are clear--the Constitution envisages a role for the State, for the private sector and also for the cooperative sector which we all call *Sajha*. The actual mixing of these three elements so that they complement each other in a manner that leads to increased savings and investments, larger output and greater welfare of the masses is the essence of economic policy-making.

The real issue here is to minimise the contradiction among the State, the private sector and the cooperative sector and broaden the areas of complementarity where efficiency in one can help build another with positive feedback in the whole system. The search for complementarity and balance is difficult but it is the key to success in policy making. I think this is precisely the kind of searching effort that is taking place not only in Nepal but also in many developing countries including, of course, our two big neighbours, India and China. I might

also add here that this is an effort that is producing results. In China it is already dramatic. In India, the early signs are encouraging.

The Conception of Private Sector

Perhaps, at this point, it's also important to make clear our conception of the private sector. For most of us the private sector brings the image of rich people, even smugglers and black marketeers ready to grab the first rupee they see. But the private sector, in true sense, is much less and much more than this image. Let us look at our economic structure. Two-thirds of our GDP is produced in the agricultural sector which, let me stress, is run by the private sector. The farmer who owns half a hectare of land and a few animals is a private sector operator, who does his cost and return calculations even though it may not be expressed in the form of cost sheets and rate of return. There are also thousands of small artisans, shopkeepers and they also form the private sector. To refuse to recognize this productive force as the private sector, which I sometimes find in the criticism of government policies, is to admit they do not count and are incapable of thinking in economic terms. Ironic as it may sound, this is exactly what the Western colonialists and academicians thought of the people in the East in the 19th century.

In Nepal, we have always been pleading for the private sector while at the same time spreading the tentacles of governmental and corporate bureaucracy with ease and impunity at the cost of people. Truly, the cost has been staggering and we will have to pay for it through the tax payer's money. Let us cite some statistics. Between 1978-79 and 1982-83 the government guaranteed a total loan of Rs. 1116.12 million and most of it at the moment remains unpaid. The rice trading companies, for example, borrowed 400 million rupees on government guarantee. One fine day they were declared as dissolved and all that huge loan has become the responsibility of the government. Likewise, the National Trading Ltd., imported some years ago many things on government guarantee. Most of the goods still lie unsold despite price reduction. All this went on in the name of strengthening the infrastructure of development. It has been costly infrastructure because the annual interest payment on these loans runs into hundreds of millions of rupees. The budget this year if you take a careful look, reflects this burden.

Complementarity Among the Sectors

In my view, a proper mix of policies that leads to complementarity between the State sector, the private sector and the cooperative sector needs to be worked out in the country. But I know that whenever one wants to move in this direction some people immediately cry "foul" and declare the person as an ideological heathen that should not be spared.

The complementarity that I am suggesting is very difficult to achieve. Once the governmental and the corporate bureaucracy experiences the comfort riding on the back of somebody else, it is very difficult for it to come down and develop a relationship with other sectors of the economy that is mutually reinforcing. But we have to try to evolve these new relationship, otherwise the creative spirit and work incentive of the people will remain suppressed and are therefore, unable to manifest themselves in rising income and output.

In our country we have gradually realized this need with each passing day. Let me cite

an example that most of us tend to forget. About two decades ago the government took major responsibility of all our forests. Over the years forest protection has dwindled and afforestation programmes have become a new topic of satire and cynical humour. Now we have gone through the whole circle and are trying to limit the role of government. Panchayat forestry, individual forestry and contract forestry are now well accepted and we are hoping that these new policies will encourage the farmer and the investor to plant trees and raise forests for economic gain. In fact, we are now accepting the idea that it's necessary to provide economic incentive to the individual to plant trees. What is happening is that the State is trying to encourage the individual and the cooperatives through its policies and incentives to invest in forestry for economic gain. I consider this the correct line because what we are aiming at is the creation of complementarity between the efforts of the State and the individual. It is interesting that those who claim themselves to be "ideologically faithful" have not yet criticized this step as giving way to the evils of capitalism; when the government is undertaking similar policies to create complementarities, however, the theological zeal of the self-declared faithfuls bursts into tall steam and the government is criticized as giving way to the evils of unbridled capitalism and ignoring the spirit of the system. When I come across this reasoning, I remember a sentence by Thomas Hobbs that I read long ago. The sentence reads "The privilege of absurdity is a phenomenon that characterizes no other creature but man".

The Design of Economic Policies

In the design of its economic policies His Majesty's Government has tried to create complementarities between the State and the private sector so that they do not emerge as adversaries but as parties looking for complementarities. It is only through this strategy that we can achieve what is known as "synergetic effect" meaning that when there is a simultaneous action of separate entities in a cooperative and complementary manner the end result is greater than the sum of individual parts. I think this is probably where our mathematical law of addition do not work.

In line with this strategy, the economic policy of the government has tended to concentrate on two things. First, as an investor the government must finish its projects within the prescribed time limit and resources so as to be able to reap the benefits for the society as planned. Second, the government's investment package as well as its policies must create an atmosphere that leads people individually and jointly to save and invest more for economic returns, in an environment of dynamic stability.

How far have we been able to move in this direction? I am sure this question immediately comes to our mind. I will be candid with you to admit that much needs to be done. We are still not able to finish our investment projects in time. In fact, in this area we must be able to do much better than what we have been able to do so far. Inability to complete investment projects on schedule leads to cost escalation and indirectly deprives the economy of planned benefits.

Second, Government's economic policies, as I have said, must create an atmosphere that allows individual and investments to complement governmental programmes within a framework

of financial stability and balance in the economy. His Majesty's Government has been aware of this and has taken a number of measures towards this goal.

On the question of project implementation, the government has identified projects that it considers as being of national importance. There will be continuous monitoring of these projects to make sure that the work goes on as planned. On the question of creating complementarities the government has taken a number of steps whose effects should be felt over a period of time. To name a few, the government has adopted the idea of encouraging efficiency by discouraging monopoly that leads to lethargy and indifference. This has been already applied in the banking sector. Since the government announced the policy of allowing joint venture in banking, change in our traditional banking style has been noticeable. Resource flow has increased and customers are being treated with a new importance and concern. For the businessman and the investor, access to resources is becoming easy and it will be easier as this process continues in the future. In the meantime, the expansion of the Agricultural Development Bank (ADB) into commercial banking has allowed the Bank to mobilize additional resources and will enable it to be more effective in the rural areas.

In the rural areas, credit is one of the most important inputs for increased agricultural production. For the individual farmer it must be available and accessible. There are times when the bank has the resources available but the farmer has no access to them. The link between the institution and the individual has to be established. This requires a banking style that is geared to the needs of the people rather than the people adapting to the needs of the bank. In this area some very successful experiments have been done in our country. The intensive banking programme at *Fikkal* in *Illam* for example, has been quite successful in reaching the farmer and creating complementarities in its investment package so that the overall rate of return on investment remains attractive. The Small Farmer Development Programme is another project that has been reasonably successful in providing the poor with access to credit and other inputs. These models need to be duplicated for increasing income and employment in the rural sector and we need new institutions and resources to achieve this end. The regional rural development banks that the government intends to set up will try to take this challenge. There are of course many who will say that ADB alone can do this job. But this is not correct. In a country where less than 25 percent of rural credit needs is met by institutional resources, we need a "cafeteria style" banking as far as reaching the people concerned. This is precisely what the government aims to do.

The focus of all these measures is to increase the availability of resources in financial institutions to make them accessible to people to boost production. Our progress in this area should go hand in hand with efficiency of governmental investments so that the overall rate of return on capital remains attractive for the economy as a whole. In this scheme, the increase in the efficiency and expansion of the financial sector is not necessarily the effect of development; it can also be one of its leading causes.

Once we accept the fact that one of the main purposes of economic policy is to encourage complementarities between the State, the co-operative and the private sector, a whole set of

measures automatically follows. Some of these policies are manifest in this year's budget. In small hydel power construction, for example, so far the government alone has taken the responsibility. The per KW cost of generation has been such high and maintenance has always been a problem. Now what we are saying is that if the entrepreneur either individually or as a group establishes a water mill for milling as well as for power generation, the government will provide some subsidy for the cost involved in acquiring generating machines and other electrical accessories. I believe, with this policy of involving the people, mini-micro hydel plants can be established at a much cheaper cost to the society as against the alternative of the government taking the whole responsibility. What is happening here is the creation of complementarities between the effort of the people and the government.

The Budget Speech for this year outlines many other measures based on this thinking, and I feel that this is the correct line consistent with the ideals of our System. The expansion and diversification of financial institutions, for example, is a case in point. As you know, as part of its programme to make resources available for improving the conditions of the poor, the government is opening regional development banks that will try to encourage the duplication of what I call the *Fikkal* Model of rural development launched in *Illam* for the upliftment of the rural people. Similarly, to make increasing quantum of resources available to the small industrialist and the entrepreneur, the government has presented legislation in the National Panchayat for the establishment of finance companies. Legislation has also been introduced to allow the Employees Provident Fund to invest in priority industries including the buying of shares and debentures of corporations. Still more, the government has also presented legislation in the Rastriya Panchyat for the establishment of pension funds by government corporations or private companies. This will be one more channel to mobilize resources for increased investments. Taken as a whole, all these measures will enhance the capability of the financial system to mobilize resources and allocate them more efficiently in a competitive atmosphere, thus leading to rising income and the opening of new employment opportunities. For the small farmer in the rural area or the small entrepreneur in the urban centre it will mean more than rhetoric since increasing amount of credit will be available and accessible to them for productive purposes. The fundamental idea again is: the government should help the people to help themselves.

The Question of Economic Balances and Stability

I will now present before you my views on the question of economic balances and stability. This is an area that should always be of concern to us.

As I see it, three important balances that should be maintained, namely, in *trade balance and balance of payments*, *revenue--expenditure balance* or *balance of public finance*, and *investment and output balance* or *balance in costs and returns*. Of course, there are other balances that immediately come to one's mind. But these three are most crucial and if ever there is an economic problem leading normally to political difficulties, the reason can be found in the behaviour path of these three variables over time.

In developing countries it is very difficult to keep these three variables operating within

what could be labelled as "safe limits". The economic problems of many Latin American, African and Asian nations have their roots in the inability of the government to maintain balances in these areas. We must be aware of this reality and must not hesitate to take timely decisions.

Let us look at our experience in maintaining these balances during the last few years. First, the revenue-expenditure balance. The deficit in government finance was only Rs. 25 crores in 1979-80, In 1981-82 it increased to Rs. 96 crores. In 1982-83, it crossed the 200 crore level and reached a figure of 207 crore rupees. In 1983-84, the government tried to control this trend and reduced the budget deficit to 148 crores. In 1984-85, the targeted budget deficit was around 140 crore rupees but revised estimates indicate that it will be higher by around 25 crores. This year the target is 140 crore rupees. The message over the last few years is clear: Once we allowed the budget deficit to rise significantly, it has become extremely difficult to reduce it rapidly.

Controlling budget deficit is difficult everywhere but it is even more difficult in developing countries like ours. Reducing budget deficit means closing offices, retrenchment and generally reducing the level of expenditure and the number of projects that the government may want to undertake. Financial prudence, therefore, requires that one should be very careful when raising the level of deficit because once it rises it is very difficult to decrease it. All measures for controlling budget deficit require decisions that are bound to be unpleasant. An iron political will is the first requirement for controlling deficit once it has started rising. In fact, I might even say that budget deficit is the biggest enemy of finance ministers anywhere in the world. It is a tough adversary that must be tamed if an environment of economic stability is to be maintained. The present government realizes this very well and will not hesitate to take appropriate decisions towards this end.

The second balance relates to trade balance and balance of payments. Here also we need to be cautious and careful. If we look at statistics, they are not encouraging. Our trade deficit has shown a tendency to increase, especially with India. To cite some statistics, in 1979-80 our trade deficit was Rs. 242 crores. It increased to Rs. 283 crores in 1980-81, Rs. 345 crores in 1981-82, Rs. 520 crores in 1982-83. It declined to Rs. 482 crores in 1983-84 and is likely to reach Rs. 515 crores in 1984-85. Clearly, this trend should not be allowed to continue because it will have an adverse impact on the balance of payments. The solution is control of deficit financing, export promotion, rapid expansion of import-substitution industries and a general increase in production and competitive efficiency of the economy. The government is quite aware of the need for these measures. In this year's budget we have already specified certain policy guidelines to promote the textile industry. The details are being worked out. The main point is that imbalance, if any, needs to be redressed and appropriate measures that I have outlined will be taken to keep it under control. The problem also highlights the fact that in our trade and aid relationship with our neighbours and friends we have to pay attention to the question of trade balance in the future. In economic relationship with our friends we must bring the trade balance issue explicitly into the picture and direct resources accordingly for mutual benefit, with mutual helps and co-operation.

The third imbalance relates to investments and output. Over the years, we have invested a great deal in building our infrastructure and improving the productive base of the economy. Yet the fact remains that the increase in output is not in line with the increase in investments. I have already indicated the reason for this behaviour. Partly, it reflects the weakness on the part of the government to successfully undertake its investment programme within the specified time and cost. It also reflects, however, the inability on our part to create complementarities in the investment programmes and economic relationships between the state, the private sector and the co-operative sector. Too often the government has acted as the boss and has tended to underestimate the creative potential of the people if they are given the opportunity to work for their economic benefit. The budgets for 1984-85 and 1985-86 have realized this serious lacuna and have taken some initial steps that I feel will have a positive impact on restoring the balance between output and investments over time.

There are a few other points that I would like to present to you. As you know, the government has recently announced measures to allow Nepalese working abroad to deposit hard currency earnings in Nepalese banks and also significant freedom in the use of such deposits. This facility has also been extended to Non-Nepalese.

Well, to come to the basic point, I have no hesitation in telling you that the objective of this measure is to create the base for developing Nepal as a financial centre in South Asia. Our neighbouring countries are gradually borrowing from the international financial market. And I see no reason why we cannot start some modified version of off-shore banking to take advantage of this trend. Besides, this is the kind of industry where landlockedness is certainly not a disadvantage. Many critics of this measure, however, cannot even dream of Nepal emerging as such a centre over time. I see no reason why it cannot--we have political stability and maintain the best of relations with all our neighbouring countries. We are also favourably placed in terms of time zone necessary for such an operation. Besides, we are also rapidly modernizing our international communication facilities vital for such operation. This is why I think we can move in this area. It is not something that will happen overnight. But if we are careful to build up the confidence, we can be successful in achieving this goal.

The government has also been criticized for selling the shares of corporations to the people. In fact, this government has made a major decision and that is to sell the shares of government corporations, at least once a month to the people, through the stock exchange. For some pundits of Nepalese economy, that is an invitation to financial disaster. "How long can you survive by burning the furniture of your own house"? They ask with disgust at the attempt of the government to create complementarities between the State and the people. On this, let us first look at our own Constitution--the *Sajha*, for example. What is *Sajha*? It is cooperation between the government and the people. Let us take a look at the *Sajha* organization. Who are the shareholders? They are the government, the employees and the people. This is a concept that is as old as the *Panchayat System*. Now that the government tries to move according to the spirit of the Constitution and the various clauses of the Cor-

poration Act, the self proclaimed theologians shout against this measure at the top of their voices.

By trying to involve the people in the ownership of the government corporations, the government is establishing a new form of co-operation between itself and the people. It is a measure that will force factory managers to resist bureaucratic interference and encourage them to act professionally since the price of the shares is going to be determined by the level of profit. I feel that this measure will develop professionalism in management and help lighten the burden of corporate bureaucracy that is increasingly absorbing resource for its survival rather than releasing them for development.

In this context, let us also look around the world for a minute. In England, the sale of British Telecom is big news; in India, the process of selling shares to the employees is considered as contributing to efficiency; in Brazil, recently, the government has decided to sell seventy seven para states for economic efficiency; and last but not the least, in China corporations are competing with each other, and there is active debate and discussion for opening the Shanghai stock exchange so that enterprises can float shares. In none of these countries has the government been charged with burning the timber that holds the house. In Nepal, of course, for some of our wizards passion is more important than logic.

Conclusion

Briefly, I would like to recapitulate what I have said so far. First, it is the policy of the government to develop a complementary relationship between the State, private sector and the co-operating sector. This does not mean abdication of responsibility by the government. In fact, it means the opposite. The government will try to increase the efficiency of its investments but at the same time it will promote measures that will encourage the people to invest for economic gain. Increase in competition, expansion and diversification of financial institutions so as to make a larger quantum of resources available and accessible to an increasing number of people in both the rural and urban areas, public participation in government enterprises and government encouragement to the private sector in tangible terms to move into areas like micro hydel stations, forestry, horticulture, gobar gas, that are vital to rural upliftment are some of the measures that have been adopted to evolve a new complementarity in the economic activities of the government and the people. All this, however, will have to proceed within a framework of three important macro economic balance of trade and balance of payments, balance in public finance, and balance in investments and output. The government is fully aware of this imperative need and will take appropriate decision to maintain the required stability and balance.