Indo-Nepalese Economic Cooperation — A Study on Trade, Aid and Private Foreign Investment (1972–1982)

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CHAPTER I

INTRODUCTION

India and Nepal have been linked historically by deep-rooted economic and socio-cultural ties. Despite of so many similarities, these two countries have maintained distinct identity.

If India was exploited by the colonial British rule, Nepal was equally subjugated by the autocratic Rana regime. Nepal overthrew this one century isolation in 1951 and embarked on planned economic and social development only in 1956. However, India could make quick strides in the field of economic development after independence in 1947. Nepal, handicapped by its landlocked character, could not make much progress. Nepal still falls under the low category of least developed country with a per capita income of $140 in 1981.

India with relatively more developed assets, skills and technical advancement, extended its hand of cooperation to Nepal. For the expedient implementation of aid projects, it set up Indian Aid Mission in Kathmandu in 1954 which was renamed as Indian Cooperation Mission in 1966. There is hardly a sphere of economic activity of Nepal in which Indian economic assistance has not penetrated. However, both are developing countries in a broad sense. So it is a peculiar and unique case that India, while being one of the largest aid recipients in the third world, is at the same time extending so much of aid to another third world country, Nepal.

Nepal is located at a very strategic place. It is generally described as 'India's Northern Gateway'. India has a vital politico-strategic interest in Nepal. If Nepal falls under the influence of any unfriendly power of India such as China, the entire Gangetic plain would be exposed. The building of Chinese aided 104 km. highway linking Kathmandu with Kodari, a town in the Tibetan border, in May 1967 posed further problems to India's defence.

Further, Nepal is a landlocked country. The nearest seaport i.e. Calcutta, is 800 miles away from Kathmandu. Unlike the other landlocked countries like Switzerland, Nepal has no competing access to sea. Despite of Kathmandu-Kodari Highway, India is the most economic entry and exit for Nepal's trading purpose. India and Nepal have maintained an open border system.

China is next immediate neighbour of Nepal. But Nepal's relation with China is 'only occasional and formal'. China does not generally figure in the day-to-day affairs of Nepal. Actually, the basis for any relationships with China cannot be as strong as that of its relationships with India.

In this background, this work studies and analyses the Indo-Nepalese economic cooperation in terms of aid, trade and private foreign investment. Though the specific period considered is since 1972, the study analyses the whole historical background in its proper perspective.

The period after 1972 has been taken mainly because this period has not been adequately discussed by the scholars. This period is also significant because of far reaching national and international changes in this region which has bearing on the bilateral relations of Nepal and India. If the economic front in Nepal showed a quick deterioration, on the political front, King Birendra had to announce referendum to consult the people of Nepal as to the type of government they wished. Nepal's 'Zone of Peace' proposal also figured prominently during this period.

Similarly, the announcement of price hike by the OPEC countries in 1974 adversely affected the Indian economy. At the same time various far reaching political changes took place in India. It varied from Sikkim's merger as twentysecond state of India in 1975 to the formation of Janata Government in 1977 and again Mrs. Gandhi's come back to power in 1980. Further, this period witnessed substantial geo-political changes in South Asia after the emergence of Bangladesh in 1972.

While analysing various facets of Indo-Nepalese cooperation the second chapter will deal with the Indo-Nepalese Trade Treaties. In this chapter, an attempt has been made to see the changes in various treaties signed till date, the major inhibitions in the treaties, and finally the usefulness or limitations of these treaties.

The third chapter is devoted to analyse Indo-Nepalese trade relations. In this chapter besides examining the trends in the value and composition of Indo-Nepalese trade, an effort has been made to trace the causes of Nepal's balance of trade deficit with India. A few suggestions have been put forward for the correction of this huge deficit. Further, this chapter throws some light on the major irritants in the Indo-Nepalese trade relations.

The fourth chapter analyses in depth the various India-aided projects undertaken in Nepal in the light of Nepalese planned economic development. This chapter is further elaborated to analyse the efficacy of Indian aid as also the Nepalese absorbtive capacity of aid.

The fifth chapter has been devoted to examine India's private foreign investment in Nepal. It gives some light on the contribution of Indian private investors to the industrial development of Nepal. Further a study on Indian joint ventures and scope to increase it in Nepal has been discussed. An effort has been made to trace the inhibiting factors leading to the shyness of participation of Indian capitalists in Nepal. A number of suggestions have been provided to increase this aspect of economic cooperation.

Finally, in the concluding chapter the major findings of all the chapters are highlighted.

This dissertation has been based mainly on primary sources easily available in India and Nepal. Information has been obtained from various governmental and departmental documents. The secondary sources have also been adequately made use of.

All the data gathered and extracted from the Indian journals, documents and papers represent the currency in terms of Indian Rupees (IR) and those from Nepalese sources are all in terms of Nepalese Rupees (NR) only.

CHAPTER II

INDO-NEPALESE TRADE TREATIES

Nature has bound India and Nepal together. The history of Indo-Nepal trade and economic relations is very old. There are versions that this trade relationship was mentioned in Kautilya's Arthavashastra too. Throughout the entire span of the middle ages, roughly extending one thousand years from the middle of the eighth century to that of the eighteenth century, there were abundant signs of active trade between India and Nepal.[1] As Nepal occupied a central position in the Himalayas, it was the main channel of trade between India and the trans-Himalayan states of Tibet and China since the ancient times.[2]

Nepal concluded a Treaty with British India in 1923. This treaty dealt with various aspects of Nepal's trade with India. As this study particularly deals with the Indo-Nepalese economic cooperation since India became independent, a detailed discussion of the 1923 Treaty has not been dealt with.

With the emergence of a new independent India, the political developments in and outside Nepal demanded some drastic changes in the old treaty of 1923. A new and more more comprehensive treaty was needed in the light of 'politico-strategic' importance of Nepal. It was made more imperative

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1 Sen, Jahar, Indo-Nepal Trade in the Nineteenth Century (Firma KLM, Calcutta, 1977), pp.15-18.

2 Ramakant, Indo-Nepalese Relations 1816-1877 (S.Chand and Company, New Delhi, 1968), p.2.

by the increasing power potentiality of the Chinese and the consequent security interest of India.[3]

Northern frontier was secure for India so long Britain stayed as a dominant power in whole of South Asia and China remained a weak and divided power. Tibet remained a buffer state between India and China. The foundation of People's Republic of China in 1949 and subsequent occupation of Tibet in October 1959 dissolved Tibet as a buffer state. The Himalayas no longer stood as sentinel for India's northern security.[4]

Pandit Jawaharlal Nehru while conforming the security aspect of Indo-Nepalese relation asserted that 'from time immemorial, the Himalayas have provided us with a magnificent frontier. Of course, they are no longer as impassable as they used to be, but are still fairly effective. We cannot allow that barrier to be penetrated because it is also the principal barrier to India. Therefore, much as we

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3 Pant, Y.P., Planning Experience in Nepal (Sahayogi Prakashan, Kathmandu, 1975), p.153.

4 Dharamdasani, M.D., Indian Diplomacy in Nepal (Aalekh Publishers, Jaipur, 1976), pp.4-5.

5 Quoted in Muni, S.D., India and the Himalayan Kingdoms - Security Interests and Diplomacy (1947-75) (Monograph - School of International Studies, Jawaharlal Nehru University, New Delhi, 1977), pp.2-3.

appreciate the independence of Nepal, we cannot allow anything to go wrong or permit that barrier to be crossed or weakened because that would also be a risk to our security'. .....'one can't go to Nepal without passing through India. Therefore no other country can have as intimate a relationship with Nepal as ours is.'[5]

Nepal, though a separate 'political entity', has historically been described as a 'yam between the two boulders' (India and China). It has always been sensitive about its independence and identity. Gradual economic development mainly through diversification of its trade relation appeared to be an important plank while preserving her national interest in the region. Compared with China, Nepal's relations with India are complex if not unique.[6]

India, where 95 per cent of the trade of Nepal was concentrated, assured Nepal that it was willing to provide necessary economic and technical assistance to help it realize the progress and prosperity. To facilitate this assurance, while maintaining its security interest, India concluded a new Treaty of Trade and Commerce with Nepal on 31 July 1950. This was the first major treaty towards strengthening the Indo-Nepalese economic cooperation after independent India viewed its trade relation with Nepal from a different perspective.

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6 Baral, L.R., "Triangular Relations", Seminar (New Delhi), no.274, June, 1982, p.20.

Treaty of Trade and Commerce, July,1950[7]

The Treaty consisted of ten articles. Two distinct categories of clauses were enumerated in the Treaty. Articles 1-5, included provisions of Nepal's commercial relations with other countries through Indian territory and Indian ports and Articles 5-7 dealt with Trade between India and Nepal themselves.[8]

By this treaty, Government of India (now onwards GOI) recognised Nepal's 'full and unrestricted right of commercial transit of all goods and manufactures through the territory and ports of India'. (Article 1). As per Article 2 India agreed to move the Nepalese imported goods through her agreed convenient places without paying any duty on Indian ports.[9] Similarly, Article 3 extended the same facilities 'to goods of Nepalese origin in transit through Indian territory from one approved place to another within the territory of Nepal'.

It further granted Nepal through Article 4, 'full and unrestricted right of commercial transit' from approved place or places in Nepalese territory, through the territories and ports of India, of all goods and manufactures of

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7 Dharamdasani, n.4, Appendix IV.

8 Jha, S.K., Uneasy Partners (Manas, New Delhi, 1975), p.39.

9 Rawat, P.C., Indo-Nepal Economic Cooperation (National, Delhi, 1974), p.70.

Nepalese origin, for export outside India.[10]

All the above rights of Nepal were, however, being subject to arrangements as may be agreed upon between the two governments. The Government of Nepal agreed to levy export duties on Nepalese manufactures which were exported to India, on par with the excise duties payable for the corresponding Indian goods. This prevented Nepalese goods to be sold in India at more favourable prices and also nullified the competitive disadvantages to the Indian manufacturers caused by imposition of excise duty in India. Thus the interests of both were safeguarded.[11]

In order to give a new dimension to the Indo-Nepalese trade and commerce, they agreed to assist each other, by making available, to the maximum extent possible, commodities essential to the economy of the other (Article 6).

While laying stress on constant intercourse in trade matters, they agreed to promote contacts between the trade interests, to give reasonable facility for the import and export of commodities and 'in particular to facilitate the use of routes and methods of transportation which are most economical and convenient (Article 7).

Article 8 permitted the civil aircraft to fly over the territory of the other in accordance with normal

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10 Dharamdasani, n.7, Appendix IV, pp.228-229.

11 Rawat, n.9, p.70.

international procedure. Article 9 cancelled all previous treaties and agreements with the British India. This treaty was to remain in force for a period of ten years (Article 10).

Shortcomings in the 1950 Treaty:

Despite the mutually advantageous stipulations, certain provisions of the treaty became controversial and were subjected to severe criticisms from the Nepalese circle. Under Article 5, Nepal was to follow a strict Indian tariff policy which in effect meant that Nepal was denied the right to pursue her own trade policy. It prohibited the Nepalese goods to be sold in the third country at the rate cheaper than in India. The Nepalese goods could not compete with the Indian goods in the Indian market. Finally, the flow of Indian goods continued unabated in Nepal in view of tariff advantages the GOI secured with regard to their goods as compared to third country goods. This common custom duties made the imported goods dearer in Nepal.[12] Further, this provision forced the Nepalese government to change export duties on the products of Nepal's infant industry sufficient to prevent their sale in India at price more favourable than those of goods produced or manufactured in India. The Treaty of 1950, thus arrested the Nepalese industrial development for a decade.[13]

12 Banskota, N.P., Indo-Nepal Trade and Economic Relations (B.R.Publishing Corporation, Delhi, 1981), p.33.

13 Rana, P.S.J.B., "India and Nepal : The Political Economy of Relationship", Asian Survey, July 1971, p.648.

However, the above argument was valid only theoretically.In reality, the manufacturing sector of Nepal was then an extremely small part of its economy and hence the immediate impact of this provision on Nepalese manufacturing was minimal.[14]

Nepal had to follow this common tariff policy mainly because of the total absence of Nepalese organisational arrangement on customs.[15]

This arrangement of common external tariff structure against third country amounted to a custom union. But this attempt failed to bear any fruits in the case of India and Nepal, as these two countries were of unequal status and at different levels of development.[16]

Nepal found the provisions to be economically disadvantageous to Nepal and contrary to its independence and sovereignty.[17] King Mahendra obsessed by his policy to reduce Nepal's dependence on India by diversifying her trade relations reached an agreement with China in September, 1956 which made provisions for reciprocal trade facilities.[18]

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14 Jayaraman, T.K., "Nepal's Trade Relations with India : Problems and Solutions", <u>Asia Quarterly</u>, 1979/2, p.133.

15 Rawat, n.9, p.72.

16 Jayaraman, n.14, p.133.

17 <u>Gurkhapatra</u> (Kathmandu), 30 January, 1956.

18 Dharamdasani, n.4, p.148.

Article 5 was actually intended to support the Nepalese economy financially with the help of exchange refund practice. Whenever any Nepalese trader imported foreign goods through Indian port he had to deposit an amount equal to Indian customs tariff at the Indian customs office. After receiving the certificate from the Nepalese customs authority regarding the physical entry of these goods into Nepal such deposits were allowed to be withdrawn. However, in practice, this deposit became the import duty of Nepal and was refunded to Nepal government in place of giving it to the traders.[19]

This good intention of the provision was invariably defeated because of cumbersome procedures established for the transit of goods through Indian ports. This procedure further locked up Nepalese liquid capital which in a poor country like Nepal could have been utilized in a productive channel.[20]

Another intriguing factor was the control of Nepalese foreign exchange earning by the Reserve Bank of India. This necessitated the Nepalese traders to procure Indian licences. This resulted into unnecessary delays and harassment to the Nepalese traders. Further aggravation of resentment by Nepal finally resulted with a new trade agreement in June 1957 which gave Nepal control on her

19 Rawat, n.9, p.71.

20 Banskota, n.12, p.35.

foreign exchange and a right to levy export duty on her goods.[21]

Treaty of Trade and Transit, September, 1960

As an accommodating and conciliatory gesture, a new Treaty of Trade and Transit, was concluded between GOI and His Majesty's Government (now onwards referred to as HMG) on 11 September 1960. This was to 'expand the exchange of goods between their respective territories, encourage collaboration in economic development and facilitate trade with third countries.'[22]

This new treaty was not only necessitated by the resentments over the 1950 Treaty but also by some internal and external politico-economic compulsions such as aftermath of the overthrow of the autocratic Rana regime, Chinese occupation of Tibet in 1959, emphasis to shift from revenue tariff to the development tariff as Nepal had launched her First Five Year Plan in 1956.

The treaty explicitly aimed at the development of their economies towards the goal of a 'common market', by eliminating all trade barriers between the two countries.[23] The new treaty incorporated many new provisions on aspects like transit and Nepal's trade with third countries.

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21 Dharamdasani, n.4, p.149.

22 Dharamdasani, n.4, Appendix V, p.231, gives full text of the original treaty of 1960.

23 Ibid., p.151.

Articles I to VI regulated the Indo-Nepalese trade procedures, while Articles VII to XI were meant to regulate transit trade and Articles XII to XIV were 'general' in nature and were meant to implement the treaties effectively and harmoniously.[24]

Article I not only promoted the 'expansion of mutual trade in goods originating in the two countries' but also cautioned to take care to avoid 'diversion of commercial traffic or deflection of trade'. This aspect of trade was included in the light of massive deflection of Indian jute, bristles and petrol to China through Nepal.[25] Article II was certainly an improved version of Article V of 1950 Treaty. This exempted the mutual trade of goods originating in either country and intended for consumption in the territory of the other from paying any sort of duties and exempted 'quantitative restrictions'. This provided goods to Nepal at competitive prices and made easy availability of primary and agricultural products of Nepal in India. Quantitatively free exchange of goods were to prevent shortages and blackmarketing.

However, in the letter exchanged between the two countries, the GOI agreed that Nepal could 'impose protective duties or quantitative restrictions on such goods as may be produced by newly established industries' in Nepal.[26]

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24 Ibid., p.232.

25 Rawat, n.9, p.74.

26 Banskota, n.12, p.38.

This was to enable the infant industries to overcome the initial handicaps of development.

Article III stated that both sides would 'maintain or introduce such restriction as were necessary for the purpose of protecting public morals and safeguarding national treasures'. The existing arrangement of refund of central excise duties on Indian exports to Nepal was to continue (Article IV). The trade with third countries was to be regulated with their respective laws, rules and regulating to imports and exports (Article V).[27]

Article VI secured for Nepal complete independence of and control over its foreign exchange account. This was in perfect cooperation with the problems faced by Nepal under the 1950 Treaty in which Reserve Bank of India controlled foreign exchange coming from Nepal and had raised much controversy. This article further made it obligatory on both sides 'to prevent infringement and circumvention' of the foreign exchange rules, regulations and laws of each country.[28]

Because of Nepal's landlocked nature, transit always figured prominently in any of its trade negotiations with India. The Nepalese side always expressed their dissatisfaction over the way Indian side had provided the transit facilities. They invariably protested against this poor transit facilities which made the Nepalese foreign trade 'unreliable

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27 Dharamdasani, n.4, p.232.

28 Rawat, n.9., p.76.

and unattractive' to the foreign importers. This long-standing grievance was given a fitting solution by the provisions of this new treaty.[29]

These provisions expressed in more clear forms are certainly a marked improvement over the 1950 Treaty where the transit was given a vague and feeble emphasis. These provisions based on Barcelona Conventions[30] accorded full freedom to Nepal on transit issue.

Article VII accorded 'freedom of transit', through the territory of other without distinction 'on the flag of vessels, the place of origin, departure, entry, exit, destination or ownership of goods'.

Article VIII gave the phrase 'traffic in transit' to the goods in transit across the territory of a contracting party when this arrangement is only a portion of the complete journey. Similarly Article IX exempted traffic in transit from customs and transit duties or other charges in respect of transit. However, Nepal agreed to pay reasonable charges for the supervision of such transit.

Article X ensured that the 'traffic in transit' shall not be subjected to unnecessary delay or restrictions. India agreed to assign a separate shed in the Calcutta port where all goods in transit could be stored pending onwards transmission.

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29 Dharamdasani, n.4. Appendix V, pp.232-233.

30 Barcelona Conference, 1921. Nepal and Afghanistan did not attend this conference. Havana Charter (Article XXIII), GATT (Article V), 1948.

Both the countries were permitted to conclude agreement relating to movement of contraband articles like opium and other dangerous drugs, or 'to prevent infringement of industrial, literary or artistic property' (Art.XII). Both the countries agreed to consult periodically to sort out the differences (Article XIII). Article XIV stated that the treaty would remain in force for five years which could be continued for a further period of five years subject to modification.

Misgivings in 1960 Treaty:

The 1960 Treaty also did not escape the usual problems and challenges arising out of the developing nature of both the countries. Political inhibitions, external exposures, misinterpretation of treaties and mistrust and suspicions made the implementation more difficult and erratic. The question of delays in movement of goods to and from the third countries, deflection of trade, transit arrangements, Nepal's policies of Gift Parcel Scheme and Bonus Voucher Scheme acquired more and more controversial dimensions.

The goods originating in the two countries for mutual trade were not defined explicitly. Such a vague clause later created confusion in its interpretation. India defined the clause 'goods originating in Nepal' as the goods comprising 100 per cent Nepali raw materials, while Nepal took a different view. India interpreted this way in order to prevent entry of third country goods into her economy. While Nepal always alleged that most of the goods that were imported from India were also based on third country materials.[31] This created immense misgiving in the mutual exchange of trade.

Procedural Delays:

The procedural formalities which Nepal had to comply with in India, for her trade with third countries mostly resulted in delay and loss. The bond system, under procedural formalities appeared to be the foremost problem in the initial years of operation of the treaty.[32]

Under this system the Nepalese importers had to produce import licences before Customs Authority at Calcutta. These importers had to execute bonds equivalent to value of consignment, with the Calcutta Customs and was refunded on the receipt of intimation from Kathmandu about the physical entry of such goods. The bond amount asked from Nepalese importers was in some cases 60 per cent of the value of the goods imported. This system blocked a substantial amount of capital for an indefinite period. Though this was introduced primarily to avoid deflection of third country goods being shipped enroute to Nepal, the

31 Banskota, n.12, p.38.

32 Dikshit, K., "Diversification of Trade : An Urgent Need for Nepal", Industrial Digest (Nepal), vol.2, no.1, September 1967, p.31.

system could not work efficiently leading to widespread resentment from the Nepalese side. India readily agreed to scale down the amount of bond surety drastically and the system was abolished from December, 1963.[33]

Other Nepalese complaints consisted of 'customs and other hold ups of good and cargo coming from and going to Nepal through Calcutta port or through Indian airports, about pilferage of goods not only at the port but also on the Indian railways by which they are exported to India or abroad, about countervailing duties on Nepalese industrial products imported by India'.[34] As against these complaints, India held that it had provided adequate transport facilities. The space in the port of Calcutta (15,500 sq.ft.) was many times more than the peak requirements of Nepal's trade cargo passing through the port of Calcutta. Additional space had been made available at satellite port of Haldia. Customs and other hold ups of Nepalese cargo were insignificantly small as compared to the volume of Nepalese cargo and transactions handled in the port.[35]

The Controversial Gift Parcel Scheme:

Another acute problem hindering the Indo-Nepalese relations was the scheme of 'Gift Parcel' introduced by

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33 Shrestha, S., Nepal and the United Nations (Sindhu Prakashan, New Delhi, 1974), p.157.

34 Baral, L.S., "Nepal's Relations with India, 1961-69" (Type script)

35 Bahadur Raj, "Indo-Nepal Economic Relation - A Review", The Nepal Council of World Affairs, 12 June 1969,pp.71-72.

Nepal on 28 April 1967. This was primarily to encourage Nepal's new entrepreneurs. Under this scheme, all types of goods (except personal luggage and belongings) having a value of Rupees one thousand (Nepalese currency) would be imported from the third countries without obtaining an import licence.[36]

Contrary to this noble objective, this scheme encouraged underinvoicing of the incoming and outgoing commodities in the parcel. Very soon, this system became a tool for increasing profits by the businessmen. Many parcels of substantial amount started pouring in fictitious names. According to a study an estimated amount of nearly $3 million (customs and sales tax revenue) was lost by the national treasury because of this system.[37]

Specially after the devaluation of Nepalese currency on 7 December 1968, a large number of luxury goods were imported from countries like Hong Kong, Bangkok, Singapore, both by air and sea. During 1967-68, goods worth Rupees six crores were imported under this scheme which by any standard was considered far in excess of domestic requirements. Bulk of them found their way in India. India, not losing sight of the massive malpractices that were going on, invariably lodged strong protest against this scheme.[38]

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36 Dharamdasani, n.4, p.163.

37 Wagley, S.P., "Gift Parcel Scheme in Nepal", CEDA Occasional Paper I, CEDA, Kathmandu, 1969, p.32.

38 Dharamdasani, n.4, p.163.

Genuine traders had to encounter several disappointments as they became unable to stand in competition.[39]

The bulk of this trade was financed by a 'handful of Indian traders'[40] who had some Nepali nationals as partners to fulfil official formalities. The HMG had to wind up the scheme in 1969.[41]

Exporters' Exchange Entitlement (EEE) Scheme: A Major Irritant

The EEE scheme popularly known as Bonus Voucher Scheme introduced in 1964 covered both the exports and imports. It allowed exporters to overseas countries a bonus in the form of convertible foreign exchange. The exporters were originally allowed to retain ninety per cent of foreign exchange earnings. Sixty per cent of their exchange could be spent on goods of their choice and forty per cent was to be spent on imports of developmental goods approved by the Ministry of Industry and Commerce. These ratios and privileges attached underwent several changes during its operational period.[42]

The scheme was designed mainly to raise the stock of convertible foreign exchange, to provide incentive to

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39 CEDA, Import-Export Structure and Trade Expansion (Nepal), Draft Paper Presented to CSSCD, Nepal, October 1980, p.10.

40 Banskota, n.12, p.51.

41 Wagley, n.37, p.33.

42 Jayaraman, n.14, p.141.

the exporters to achieve certain degree of economic independence through trade diversification. In view of this incentive structure, the export index registered tremendous increase during the year 1965-66 which was calculated as 161% [redacted] greater than 1962-63 index.[43]

Nepal lacked items of exports and started exporting unprocessed jute (even by smuggling from India) at a much lower price in the world market. But this loss appeared meagre in comparison to the profit they could fetch by importing foreign luxury goods under the scheme and later smuggling to India.[44]

The scheme suffered from two fundamental defects: (a) Nepal's export products were not being subject to international trade discipline. The re-exporting of Indian products to third country as well as the practice of exporting third country products to India became so deep rooted that while Nepal temporarily enjoyed the benefits of an 'entrepot' trade, it encouraged two way traffic of smuggling across the open Indo-Nepalese border. (b) This scheme in effect created several exchange rates which oscillated erratically depending on the smuggling conditions. Both of these conditions gave rise to distortions in investment patterns and led to inefficient allocation of investible resources.[45]

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43 CEDA, n.39, pp.10-12.

44 Jha, n.8, p.250.

45 CEDA, n.39, p.13.

It induced a 'false sense of growth and complacency based on the mistaken belief' that Nepal is achieving economic independence. Clandestine trade of bonus voucher at varying prices markedly developed. This not only caused diversion of export earnings to unproductive and illegal activities, but also caused reversal of the gains to trade and economic growth.[46]

The incentives given by the government have 'distorted the pattern of trade and investment and channelled capital and trading enterprise into areas like stainless steel and nylon yarn which 'have no prospects for growth' and have minimum external economic and social gains.[47] Jute, stainless steel and synthetic fabric occupied a remarkable position in the whole chain of two-way traffic of smuggling episode under this scheme.

Jute Exports:

Jute and jute goods which occupied 65 per cent of Nepal's overseas trade in 1962-63 increased to 93 per cent reaching $7.5 million. However, the increase in jute production in Nepal was merely 14 per cent in 1966-67 as compared to the figure in 1962-63. This implied that there was either a hidden import of jute from India for re-export or there was overinvoicing of jute goods or both.[48] Nepal

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46 Nigam, R.S. and Banskota, N., "Economic 'Fall Out of Nepal', Bonus System", Eastern Economist, 28 July, 1978.

47 Rana, P.S.J.B., "Indo-Nepalese Trade Today and Its Policy Implications for Nepal", CEDA, Occasional Paper I, Kathmandu, p.5.

48 CEDA, n.39, p.12.

initially did not accept the former argument which was true in grim reality.

Speculation in the export permit flourished, giving rise to many scandles and abuse of these facilities.[49]

India expressed its increasing concern over the deflection of this precious item. In a sequel to this disastrous phenomenon and increasing smuggling of manufactured goods such as stainless steel and other luxurious goods to India, in 1966, the GOI under the 'Indian Tariff Act' levied an additional duty equal to excise duty on imported manufactures. This was applicable to goods imported from Nepal also. This hit the Nepalese jute industry.[50]

Stainless Steel and Synthetic Fabrics:

In a Memorandum of Understanding signed on 27 December, 1966 to implement Article II of the Treaty, India agreed not to impose any quantitative restrictions on import of Nepalese goods based on indigenous raw materials and to exempt such goods from customs and other countervailing duties. Nepal wrongly interpreted it and took a stand that all the manufactured goods produced in Nepal could be exported to India and started grossly misusing this sympathetically given advantage.[51]

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49 Ibid., p.12.

50 Dharamdasani, n.4, pp.159-161.

51 Ibid., pp.161-162.

It is observed that out of the total imports of Rs 16 crores in 1966-67, Rs 5 crores formed stainless steel, synthetic fabric and nylon goods. To give a cover to this massive imports which always far exceeded the domestic demands and to evade the Indian customs, the Nepalese set up a number of industries based on foreign raw materials mainly in Biratnagar area bordering India.[52]

The Nepalese obtained raw materials at extraordinarily nominal rate as compared to India. This along with the HMG's policies of exempting new industry from paying income tax on profits earned for a period of ten years, made the cost of Nepalese goods several hundred per cent below the cost of Indian industries. This along with Biratnagar's direct links with bordering state of India, made Nepalese goods easily available in the Indian market outclassing the Indian manufactured goods. Within a period of five years, the production of synthetic textiles increased from 5.7 thousand yards to 2,305.4 thousand yards, a wonderful record ever made by any underdeveloped country, not to talk of Nepal.[53]

This problem having a direct impact on the Indian economy increasingly became alarming. Within Nepal also, the sensitive circles had started feeling the detrimental effects of this abuse of facility. The Nepalese economists

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52 Rawat, n.9, p.86.

53 Ibid., pp.86-88.

admitted the fact that stainless steel assembly plants are not needed at the present stage of our economic development since they contribute very little to Nepal's long-term goal of economic development.[54]

In November, 1968 the Bhagat delegation to Nepal had accepted the import of stainless steel goods and synthetic fabrics at the 1967-68 level. Nepal interpreted this period as the twelve months ending in November 1968, when the exports of such goods was at its zenith. Whereas India considered it a fiscal year from March, 1967 to March 1968. This led to a deadlock, which prompted India to unilaterally issue a notification on 21 March, 1969 strictly sticking to its stand.[55] This was a practical step since one sided ban was impossible and would have affected the Nepalese economy.[56]

In June 1970, New Delhi, however, offered to lift the accumulated stocks of synthetic fabrics and stainless steel utencils, owing to the above decision, to the extent of an agreed quota through State Trading Corporation. The offer was not acceptable to the Nepalese.[57]

Declaring this act of India as highhandedness, the Nepal Textile Manufacturers' Association published a

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54 P.C. Lohani, the present Finance Minister, in Dharamdasani, n.4, p.162.

55 Ibid., p.162.

56 Patriot (Delhi), 23 November 1968.

57 Jha, n.8, p.249.

statement on 13 February 1969, which read,[58] 'the giants of the synthetic industries of India have launched the most methodical and systematic campaign aimed at strangulating the infant textile industry of Nepal'. Displaying a comparative capacity and production figures of Nepal and India, the statement further added ....'We ask whether such insignificant production of Nepal can really distort the Indian economy. Is it not possible that quiet Nepal is being made the scapegoat for the most organized and gigantic smuggling of hundreds of crores of rupees being carried on in India from across the sea, our .... existence is at stake'. The Nepali Chambers of Commerce and Industry also issued a statement on the same line.

Indian Dissatisfaction:

In August, 1963, India expressed its concern over the Nepalese tariffs which were discriminatory against Indian goods. Indian goods were discriminated against Pakistani goods. It is said that 750 Indian items were taxed against the provisions of the treaty and some of them were either totally or partially banned. Indian cigarettes was a prime example, imports of which was unilaterally banned by Nepal in order to reportedly protect the Russian aided cigarette factory in Nepal. Cigarettes constituted a significant portion of India's

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58 Gorkhapatra (Kathmandu), 13 February 1969.

exports to Nepal. Nepal did it in some vague grounds. Ironically, it did not impose ban on cigarettes of other countries. This violated Article XIII of the Treaty.[59] India's strong protest on this front forced the Nepalese side to remove discriminatory attitudes towards Indian goods in August 1966.[60]

To pursue the policies under Article XIV, the Nepalese goods were 'harmonised' by charging additional duty to fit into the overall supply structure. In 1968, the Bhagat Mission agreed to give twenty per cent preference to indigenous Nepalese goods in levying this harmonizing additional duty. To prevent Nepalese industries from damaging competition, India agreed to impose an import duty on Nepalese goods, which was eighty per cent of the excise duty paid by the counter Indian manufacturers. Nepal showed its disagreement over the proposal of harmonising her economic system and interpreted the Indian action of levying eighty per cent duty as total violation of Article II.[61]

Transit as an Irritant:

Though the transit issue was given special emphasis in the 1960 Treaty, it increasingly became a controversial issue. Nepalese lodged an all out campaign against the

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59 Rawat, n.9., p.84.

60 Banskota, n.12, p.84.

61 Ibid., pp.48-53.

'poor and ineffective' transit facilities given by India. Contrary to 1960 agreement, Nepal was not provided with any separate shed. There was no warehousing facility at the port beyond accommodating one thousand bales of cotton. Other commodities lay outside the shed to the vagaries of the weather.[62]

India was tightly gripped by the fear that road transit would encourage deflection of third country goods to India. Nepal complained about the high cost of railway freights in India. This along with the insufficient railway wagons made the situation more acute. As a concession, India allowed only the use of container type of trucks and carriers which could be sealed and closed and provided Nepal with a fleet of trucks for this purpose.[63]

Talks were held in July-August 1963 on transit facilities required by Nepal and other matters connected with her trade.[64] The Nepalese delegation stressed on the transit facilities at Radhikapur, a town on East Pakistan (now Bangladesh) - India border and Wagah on West Pakistan-India border. In compliance with this demand, GOI, while showing its readiness to give more facilities, requested

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62 Sharma, H.R., "Nepal's Trade with and Through India", The Rising Nepal (Kathmandu), 5 July 1969.

63 Banskota, n.12, p.43.

64 Bhasin, A.S. (Editor), Documents on Nepal's Relations with India and China, 1949-66 (Academic Books, New Delhi, 1970), pp.132-133.

the Nepalese government to indicate the expected volume of trade, requirements of wagons and the points of destination, etc. so as to enable the authorities in India to determine the character and quantum of facilities to be provided.[65]

The second round of talks were held in Kathmandu in October 1963. The political and economic implications of India's concession were obvious in view of the strategic strip linking NEFA (now Arunachal Pradesh) and Assam with West Bengal at a point where the corridor is the narrowest.[66]

Despite the several opposition in the Parliament with regard to India's transit facilities to Nepal with Pakistan, the GOI maintained that this is done in accordance to international law and convention in which a landlocked country is entitled to transit facilities to its neighbour. 'It is not a favour we are doing, it is an obligation we have to discharge', stated the GOI.[67]

Some other rounds of talks took place but proved to be inconclusive mainly because of the Indian proposal for levying a service charge of Rs 1.50 per tonne (in wagon loads) and 50 paise per parcel in transit via Radhikapur.

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65 Foreign Affairs Record, IX (8), August 1963, pp.1968-69.

66 Bhattacharjee, G.P., India and Political of Modern Nepal (The Minerva Associates, Calcutta, 1970), p.217.

67 Jha, n.8, p.241.

India reasonably justified this levy under the provisions of Article IX of the 1960 Treaty. Nepalese delegation took a uncompromising stand and wanted that just as in Calcutta no service charges should be levied at all for this supervision and handling. On the other hand, India substantiated her position by pointing out the fact that Calcutta possessed facilities for the large sea borne trade of India within which Nepal is given a unique concession. Calcutta port did not charge any rent on cargo assigned to the Nepalese government, the royal family and public enterprises such as Nepal Trading Ltd. Significantly, this port does not give this unique concession to any organisation or country not even to the GOI. During 1967-69, it waived rent amounting to Rs 1.13 crores on cargo consigned to Nepal which led to a loss of approximately twentyeight per cent of the total loss incurred by the port in 1967-68.[68] It will not incur any additional cost to the GOI, if Nepalese transit trade is to be handled through this port. But in case of Radhikapur, completely new facilities are to be set up to enable Nepal's transit trade with Pakistan. The parcel service charge was also meagre as compared to the ten or fifteen times higher service charge imposed on India's transit trade with Iran through Pakistan.[68(a)]

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68 Ayoob, M., "India and Nepal, Politics of Aid and Trade", IDSA (New Delhi), vol.3, no.2, October 1970, p.153.

68(a) Jha, n.8, pp.242-243.

Taking advantage of this delicate situation, Pakistan who had already signed a trade and transit agreement[68(b)] with Nepal came forward to sympathize with the Nepalese cause and condemn India.[69]

In order to avoid further imbroglio and danger, a complete accord between India and Nepal, on the question of Nepal's transit trade with Pakistan via Radhikapur was announced on 7 January 1965.[70] Nepal agreed to pay railway charges. But Nepal could not avail of these facilities fully and immediately because of the Indo-Pakistan war of September 1965. Whatever Nepalese goods meant for East Pakistan were sent, they could not reach destination because of road disruption and they lay scattered on the border. In the meantime, Pakistan had stopped transit facilities to India in her trade with Afghanistan.

Under the circumstances India took a stand that'no transport of Nepalese goods, by rail or road, through India to Pakistan, is possible unless and until Pakistan agrees to reopen rail and transport between the two countries'. The Nepalese again strongly resented this stand of India falling on the eve of the termination of last treaty in October 1970.

68(b) Signed on 28 January 1963, in Karachi.

69 Mishra, P.K., India, Pakistan, Nepal and Bangladesh (Sandeep Prakashan, Delhi, 1979), p.34.

70 Bhasin, n.64, p.142.

71 Bahadur,Raj, n.35, pp.71-72.

The Fourth Plan (1970-1975) of Nepal began with a fresh purpose, a move towards a Development Decade.[72] This in turn called for more friendliness and tolerance vis-a-vis India for an increase in trade. Nepal persistently demanded unfettered transit facilities on rail road and sea routes. They pleaded more facilities at Calcutta port and transit via Radhikapur and to use other ports like Madras, Bombay and Kandla. Besides, Nepal stressed on signing of two separate treaties on trade and transit.[73]

But India with very harsh experience of Nepalese trading policies and undue exploitation of her liberal attitudes by Nepal, became ready to provide transit facilities only on the basis of Nepal's export surplus. This led to further failure in talks for conclusion of a new treaty. This failure erupted a chain of protests in Nepal. Some of them alleged India to have used 'economic blockade' by linking transit with security and to have challenged Nepal's independence and sovereignty.[74]

Nepal used all sorts of tactics and diplomatic manoeuvrs to pressurize India. After the expiry of the Treaty, Kathmandu announced its intention to import a number of Chinese goods. Contrary to the earlier commitment that no Chinese would be

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72 Fourth Plan (1970-75), National Planning Commission, His Majesty's Government, Kathmandu.

73 Gorkhapatra (Kathmandu), 9 March 1970.

74 Pratinidhi Weekly (Kathmandu), 11 December 1970.

allowed to undertake any project in the Terai area, Kathmandu signed agreements with China on the cotton cultivation in the Terai areas of Nepal, bordering India.[74(a)] The Nepalese Chambers of Commerce even asked the Government to send purchase missions abroad for importing essential goods.[74(b)]

Transit Issue in International Forums:

In a bid to get absolute freedom on transit, Nepal raised transit issue in various international forums. This indirectly amounted to maligning India who had already given far exceeding facilities than what the International Convention of Trade and Transit for Landlocked Countries permitted. The provision of Principle V of the UNCTAD and the Preamble to the Convention on Landlocked Countries, states that, 'the state of transit, while maintaining full sovereignty over its territory shall have the right to take all indispensable measures to ensure that the exercise of the right of free and unrestricted transit shall in no way infringe its legitimate interests of any kind.'[75]

So the preservation of 'legitimate interest' and sovereignty of the transit state is the foremost consideration to be made. The GOI intertrets this 'legitimate interest' as the interest of its security as also the

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74(a) Patriot (New Delhi), 18 July 1971.

74(b) Banskota, n.12, p.59.

75 Quoted in Jha, n.8, p.247.

protection of the sensitive sectors of its economy against such malpractices as smuggling and diversion of traffic. In fact, 'by affording free transit facilities to Nepal, India has only opened the flood gate for the entry of unauthorized goods into this country.'[76]

While highlighting transit issue, Nepal became a highly vocal spokesman for the rights of landlocked countries. It led the fight at the first UNCTAD in Geneva in 1964 and second UNCTAD in New Delhi in 1968. Nepal presented a nine-point programme that would have further expounded the obligation of coastal lines to landlocked states, if it had been accepted.[77]

King Mahendra even went to the extent of raising this issue at the Non-aligned Summit Conference at Lusaka on 9 September 1970 and at the ECAFE (now ESCAP) Ministerial Conference for Asian Economic Cooperation, held in Kabul in December 1970. In Lusaka he said, 'the landlocked countries are additionally handicapped in their development and it should not be difficult even for developing transit countries to ensure that the effects of the handicap are minimized and full unrestricted transit rights are granted.'[78]

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76 Assam Tribune (Gauhati), 21 November 1968.

77 Rose, Leo E., Nepal : Strategy for Survival (OUP, Delhi, 1971), p.252.

78 Ministry of Information and Broadcasting, HMG of Nepal, Address by the HM King Mahendra to the Third Non-aligned Summit Conference, Lusaka (Kathmandu, 1970), pp.12-13.

In the ECAFE Conference he urged the member countries of the region to enable Nepal to enjoy the right of free access to sea and to provide port and transport facilities, minimum and simple customs formalities, reasonable transport charges and transit by air and overland routes.[79]

As a sharp reaction to this and other unbecoming attitudes of the HMG, India resorted to the partial blockade of the goods on the Indo-Nepalese border. At the same time, India displayed its extreme magnanimity, patience and goodwill by continuing to give Nepal access to sea and the flow of essential commodities like, milk, salt, medicines, kerosene oils.[80]

The official squrces in New Delhi clarified on 4 January, 1971 that it was Nepal's intransigence that had led to the present impasse. New Delhi at one stage, reportedly, threatened to close the five hundred fifty-mile border between the two countries and put a squeeze on Nepal's trade and transit. Nepal had to accept the grim reality that it no longer harp on anti-Indian tirade. Its irreconciliable attitudes were proving to be disastrous and suicidal.[81]

It was no longer entitled from India for the refund of excise duty imposed on its goods by India. This deprived

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79 Pant, Y.P., Banking and Development (Nepal Rastra Bank, Kathmandu, 1971), p.23.

80 Times of India (Delhi), 3 January 1971.

81 Jha, n.8, pp.282-290.

them of a handsome sum. The traumatic impact on the Nepalese economy became more serious when its overseas trade started dwindling. Nepal faced a grave financial crisis by mid 1971. The landslide victory of Congress headed by Mrs. Indira Gandhi, made it more imperative for Nepal to change her attitude towards India.[82] King Mahendra in his visit to India in June 1971, desperately expressed his willingness to quickly conclude a new treaty. Further talks at different levels, finally resulted into a new Treaty of Trade and Transit signed on 13 August 1971 for a period of five years.[83]

Positive Aspects of 1960 Treaty:

Despite all these misgiving and fierce exchange of protests against each other during the operational period of 1960 Treaty, Nepal, undoubtedly, gained largely from both the trade and transit facilities extended by India. Nepal's trade with the third countries registered a phenomenal increase. Her export to third countries increased from Rs 24 lakhs in 1962-63 to Rs 5.75 crores in 1966-67.[84]

Nepal's imports from overseas had increased from Rs 12.7 million to Rs 51.2 million during 1962-68. Nepal's imports from India also increased from Rs 35.9 million to

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82 Ibid., pp.282-290.

83 Gurkhapatra (Nepal), 13 August 1971.

84 Rawat, n.9., p.81.

Rs 150.8 million while her exports to India had increased from Rs 91.6 million to Rs 184 million during the same period.[85]

The gap in the balance of payment position for Nepal diminished from a figure of Rs 5.55 crores in the total trade of Rs 12.75 crores to Rs 3.33 crores in the total trade of Rs 33.5 crores.[86]

Treaty of Trade and Transit, August 1971

In the light of past experience the 1971 Treaty has undergone a substantial change. It has incorporated many new provisions and corrective measures. Both the countries abandoned the concept of a common market as envisaged by the 1960 Treaty. The new treaty has been concluded on the basis of most favoured nation treatment on a reciprocal basis.[87]

Like previous treaty, this new treaty also divided the treaty into three sections viz., trade, transit and general provisions. Articles I to VII consisted of trade, Article VIII to XV concerned with transit and Article XVI to Article XIX concerned with the general provisions.[88]

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85 Nepal Rastra Bank, Economic Bulletin, vol.VIII, no.1, Mid-October 1973, pp.50-53.

86 Rawat, n.9, p.81.

87 Dharamdasani, n.4, Appendix VI, p.235 gives full text of the original treaty of 1971.

88 Ibid., pp.235-240.

Besides a long protocol annexed with the treaty amplifies each provision of the treaty clearly.

In the sphere of trade, 'expansion and diversification of the mutual trade' by making available to each other their own goods is aptly emphasised (Article I). They would accord 'treatment no less favourable than accorded to any third country' regarding 'customs duties' and quantitative restrictions (Article II).

Unlike 1960 where India permitted all goods into its economy irrespective of percentage of Nepalese materials and labour, the new treaty under Article III permits its markets free of duties and customs charges to primary products of Nepal, provided they are produced in Nepal.

In order to promote industrial development of Nepal, Article IV provides a favourable 'treatment to imports into India of industrial products manufactured in Nepal in respect of custom duty and quantitative restrictions' on non-reciprocal basis. The GOI will provide free access to the Indian market for all manufactured articles which contain not less than ninety per cent of Nepalese materials or Nepalese and Indian materials. In case of other manufactured articles in which the value of Nepalese material and labour added in Nepal is at least fifty per cent of the ex-factory price, the GOI will determine the nature and extent of access on an individual basis.[89]

89 Pant, n.3, p.155.

Pending mutual agreement on procedures in this respect, the following sixteen Nepalese industrial products will be exempt from basic custom duties and quantitative restrictions. The sixteen products are viz, matches, strawboard, jute goods, articles made out of wood, vegetable oils, sugar confectionery other than chocolate, handicrafts, prepared fruits, preserved vegetables, oil cake including de-oiled cake, refined butter, tanned leather and leather good, plywood, cattle feed and catechu.[90]

Concessions in excise duty available to small units in India will also be available to products imported from similar units in Nepal.[91]

India further agreed to import the products of the Nepal's large scale industries subject to payment of customs duties and quantitative restrictions, as well as subject to a twentyfive per cent concession on payment of excise duties due on Indian goods of similar categories. Industries entitled to such concessions may be based on both Nepali and Indian raw materials. This is one of the major achievements of this treaty which will greatly help in the industrial development of Nepal.[92] 'To facilitate greater interchange of goods', HMG agreed 'to exempt

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90 Ibid, p.155.

91 <u>Gorkhapatra</u> (Kathmandu), 14 August 1971.

92 <u>Gorkhapatra</u> (Kathmandu), 17 August 1971.

wholly or partially, imports from India from customs duty and quantitative restrictions to the maximum extent compatible with their development needs and protection of their industries'. (Article V)

With reference to most favoured nation treatment the GOI will continue to reimburse Nepal the central excise duties levied on goods exported from India to Nepal provided such reimbursement shall not exceed the import duties levied by Nepal on similar goods imported from any other country. (Article VI)[93]

Article VII of the treaty is an addition to the 1960 treaty in which they have 'agreed to cooperate effectively', 'to prevent infringement and circumvention' of foreign trade and foreign exchange laws, rules and regulations of either country. Special care should be taken to curb the nefarious activities of the smugglers' gang.

Article VIII while giving freedom of transit to each other, forewarns that, it should not in any way infringe its legitimate interest of any kind.

Unlike the previous provision on 'traffic in transit' in 1960 Treaty, this has been lucidly defined in Article IX of this treaty. It includes transhipment, warehousing, breaking bulk and assembly processes provided such operation is done for the convenience of transportation.

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93 Rawat, n.9, p.96.

Under the previous treaty, Nepal's only access to third countries was through the port of Calcutta and transport through India by Indian railways. The new treaty provides:(1) that goods moving to and from Calcutta will be shipped in either sealed railway wagons or truck containers, and (2) that to use Haldia as an alternative port to Calcutta port as well as at specified points of entry on Indian territory along the common border. Under the terms of the Protocol, new routes may be added by mutual agreement at any time.[94]

Another new provision in this treaty related to the Indian permission that Nepal will be able to transport from one point of its territory to another even goods imported from third countries.

Under this new treaty India provided free, unrestricted and uncomplicated transit facilities. It will no longer be necessary to affix seals on every package in transit nor to produce before the Indian customs authority export or import licences issued by Nepal for goods exported by it to overseas countries or imported therefrom, other than consumer goods.

In order to expedite the movement of transit goods and minimize the unnecessary losses, a new system has been adopted in accordance with international practice under

94 Pant, n.3, p.156.

which goods will be moved on the basis of customs transit declaration forms submitted by exporters or the importers.[95]

It shall be exempt from customs and transit duties except reasonable charges for transportation and service rendered. (Article X).

In contrast to the old arrangement, India will provide on twentyfive years lease on agreed terms separate sheds of storage of transit cargo awaiting custom clearance at point or points of entry and exit. This will be done in accordance with the relevant Indian laws. The transit cargo shall be subject to the levy of all charges by the Commissioners in accordance with their schedule and shall enjoy same facilities as non-transit cargo. (Article XI). This has been an additional benefit to Nepal.

'The procedure to be followed for traffic in transit to or from third countries is laid down in the protocol hereto annexed'. It shall not be subject to avoidable delays or restrictions. (Article XII).

Under Article XIV they agreed to prevent deflection of trade and to limit the exports to the third countries to goods produced only in their countries and to prevent imports from the territory of the other party of goods the export of which are prohibited by the others. The definition of goods of Nepali origin was clearly mentioned.

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95 Gurkhapatra (Kathmandu), 17 August 1971.

The words 'goods required' and 'available for export' did not occur in the 1960 Treaty. The most significant outcome of this new treaty is that the imports from third country will not be permitted by Nepal unless foreign exchange has been specifically authorized by her. She will now issue import licences on the basis that the required foreign exchange will be arranged by the importer himself.[96]

It was decided that traffic in transit would pass through eleven (at the time of signing) specified routes, viz., Calcutta and Galgalia, Jogbani, Bhimnagar, Jayanagar, Raxaul, Nantanwa, Berhni, Nepalganj, Gauripanta and Bansbara. As a new concession, India agreed to make arrangement for storage facilities at Haldia.[97] Breaking of the bulk will be done in the presence of Indian customs.

Article XVI was simply a repetition of Article III of the 1960 Treaty. Article XVII provided them with provision under which they may take measures for protecting their 'security interests' or export-import of 'dangerous drugs', or intentions to false marks, 'false indications of origin or other matters of unfair competition'. For effective and harmonious implementation of the treaty a joint committee has been suggested.

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96 Rawat, n.9., p.98.

97 Dharamdasani, n.4, p.170.

Operation of 1971 Treaty:

The conclusion of the treaty revealed that both the countries sacrificed some contentious issue which otherwise would have created more chaos in the existing relationship. Nepal understanding the gravity of the situation created by the deflection of trade through her EEE scheme resorted to some sort of restriction. India on her part withdrew quantitative restrictions on Nepal's export of goods. Nepal also withdrew her claim for unrestricted entry of its manufactured products (irrespective of the nature of raw materials used) in the Indian market. As a goodwill and accommodating gesture, India further convinced Nepal that overland route to Radhikapur would be provided through regional or sub-regional cooperation, when possible.

But the 1971 treaty too could not work as smoothly as expected by the two sides. Many of the provisions of the treaty became subject to sharp criticism. Both the countries are equally responsible for not carrying out the provisions in a friendly and accommodating spirit.[98]

EEE - The Most Vexing Problem:

The Exporters' Exchange Entitlement Scheme which created an intense controversy in the operation of the 1960 Treaty, again became a bone of contention in the operation

98 Jha, n.8, p.293.

of this new treaty. Though the advantages of this scheme went only to few pockets of Nepal, still she found it worth-continuing.

As Nepal increasingly felt that her economic dependence on India was drastically reducing, she started justifying her stand towards the continuation of the said scheme. There was a dramatic increment in the total receipts of convertible foreign exchange during the period 1962-78. For instance, total receipts of convertible foreign exchange from export of merchandise goods to countries other than India rose from twenty per cent in the fiscal year (FY) 1960-61 to over one-third of the total receipts during the period from 1965 to 1978. The increment in official foreign exchange reserves by about $160 million during the period from FY 1960-61 to mid-March 1978 is mainly attributed to the increments in merchandise exports to countries other than India, brought about by the EEC scheme.[99] This merchandized exports were dominated by jute and jute goods.[100]

Paradoxically, trade diversification of Nepal - major objective behind this scheme - increasingly made her dependent on India for export of raw jute to the third countries. 'The whole growth of our exports to hard

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99 CEDA, n.39, pp.12-13.

100 Nigam and Banskota, n.46.

currency countries rests on a very precarious and fragile base, ... if we are so dependent on India still, the success of our policy of diversification must indeed be termed hollow'.[101]

The goods imported far in excess of their demand found easy market in India. These goods converted potential convertible currency reserves into actual Indian rupees at rates very favourable to the Nepalese and this helped to meet the problem of chronic Indian rupee shortages.[102]

Most of the industries which suddenly sprouted and flourished under this scheme were owned by Indians based in India and abroad. The profits were transferred either to India or abroad. HMG suffered a net loss in hard currency without any corresponding gains to the country's economy. 'Nepalese participation in terms of capital in stainless steel and synthetic fabrics is not more than twenty per cent. At the managerial and executive level, Nepalese participation is particularly non-existent.'[103]

The scheme failed to yield good results in various respects. The scheme would have achieved the major objective if it had been extended to India also since the volume of trade with third countries formed a very small part of

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101 Rana, n.47, p.5.

102 Blaikie, P., Cameron J., Seddon, D., Nepal in Crisis, Growth and Stagnation in the Periphery (OUP, Delhi, 1980), p.163.

103 Ayoob, M., n.68, pp.146-147.

total volume. If the scheme had been drawn on the line of exporting processed primary goods rather than agricultural raw materials, the gains would have covered the total export sector which in turn would have laid as sound industrial base in the country.[104]

The Nepalese insistence on the continuation of this scheme even after realizing the hazardous impacts, along with their persistent demand for a separate trade and transit treaty, prolonged the conclusion of a new treaty after the expiry of 1971 Treaty in August, 1976.

India frequently registered its unhappiness over its fall out in deflection of trade. Finally, on 31 March 1978, the EEE scheme was abolished and was described as 'political concession' to India. But in reality, the rationality of the decision rests on the appreciation of the fact that it failed to achieve the objective of trade diversification both country and commodity wise.[105] This scheme instead of helping evolve an entrepreneurial class, had led to the creation of a group of speculators, which held the national economy to ransom by fostering a 'parallel economy'.[106]

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104 Jayaraman, n.14, p.142.

105 Ibid., p.142.

106 Statement by the Finance Minister of Nepal, Economic Times (Delhi), 26 July 1978.

Misinterpretation of the Provisions:

Another major criticism which this treaty had to face was with regard to the stipulated percentage requirement of raw materials. The Nepalese economists complained that if the presence of Nepalese materials and labour is at least fifty per cent of ex-factory cost, India will take into consideration many factors such as the extent of third country material used and manner of obtaining them before their entry is permitted. This, they say, has given a jolt to foreign investment prospects in the Kingdom.[107]

Under the 1971 Treaty Nepal cannot raise tariff to protect her new industries because if it does so, India can refuse her markets on the pretext of providing the preferential treatment to Nepal in accordance with its practice of allowing the same kind of treatment to third countries.[108]

However, any criticism that India is averse to the industrialization of Nepal is equally untenable. The earnestness of India in seeing Nepal process its primary materials and increasingly undertake value added exports is evident from the fact that the percentage of indigenous content in industrial products entitled to preferential

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107 Banskota, n.12, p.67.

108 Ibid., p.68.

treatment in India was reduced to eighty per cent from ninety per cent in the 1971 Treaty.[109]

The working of the Treaty was not satisfactory, especially in the midst of raw material crisis in 1973-74. India unilaterally reduced the export quantum of essential commodities such as coal, cement and cotton yarn and also raised the prices of petroleum products much to the disadvantage of a poor country like Nepal.[110] This aspect is further elucidated in the following chapter on Indo-Nepalese trade.

Transit Issue - Still an Irritant:

Despite a chain of concessions extended by India on transit under the new treaty, the Nepalese never felt satisfied. Their first complaint was against the reduced number of transit routes (ten) from Nepal to Calcutta which was eighteen in 1960 Treaty.

India was alleged to have slowly and steadily destroyed the spirit of the treaty. India disregarding such allegations offered an open space about twenty thousands square feet adjacent to the area of ten thousands sq.ft. already provided to Nepal at King George Dock extension at Calcutta. This was done in the first meeting of Joint Review Committee for Nepal-India Trade and Transit held in Kathmandu on 24 July, 1972.[111]

109 Eastern Economist, 16 May 1980.

110 Times of India (Delhi), 11 January 1975.

111 Gurkhapatra (Kathmandu), 29 July 1972.

Other complaints revolved round the delays in procedural formalities. Delays in berthing ships were reported to be quite frequent. Since obtaining a pier was a problem, ships had to queue up for days before they were allotted the berthing facilities. They complained that they had to spend millions of rupees in demurrages and wharfages besides suffering damage to and loss of goods in transit. Unsatisfactory unloading and storing facilities, red tapism in transhipment, high shut-out rent in case of accidental unloading in the shipping yard and arbitrary checking and opening of packages remained to be looked into by the Indian side.[112]

Besides some avoidable procedural delays, India could hardly resort to fulfilment of Nepalese demands. This was mainly because India apprehended constant fear of goods being smuggled into or from Nepal to India. She was forced to check the outbound consignments in the light of past experience.

As a further concession to the Nepalese exports of rice, India permitted Nepal to export rice to any place in India without transit permits. This was to facilitate exports from Nepal to deficit areas like Kerala in India.[113]

Kathmandu preferred an entirely different approach to the question of transit. Nepalese insistence on two separate

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112 Banskota, n.12, pp.75-78.

113 Gurkhapatra (Kathmandu), 22 April 1976.

treaties was rooted in the sense of insecurity.[114]

Nepal again raised the transit issue in international forum. Addressing the sixty-fourth session of Inter-Parliamentary Union at Sofia on 24 September 1977, Nepali representative declared that, 'Nepal's position is unique as compared with ..... European and African landlocked countries, who enjoyed alternative routes and port facilities. Nepal practically had no alternative transit country except India. Nepal as such can be described as India-locked.'[115]

India so far expressed its reluctance over the separate treaties mainly on the contention that trade was ultimately linked with transit between India and Nepal 'owing to the very nature of geographical contiguity and economic linkages between them'. Moreover, India feared that this separation would further encourage and enhance the already existing serious problems of illegal trade.[116] But the solution did not lie in 'emotional outbursts of anger' rather it hinges upon Nepalese ability to think rationally.[117]

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114 The Statesman (New Delhi), 29 August 1977.

115 Gurkhapatra (Kathmandu), 28 September 1977.

116 Muni, S.D., "India's 'Beneficial Bilateralism' in South Asia", India Quarterly, New Delhi, October-December 1979, p.420.

117 Lohani, P.C., "Nepal-India Trade Relations", Trade and Transit : Nepal's Problem with Her Southern Neighbour, CEDA, Occasional Paper No.1, Kathmandu, p.22.

In the light of emergence of Bangladesh and other political and military developments in the region, a new balance of power has emerged. India's importance in the region has squarely increased. The year 1976 signalled a new era in Nepal-Bangladesh relations. They signed four separate treaties on trade, transit, technical cooperation and air service on 12 April 1976. Within this, the transit agreement provided Nepal, points of entry and exit for movement of traffic in transit through her ports and other territory by all means of transportation. The facilities at Khulna-Chalna port, Chittagong port, Bangladesh, Chilhat and Buapot were extended.[118]

India had already added a provision regarding Nepal's overland route to Radhikapur in the Indo-Bangladesh Trade Treaty concluded in early 1972.[119]

The change of government in India in 1977 and subsequent Janata government's rule in India brought about an ever significant change in the existing trade and transit relation between India and Nepal. Janata government's policy of 'Beneficial Bilateralism' towards its neighbours which had three major dimensions viz., personal rapport, economic accommodation and political neutrality and non-interference in internal affairs, played a vital role in fulfilling Nepal's long cherished demand for a separate trade and

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118 Mishra, n.69, pp.121-169.

119 Times of India (New Delhi), 11 September 1972.

transit treaty.[120]

Personal rapport was accomplished through frequent exchange of visits at the highest level. The facet of non-interference provided a heavy sigh of relief to Nepal. Within the realm of economic accommodation, after eighteen months of extensive dialogue following the expiry of former treaty in August 1976, India and Nepal poised for a separate Treaty on Trade and Transit and an Agreement for the control of unauthorized trade, on 17 March 1978.[121]

Welcoming this the Chairman of Nepalese Federation of Chamber of Commerce and Industry said, 'This arrangement will greatly encourage the export-oriented industries in the Kingdom. It will eliminate the atmosphere of uncertainty under which exporters have been operating.'[122] India has gone more than half way in meeting Nepal's demands concerning trade and transit facility.[123]

Treaty of Trade, 1978:

This treaty consists of twelve articles which shall remain in force for a period of five years renewable for a further period of five years by mutual consent.[124]

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120 Muni, n.116, p.418.

121 Ibid., p.419.

122 Gurkhapatra (Kathmandu), 26 August 1977.

123 Himali Bela (Kathmandu), 22 March 1978.

124 Shastri, V.S., A Study of Economic Relations Between India and Nepal Since 1950 (Unpublished Ph.D. Thesis, Nagpur Mahavidyalaya). Full text of 1978 Treaties given in pp.A17-A29.

Under the 1971 Treaty, Article I assures the exploration and undertaking of all measures, 'including technical cooperation, to promote, facilitate expand and diversify trade between these two countries'.

Under Article II, the two countries have agreed 'to undertake all necessary measures for the free and unhampered flow of goods' needed by each other.

This new treaty under Article IV withdrew the facility given in Article III of 1971 Treaty in which India had agreed to exempt from customs duty and quantitative restrictions of primary products produced in Nepal and imported into India. Now under the new provision this is done on a reciprocal basis and not by India alone.

The protocol to the Treaty clearly mentions eleven items of goods under this category viz., agriculture, horticulture and forest produce, unprocessed minerals, rice, pulses and flour, timber, jaggery, animals, birds and fish, honey, raw wool, goat hair, milk products and eggs, ghani produced oil and oil cakes, native medicines and articles produced by village artisans and other mutually agreed upon primary items.[125]

Unlike 1971 Treaty where sixteen categories of goods were exempted from basic custom duty and quantitative restriction, the new treaty contains twentythree categories.[126]

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125 <u>Gurkhapatra</u> (Kathmandu), 10 May 1978.

126 Jayaraman, n.14, p.138.

Articles V to XI are simply the repetitions in toto of articles under the Trade and General provisions of the 1971 Treaty.

The protocol signed under this treaty provided the industrial products of Nepal access to the Indian market free of basic custom duty and quantitative restriction provided they contained not less than eighty per cent of Nepalese raw materials or Nepalese and Indian raw materials. The tariff concession would be somewhat diluted if the value of Nepalese and Indian materials and labour added in Nepal was at least fifty per cent of the ex-factory price.[127]

The protocol further provided procedures to determine the eligibility of industrial production to these concessions and for verification of the values of different components of Nepalese industrial products would be agreed upon mutually. Pending an agreement on procedures, the fifty odd items listed in Annexure B to the protocol were to be exempted from basic customs duties and quantitative restriction for import into India. This is a significant improvement over the previous treaty. This reflects India's desire to ensure that Nepal no longer remains an exporter of raw materials and importer of finished products of India.[128]

The above procedures were mutually agreed upon in early September, 1979. Proformas about the Nepalese and

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127 Ibid., p.138.

128 Shastri, n.124, p.80.

Indian content in the manufactured products were to be submitted by Nepal within a stipulated period so that duty exemption could be continued. Pending this, preferential treatment was to be continued upto 15 January, 1980. This date was extended twice.

Although customs duties have come to be levied on Nepal's exports of industrial products to India, no quantitative or movement restrictions have been placed by India on their imports.[129]

Unlike the 1971 treaty, the protocol of the 1978 Treaty made specific reference to three categories of goods subject to exception in respect of which free trade may not be possible without quantitative restrictions. The first category includes goods restricted for export to third countries. There is no controversy in this category.[130]

Goods subject to control on price for distribution or movement within the market belong to the second category. This involved certain essential goods like coal, petroleum, cement and cotton yarn in which Nepal has an acute shortage. Within India they are subject to control in terms of their movement and prices. The third category includes goods prohibited for export to each other. This is mainly aimed at preventing deflection of trade. Goods having low percentage of value added in Nepal fall into this category.[131]

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129 Eastern Economist, 16 May 1980.

130 Jayaraman, n.14, p.139.

131 Ibid., p.139.

Protocol included a provision that Nepal should furnish by November every year the demand for goods on quota basis from India subject to its availability and overall need in India.

This new treaty indirectly recognised the inherent fact that the trade relations between India and Nepal were on the line of unequal partners. This is aptly manifested in India's attitude of highly appreciative spirit of accomodation.

Treaty of Transit, 1978:

Nepal's aspiration to have a separate treaty on transit as 'legitimate right' became a reality by the conclusion of this Treaty.[132] This consists of eleven articles and would remain in force for a period of seven years, renewable for another seven years by mutual content.[133]

Article I is just a repetition of Article VIII of the 1971 treaty with a slight modification that 'no distinction shall be made which is based on flag of vessels, the places of origin, departure, entry, exit, destination, ownership of goods or vessels'.

Article II preserves the 'legitimate interest' while observing such freedom. They would take measure to protect their essential security interests. This aspect of the Article is new to this treaty.

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132 The Commoner (Kathmandu), 16 April 1979.

133 Shastri, n.124, p.A22.

Articles III and IV observe exactly what articles IX and X of the 1971 Treaty do.

Unlike the Article XI of 1971 Treaty, Article V of this treaty provides traffic in transit, at point or points of entry or exit in reciprocal basis and not only by the GOI.

Articles VI to X are in toto same as Articles XII, XV, XVI, XVII and XVIII of the 1971 treaty.

However, this treaty on transit drops Articles XIII and XIV of the 1971 Treaty and includes them separately on the Agreement of Cooperation to control unauthorized trade.

Fifteen routes have been specified for Nepal in the treaty to facilitate Nepal's trade with third countries. The number of routes specified for trade with India was ten in 1971 Treaty which has been increased to twentyone in this new treaty. The free time for Nepal's transit cargo has been increased from three to seven days at Calcutta and Haldia ports under this treaty.[134]

The transit facilities include covered accomodation and open space for warehousing facilities for the storage of cargo from and to Nepal at Calcutta.[135]

The new facilities included movement by bulk cargo by both rail and road. India agreed to provide an overland route for Nepal's trade with Bangladesh as well as with

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134 Gurkhapatra, 21 March 1978.

135 Jayaraman, n.14, p.140.

third countries through Bangladesh.[136]

In a sequel to this, on 14 August 1978, India and Bangladesh signed a Memorandum of Understanding to provide Nepal with transit facilities to Dacca and third countries through their territories with a railway route connecting Bangladesh and Nepal through a short corridor of Indian territory at Radhikapur. This will have three terminus points for entry and exit of Nepalese exports and imports cargo viz., Raxaul, Galgolia and Jogbani in the Nepal-India border. The agreement then provided Nepal with access to the sea through the ports of Chittagong and Chalna in Bangladesh.[137]

Agreement of Cooperation to Control Unauthorised Trade, 1978: [138]

This Agreement is the result of a long-felt need arising out of the open border where there is free movement of persons and goods across the border. One of the vexing issues, in the past, was the deflection of trade which, because of geographical contiguity appeared to be uncontrollable. This Agreement has brought both the countries to work together towards stopping such surreptious activities and ever flourishing illegal trade. This agreement will remain in force for a period of five years, renewable for another five years.

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136 Gurkhapatra (Kathmandu), 18 March 1978.

137 Banerjee, B.N., India's Aid to its Neighbouring Countries (Select Books, New Delhi, 1982), p.595.

138 Shastri, n.124, pp.A26-A29.

Article I reconformed the right of both countries to pursue independent foreign trade policies and need to ensure that the economic interest of either country was not adversely affected through unauthorized trade.

Article III dealt with what Article XIV of 1971 Treaty concerned with. It provides that each country should prevent re-exports to the other contracting country of goods imported from third countries and of products which contain imports from third countries exceeding fifty per cent of the ex-factory value of such goods.

Article IV deals with the prohibition of import from other party and its re-exports to the third country from its territory. In order to stop the diversion of imported goods to the other contracting party, provisions permit them to undertake baggage rules, gifts and foreign exchange authorization for the import of goods from third country.

To keep each other abreast of imports and exports of prohibited goods, they agreed to exchange list. They shall further exchange statistical and other information relating to such trade. (Article V).

The respective Heads of the Border Customs offices will meet, at least, once in two months to prevent unauthorized trade, to maintain smooth and uninterrupted movement of goods across their territories and to render assistance in resolving administrative difficulties. (Article VI).

To ensure effective implementation of the treaties and the agreement, the two governments agreed to consult each other regularly, with a committee to meet at six months interval.

Dual Exchange Rate System - Another Problem:

After scrapping EEE scheme in August 1978, Nepal experimented an exchange rate variation to make its exports attractive to outside buyers. On 30 March 1978, Nepal devalued its currency by 4.3 per cent against the Indian Rupee and upvalued by the same per cent against the US dollar. The basic rate was fixed at Rupees twelve per US dollar while a record rate of Rupees sixteen per US dollar was fixed for overseas trade purposes.[139] All receipts from exports to overseas countries are converted at the second rate. This also implied in case of imports by the public and private sectors from overseas. However, import of certain development goods such as petroleum products, chemical fertilizers, machinery needed in agriculture and industry is made available at the basic exchange rate.[140] Thus HMG totally delinked the export and import trade.

This system has been evolved with a view to encouraging exports to third countries, discouraging non-essential imports and making the developmental imports available at cheaper domestic prices. The HMG has put quantitative restriction on items including pocket calculators, zip fastners,

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139 Economic Times (Bombay), 1 April 1978.

140 CEDA, n.39, p.14.

stainless steel, synthetic and acrylin yarn, radio, tape recorders which usually found their way into India. However, the announcement does not specify as to the percentage by which their imports have been restricted. Textile, which is smuggled into India in bulk does not figure in the list.[141]

The system gradually saw a spurt in the imports. The Commerce Department started getting flooded with application for imports of various things. This new liberal import policy soon became a way to make quick money. Many people turned importers. Imports of goods in huge quantities far exceeding the genuine requirements of the country brought in a potential new irritant in the Indo-Nepalese relation. Substantial quantum (some say over seventy per cent) of the goods imported were smuggled into India.[142]

An inter-governmental meeting held on 29 July 1980 broke off on the question of Nepal's issuing import licences for quantities much beyond its genuine requirements.[143]

However, to tighten the free movement of illegal goods in the open border, the officer on special duty in the Directorate of Revenue Intelligence in New Delhi and the Director General of Customs, Kathmandu, have been designated as 'contact points'. They would meet at least once in six months and would exercise greater vigilence.[144]

141 Hindustan Times (New Delhi), 1 April 1978.

142 Ibid., 20 April 1982.

143 Ibid, 31 July 1980.

144 Times of India (Delhi), 19 May 1982.

Auxiliary Duty

On 25 March 1978, Indian customs authorities were to have started levying a five per cent auxiliary duty on Nepali goods exported to India even when these goods contained over eighty per cent Indian raw materials. This was contrary to the agreement in 1975 which did not levy such duty on Nepali goods.[145]

'Scarcely had the ink dried on the new treaty.... when India imposed an auxiliary duty.... Nepali manufactures will be unable to compete in the markets of India notwithstanding the recent devaluation of the Nepali Rupee', commented a Nepali weekly.[146]

However, India on 9 May 1978 announced that she had exempted auxiliary duty for eleven primary products exported by Nepal to India from 7 May 1978. They are also exempted from the basic duty under the new treaty.

Transit Issue - Persisting Irritant:

In spite of such strenuous efforts by India in solving the transit problem within the framework of an international norm, the implementation of transit treaty could not be so effective as it had been expected.

The Nepalese invariably lodged complaints about the heavy demurrage charges at the Calcutta port. It varied from one to six million rupees. This was primarily caused

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145 Gurkhapatra (Kathmandu), 29 April 1978.

146 Bimarsha Weekly (Nepal), 27 April 1978.

by inadequate railway wagons; valuable imports also lay scattered due to lack of warehousing. It is believed that truck transport, even though more costly than railway transport, would have saved much demurrage payments.[147]

In the Nepal-India Inter-Governmental talks held in Kathmandu in August 1980, the Indian side claimed that all necessary arrangements have been made for storing Nepal bound goods in separate godowns provided to Nepal Transit and Warehousing Company. Hence, the problem of demurrage would no longer arise. India agreed to give transit facilities at Banapol to goods other than paper also.[148]

Further, in the fifth meeting of the said committee, held in May 1982 in Kathmandu, India in a spirit of 'accomodation, understanding and trust' made at least ten concessions in the area of transit. It agreed to simplify procedural matter with regard to trade and evolved a three-point formula to effectively control unauthorised trade.[149]

The Nepalese imports of third country goods had been facing the problems of insurance. India is now to provide insurance coverage to all goods imported by Nepal and transported through India by railway wagons and by official carriers. Private carriers goods were to be given insurance by June 1982.[150]

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147 Samaj (Nepal), 22 July 1979.

148 Rising Nepal, 19 August 1980.

149 Economic Times (New Delhi), 16 May 1982.

150 Rising Nepal (Kathmandu), 16 May 1982.

India extended the time limit for the imposition of the 'triple rent' at the Calcutta port to fortyfive days and the waiving for the first three days of the retention charges at the port. This will drastically cut down the cost of third country imports. This ensures cheaper developmental and construction materials imported from third countries and their faster transportation to Nepal.[151]

The decision by India to allow one more transhipment point at Gorakhpur for third country imports and also to allot land at Haldia port and at Narayanpur should enable the construction of the necessary warehouses. This will simplify and accelerate trade. India waived the proforma procedure in trade. It decided once the customs in India agreed to certificate of origin and contents of the goods manufactured in Nepal, there would be no need to go through the same process again and again. This has significantly simplified the procedural matter.[152]

Renewal of the Treaties:

The sixth meeting of Inter-governmental Committee held in New Delhi on 17 March 1983 renewed the Treaty of Trade and Agreement of Cooperation on unauthorised trade by another five years with marginal improvements.[153]

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151 Ibid., 16 May, 1982.

152 Rising Nepal (Kathmandu), 16 May, 1982.

153 Indian Express (New Delhi), 25 March, 1983.

The number of goods which India allows to import (duty free) have been increased from twentysix to thirtysix and includes sugar, lime, cattle and poultry feed and leather goods. Besides, all the Nepali manufactures which contain Nepalese or Indian inputs to the tune of at least four-fifth of their total value, can enter India duty free.[154]

On the issue of transit, the insurance premium on Nepalese transit cargo has been reduced and further reduction is to be discussed. Provision has been made to widen the scope of insurance for transit cargo by including Nepalese companies. The railway transit and transhipment points have been increased to include Gonda and Katihar to facilitate speedy movement of transit cargo to Western and Eastern region of Nepal. Nepal has agreed to increase the Raxaul railway line upto Birganj - a distance of five km. - to facilitate direct movement of transit cargo. 'Three-day free-time' facility provided to Nepali goods in Narayanpur-Ananta has been extended upto 30 September 1983.[155]

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154 Main Economic Indicators, Nepal Rashtra Bank, Nepal, July/August 1983.

155 The Statesman (Delhi), 22 March 1983.

CHAPTER III

INDO-NEPALESE TRADE

I. Background

In the previous chapter we have reviewed the evolution of Indo-Nepalese trade treaties - their content, operational constraints as well as possibilities. This chapter will examine the magnitude as well as structure and composition of Indo-Nepalese trade. Some irritants in Indo-Nepalese trade are highlighted as also some guidelines for their resolution have been suggested.

The history of Indo-Nepalese trade as examined in the preceding chapter is very old. The first Treaty of Commerce of British India with Nepal was signed on 1 March 1792. The estimated total export from India to Nepal in 1795 amounted to Rs 4 or 5 lakhs.[1]

In the closing years of the nineteenth century, with the completion of the chain of roads surrounding the southern part of the district and facilitating trade with Nepal, the terai areas emerged as a promising economic unit.[2]

The trade routes from Purnea, Bhagalpur, Darbhanga, Mozaffarpur, Gorakhpur, Gonda, Bahraich, Kheri, Bareily, Champaran, Darjeeling and Kumaon became immensely useful. Most of them were cart-tracks possible for traffic at all

1 Sen, Jahar, Ch.II, n.1, pp.15-18.

2 Ibid., p.43.

seasons. Among the traded goods rice, timber, ghee, spices, oilseeds were the principal imports to India and cotton goods, salt, sugar, tobacco were the principal exports of India. The bazars of Uska and Lotan, commercially speaking, were by far the most important centres of trade on the Indian frontier.[3]

The Britishers had an exclusive commercial interest in Nepal. 'From 1767 to 1816 political persuasion or military assistance or diplomatic guile was used by the British government as a technique for the realization of the economic goal, i.e. the maintenance and furtherance of the trans-Himalayan trade of the East India Company. Nepal was considered not only a trade centre but a transit media for lucrative British trade with Tibet and through Tibet with Central China.[4]

The introduction of railways in India in 1850s and its increasing importance as an important artery of commerce led to various extensions of railways to the convenient points at the frontier with a view to encourage and facilitate trade with Nepal.[5] Nepal's entry into foreign trade was further aggravated by the decline in ocean freight rates following the introduction of steam engine.[6]

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3 Ibid., pp.45-56.

4 Cha, Ch.II, n.8, p.8.

5 Sen, Jahar, Ch.II, n.1, p.70.

6 Banskota, N.P., "Nepal : Towards Regional Economic Cooperation in South Asia", Asian Survey, March 1981.

Foreign trade is necessary because every country has requirements for products which it otherwise either could not produce at all or for which it could find substitutes only at high cost.[7]

Trade provides material means (capital goods, machinery and raw and semifinished material) indispensable for economic development. Trade is the means and vehicle for the dissemination of technological knowledge, the transmission of ideas, for the importation of knowhow, skills, managerial talents and entrepreneurship.[8]

This chapter will examine Nepal's foreign trade since the period after the 1950 Treaty and more specifically the period after 1972. Certain changes in the composition and direction of Indo-Nepalese trade can easily be discerned from an analysis of statistical data over the last thirty years. As both the countries were passing through a developing phase, variations in requirements of each other are to be expected. For instance, the pattern of Nepal's imports changed in tune with the development needs of the country. The imports of manufactured goods in Nepal have been increasing constantly overtime.

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7 Thorp, Willard L., The Reality of Foreign Aid (Praeger, New York, 1971), pp.271-272.

8 Haberler, Gottfried, "Dynamic Benefits of Trade" in G.E. Meir, ed., Leading Issues in Economic Development (Oxford University Press, New York, 1976), p.704.

India's exports to Nepal consist of two kinds of goods - traditional and non-traditional. Among the traditional items cotton fabrics, cigarettes, cosmetics, tobacco, biscuits, papad, spices, fruits and vegetables, sugar and sugar preparations, confectionary and chocolate and tea exports are most notable.

To name few non-traditional items such as petroleum products, chemical elements, dyeing, tanning and colouring materials, cement, iron-ore, iron and steel metal manufactures, paper and paper boards, electrical machinery, medical and pharmaceuticals are most important.

Similarly, India imports from Nepal traditional commodities like rice, paddy, melted butter, oilseeds, wheat, raw jute, sheep and lamb wool, maize, hide and skins, ghee and wood and timber. Among the non-traditional imports of India from Nepal dyeing, tanning and colouring material, textile, yarn fabrics, domestic utensils of steel, clothings are of much importance.

II. Nepalese Imports from India: 1950-72

Imports serve two purposes; firstly, to protect against domestic monopoly and secondly as an element of resistance against increasing prices.[9] Although the Nepalese economy did not remain under colonial regime, it suffered from various economic onslaughts and remained undeveloped to the maximum scale because of the autocratic Rana regime.

9 Thorp, n.7, pp.271-272.

India figures prominently in Nepal's trade pattern in view of her substantial share in Nepal's export and import. However, Nepal figures only marginally in India's trade when judged by the same criterion. Nepal ranked sixth in the total trade of India in 1965-66 which went down to eighteenth in 1971-72.[10]

During the period 1950-60, India's share in Nepal's trade always remained ninetyeight per cent. It is only after the mid-1960s that India's share started declining which reached sixtyeight per cent in 1970.[11]

Table I reveals the trend of Nepalese imports from India. Nepal's imports are more diversified than her exports. If we carefully examine the table we will find that almost all the commodities have shown a fluctuating tendency. It will be seen that the demand for cement and iron and steel have shown marked increase overtime excluding 1971-72. This is because of various developmental projects and the increase in the demand for construction materials. Till 1975, India was a sole supplier of petroleum to Nepal and distribution was handled by ESSO, Burma Sales and Indian Oil. India had to pay foreign exchange for the import of petroleum products but she accepted Indian rupees for it from Nepal. Nepal remained the biggest buyer of engineering goods manufactured in India.[12]

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10 Shastri, Ch.II, n.124, p.102.

11 Ibid., p.91.

12 Ibid., pp.121-124.

TABLE I

NEPAL'S IMPORTS FROM INDIA (SELECTED COMMODITIES) '000 Rs.

Years	Jute goods	Cement portland	Iron and steel	Road Motor vehicles	Petroleum products	Foot wear	Machinery	Sugar	Tea	Medical & Pharmaceutical production	Cotton Fabrics: Handloom	Cotton Fabrics: Mill Made
1	2	3	4	5	6	7	8	9	10	11	12	13
1962-63	N.A.	N.A.	28	5918	N.A.	3399	7587	247	100	5911	N.A.	N.A.
1963-64	324	917	1213	1118	N.A.	1709	2179	3886	2188	692	N.A.	N. A.
1964-65	391	1541	3264	4525	259	2225	2409	5666	2892	2203	52,762	46,988
1965-66	437	3863	2288	3023	34,259	1589	1750	4926	2999	2857	14,290	52,771
1966-67	497	1760	2976	5824	41,884	3097	2988	925	3979	3281	22,614	38,390
1967-68	1001	4741	2336	3827	26,239	2896	2876	264	4864	6500	1,11,718	51,833
1968-69	896	7263	3028	4471	39,773	5202	7934	972	5924	7781	1,754	78,252
1969-70	664	10176	6161	8467	41,430	4244	5459	690	6329	9950	N.A.	N.A.
1970-71	360	8117	6451	6516	63,002	2871	5536	463	4898	8431	7,694	47,364
1971-72	785	N.A.	2710	N.A.	53,229	N.A.	N.A.	N.A.	N.A.	N.A.	4,664	70,864

Source : Extracted from Table III: 8-10 (pp.122, 126 and 128) of V.S. Shastri's unpublished Thesis, 'A Study of Economic Relations Between India and Nepal Since 1950', Nagpur Mahavidyalaya, 1980.

In case of cotton fabrics, the volume of handloom cotton fabrics imports has declined from Rs 52 crores in 1964-65 to Rs 4 crores in 1971-72. This can be explained in the light of changing taste of people and the spurt in the import and production of synthetic fabric in Nepal caused by the ever controversial EEE scheme.

The share of primary products in Nepal's imports from India declined from 34.89 per cent in 1956-57 to 24.02 per cent in 1975-76. The share of manufactured goods in Nepal's imports from India increased from 65 per cent in 1956-57 to 76 per cent in 1975-76. In the Nepalese economic development as per capita income rose, the demand for primary goods did not rise as fast as the demand for manufactured and sophisticated goods. The high income elasticity of demand for these goods accounts for these rapid growth in the imports of manufactured goods into Nepal.[13]

III. Nepalese Exports to India

Production based on the domestic market may not generate adequate economies of scale. Exports, by adding to production, can help take advantage of economies of scale.[14] Exports provide the primary means for paying for imports. Exports are related to income in a multiplier type relationship.[15]

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13 Rana, Ch.II, n.47, p.4.

14 Thorp, n.7, pp.271-272.

15 Balassa, Bela, Trade Prospects for Developing Countries (Richard D.Irwin Inc., Illinois, 1964), p.3.

Till the year 1960, Nepal's chief exports to India consisted of rice, gram and pulses, raw jute, oilseeds, ghee and raw wool. In the late '60s jute goods, wheat, mustard seeds, sugar oil cakes dyeing and tanning materials became other important exports to India.

Tables II(a) and (b) give us some notions about the pattern of Nepal's exports to India. In 1965, an estimated 3.4 lakh metric tonnes of rice was exported from terai to India making Nepal the fifth largest rice exporter in world that year. Nepal earned Rs 237 million (IC) from its rice exports in 1965.[16]

Indian currency (IC) earned through export of rice has always played an important role in the economic development of Nepal. In fact, we would later on realise that the increasing balance of trade deficit faced by Nepal has a deep negative correlation with the declining rice exports to India.

The second important item exported by Nepal to India is ghee, mostly exported from Butwal, Nepalganj, Rajapur and Koliabas in Western Nepal. Demand for ghee in India is increasing notwithstanding poor quality of Nepalese ghee. In fact, because of lower quality, Nepali ghee sold to India in 1969-70 was at half the price of similar products from the US.[17]

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16 Gaige, Frederick, Regionalism and National Unity in Nepal (University of California Press, Berkeley, 1975), p.29.

17 Shastri, Ch.II, n.124, p.137.

TABLE II(a)

NEPAL'S EXPORTS TO INDIA (SELECTED COMMODITIES)

Years	Rice	Oil seeds	Grams and pulses	Ghee
1950-51	529.1	197.1	150.0	24.8
1952-53	1075.5	100.0	152.5	44.3
1954-55	906.5	130.8	139.7	38.9
1956-57	1180.3	169.9	278.2	41.2
1956-59	515.6	242.5	211.5	40.2
1962-63	66,447	5811	*	10,926
1964-65	31,614	3004	*	4,965
1966-67	53,770	5294	*	6, 317
1968-69	25,061	7382	*	11,953
1970-71	48,241	2982	2885	10,180

*Does not figure in the first six ranks of the exports of Nepal to India. Figures from 1950-51 to 1958-59 indicate the quantum in maunds and from 1962-63 to 1970-71 indicate value in '000 Rs (NR).

Source: Extracted from Table III:14 of Shastri. Ibid., pp. 134-A and B.

TABLE II (b)

NEPAL'S EXPORTS TO INDIA (VALUE IN RS '000)

Years	Jute Raw	Jute Goods	Raw Wool	Stainless Utensils	Medical and Pharma-ceutical produces
1963-64	2045	4236	-	-	-
1964-65	2157	1512	-	-	-
1965-66	11614	19362	4	1695	314
1966-67	4860	3142	192	1782	279
1967-68	1696	127	104	18564	40
1968-69	1871	223	340	-	96
1970-71	6035	9714	1250	-	87

Source : Supplement to Monthly Statistics of Foreign Trade of India, Vol.II, Quarterly Combined Issues, March 1963 to 1972.

Oilseeds both mustard and others have been fetching Nepal good revenue. Besides, raw jute and jute goods became a constant source of revenue for Nepal. Nepal's jute exports to India have declined (except in 1970-71) because her jute exports to third countries are increasing. This became more prominent because of Nepal's policy of EEE Scheme.

As illustrated by Table II(b) Nepal's exports of utensil steel went upto a record level in 1967-68, which amply subtantiates the fact that under EEE scheme, Nepal, in a very short time, had been able to build up a large number of stainless steel industries in the Indo-Nepalese border which was thoroughly against India's economic interest.

IV. Trade Diversification and Balance of Trade (1950-1972)

King Mahendra invariably laid emphasis on diversification of trade both country and commodity-wise to end Nepal's age-long economic dependence on India. Further, he was committed to preserve Nepal's political independence, identity and sovereignty. In a bid to do so, he brought under legislation many policies. Despite the harmful nature of some of these policies, he pursued and implemented them fully.

In order to facilitate trade diversification policy, Nepal entered into various trade and payment agreements with countries like Pakistan, China, USSR, Japan, US, Germany, Israel and Poland. King Mahendra announced import diversification programs by reducing customs duties on overseas imports.

This brought about certain visible changes in the direction of Nepal's trade. Nepal's share of imports from India went down to 66.2 per cent in 1972 from 97.6 per cent in 1956-57 and her share of exports to India went down to 55.17 per cent from 97.9 per cent in the same period.[18]

Nepal maintained a balance of trade (BOT) surplus with India upto 1954-55. It was Rs 5 million in 1944-45 and increased to Rs 44 million in 1949-50 and came down to Rs 2.6 million in 1954-55.[19]

The BOT deficit of Nepal with India which was Rs 55.7 million in 1961-62 rose to Rs 121.7 million in 1965-66 and further touched a record of Rs 140.00 million in 1970-71.[20]

However, because of the continuous increase in Indian currency reserves and invisible earnings from India, the balance of payments (BOP) remained favourable. These invisible earnings consisted of: (1) Gurkha and other remittances from Nepalese working in India net of payments of remittances by Indians working in Nepal, (2) interest on Nepalese investment in India, (2) a small item on tourism and lastly, (4) what might be called leakages and miscellaneous.[21]

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18 Chauhan, R.S., "Nepal : Where does it Stand", Commerce, (Annual), no.1981.

19 Far Eastern Economic Review, 15 March 1962, p.617.

20 Rawat, Ch.II, n.9, p.112.

21 Rana, Ch.II, n.47, p.2.

The very nature of the components of Nepal's BOT with India leads one to expect a progressive rise in the trade deficit. The deficit in BOT with India was further caused by the unfavourable terms of trade in agricultural products after the Green Revolution in India. The prices of food-grains nearly doubled between 1963-64 to 1967-68 in India whereas the wholesale price index for manufactures rose by only 25 per cent in India. This made terms of trade in favour of Nepal. But after the 'green revolution' when the production of foodgrains improved in India, the terms of trade moved against Nepal. Moreover, Nepal's exportable surplus diminished with rising domestic demand.[22]

V. India's Exports to Nepal, 1972-83

Tables III to V give us a compact idea of the trends in the composition and direction of India's exports to Nepal. Subsequently, some of the irritants in Indo-Nepalese trade are discussed. The data have been collected from various sources, viz. Indian documents, Nepalese documents and other international institutional journals and documents.

Among the traditional items, India's exports of tea, coffee, molasses, spices, tobacco, sugar, soaps, textile yarns, cotton piece goods, handloom and footwears still occupy prominent positions in India's export list despite remarkable upswings and downswings in the level of exports.

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22 Ibid., p.4.

TABLE III

INDIA'S EXPORTS TO NEPAL, PRINCIPAL COMMODITY-WISE

Value in '000(Rs)

Sl. No. Commodities	Unit	1974-75 Quantity	1974-75 Value	1975-76 Quantity	1975-76 Value	1976-77 Quantity	1976-77 Value	1977-78 Quantity	1977-78 Value	1978-79 Quantity	1978-79 Value	1979-80 Quantity	1979-80 Value
1. Fish and Fish Preparation	MK	93	489	42	571	-	-	15	162	14	159	20	218
2. Biscuits	MK	314	2248	231	1709	120	1113	154	1364	123	2120	66	764
3. Potatoes	MK	3660	2371	2773	1976	4428	3633	41	66	2282	2393	3556	3006
4. Onions	MK	1099	662	678	445	-	-	7	8	1334	1471	1155	1445
5. Molasse Edible	MW	7	2964	1	855	2(T)	4	217(T)	210	5	2379	2	3443
6. Tea	MK	760	9148	752	9562	-	-	117	2138	181	3042	407	7530
7. Spices	MK	1330	7121	1431	3681	178	1122	391	3908	720	5131	1502	9898
8. Tobacco	MK	921	5078	1738	12446	-	-	-	-	-	-	-	-
9. Medicaments	-	-	19721	-	20072	-	-	-	3741	-	4163	-	3841
10. Eggs	HND	-	-	-	-	155	6	165	6	1129	42	2398	91
11. Butter Fresh	Kg.	-	-	-	-	2305	36	3481	56	600	20	69786	1429
12. Barley	T	-	-	-	-	121	136	400	450	478	715	158	317
13. Maize	T	-	-	-	-	105	227	-	-	5	4	3	7
14. Pref. Rice	Kg.	-	-	-	-	1319	3	15200	108	60955	391	35665	257
15. Paper and Paper Board	MK	863	5550	1099	5753	-	-	31	168	1	4	2	13
16. Cotton piece goods & Handloom	L	2602	9459	5461	19702	-	-	85665 (SM)	459	361670 (SM)	1499	(SM) 129970	6449
17. Jute Manufactured.	W	139	736	50	1407	-	-	-	-	-	-	-	-
18. Lime, Cement & Fabricated building material	-	-	8579	-	3447	-	-	-	-	-	-	-	-
19. Iron & Steel	MW	15	20545	9	17976	-	-	-	-	-	-	-	-
20. Road Motor Veh.	No	-	25051	-	31917	-	-	-	-	75	305	106	516
21. Electro-Thermic Appliances	Kg.	-	-	-	-	-	-	33675	697	467	17	-	8
22. Steel Furniture	Kg.	-	-	-	-	14368	119	27197	335.	41070	458	3649	25
23. Oiled Paper	Kg.	-	-	-	-	-	-	15650	49	3145	35	1586	8
24. Footwears	MP	271	2740	359	3596	83	841	62	710	110	3297	115	2171
25. Refined Sugar	T	-	-	-	-	1	2	3	9	6	25	-	1

Notes: HND: Hundred; MK: Thousand Kg.; L: Hundred Metres; SM: Square Metres; MW: Thousand Tonnes; MP: Thousand Pairs; Kg: Kilogram; T: Tonnes; No.: Numbers.

Sources: 1) Statistics of the Foreign Trade of India by Country and Economic Regions, 1975-76, DGCIS, Calcutta. (2) Monthly Statistics of the Foreign Trade of India, vol. I, March 1980, Govt. of India, Directorate-Gen. of Commercial Intelligence & Statistics (DGCIS), Calcutta.

Tea export showed considerable fluctuation. It attained an apex in 1974-75 when export was 7.6 lakh kgs. and went down to a level of about 1.8 lakh kgs. in 1977-78. The export of spices, one of the main exports of India, was 13.3 lakh kgs. in 1974. It rose to 15 lakh kgs. in 1979-80.

In the year 1973-74 exports of handloom and mill-made cotton fabrics were valued at Rs 1.2 crores and Rs 5.3 crores respectively. The export revenue earned from cotton piece goods and handloom fell sharply to Rs 1.9 crores in 1975-76, which further decreased to Rs 6.8 million in 1979-80.

In case of vegetables, potato export has been increasing excluding a major setback in 1977-78. Its export was 36.6 lakh kgs. in 1974-75 which drastically fell to 42 thousand kgs. in 1977-78 and again touched the height of 35.6 lakh kgs. in 1979-80. The export of onions has shown a significant decline between 1974-78 and again a similar significant increase during 1978-79. Its export which was 11 lakh kgs. in 1974-75 showed an abrupt fall to 7,622 kgs. in 1977-78. More surprisingly, it increased to a new record of 13.3 lakh kgs. in 1978-79.

The footwears export which earned India a revenue of Rs 27.4 lakhs in 1974-75 and Rs 32.9 lakhs in 1978-79 has emerged to be a major item of exports despite the establishment of famous Bansbari shoe factory in Kathmandu in collaboration with China.

Among the non-traditional items the most notable items whose data are easily available are cement, steel furniture, paper and paper boards, electro-thermic appliances and medicaments. Nepal has no energy resources of its own other than hydro power. It has to depend upon imports from India for coal as well as kerosene and other petroleum products requirements. Similarly, it has to depend for intermediate goods such as iron and steel in its various forms and non-ferrous metals.

The exports of paper and paper boards was 8.6 lakh kgs. in 1974-75, 31,169 kgs in 1977-78 and 2,000 kgs. in 1979-80. This reveals the steadily declining export of paper and paperboard from India. The export of medical and pharmaceutical items which fetched India a sum of Rs 1.97 crores in 1974-75, fetched only Rs 38.41 lakhs in 1979-80.

However, the export of steel furniture has shown an increasing trend. It was 14,368 kgs in 1976-77 which increased to 41,070 kgs. in 1978-79 but fell to 3,649 kgs. in 1979-80.

Though Nepal is a rice exporting country to India, it has also been importing rice from India. This is attributed to Nepal's inability to move the grains from the surplus areas (terai) to deficit areas (hills) because of the absence of integrated transport system. Even in good crop years there are substantial price differences between one part of the country and another.[23]

23 Pant, Ch.II, n.3, p.152.

Iron and steel products yielded the Indian government Rs 20.5 million in 1974-75 and Rs 17.9 million in 1975-76. The export of lime, cement and fabricated building materials earned Rs 8.5 million and Rs 3.4 million in the respective years.

The whole analysis shows that India's exports to Nepal have been diversified. Petroleum products, though one of the major items of India's exports, has been excluded from the list while exports of chemical products have shown rising tendency.

Table IV presents a compact picture of the present trend of Indian exports to Nepal in terms of major SITC groupings. The most prominent place as an export group has been occupied by manufactured goods classified chiefly by materials whose exports rose from Rs 42.5 crores in 1974-75 to Rs 71.4 crores in 1981-82. The exports of food and live animals come next in importance. These exports amounted to Rs 23.4 crores in 1974-75 which nearly doubled to Rs 44.6 crores in 1981-82. This includes a major spurt in 1980-81 which recorded the highest export of Rs.47.3 crores. This is very true in the light of Nepalese imports of more foodgrains arising out of alarming food deficit in Nepal caused by drought and decreasing productivity. In 1980-81, India made available eleven thousand metric tonnes of foodgrains to Nepal from its reserve as a temporary expedient to the relief operations.[24]

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24 <u>Main Economic Indicators</u>, Nepal Rashtra Bank, Kathmandu, March-May 1980.

TABLE IV

INDIA'S EXPORTS TO NEPAL : CLASSIFIED BY MAJOR SITC COMMODITY GROUPS!

(Rs '000)

Years	Total	Food and live animals	Tobacco and beverages	Crude materials, inedibles except fuels	Mineral fuels & lubricants	Animal & vegetable oils & fats	Chemicals and drugs	Manufactured goods classified chiefly by materials	Machinery & transport equipments	Misc. manufactured articles	Commodity and transaction not classified according to kind
SITC	0-9	0	1	2	3	4	5	6	7	8	9
1974-75	1,475,634	234,145	16,556	46,693	179,892	6,699	134,737	427,052	156,592	144,934	21,884
1975-76	1,227,124	258,203	31,921	31,104	95,267	5,528	114,925	409,465	158,059	105,392	17,260
1976-77	1,343,542	228,405	18,916	34,848	116,379	7,446	141,710	499,774	173,579	92,468	30,017
1977-78	1,556,324	285,469	29,097	42,849	113,416	24,329	169,409	550,251	209,202	124,711	7,591
1978-79	1,581,699	261,839	31,576	41,377	20,694	18,414	194,199	616,463	256,703	135,632	4,802
1979-80	1,786,406	344,303	22,349	73,121	35,269	15,142	230,900	602,706	292,835	166,262	3,529
1980-81	2,179,047	473,588	23,978	69,037	51,696	23,825	273,368	655,061	399,659	199,455	9,380
1981-82	2,280,877	446,669	30,922	100,064	50,087	11,132	341,923	714,788	380,978	200,237	4,077
1982-83*	1,208,377	186,081	4,948	45,106	28,510	15,732	201,989	416,595	226,748	82,404	2,24

* July 1982-January 1983.

! Based on custom data

Source: Various issues of Quarterly Economic Bulletin (1977-1983), Nepal Rashtra Bank, Kathmandu, Nepal.

Similarly, the exports of chemical and drugs, animal and vegetable oils and fats, tobacco and beverages, crude materials have been manifesting an ever increasing trend.

The exports of machinery and transport equipment and miscellaneous manufactured articles are the third category of items whose exports have been of a considerably high magnitude. In case of the former item, the export was of the order of Rs 15.6 crores in 1974-75 which attained a height of Rs 38 crores in 1981-82 and had already reached Rs 22.4 crore in the first seven months of the FY 1982-83. For the latter item, the export amounted to Rs 14.4 crores and Rs 20 crores in the corresponding period.

However, the exports of mineral fuels and lubricants have always displayed a diminishing trend. The value of this export amounted to Rs 17.9 crores in 1974-75 and plunged drastically to Rs 2 crores in 1978-79. This decrease may be attributed to the sharp increase in the prices of manufactured goods due to phenomenal increase in the prices of oil. The dominant share of manufactured goods in total import indicates that the country has still a long way to go to develop import substituting industries strong enough to replace imports of some basic goods.[25]

This analysis of Nepalese imports from India reveals the fact that the imports of different manufactured goods

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25 IBRD, World Development Report, 1981.

into Nepal is ever increasing. This is true in the light of the structural changes in the Nepalese economy which is influenced by rate of economic growth and rising incomes.[26]

VI. Indian Quota System to Nepal

In addition to normal trade flows through private channels, India and Nepal have periodical exchange of goods and services on institutional basis. On 30 May, 1980, the Nepal Oil Corporation (NOC) and the Indian Oil Corporation (ICC) signed an agreement in Kathmandu under which IOC agreed to process one lakh ton of crude oil obtained by Nepal from Iran and supply the refined products to Nepal.

This arrangement was said to be in addition to the current long-term arrangement for the supply of petroleum products from India against kerosene and diesel imported by NOC from third countries.[27]

Similarly on 1 June 1975, an agreement was signed in Kathmandu between Salt Trading Corporation and Hindustan Salts Limited of India for the supply of 75,000 tons of salt during 1975-76.[28]

In March 1982, a fresh agreement was signed with the HMG for the supply of iodised salt and the setting up of iodisation plants in Nepal at a total cost of Rs 2 crores.

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26 Balassa, n.15, p.67.

27 The Rising Nepal (Kathmandu), 31 May 1980.

28 Gurkhapatra (Kathmandu), 2 June 1975.

This salt assistance program is extremely important for controlling goitre in the hill and remote areas of Nepal.[29]

The goods in which India suffers a shortage such as iron and steel, cement, flour, pulses, salt and coal are being supplied to Nepal by India under quota system and are handled by the National Trading Company of Nepal.[30] With the termination of the quota of oil supplies from India in January 1975, Nepal had to look out for it from the third countries.[31] Items other than quota could be imported freely.

Table V gives the year-wise allocation of quota by India to Nepal. The system has proved to be mutually useful and as most quotas have fully met Nepalese need, a substantial amount of foreign exchange has not only been saved, but also used by Kathmandu for buying other developmental goods from overseas.

However, Kathmandu has been issuing permits for the imports of Indian quota allocation far below its own earlier estimates. During 1976-77, for instance, permits were issued for barely 10,000 tonnes of varieties of iron and steel against a total állocation of 40,000 tonnes. It was worse with regard to writing and printing paper. As the honest trader has to wait for long to secure his import permit and the market demand is great, the under-utilization of quota only helps the smuggler. This needs to be looked into.[32]

29 Annual Report, Ministry of External Affairs, Government of India, 1982-83.

30 Rawat, Ch.II, n.9, p.105.

31 Banskota, Ch.II, n.12, p.72.

32 Times of India (Delhi), 10 June 1977.

TABLE V

QUOTA ALLOCATION BY GOVERNMENT OF INDIA TO NEPAL

Sl. No.	Commodity	1974-75	1976-77	1977-78	1978-79	1980	1981	1983
1.	Baby food and milk powder				200 MT	300 MT	500 MT	
2.	Vegetable ghee				1,000 MT	100 MT	2,000 MT	
3.	Cement	1 lakh MT	1 lakh tons	40,000 MT	10,500 MT	-	64,500 MT	50,000 MT
4.	Writing and printing paper			8,000 MT	8,000 MT		8,000 MT	12,000 MT
5.	GI pipes	2 lakh metres	2 lakh metres	2 lakh meters	2 lakh meters	1.80 lakh meters	1.80 lakh metres	
6.	Coal	1.50 lakh MT	-	-	72,000 MT	-	90,000 MT	1.5 lakh MT
7.	Hard coke B.Hive	10,000 MT	-	-	-	-	1,000 MT	-
8.	Breeze Coke	-	-	-	-	-	20,000 MT	-
9.	Soft coke	-	-	-	-	-	1,000 MT	-
10.	Aluminium ingots	1,800 MT	300 tons	-	-	900 MT	900 MT	1,000 MT
11.	Aluminium reels and circles	-	-	-	-	500 MT	500 MT	1,000 MT
12.	Tin Plates	4,000 MT	2,000 MT	4,000 MT	-	1,500 MT	1,500 MT	-
13.	Corrugated iron sheets	2,500 MT	2,500 MT	50,000 MT	5,000 MT	2,000 MT	2,380 MT	-
14.	Hardware	10,000 MT	5,000 MT	5,000 MT	8,000 MT	8,000 MT	8,000 MT	-
15.	Billets	20,000 MT	20,000 MT	15,000 MT	-	-	5,000 MT	30,000 MT
16.	Pencil ingots	-	-	-	-	-	4,000 MT	-
17.	Pig iron	500 MT	1,000 MT	1,000 MT	-	800 MT	1,000 MT	2,500 MT
18.	M.S.H.R. B.P. sheets	-	2,000 MT	2,000 MT	-	1,000 MT	1,000 MT	-
19.	M.S.G.P. sheets	-	-	-	-	500 MT	600 MT	1,000 MT
20.	M.S.C.R.B.P. sheets	200 MT	2,000 MT	2,000 MT	-	1,500 MT	1,500 MT	1,000 MT

.....Table Contd...

Table continued...

Sl. no.	Commodity	1974-75	1976-77	1977-78	1978-79	1980	1981	1983
21.	M.S. Round Bars	5000MT	10,000MT	10,000MT	-	3,000MT	3,000MT	-
22.	Iron angles and channels	-	1,000MT	1,000MT	-	750MT	750MT	750MT
23.	H.B. and G.I. wire	-	-	-	-	-	4,950MT	-
24.	Polythene Granules (low density)	-	-	-	-	1,000MT	1,000MT	-
25.	Polypropylene	-	-	-	-	1,800MT	1,800MT	-
26.	Alcohol	60,000Ltrs.	2.5 lakh Ltrs.	2.5 lakh Ltrs.	3.5 lakh ltrs.	5 lakh ltrs.	30,000 lakh ltrs.	-
27.	Raw Cotton	-	-	-	3,000MT	3,000MT	3,000MT	3,000MT
28.	Aluminium wires	-	-	-	-	-	500MT	-
29.	Aluminium rods	1,800MT	-	-	-	-	500MT	-
30.	Cotton waste	-	-	-	-	-	400MT	400MT
31.	RNA Rubber	-	-	-	-	-	100MT	-
32.	High Stensil galvanised steel wire	300MT	-	-	-	-	-	-
33.	M.S. Strips	2,000MT	2,000MT	2,000MT	-	-	-	2,000MT
34.	Salt	60,000MT	-	-	-	-	-	-
35.	Molasses	-	-	5,000 tonnes	5,000MT	-	-	-

Notes: MT : Metric Tonnes ; Ltrs : Litres ; Mts : Metres.

Sources: 1974-75 - Banskota, ch.II n.12 , p.74; 1976-77 - Gurkhapatra (Kathmandu), 3 May 1976.
1977-78 - Rising Nepal (Kathmandu), 13 May 1977; 1978-79 - Ibid., 26 April 1978;
1980 - Main Economic Indicators, NRB, Kathmandu, February 1980;
1981 - IIFT, ch.II n.47 , Annexure 22, A55-56;
1983 - The Statesman (Delhi), 20 March 1983.

VII. India's Imports From Nepal: 1972-1983

Tables VI and VII reflect the pattern of India's imports from Nepal. These import figures are worth examining as they have become an important factor contributing to the alarming balance of trade deficit faced by Nepal since quite a few years. Nepal's exports to India are limited to rice, ghee, animal foodstuffs and wood.

In the year prior to 1977-78 rice used to be the major export of Nepal to India but from 1977-78 onwards, Nepal's rice export has declined sharply and became quite negligible in the year 1981-82. Table VI shows that in 1975-76 Nepal exported rice worth Rs 495.4 million; in 1976-77 it was Rs 343 million, but recorded a sharp decline in 1977-78 when it touched a low figure of Rs 46.5 million; the year 1978-79 became worse year where Nepal's export of rice was mere Rs 13.8 million.

1975-76 was a favourable year for the Nepalese economy in respect of foodgrains production. In that year the production touched as high as over 39 lakh tonnes. This led to an appreciable increase in rice exports of Nepal. But since then, the agriculture sector, the mainstay of the economy, has not shown any appreciable trend. Such a severe decline in Nepal's rice export is attributed to a number of exogeneous and indigeneous factors.

First and foremost was the decline in productivity and consequently a decline in exportable surplus of Nepal which was accompanied by the frequent occurrence of natural calamities like drought and flood. In 1980, the Nepalese economy nearly faced a food crisis because of severe drought.

TABLE VI

VALUE OF EXPORTS OF MAJOR COMMODITIES OF NEPAL TO INDIA (In Million Rs.)

Sl. no.	Items	1973-74	1974-75	1975-76	1976-77	1977-78	1978-79
1.	Maize	-	-	-	1.4	4.7	4.8
2.	Rice (Husked)	64.4	121.6	495.4	343.0	46.5	13.8
3.	Mustard and Linseeds	-	-	40.3	31.1	4.5	-
4.	Mustard oil	-	-	0.3	3.8	-	-
5.	Herbs	-	-	2.8	6.3	6.5	4.8
6.	Ghee	-	16.2	60.5	35.8	33.2	41.5
7.	Dried Ginger	-	-	15.0	27.3	16.1	13.8
8.	Timber	-	9.1	54.1	103.4	146.7	138.9
9.	Jute goods	-	-	-	-	-	8.2
10.	Raw Jute	-	-	-	-	-	2.1

Source : Statistical Pocket Book, 1982, National Planning Commission, Nepal.

The year 1982-83 recorded an ever low foodgrain output as shown by Table VIII p.95. India signed an agreement with Nepal in September 1983 for the supply of 10,000 tonnes of rice on an urgent basis. Similarly, a commodity loan of 25,000 tonnes of wheat was extended to Nepal in 1983-84 to help her tide over its problems of food shortage.[33]

Despite of increased quantum of physical inputs and institutional reforms, the agricultural productivity and production remained the same. The production target was not met in any crop. The total output of foodgrains dropped from 3.77 million metric tonnes in 1974-75 to 3.20 million metric tonnes in 1979-80, reflecting a decline of 15.4 per cent. It is feared that the food shortage will soon grip the entire economy.[34]

The above paradox is mainly due to the very system and strategy adopted by the HMG. The reforms programmes and measures are thrust from above on the advice of planners disregarding the views and constraints of rural farmers as they are believed to be illiterate and conservative.[35] Further, implicit in all programs and measures is the assumption of 'homogeneous farmers' having equal access to capital, technology and other facilities.[36]

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33 Annual Report, n.29, 1982-83 and 1983-84.

34 Poudyal, S., Planned Development in Nepal (Sterling; Delhi, 1983), p.56.

35 Ibid., p.58.

36 Lohani, P.C., "Some Observations on Economic Growth in Nepal", Mimeo, NCWA, Kathmandu, 1976, p.52.

So, whatever opportunities are offered by the government, these are mostly utilized by the minority group, the privileged large farms, who wield the social and economic power.[37]

Secondly, the decline in Nepalese rice exports has been attributed to the institutionalization of the exports of rice in 1975. Seven rice companies have been established and all exports were to be channelled through these companies. This was undertaken with a view to control smuggling, to stabilize prices, to increase state's revenue and to transfer rice from import surplus to deficit areas. Farmers and traders were confused over this new arrangement as no definite regulations about the sale of rice nor buying prices were fixed. As a consequence, a lot of rice was hurriedly smuggled to India.[38]

Thirdly, although ninetyfive per cent of Nepal's food exports each year have been found to be directed towards India, export receipts from food items to India have been found to be largely influenced by agricultural conditions in India. An empirical study on Nepal's foreign trade model estimated the elasticity of demand for Nepal's food with respect to the ratio of India's income from agriculture to aggregate national income to be negative and substantially greater than unity. This categorically implies that fluctuation in India's agricultural conditions would have a significant impact on agricultural imports from Nepal into

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37 Poudyal, n.34, p.60.

38 Quarterly Economic Review, no.1, 1975. Economist Intelligence Unit, Spencer House, London.

India. This renders export earnings from food items to India relatively unstable.[39]

It is because of a generally good production of food-grains in India that the import of rice is less needed. Food-grains production in India was at the level of 133.3 million tonnes in 1981-82 and attained a new height of 149.8 million tonnes in 1983-84. The rice production which was merely 44.05 million tonnes in 1973-74 has made a breakthrough by attaining a record level of 59 million tonnes.[40]

Fourthly, Nepalese exports of rice are fully dependent upon the marketable surplus of the terai region. Inadequate transportation facilities have prevented this surplus to reach both the deficit and inaccessible hill regions. This, along with a considerable price differential (between 2 to 30 per cent) overtime and between official and 'black' prices are large enough to encourage illegal and unrecorded movement of rice into India, thereby reducing the official exports.[41] This adversely affected HMG's policy of institutionalising rice exports from Nepal.

Since India's emphasis in its plan is on food sufficiency, it is desirable for Nepal to diversify her agricultural production which still consists of sixtyfive per cent of the GDP and seventyfive per cent of the total exports of Nepal.[42]

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39 Shrestha, O.L., "Foreign Trade Model of Nepal: 1960-61 to 1969-70", University of Hawaii, 1975.

40 <u>Economic Times</u>, 25 April 1984.

41 Blaikie et.al., Ch.II, n.102, p.140.

42 <u>Economic Times</u>, 29 December 1983.

Among other noticeable decline in Nepal's exports, mustards, linseeds and ghee are most eminent as shown in Table VI. Mustard and linseed which contributed Nepal Rs 40.3 million in 1975-76 displayed a declining trend after 1976-77 and fell to a level as low as Rs 4.5 million in 1977-78.

Similarly, the export of ghee also declined perceptibly in 1977-78, when its exports came down to Rs 33.2 million from Rs 60.5 million in 1975-76. This is basically because of the poor quality of ghee which was accompanied by India's increasing number of dairies under the operation flood II scheme which further diminished the imports of ghee. A policy improving the ghee standard in Nepal can augment its export potential in India.

One of the few important resources of Nepal is forestry. These resources have been considerably depleted in the last few years. It is earning a handsome revenue from the export of timber to India. It earned Rs 54.1 million in 1975-76 which rose to Rs 146.7 million in 1977-78. So, seeing this good market, Nepal should always try to set up and develop timber, pulp, paper, plywood, cardboard, resin and turpentine industries by properly exploiting these resources. Besides this, Nepal can always make sports goods out of these resources which have a ready market in countries other than India also.

Table VII presents the structure of Nepalese exports to India in terms of SITC commodity groups. The exports of food and live animals have shown a fluctuating tendency.

TABLE VII

INDIA'S IMPORTS FROM NEPAL : CLASSIFIED BY MAJOR SITC COMMODITY GROUPS!
(Value in '000 Rupees)

Years	Total	Food & live animals	Tobacco & beverages	Crude materials, inedibles except fuels	Mineral fuels & lubricants	Animal & vegetable oils & fats	Chemicals & drugs	Manufactured goods Classified chiefly by manufacturers	Machinery & transport equipments	Misc. manufactured articles	Commodity and transactions not classified according to kind
SITC	0-9	0	1	2	3	4	5	6	7	8	9
1974-75	746,849	493,288	384	174,708	1,542	2,319	471	10,830	235	12,550	5,622
1975-76	893,691	721,553	8,493	136,148	1,009	1,420	5,752	14,493	1,433	3,115	5,275
1976-77	779,580	540,644	1,482	207,096	490	5,136	10,341	7,188	257	2,280	4,666
1977-78	498,021	222,197	239	251,472	164	5,772	3,130	8,783	2,575	2,535	1,154
1978-79	650,134	241,784	965	362,264	651	16,539	553	20,969	1,319	4,866	224
1979-80	520,935	182,774	1,578	259,157	465	19,900	551	13,031	2,653	4,273	553
1980-81	992,390	484,197	375	444,148	22	37,561	56	19,030	1,285	4,818	916
1981-82	994,348	538,577	1,621	296,948	967	41,939	925	91,636	5,455	15,645	635
1982-83*	306,810	97,947	-	44,904	73	23,213	47	107,775	1,122	1,712	17

! Based on custom data.

* July 1982-January 1983.

Source : Quarterly Economic Bulletin, Nepal Rashtra Bank, Kathmandu, Nepal, Mid-July 1977 to Mid-April 1983.

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It abruptly recorded an ever attained peak of Rs 72.1 crores in 1975-76. More surprisingly, it declined to the level of Rs 18 crores in 1979-80 and has been picking up gradually reaching 53.8 crores in 1981-82.

The peak in 1975-76 was mainly contributed by increase in agricultural output. That was declared an Agriculture Year. The abrupt decline in 1979-80 was also mainly because of the poor performance of Nepal in the agricultural front.

The revenue earned from the export of crude materials, inedibles except fuel recorded almost three times'increase from Rs 17.4 crores in 1975-76 to Rs 44.4 crores in 1980-81.

The export of animal and vegetable oils and fats has shown an increase over the period 1974 to 1983. Nepal's exports of manufactured goods have also recorded an increasing trend. This item of export fetched a meagre sum of Rs 7.1 million in 1976-77 but gradually increased overtime and fetched Rs 9.1 crores in 1981-82. Furthermore, in the first seven months of the Nepalese fiscal year, 1982-83, it had already fetched a sum of Rs 10.7 crores.

Customs-based exports during the first ten months of the FY 1982-83 totalled to Rs 826.1 million, reflecting a steep fall of Rs 412.1 million (33.3 per cent) over the corresponding period last year. Such negative growth rate in exports is largely due to the marked decline in exports of major commodities like rice, timber, raw jute and jute cuttings.[43]

43 Main Economic Indicators, Kathmandu, July/August 1983.

TABLE VIII

PRODUCTION OF MAJOR CROPS NATIONAL

Production: '000 Metric Tonnes
Value : Million Rs.

Year	Crops							Value
	Rice	Maize	Wheat	Sugar-cane	Tobacco	Jute	Potato	
1970/71	2304.2	833.2	193.4	235.61	6.86	53.00	272.51	5439.58
1971/72	2336.5	759.2	223.2	244.7	6.89	58.06	294.07	5478.87
1972/73	2010.4	822.0	312.5	245.7	7.02	55.45	297.01	5251.16
1973/74	2416.3	811.6	308.4	267.1	3.75	40.14	303.19	5765.14
1974-75	2457.3	826.7	330.8	251.4	4.78	41.35	306.49	5894.79
1975/76	2603.7	747.8	386.3	252.8	4.82	44.92	310.03	6115.33
1976/77	2386.3	798.3	361.9	311.2	5.13	44.92	271.22	5784.95
1977/78	2282.4	740.5	410.7	386.9	6.03	55.80	271.12	5684.86
1978/79	2339.3	742.6	412.2	370.3	5.11	65.55	278.80	5791.25
1979/80	2059.9	553.8	440.0	605.9	5.55	67.50	278.33	5215.09
1980/81	2464.3	742.9	481.7	478.8	5.48	59.00	294.94	6125.32
1981/82	2560.1	867.0	515.9	590.0	4.82	43.00	518.57	6507.40
1982/83	1832.6	718.2	660.4	630.3	6.66	43.00*	374.57	5618.16

Annual Growth Rate of Value of Crops : 0.7%

Note: The value of above commodities is calculated multiplying the average price of 1970/71, 1972/73 with corresponding quantity. Growth rate is calculated using semi-log model of type Y = loga + bt.

*The production of Jute in 1982/83 is taken at 1981/82 level.

However, the exports of machinery and transport equipment is yet to pick up the tempo which so far fetched negligible earnings of Nepalese exports to India. The Nepalese merchandise exports consist of eightyseven per cent of primary commodities, six per cent of textile clothing and seven per cent of manufactures.[44]

Nepal's testiny does not lie in the production of these primary commodities and selling them in the foreign market because the exports of primary products are subject to wide price fluctuations and the terms of trade in case of these products are declining over the period.

VIII. Nepal's Trade Diversification Policy : An Illusive Success

Nepal's trade with India as a proportion of her overall foreign trade has declined over the years. India's share in Nepal's total exports has come down from 84 per cent to 45 per cent during 1974-75 to 1979-80. But, subsequently this share again has been gradually increasing and has attained 76.7 per cent in 1982-83. Table IX shows this clearly.

Nepalese traders receive payments in non-convertible currencies from India whereas, imports of capital and other goods from overseas countries are in hard currencies. It is for this reason that trade policies have been addressed to promote exports to overseas countries.[45]

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44 IBRD, World Development Report, 1981.

45 CEDA, Ch.II, n.39, p.6.

TABLE IX

DIRECTION OF FOREIGN TRADE OF NEPAL (VALUE IN MILLION RS.)

	1974-75	1975-76	1976-77	1977-78	1978-79	1979-80	1980-81	1981-82	1982-83
Total Exports	889.6	1185.8	1164.7	1046.2	1091.0	1150.5	1243.0	1232.2	826.1
To India	746.9 (83.4)	893.7 (75.3)	779.6 (66.9)	498.1 (47.6)	524.8 (48.1)	520.9 (45.3)	754.1 (60.7)	792.0 (64.0)	633.6 (76.7)
To other countries	142.9 (16.6)	292.1 (24.7)	385.2 (33.1)	548.1 (52.4)	567.1 (51.9)	629.6 (54.7)	488.5 (39.3)	446 (36.0)	192.5 (23.3)
Total Imports	1814.6	1981.7	2008.0	2470.5	2899.2	3480.1	3656.0	3993.4	4891.7
From India	1475.7 (81.3)	1227.1 (61.9)	1343.5 (66.9)	1534.1 (62.1)	1583.5 (54.6)	1786.4 (51.3)	1793.2 (49.0)	1898.5 (47.5)	2051.5 (41.9)
From other countries	338.9 (18.7)	754.6 (38.1)	664.4 (33.1)	935.4 (37.9)	1315.7 (45.3)	1693.7 (48.7)	1862.8 (51.0)	2094.9 (52.5)	2840.2 (58.1)

Note : Numbers within parentheses are in percentage.

Sources : Nepal Overseas Trade Statistics, Trade Promotion Centre, Kathmandu,
Main Economic Indicators, Nepal Rashtra Bank, Kathmandu, July/August 1983.

Confinement of major proportion of exports to a single foreign market is most disadvantageous. Under these circumstances, a country's bargaining position at the time of sale of its produce is weakened. This is one way Nepal justified its diversification policy.[46]

Similarly India's share in Nepal's total imports has been showing a continuous declining trend. It declined from 81 per cent in 1974-75 to 51 per cent in 1979-80 and further declined to 41.9 per cent in 1982-83.

This trend of Nepalese trade vis-a-vis India categorically implies that her exports and imports to third countries have been on just the opposite line. Rice, raw jute, jute goods, hides and skins are the country's main exports to third countries. The major overseas markets of Nepal excluding India are Bangladesh, USA, Mauritius, Japan, West Germany, Pakistan, Malaysia, Singapore and UK.[47]

The main imports of Nepal from third countries are textiles, machinery, petroleum and petroleum products, transport equipment and parts, fertilizers and cement. The main sources of imports among third countries are Japan, China, Sri Lanka, USA and USSR.[48] Under the trade diversification policy of HMG, the number of countries having made

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46 Pradhananga U., "Policy Instruments for Effective Import Substitution and Export Promotion", Seminar-cum-Workshop on Development Planning, CEDA, Kathmandu, 1971, p.66.

47 Import-Export Structure and Trade Expansion in South Asia (Indian Institute of Foreign Trade, New Delhi), June 1982, p.8.

48 Ibid., p.8.

agreements with Nepal reached fourteen.[49]

Out of the total foreign trade of Nepal of Rs 5717.8 million in 1982-83, share of India was of the order of Rs 2685.1 million. Consequently, India's share in the total trade volume declined from 51.4 per cent (1981-82) to 47.0 per cent in 1982-83.[50]

So, the fall in India's share in Nepal's total trade from 82 per cent in 1974 to 47 per cent in 1982-83 is due, in no small measure, to the HMG's policy of trade diversification in favour of third countries.

Nepal's volume of trade with India has been declining not because importers of Nepal do not like Indian goods but because Indian manufacturers have not been able to supply the materials on time due to power shortages and other reasons.[51]

The various export promotion schemes of the 1960s and 70s favouring overseas exports brought off this change. But this shift away from India contributes hardly anything to increasing the overall volume of exports from Nepal. Neither has it affected a diversification of exports commodities as desired. The whole aim behind this trade diversification policy was to bring down Nepal's trade deficit with India. But, the contrary has happened.

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49 MEI, n.24, July/August, 1982.

50 Ibid.

51 Mittal, A., "Finance Director of Dooars Transport Private Ltd." in Economic Times, 29 December 1982.

The shifting of exports away from India to other countries has resulted in a shortage of Indian currency to pay for imports from India. During the period 1975-76 to 1979-80, Nepal bought Indian currency amounting to Rs 2,318.4 million by surrendering the hard earned convertible foreign exchange to meet the ever growing trade deficit with India. This entailed additional loss too. Dollar sales against Indian currency were at a lower level than what the HMG had to pay to buy dollars.[52]

The only gain Nepal has concretely received from this policy is psychological gain which has, to a large extent, consoled Nepal on the plea that her dependence on India has been drastically reduced. This has helped Nepal in maintaining its long cherished aspiration of 'independence and identity'. This is more of an illusion than a real success.

Moreover, Nepalese tactics to reduce such dependence by any means were fully exposed in terms of its various schemes, particularly Gift Parcel and Bonus Voucher (discussed in the preceding chapter). They pursued such policies even at the cost of disrespecting various treaties with India and more noticeably the economic interest of India.

This policy of diversification completely distorted the market economy of the kingdom and virtually brought about a total decay of indigeneous production like handloom textiles of Bhaktapur district and metal utensils of Patan.[53]

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52 Poudyal, n.34, p.105.

53 Ibid., p.105.

However, it should be noted that the sharing of an open border of 800 kms has permitted the free movement of goods and people. In fact, according to reports at least one-third to one-half of trade with India is unrecorded. It means the trade volume with India is far greater than what the statistics show.[54]

Further, Nepal adopted such policy on the plea that most goods imported from other countries were cheaper and qualitatively better than that of India.

While carrying out this policy, Nepal did not[55] mind even to procure things at such higher prices from third countries. While engaging itself in overseas trade, Nepal had to transport all imports and exports about 400 miles to and from Calcutta. Because of the long delays in shipment, pilferage and damage during shipment, the cost of Nepal's overseas exports and imports substantially increased.[56]

IX. Nepal's Balance of Trade with India and Third Countries

The balance of trade (BOT) problems between India and Nepal has taken a more intricate and worsening dimension in the past few years. The ever increasing BOT deficit of Nepal has certainly emerged to be a subject of grave concern to Nepal. This alarming trend has gradually started adversely affecting Nepal's economic, fiscal and

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54 Asian Regional Team for Employment (1974), Challenge for Nepal's Growth with Employment, a Mission Report, Bangkok, p.23.

55 Economic Times (New Delhi), 29 December 1982.

56 Banerjee, Ch.II, n.137, p.597.

monetary policies. The HMG have been desperately trying to overcome and remedy this substantial deficit through different means and strategies but have still been unsuccessful in their venture.

Table X represents the Indo-Nepalese BOT position between 1974-1983. The BOT which was always adverse to Nepal except a few initial years in 1950s. But figures during the fifties were not so alarming as could be perceived in the past five to six years. The magnitude is widening at an unprecedented pace. This deficit which was considerably small at Rs 728.9 million in 1974-75 and Rs 353 million in 1975-76, doubled to Rs 1417.9 million in 1982-83.

Nepal's trade deficit with India narrowed down by Rs 226.4 million between 1979-80 to 1980-81. The increase in exports of Nepal by Rs 232.2 million and imports of Rs 76.4 million only is responsible for this fall.[57] Since 1981-82 however, Nepal's trade deficit with India is on the increase.

As the table shows, the percentage of BOT deficit in Nepalese total trade vis-a-vis India has mostly remained more than fifty per cent till the year 1979-80. After attaining the height of 78.7 per cent in 1974-75, the Indian share in the Nepalese overall BOT deficit has more or less displayed a declining trend. It is more so after 1980-81 where the share declined from 43.1 per cent to 34.9 per cent in 1982-83.

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57 Economic Times (Delhi), 5 August 1982.

TABLE X...

NEPAL'S BALANCE OF TRADE, 1974-1983

(In Million rupees)

Years	Trade Balance	With India	With Other countries
1974-75	- 925.0 (100.0)	- 728.9 (78.7)	- 196.1 (21.3)
1975-76	- 708.2 (100.0)	- 353.0 (49.8)	- 355.2 (50.2)
1976-77	- 843.2 (100.0)	- 563.9 (66.8)	- 279.3 (33.2)
1977-78	- 1423.4 (100.0)	- 1036.0 (72.8)	- 387.4 (27.2)
1978-79	- 1587.9 (100.0)	- 931.7 (58.7)	- 656.2 (41.3)
1979-80	- 2329.6 (100.0)	- 1265.5 (54.3)	- 1064.1 (45.7)
1980-81	- 2413.0 (100.0)	- 1039.1 (43.1)	- 1373.9 (56.9)
1981-82	- 2755.2 (100.0)	- 1106.5 (40.2)	- 1648.7 (59.8)
1982-83	- 4065.6 (100.0)	- 1417.9 (34.9)	- 2647.7 (65.1)

Notes: Data within parentheses are in percentage.

Sources: Main Economic Indicators, Nepal Rashtra Bank, Kathmandu, Nepal, August 1977 to July/August 1983.

However, Nepal's trade deficit with third countries which was just Rs 196 million in 1974-75, has gone up to a substantial sum of Rs 2647.7 million by 1982-83, which is 65.1 per cent of the total trade deficit of Nepal. Faced with a rapid fall in the country's foreign exchange reserves arising out of this deficit, the HMG last year stopped issuing import licences to individual businessmen.[58]

This trend amply reflects the inherent tendency that the Nepalese drive and success in achieving diversification of trade at least country-wise has a somewhat positive correlation with the increasing share of third countries in the BOT deficit of Nepal.

Nepal's BOT problem with India became so acute in the 1970s that in 1976, Nepal had to convert several million dollars worth hard currency into Indian currency to meet the growing demand.[59] This has been repeatedly done in the following years also.

X. Factors Behind BOT Deficit with India

The first and foremost is an emerging system of unequal exchange between India and Nepal. India, a relatively more developed country, has already attained near self-sufficiency in food production. She has been endowed with much wider and richer resource base and has already made a

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58 *Times of India* (Delhi), 29 January 1984.

59 *Times of India* (Delhi), 26 August 1976.

significant stride in infrastructural, scientific and industrial development. It is doubtlessly a big power in the region because of its size, military setup and political system.

Against this background, it is undoubtedly clear that India would always have an upper hand in its trade relations with Nepal, as this tiny Himalayan Kingdom has done very little to add succour to its export potentials. Nepal's experience of foreign trade is relatively short.

The very nature of its geographical location i.e. 'landlockedness' makes her aptly handicapped and her trade with India substantially unequal.

Nepal's foreign trade has a very poor base of auxiliary services like transport, banking and insurance. There is also absence of organised exports. The public sector contribution to the national exports is very negligible. The export servicing institutions have not been developed. Credit and loan facilities and other prerequisites for exports are also inadequate.[60]

Besides, because of its open border and easy geographical proximity with India, the transmission of undesirable economic fluctuation in India to the Nepalese economy is natural and unavoidable. Any unforseen serious

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60 Pradhananga, n.46, p.66.

fluctuation in the prices and quantities of imports may even tear the very fabric of Nepal's plan to tatters.[61]

In other words budgets and economic development of India leave a broad based impact in Nepal. This is a reality which cannot be ignored. When prices of consumer goods declined in India after the emergency was declared in 1975, a similar trend had been noticed in Nepal also.[62]

The second major factor that may be attributed to this growing deficit is the very nature of structure and composition of trade in which Nepal has undeniably remained as a primary goods exporter and India an exporter of manufactured goods. India exports expensive items like cement, stainless steel, coal, printing paper, petroleum, cotton textiles and imports relatively much cheaper items like rice, ghee, jute goods.

Though the increase in the prices of cereals in India in the past and present helped the Nepalese export, it did not compensate for the rise in the prices of expensive goods imported as mentioned above. Moreover, the stagnant food production, a major item of exports of Nepal, along with the growth in population have reduced the exportable surplus.

This has certainly put India in an advantageous position in the sense that Nepal can hardly bargain on issues pertaining to imports of manufactured goods as they are indispensable

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61 Rajbahak, R.P., "Foreign Trade of Nepal", United Asia, July-August 1967.

62 Swatantra Samachar (Kathmandu), 24 March 1976.

for the economic advancement of Nepal at this stage.

The most culpable failure leading to the growing BOT deficit is still perhaps the failure to set up a number of processing industries for import substitution in Nepal because Nepal has to export materials such as wheat, ghee, oilseed, etc. to India only to be re-exported to Nepal in the processed forms.[63]

The vulnerability of Nepal's export earnings as combined with her high income elastic imports is another serious nature of its trade. Besides, a continuing trade concentration both in terms of commodities and countries, despite its highly talked diversification policy, is another major problem which is structural and long-term in its nature.[64]

Besides, the Nepalese situation fully subscribes to Raul Prabisch's view that a slowing down in the exports of primary producing countries would be accompanied by a deterioration in their terms of trade.[65]

The existing exchange rate between India and Nepal is another crucial factor leading to this situation. A Nepali rupee (NR) is equivalent to Indian Re. 0.67 (selling)

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63 Rana, P.S.J.B., "Role of Foreign Aid and Trade" in S.D. Muni, ed., Nepal : An Assertive Monarchy (Chetna; New Delhi, 1977).

64 Shrestha, O.L. and Jayaraman, T.K., "Some Trade Problems of Landlocked Nepal", Asian Survey, December 1976, p.1116.

65 Balassa, n.15, p.5.

and Re.0.66 (buying) at present.[66] 'The Nepalese official exchange rate with the dollar is basically determined by India.'[67] The double exchange rate policy of Nepal evolved in 1978, has been fully discussed in the preceding chapter. This exchange rate puts India into an advantageous position as her exports are always high priced and imports much cheaper. Nepalese are helpless and apprehend that if they resort to devaluation, it may further deteriorate the BOT position except in the initial few years.

XI. Gains to India

India has definitely been gaining from its trade with Nepal. Besides this substantial trade surplus, India does enjoy other major benefits in the trade relationship. Nepal has emerged as a ready market for major Indian manufacturing and engineering products.

India even skims the cream from Nepal's 'multiplier'. Since the incremental elasticity of demand for manufactured goods of India is higher than that for primary products of Nepal, a rise in the developmental sectors in Nepal means a rise in the demand for Indian imports. The secondary benefits of development investment in terms of income, skills and demand generation, all benefits go to India more than Nepal. In an economic jargon, Nepal exports the 'multiplier' to India.[68]

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66 Economic Times (Delhi), 26 March 1984.

67 Banskota, Ch.II, n.12, p.251.

68 Rana, Ch.II, n.13, p.657.

Even a cursory assessment would display that the growing market of Kathmandu is largely under the control of Indian merchants. The business has been run by a chain of Indian wholesellers, retailors and door to door vendors. This means that the growing income from these transactions would be regularly transmitted outside the country rather than being used for strengthening the indigenous supply channels.[69]

XII. Nepal's Favourable Balance of Payments Position vis-a-vis India

Had the invisible earnings, net transfers and the net official capital inflow not registered high growth, Nepal would have faced quite an unfavourable Balance of Payments (BOP) problem long ago. This invisible earnings include Gurkha remittances from Nepalese working in India, tourist expenditures in Nepal and interest on Nepalese investment in India.

Besides, the massive aid extended by India (discussed in the following chapter) has certainly eased the Nepalese BOP position with India.

Despite increased trade deficits, the overall BOP position remained favourable by Rs 140 million in 1981-82.[70] Last year the country's BOP showed a surplus of Rs 26.4 million. However, it is really very difficult to know the

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69 Poudyal, n.34, p.106.

70 Economic Times (Delhi), 5 August 1982.

exact BOP position of Nepal with India, because of the absence of any authentic data and documents. But this manner of meeting trade deficits cannot be relied upon indefinitely.

Table XI gives an idea of how receipts of convertible foreign exchange have been behaving in the last thirteen years. Foreign exchange has been a major instrument of reducing dependence on foreign aid and of maintaining favourable BOP. So, the foreign constraint may be eliminated only by increasing exports. India's share in all the elements of convertible foreign exchange (Table XI) is very substantial. Hence, Nepal has always been able to maintain favourable BOP vis-a-vis India amidst a substantial BOT deficit.

XIII. Trade Deficit with India : Remedial Measures

In relation to the size of the country and its resource endowments, foreign trade will continue to be very important in the Nepalese economy. At present the share of exports and imports in National Income is 5 and 15 per cent respectively. However, in relation to the income originating in the monetized sector their percentage composition is very high.[71] The percentage share of foreign trade in the GDP of Nepal is gradually increasing. It increased from 11 per cent in 1970-71 to 21 per cent in 1978-79.[72]

71 Summary of the Country presentation of Nepal, United Nations General Assembly Conference on the Least Developed Countries, Paris, 1 September 1981.

72 CEDA, Ch.II, n.39, p.16.

TABLE XI

RECEIPTS OF CONVERTIBLE FOREIGN EXCHANGE*

(Value in '000 Rs.)

Year	Invisibles (2+3+4)	Remittances	Tourist Expenditures	Interest Receipts	Merchandise exports (6+7)	Exports under A/C arrangements	Other Exports	Diplomatic missions	Foreign Aid	Misc.
	1	2	3	4	5	6	7	8	9	
1970-71	106,306	48,768	16,650	40,942	104,429	17,000	87,429	11,403	7,776	41,290
1971-72	130,466	65,659	22,019	42,788	118,112	28,728	39,384	16,531	22,397	40,265
1972-73	153,680	42,722	53,215	57,743	160,524	8,887	151,637	18,778	36,354	47,596
1973-74	236,194	52,897	95,332	87,983	202,317	72,011	130,306	25,293	43,397	34,927
1974-75	299,080	90,693	120,668	87,719	151,332	31,882	119,450	22,354	26,531	65,312
1975-76	354,500	97,661	189,936	66,903	296,907	102,263	194,644	27,905	132,148	49,436
1976-77	447,864	125,384	244,141	78,339	385,722	64,627	321,095	54,199	161,044	46,800
1977-78	570,547	120,004	342,509	108,034	557,639	49,999	507,640	104,759	211,194	18,404
1978-79	645,515	146,276	406,807	92,432	517,991	22,846	495,145	104,983	542,248	37,472
1979-80	811,245	50,308	518,707	142,230	717,817	74,130	643,687	159,155	623,499	59,366
1980-81	1,001.218	216,766	616,795	167,657	642,046	69,635	572,411	263,706	622,761	122,292
1981-82	925,991	205,455	493,842	226,694	513,505	26,333	487,172	196,589	563,286	89,246

* On payment basis. Data based on foreign exchange records.

Sources : 1970-71 to 1976-77 - Quarterly Economic Bulletin, Nepal Rashtra Bank, Kathmandu, Mid-January-July 1978; 1977-78 to 1981-82 - Ibid.; Mid-April 1983.

Keeping this background in focus, Nepal has been desperately trying to reduce,if not bridge the present substantial BOT deficit with India. In almost all the plan documents, considerable emphasis has been directed toward achieving export promotion, import substitution, diversification and industrialization.[73]

Various fiscal, monetary and foreign exchange policies have been attempted to the issues regarding discouraging the import of luxury goods and to ensure adequate supply of developmental and consumer goods at fair price. In general foreign trade policy of Nepal could be regarded as import substituting policy as indicated by heavy protection accorded to domestic industry.[74]

Export Promotion

Considering the small size of the domestic market, the limited purchasing power of the people, as also taking into account the need to earn foreign exchange, Nepal is laying increasing emphasis on export promotion.

Private sector and Government should work together to promote exports. A bulk of trade is still carried through unorganized private channels in Nepal. The private enterprises working purely for profit motive such as banks and insurance companies must provide considerable services which

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73 Ibid., p.29.

74 Ibid., p.29.

are indispensable for the expansion of foreign trade. It should work with public sector companies in close harmony.[75]

India can always extend to Nepal its vast experience in foreign trade. It must help Nepal in setting up basic infrastructure for smooth and beneficial trade. The setting up of various banking and public insurance companies should be encouraged. In order to extend credit facilities, by an agreement signed in 1973, India provided the facility of standby credit to Nepal. Under this facility Nepal could continue to draw upon the facility and repay the amounts due within the overall ceiling of Rs 10 crores.[76]

As far as HMG is concerned, it has already made certain strides in this field by setting up Trade Promotion Centre in December 1970.[77] A new trade policy has been announced in June 1982. A key feature of the new strategy is a high level national commitment to exports accompanied by strengthened institutional machinery and a new policy framework for exports.[78]

The private sector has been given a leading role in the new export drive. Export Trade Development Council has been set up to provide the necessary policy support to export

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75 Rawat, Ch.II, n.9, p.107.

76 <u>Times of India</u> (Delhi), 6 March 1976.

77 Pradhananga, U., n.46, p.76.

78 Special Supplement on Nepal, <u>Economic Times</u> (Delhi), 29 December 1983.

development. Trade Promotion Centre would function as this Council's secretariat.[79]

As an integral part of the export strategy, the HMG has initiated several back-up measures. These include simplification of licensing procedures, streamlining of customs procedures and provision of warehousing facilities and exemption from export duties. Income tax rebates will also be provided. Cash incentives for selected exports products are now in effect.[80]

The most significant aspect of these new developments is that while incentives to increase hard currency exports are provided, profitable exports to India are also encouraged at the same time.[81] Nepal has announced her intention to have an export processing zone in the country.[82]

Agriculture

Since this is the most important item of exports, all-out efforts should be made to improve the performance of agriculture. Though it still remains to be a vagary of monsoon, the uncertainty can be greatly minimised by various measures such as dryland farming.

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79 Ibid., p.x.

80 Ibid., p.x.

81 Ibid., p.x.

82 IIFT, n.47, p.17.

The Royal Economic Commission set up in June 1979 headed by Dr. Y.P. Pant also laid emphasis towards this goal of reducing BOT deficit. Nepal could bridge the deficit only by increasing the productivity and lowering the cost of production of the highly demanded products in India like rice, wheat, wood, [redacted] dairy products and oilseeds.

Usually, low export growth is attributed to the shortfall in agricultural sector. This sector constitutes two-thirds of the GDP, accounts for nine-tenths of the employment and eight-tenths of the total exports, besides remaining the major supplier of raw materials to industry. Keeping this view in mind and the need to achieve the target outlined in the Sixth Plan, top priority has been accorded to agricultural development with 33.2 per cent (the highest) of the total plan outlay devoted to agriculture.[83]

It is on the part of India to stop deflection of subsidised agricultural inputs of Nepal into India. For instance, in May 1980, the GOI decided to increase the prices of petroleum products and accordingly the prices of fertilizers were also increased significantly in India. As a result the gap in the prices of fertilizers in the border towns of India and the adjoining terai of Nepal widened. This led to deflection of heavy quantity of fertilizer into India.[84]

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83 Poudyal, n.34, pp.8-9.

84 Economic Report, Nepal Rashtra Bank, Kathmandu, 1980-81, p.10.

Considering the limited base of Nepal's industrial structure, the present structure of Indo-Nepalese trade which is confined to the import of a limited number of items from Nepal into India is understandable. However, most of the countries that we now think of as advanced have been at one time or another dependent on just as narrow a range of exports. Japan in the early stages of industrialization was heavily dependent on exports of silk, US and Canada on exports of gram, Britain on exports of wood and textile manufactures.[85] So, Nepal too is at its early stage of economic development. It should not get discouraged and frustrated with its narrow range of exports. It should, however, keep in mind the urgency of increasing its productivity and exports.

Yet the risks of specializing on a narrow front are very real. In the long run there is the danger of a substitute provided at lower cost by factory methods, in the short run there is the danger of wide fluctuation in price. Of these two, the long run danger is more alarming but so far it has been rare for a natural product of agriculture to have superseded by a synthetic one.[86] So Nepal being primar-ily an agricultural country should not feel alarmed.

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85 Cairncross, A.K., "Contribution of Trade to Development" in G.E. Meier, ed., Leading Issues in Economic Development (Oxford University Press, New York, 1976), p.713.

86 Ibid., p.714.

However, there is ample scope for India to step up her imports of the items like long pepper, hides and skins, pulses, maize, hand made paper, low valued high volume minerals such as limestones, lead, zinc and construction materials.[87]

Similarly, India can step up her exports of a number of items that Nepal is currently buying from third countries. These include cotton textiles, synthetic, textiles, medicines, soaps, matches, paints, sports goods, toys, dry cells, glassware, crockery and engineering items such as bicycles, hand tools, machinery and agricultural implements.[88]

While trying to increase the volume of trade, Nepal should make a drive to reduce unnecessary imports from third countries which usually find their way to India. Because, other things being equal, the larger the volume of trade, the greater will be the volume of foreign capital that can be expected. The reason is that with a large volume of trade the transfer of investment and repayments on principal is more easily effected than with a small volume of trade.[89]

Trade deficit of Nepal should be a great concern for India mainly due to the fact that such gap in bilateral trade, if not checked well in time, may affect trade between India and Nepal. India has to introduce suitable

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87 IIFT, n.47, p.10.

88 Ibid., p.11.

89 Haberler, n.8, p.706.

flexibility in her foreign economic policies vis-a-vis Nepal. India can always liberalize the terms of trade and transit facilities.

India as a neighbour and a big power should not misuse its dominant position in the trade relation with Nepal. Instead, it should try to follow such a fiscal measure which could keep the prices in Nepal stable.

Industry and Import Substitution

The role of industry in reducing the trade deficit, though vital, is certainly not so in case of Nepal as her industrial base and development is still at its infant stage. This will be thoroughly discussed in the following chapters.

Besides the rate of savings, expansion of exports and inflow of foreign capital, import substitution is a major determinant of economic growth.[90] Nepal can, to a large extent, accomplish its efforts to reduce BOT deficit by setting up more and more import substitution industries mainly in the field of basic goods requirements. The export processing industries should be given the highest priority, as this is of crying need in the present trade structure.

Though this venture is capital-intensive in nature and a poor country like Nepal may find it difficult to undergo it, it will certainly have more long-run benefits.[91]

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90 Balassa, n.15, p.67.

91 Pradhananga, n.46, p.62.

Foreign aid received by Nepal from various sources can be largely utilized in this productive sector. A national consciousness can be aroused by the government which would help in building significant savings and capital formation.

In case of imports of manufactured goods, though the past behaviour presents a high income elasticity of demand for Indian manufactured goods there is scope for domestically producing simple manufactured goods such as soap and leather products so as to reduce dependence on India.

In the short run, however, it appears that the existing BOT deficit is likely to persist till viable means and policies of reducing luxury imports which is often encouraged by skewed distribution of foreign aid is adopted.

Horticulture

The potentialities of horticultural development has been amply demonstrated in North India. Yet, with equal potential, and perhaps greater potential in herbal farming. Nepal still has not succeeded in getting farmers to start herbal and horticulture development in any scale. Along with this, the development of processing industries for these and modernization and expansion of agro-based industries or even the traditional farm products would help to boost Nepalese exports and help widen the range of exportable commodities.[92]

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92 Rana, Ch.II, n.47, p.7.

Hydro-electric Power

Unless and until substantial energy including hydro-electric power and mineral resources are developed in Nepal, the trend of BOT deficit would be extremely difficult to reverse in the near future. The tremendous potentiality of Nepal in hydro-electric power will be discussed in detail in the following chapter on India's aid to Nepal.

Tourism:

Another major source from which Nepal can indirectly reduce its balance of trade deficit with India is through tourism. This would help Nepal to improve its BOP vis-a-vis India and would, in turn, affect the present huge deficit.

Tourism has been one of the fastest growing industries in Nepal. It is one of the prime sources of foreign exchange earning. While a decade back it was earning only Rs 13.21 million, it earned Rs 406.68 million in 1978-79.[93] The foreign exchange earning from it went up to US dollar 51.8 million in 1980-81.[94]

Tourists'arrival in Nepal have gone up from 45,970 persons in 1970 to 1,75,488 in 1982 in which two-thirds of the total tourists were from India.[95] Nepal is the only foreign country for the Indians which can be visited without passports.

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93 MEI, n.24, January 1980.

94 Economic Report, n.84, p.13.

95 MEI, n.24, July/August 1983.

Nepal can further exploit this avenue of its economy by attracting more tourists by means of developing more tourist resorts and facilities in collaboration with the Indian investors. This industry has substantial forward and backward linkages.

There are promising opportunities for Indian investment in the expansion of hotel capacity, establishment of projects such as restaurants and health resorts, development of facilities such as water,sports, golf and amusement parks and creation and strengthening of transport facilities both by land and air.[96]

Nepal has already made a strong move to form a widely representative high power board to be known as Nepal Tourism Promotion Board. This will pool the resources of HMG and private enterprises and promote tourism.[97]

The banking system must be made competent enough to control all foreign exchange transactions, especially in regard to Indian currency. Further, a politically favourable atmosphere should prevail not only in the host country but also in the region, as tourists are very sensitive to any such events.[98]

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96 IIFT, n.47, pp.22-23.

97 Special Supplement on Nepal, Economic Times (New Delhi), 29 December 1983, p.viii.

98 Dhungel, R.N., "Tourism and the Nepalese Economy", Nepal Industrial Digest, NIDC, Kathmandu, 1982, pp.11-12.

XIV. Some Recent Irritants in Indo-Nepalese Trade

Indo-Nepalese trade in recent years was subject to stresses and strains. Some of the major strains have been discussed in the following few headings.

1974 Oil Crisis:

The announcement of four-fold increase in the prices of crude oil by the Organisation of Petroleum Exporting Countries (OPEC) in 1974 hit almost all the oil importing countries. India, doubtlessly an adversely affected country, had to curtail its exports of oil to the neighbouring countries. On 1 January 1975, India discontinued the supply of petroleum products to Nepal.[99]

Nepal's annual requirements of petroleum products were estimated at 10.5 lakh tonnes. This abrupt decision of the GOI raised hue and cry in Nepalese circles, as it became highly difficult for Nepal to import such products from the third countries. The freight and handling charges were alone more than the production cost in India. A barrel of kerosene purchased in the USSR for US dollar 11.9, for instance, cost US dollar 17.9 by the time it reached the Nepalese border.[100] The Nepalese press started attacking vehemently the GOI's unilateral decision.[101]

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99 Times of India (Delhi), 11 January 1975.

100 Nigam and Banskota, Ch.II, n.46.

101 Nepal Press Digest (Kathmandu), January-March 1975.

However, India still provided facilities for products handling, refining, product exchange and commercial assistance required by Nepal for its supplies of petroleum imported from foreign countries.[102]

At the same time, a ban on supply of goods which India had been supplying to Nepal on quota basis was imposed. But the GOI did allow Nepal to import these items from the third countries.

Displaying an understandable attitude a Nepali newspaper wrote, "We can't blame India if it refuses to supply petroleum since it is not a major petroleum producing country. India procures oil against payment in convertible foreign currency, but supplies it to Nepal against payment in Indian currency. Nepal should now develop contacts with the producer countries themselves for the supply of petroleum products."[103]

Another Nepali paper '<u>Himali Bela</u>' accused the GOI of using 'strong arm tactics' against Nepal by barring the supply of goods. Describing India's motive as confronting Nepal with 'currency diplomacy' the Naya Sandesh, a Nepali weekly, remarked that 'GOI was obviously taking this step because it wanted payment in foreign exchange' and declared India as a 'big' but 'unwise' neighbour.

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102. Times of India (Delhi), 11 January 1975.

103. Naya Samaj (Kathmandu), 31 December 1975.

However, Indian version of explanation said: "There is world-wide scarcity of some consumer goods. India itself imports most of them. India is probably hit by the growing scarcity and rising prices of petroleum products and paper. Even then, India has been supplying these goods to Nepal as far as possible. After it became impossible to do so, India provided full facilities to Nepal to procure them through alternative sources."[104]

A situation such as above, which is beyond the control of GOI, has been misunderstood by the Nepalese. This expression and furore could be justified only if India intentionally imposed such bans. It was inevitable on part of India to ban such exports because the total crude oil production of India was just eight million tonnes compared to the present production of 26.3 million tonnes.[105]

Here, a lack of understanding and cooperation on the Nepalese front is apparent. Nepalese, should have reacted more cautiously knowing the fact that India itself is an underdeveloped country and was hard hit by such unprecedented increase in the price of this scarce material.

India Charges International Prices

In the month of April 1975 another imbroglio gripped the Indo-Nepalese trade relation when India decided to charge international prices for such commodities as coal,

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104 Dainik Nepal (Kathmandu), 9 February 1975.

105 Economic Survey, Government of India, 1983-84, p.25.

cement, iron and steel, printing paper provided to Nepal on quota basis. India so far had been selling these essential commodities at domestic Indian prices. It now decided to charge prices which apply to exports to several friendly neighbouring countries.[106]

India was apparently unhappy about the fact that Nepal paid foreign exchange to countries like South Korea, China and Soviet Union while buying the same in Indian rupees from India.

Taking this announcement as an economic exploitation a newspaper asserted, "Nepal cannot bear the economic consequences of the new policy of India. It is obvious that India... is planning to exert increased economic pressure on Nepal and ... that India is determined to ruin Nepal's economy."[107]

Calculating the revenue loss from this policy Jagriti Weekly pointed out that "as a result of India's unilateral decision to increase prices of goods exported to Nepal from April 1975, the prices of coal will increase from about Rs 65 or 75 per ton to Rs 375 or 400 per ton. Nepal is importing 45 thousand tonnes of coal from India every year for which it will now have to pay Rs 15 million more."[108] Nepal will now have to pay about Rs 60 a ton more for the cement, if it buys from India.[109]

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106 Indian Express (Delhi), 30 March 1975.

107 Samiksha Weekly (Kathmandu), 10 April 1975.

108 Jagriti Weekly (Kathmandu), 10 April 1975.

109 Indian Express (Delhi), 30 March 1975.

But within Nepal also some newspapers maintained understandable and wise stand. "We should now utilize this opportunity to promote our self-reliance instead of blaming India for every inconvenient situation," outrightly commented Swatantra Samachar. Nepal will now have to pay India rational and realistic prices.[110]

Sikkim Issue

However, all these issues certainly carried political precipitant or repercussion. Certain quarters in Nepal attributed India's move as a direct outcome of the review of relations undertaken by New Delhi in the wake of anti-Indian demonstration in Kathmandu over Sikkim's merger in India as the twenty-second state in 1975.

Naya Samaj wrote, "Using Nepali Peoples' opposition to India's policy of Sikkim, the Indian government took a series of unilateral steps contrary to the spirit of the 1971 Treaty."

In spite of all these, the GOI lifted control on all nine out of fifty-three items of hardware to help Nepal to revitalize its developmental activity. The other forty-four items could be freely purchased by the Nepalese in the Indian markets. Though India herself had shortage in these commodities she allocated several items of essential commodities to Nepal for the Indian fiscal year 1976-77 at the request of the Nepalese government.[111]

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110 Motherland (Kathmandu), 31 March 1975.

111 Financial Express (Bombay), 10 January 1976.

India's charging of foreign exchange to Nepal is justified by the fact that India cannot go on trading with Nepal at the cost of its already eroding foreign exchange reserves. If Nepal can follow some of the detrimental economic policies vis-a-vis India, it is not wrong on the part of India to ask for a legitimate right as above.

The World Bank Report also suggested that Nepal would be much better off if it were to use its hard currency reserves for purchases from India.[112] In any case it is proving very expensive for Nepal to fill the gap created by the shortage of Indian rupees which it normally fills by converting the hard currencies.

Transit Issue

The constant irritation arising out of Nepalese increasing dissatisfaction over the transit issue has been fully dealt in the preceding chapter. Nepal started facing transit problems quite recently because of her increasing overseas exposure. Though the volume of trade between the two countries increased, Nepal continued to have a feeling that the volume of trade could have increased manifold to its advantage but for the way some of the clauses of the treaty were drafted.

The situation became more complicated when the 1971 Treaty actually expired on 16 August 1976. Reacting sharply

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112 Banskota, Ch.II, n.12, p.71.

to the Nepalese demand for the conclusion of a separate treaty on trade and transit a Delhi-based daily wrote, "Nepal has in fact been allowed access to third country markets through transit points and warehousing and port facility in India. Imports from third countries make their way from Calcutta port. But it should not be forgotten that being situated in a sensitive area vis-a-vis India, Nepal has the potential to be drawn into the vortex of some intricate political problems that can create embarrassment to India and which, therefore, the latter cannot easily ignore."[113]

However, the conclusion of separate treaties on Trade and Transit in 1978 have to a large extent eased the mutual tensions. GOI understanding the need to develop the Nepalese economy, now must, simplify transit procedures and should provide adequate warehousing facilities and railway wagons.

Preferential Treatment

Recently through a notification the HMG ended the preferential treatment accorded to imports of certain commodities from India. "As a result Nepal has reduced the general and most favoured nation rates of import duty on some items from third countries, thereby bringing them at par with the rates of duty applicable to imports of these items from India."[114]

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113 Patriot (Delhi), 13 December 1977.

114 Joshi, N.C., "Trade Problem with Nepal", Eastern Economist, 11 December 1981.

While this act has caused a surprise, it is also in violation of the terms and spirits of the Indo-Nepalese treaty which enjoins upon both the countries preferential treatment in the import of each other's goods of certain categories as against similar imports from third countries.

Kathmandu while refuting this well founded allegation argues that India is still favoured to the extent of thirty per cent because other sellers have to pay sales tax and much higher freight.

Nepalese government can still make the Indian goods competitive through the process of subsidy. Even then the scope to do so is visibly limited as the gap between cost of production of Indian goods and those of advanced countries is so wide that it cannot be wiped out so easily. This explains the disadvantageous position of Indian goods in comparison to goods from advanced countries in the Nepalese market.

Deflection of Trade and Smuggling

These two factors have been major irritants in the Indo-Nepalese trade relation. The first factor has been widely discussed in the preceding chapter. The second gets some light under this title.

Smuggling is a world-wide phenomenon. But smuggling across the Indo-Nepalese border has assumed serious proportions in the recent years, causing anxiety to the Indian government. It is to a large extent facilitated by open border and free exchange of citizens of two countries. This long border of 800 km. is manned by only twentyone check posts.[115]

It is obvious that the smugglers do not use the officially designated transit points. They operate through the local inhabitants of the border region for the safe passage of contrabands.[116]

Large scale smuggling across the Nepal border has upset India's export and import trade. The smuggling which may at present be Rs 40 crores annually has an adverse impact on India. This is mainly attributed to recent issue of permits by the HMG of high value import and export licences which far exceeds Nepal's requirements.[117]

On the import side, the goods smuggled are mainly electronic items like calculator and tape recorders which attract heavy import duty. In the presence of limited purchasing power in Nepal, the neighbouring Indian markets easily become susceptible to such cheap goods. This gradually flourishes into a lucrative business.[118] Other products include synthetic textiles and zip fasteners and narcotic drugs like ganja for which there is no restriction on cultivation and sale in Nepal.

The Nepalese government would maintain that "even if we only buy ten per cent of our requirements, some of it will

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115 Indian Express (Delhi), 7 August 1980.

116 Patra, Saral, "India-Nepal Relations", Mainstream, 17 December 1977.

117 Economic Times (Delhi), 7 August 1980.

118 Rawat, Ch.II, n.9, p.236.

be smuggled into India because of the demand and supply position in your country (India)."[119]

On the question of smuggling of Indian products, into Nepal, mention may be made of snake skins whose exports are banned in India and hides and skins.

On the one hand the Indo-Nepalese talks to prevent and stop the massive smuggling are frequently held, on the other hand, border areas like Darjeeling, Dhulabari, Gorakhpur, Bhagalpur, Darbhanga are seen flooded with the smuggled items.

In Darjeeling because of its close proximity with Pashupati in Nepalese border the smuggled items are freely bought and sold. Policemen, vigilance and customs while claiming to have reduced the magnitude of smuggling, do not lay much stress on the ransacking of real sub-economy created by this trade. In Siliguri, because of adjacent Dhulabari, a famous 'Hongkong market' has been firmly established. It is like any other expensive markets in India. The only difference being that this market is flooded with smuggled items. One would certainly be surprised by 'how openly they do this business' scene in that area. It seems that there is no department such as vigilance, customs and police in that area. Even if the raid is conducted, the market never loses its foreign appearance. This type of complex invariably becomes the safe shelter of anti-social elements, also.

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119 Dattaray, Sunanda K., The Statesman (Delhi), 6 April 1982.

The Chinese policy of financing their projects in Nepal by the sale proceeds of their goods in Nepal have essentially made the Chinese goods cheaper and attractive. These goods besides outmarketing Indian products have in a massive way entered into India.

The Kathmandu talks held on 29 July 1980, between India and Nepal on cooperation to check unauthorised trade reportedly broke off abruptly on the question of Nepal issuing import licences for quantities much beyond its requirements. The Nepali side declared this issue to be beyond the purview of the talks. This ruling was not accepted by the Indian government.

HMG did not want to be stern enough in dealing with such activities as her interest is not confiscated by this business. In other words, Nepal has less to lose and much to gain from this lucrative business. But, it should realise that this is happening at the cost of long term industrial development of Nepal and India.

However, the two countries have agreed upon a number of measures to check smuggling. Both countries have set up 'contact points' to check unauthorised trade. An agreement has been reached on increasing and strengthening survelliance across the common border.[120]

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120 Rising Nepal (Kathmandu), 5 August 1980.

This will always remain as a serious problem, unless and until there is some major revision in the open border system, something both governments would prefer to avoid.[121]

Excise Duties Refund

Nepal is in advantageous position because of the agreement with India that Nepalese excise duties on Nepalese products exported to India are not refunded to India, while the latter refunds excise duties to the former on the goods exported under AR-1 forms.

Goods are imported into Nepal through AR-1 forms and free channels. Under AR-1 system of importation duties are leviable at the Nepalese customs on the goods imported into Nepal since excise duties are levied by the GOI. Such excise duties are refunded to Nepal as per 1954 agreement. Under the free channel system importers have to pay all kinds of existing duties to the Indian Government in addition to duties at the Nepalese customs.[122]

In a study made by Nepal Rashtra Bank in 1975, it was found that imports under AR-1 system in 1975 amounted to Rs 3.59 crores while under the free channel system it came to Rs 3.87 crores. Under the latter systems, the imports of primary commodities as percentage of manufactures come to Rs 56.2 per cent. While under the AR-1 system the percentage is 13.2 per cent. Thus, it shows that there is

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121 Rose, Leo E., Nepal : Strategy for Survival (Oxford University Press, Delhi, 1971), p.255.

122 Banskota, Ch.II, n.12, p.79.

a tendency for speculation under the free channel system to import primary commodities, while AR-1 has been used for the import of manufactures. Thus excise duty is a main source of revenue for Nepal.

Lately, Nepal is expressing its deep concern over the increasing trend towards the import under free channel system and have aptly emphasised, on the line that excise duty from free channel system should also be refunded to Nepal.[123]

However, because of the existing trade pattern between the two countries, Indian goods generally become more expensive to the consumers in Nepal. This is so expensive that it exceeds the prices of goods directly bought from India by a Nepali consumer after paying all the duties. This question is quite often raised by the Nepalese circle itself. This is simply because of the excise duty levied by India but refunded to Nepal after the goods enter Nepal. The excise duty goes into the Nepalese government's coffers and the refund has no impact on prices. This prevents the prices of Indian goods to be lowered as a result of excise duty refund. So, the whole purpose of providing goods at cheaper rates by way of refunding excise duties by India gets defeated because of HMG's policy of handling the excise duty which deprives the consumers from the spread effect of this refund.[124]

On the other hand, this way of collecting revenues by the HMG has rendered the Indian goods incompetitive in the Nepalese markets.

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123 Ibid., p.85.

124 The Statesman (Delhi), 12 September 1982.

CHAPTER IV

INDIA'S AID TO NEPAL

I. Economics of Foreign Aid

'Foreign economic aid' or 'external economic assistance' is the transfer of capital and know-how from one country to another which is made on concessional terms, that is, on terms more favourable than those obtained currently in world capital and labour market.[1]

Foreign aid consists of long term loans repayable in foreign currency, grants which do not have any repayable liability, sale of surplus products for local currency payments and technical assistance,[2] to widen the recipient country's capacity constraints in the field of management and administrative skills.[3]

Aid increases the amount of resources devoted to capital formation over and above what economy can provide. In this role it supplements domestic saving and hence fills the "savings gap". On the other hand, it also increases the economy's ability to import the goods it wants. In this role it provides foreign exchange and helps the balance of payments.

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1 Sharma, R.K., Foreign Aid to India : An Economic Study (Marwah, Delhi, 1977), p.1.

2 Rosenstein Rodan, P.N., "International Aid for Underdeveloped Countries" in Bhagwati and Eckaus, eds., Foreign Aid (Penguine, 1970), pp.86-87.

3 Radetzki, Marian, Aid and Development (Praeger, New York, 1973), p.80.

In other words, it helps fill the 'foreign exchange gap'.[4]

Foreign capital by itself cannot be expected to raise the standard of living in the underdeveloped countries. But it can certainly help an underdeveloped country to reach the 'critical minimum effort' and turn the vicious circle of poverty into a virtuous process of growth. When a new capacity is set up with the help of foreign aid it opens up the possibility of setting up of some more activities via 'linkage effects' and 'spread effects' and via the breaking external economies.[5]

The increase in income, savings and investment which aid directly and indirectly makes possible, will shorten the time a country takes to achieve self-sustaining growth. Aid should continue until it can mobilize a level of capital formation sufficient for self-sustaining growth.[6]

Ideally, aid should be allocated where it will have the maximum catalystic effect of mobilizing additional national effort or preventing a fall in national effort. The primary criterion is thus to maximize additional effort.[7]

Aid diplomacy has always been considered as prop to the foreign policy of states and has emerged as a very important

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4 Joshi, Vijay, "Two Gap Analysis" in Meir, ed., Ch.III, n.85, pp.336-337.

5 Chatterjee, P.K., Foreign Capital and Economic Development (Progressive; Calcutta, 1971), p.56.

6 Rosenstein Rodan, n.2, p.81.

7 Ibid., p.82.

phenomenon since the Second World War. It has been practised extensively by super powers and lesser powers in various forms depending on the material resource base of a state and its level of economic development.[8]

A scholar is of the view that aid has never been an unconditional transfer of financial resources and usually the conditions attached to aid are clearly and directly intended to serve the interests of the governments providing it.[9]

II. Indian Aid to Nepal : Aims and Objectives

India's aid program is one of the facets of her foreign policy which is aimed to promote peace and stability in the world. The evolution of a new world order in which various countries would be free to shape their destiny without interference from outside and in accordance with their own national aspirations and interests is the prime factor incorporated in such program.[10]

In real terms there appears a paradox in India's aid to Nepal. On the one hand, India is the largest aid recipient in the comity of underdeveloped economies and on the other hand, she has been extending economic aid to Nepal for the last three and a half decades. This looks more paradoxical if we stick to the popular notion of aid immediately after the Second World War in which case only the developed countries extended assistance to lowly developed countries.

8 Vohra, Dewan C., India's Aid Diplomacy in the Third World (Vikas, Delhi, 1980), p.1.

9 Teressa, Hayter, Aid as Imperialism, (London, 1971),p.4

10 Vohra, n.8, p.70.

Further, it is unique in the sense that both of them are underdeveloped in their nature. If India suffered from continuous colonial onslaughts, in Nepal the feudal-cum-aristocratic elite did not permit the benefits of economic development to percolate down to the people.[11]

The decision to extend technical and economic assistance to Nepal immediately after independence was not born out of a new diplomatic process but was simply the extension of British policy to maintain special relation with the Himalayan states.

India basically had three aims, viz, to increase the link between India and Nepal for preservation of the national security interest of India, to promote economic progress of Nepal and to encourage political stability in Nepal.[12]

This development assistance inevitably was part of India's foreign policy. The actual administration of such a programme neither could be nor should be entirely separated from current diplomacy.[13] Strategic and political considerations have significant influence on the direction and contents of India's aid, besides commercial interests play a major role.

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11 Ramakant, "Foreign Aid, Economic Growth and Political Development in Nepal", India Quarterly, July-September 1973, p.256.

12 Phibbs, M. Philip, "India's Economic Aid Programs", Current History, April 1968, p.91.

13 Ohlin, G., "Evolution of Aid Doctrine" in Bhagwati and Eckaus, eds., Foreign Aid (Penguin, 1970).

Strategic Factor

With the occupation of Tibet by China, Tibet no more remained a natural buffer between India and China. Nepal thus emerged as the last and very important buffer between these two giants.[14] Further China's potential activity much concerned India. So Nepal is of immense strategic importance to India. "Where the question of India's security is concerned we consider the Himalayan mountains as our border."[15]

Aid became a new diplomatic instrument which India has been using to deal with the changed nature of her traditional security problem in the Himalayas.[16] Jawaharlal Nehru was determined to strike a balance between Indian national interest and the liberal ideas of aid.[17]

Economic Progress

Nepal is among the poorest of the third world countries. It lacks basic economic and social infrastructure. Like most underdeveloped countries, Nepal appeared in the international economic scene only in the post-war years. Geography has played an important role in moulding her economy and most notably her foreign economic policy. Her poverty stricken economy cannot generate adequate resources required for sustained economic growth.[18]

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14 Dharamdasani, M.D., "India's Economic Aid to Nepal", South Asian Studies, January 1973, p.29.

15 India, Lok Sabha Debates, 1952, Part 2, vol.II, no.3, col.1969.

16 Phibbs, n.12, p.243.

17 Mihaly, E.B., Foreign Aid and Politics in Nepal (OUP; London, 1965), p.43.

18 Rawat, Ch.II, n.9, p.159.

India readily extended its support in Nepal's venture of planned economic development. India's policies in Nepal were Nehru's dream to make her economically strong and progressive since he always advocated economically strong democracy. India's massive experience in planned development has been considered specially appropriate and useful because the type of technology developed in India are neither very sophisticated nor very capital-intensive. This is more suited to the present stage of development in Nepal.[19]

India also has vital economic interest in Nepal. A large part of the eastern river system of India has its origin in Nepal. India would certainly gain if it could tap this concentrated power potential.[20] Nehru during his visit to Kathmandu in June 1951, said, "If you seek our help in any technical or other sphere, we will do our utmost to be useful to you."[21]

To realize mutual help and cooperation through sharing of experience, expertize and technology for collective self-reliance within the third world, India has been playing a major role.[22]

Political Stability

This was intimately connected to the aid program of India. In Nepal, India repeatedly urged democratic reforms in 1949 and 1950. India played a vital role in ending the

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19 Ibid., pp.167-69.

20 Dharamdasani, Ch.II, n.4, p.17.

21 The Statesman (Calcutta), 17 June 1951.

22 Vohra, n.8, p.9.

agelong autocratic Rana regime and setting up the first democratically elected government of B.P. Koirala in 1959. When King Mahendra assumed personal control of the government in 1960, New Delhi openly indicated its disapproval.[23] Nehru called it 'a setback in democracy'.

India initially looked for a change in status quo in Nepal because she believed that only under democratic rule with people's innermost strivings the national progress can be assured and protected,[24] and international peace and equality can be ensured. India believed that a democratic Nepal would always be in rapport with it and would remain within its sphere of influence. It worked upon a democratic Nepal as a significant component of its security system in terms of its defence preparedness vis-a-vis China.[25]

However, at present the Nepalese partyless Panchayat system apparently suits India. So greater Indian aid and investment would mean higher India's stake in the status quo in Nepal.[26] This has been able to maintain the political stability in Nepal.

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23 Phibbs, n.12, p.235.

24 Rawat, Ch.II, n.9, p.167.

25 Baral, L.S., "India and Nepal" in Bimal Prasad, ed., India's Foreign Policy, (Vikas, Delhi, 1979), p.200.

26 Ibid., pp.198-200.

III. Indian Aid to Nepal : A Historical Survey

Nepal began receiving foreign aid shortly after it broke the shackles of the Rana regime nearly three and a half decades ago. Soon after entering into democratic and modern era, the vital problem was to transfer her monolithic agro-based economy into modern concept of economic development. This made her imperative to strengthen her relation with her strong neighbour India.

On the other hand, immediately after independence India regarded Nepal as her most trusted ally and always stood by her side in any event of distress. Nehru firmly said, "We have desired not only to continue our old friendship with Nepal but to put it on a still firmer footing."[27]

India firmly believed that her own economic progress would be incomplete without the economic growth of her neighbour. She formally became involved with a conclusion of a Peace and Friendship Treaty on 31 July 1950, which envisaged that 'there shall be everlasting peace and friendship between the Government of India and the Government of Nepal.'[28]

The construction of Tribhuvan Rajpath (1956) and Gauchar Airport (1954) were the first two projects successfully undertaken by India. These two projects were just the beginning of strong Indo-Nepalese economic cooperation. To monitor and expedite the Indian aided projects, the Indian

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27 Jawaharlal Nehru's Speeches, 1949-53.

28 Foreign Policy of India, Text of Documents, 1947-1959, Lok Sabha Secretariat, p.31.

Aid Mission (IAM) was established in 1954 in Kathmandu, which was renamed as Indian Cooperation Mission (ICM) in 1966.

IV. Transport and Communications:

More than fifty per cent of India's assistance to Nepal has been allocated for the development of transport and communications. Among the factors attributed to the slow level of overall development in Nepal, transport and communication still occupy the place of prominence. In this perspective, it is essential to have a close look on the headway made by the Indo-Nepalese economic cooperation in this field.

The very topography of Nepal forced India to give maximum stress on infrastructure. Because of rugged and mountainous terrain, Nepal remained a fragmented economy with embryonic internal transportation system. Roads which are vital for the integration of the country were virtually non-existent before 1950. This massive road construction will facilitate the development of internal trade and commerce, and bring about administrative cohesion and social homogeneity.[29]

The Nepalese ruling class also encouraged the building of roads largely for reasons of internal security so that at worst government troops could be transported swiftly to trouble spots within Nepal.[30]

Tribhuvan Rajpath

The willingness to have a comfortable mechanical link in between Kathmandu and Raxaul (border town in Bihar) goes

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29 Shastri, Ch.II, n.124, p.249.

30 Blaikie, et. al., Ch.II, n.102, p.69.

back to 1924. Since then it took almost 42 years to have a direct link right from Raxaul to Kathmandu.[31]

This was the first National Highway of Nepal completed in December 1956 with Indian assistance of Rs 5.65 crores. This 73 mile-long highway linking Thankot (near Kathmandu) and Bhainse, is a veritable life-line in Nepal's economy. It was handed over to HMG in August 1965.[32]

This Rajpath had farflung effects on the Nepalese economy. The first and foremost immediate impact was reduction of transport cost in case of freight and increased comfort in case of passengers travel. This made the imported commodities cheaper in Kathmandu valley. This decreased the importance of old railway.[33]

This highway passes through Birgung, Simra, Amlekhganj, Hetauda, Bhainse, Dhorsing and Bhimfedi.

The Nepalese government benefited with different categories of revenue. Foreign currency earning increased tremendously. The prospect of foreign trade grew up. This provided opportunity to establish industries like Birganj Sugar Factory 1965, Hetauda Saw Mill 1955, Modern Flour Mill, Hetauda 1973, Nepal Brewery, Hetauda 1972 and Janakpur Cigarette Factory 1965.[34] Agriculture has also been deeply

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31 Shrestha, R.L., Impact of Kathmandu-Raxaul Highway on Nepalese Economy, 1956-1975, (Kathmandu, 1980), p.193.

32 DAVP, Cooperation for Progress in Nepal, Ministry of Information and Broadcasting, Government of India, 1966.

33 Shrestha, n.31, p.193.

34 Ibid., p.194.

affected by this Rajmarg. About 89.6 per cent of chemical fertilizers, 59.1 per cent of improved seeds, 68.40 per cent of improved tools and 83 per cent of insecticides were used during the Third Five Year Plan in the Central Development Region which has close proximity with this road.[35]

Shrestha's study revealed that road is in satisfactory condition from the geometrics and maintenance point of view and suggested that an alternate road is not a must for at least the next two decades.[36]

Sidhartha Rajmarg:

This Rajmarg popularly known as Sonauli-Pokhra highway was started in 1964. This starts at Indian border and ends at Pokhra. This 200 km. highway was completed in 1971 at an estimated cost of Rs 20 crores. This has 34 major bridges. The highway was opened for commercial traffic in 1968 and was maintained by the GOI until June 1972 at a cost of Rs 10.3 million. The single span steel bridge over the Kali Gandaki at Ramdighat is the largest bridge of its kind in Nepal.[37]

The opening of this Rajmarg immediately replaced mules. Besides this road construction has brought about a dramatic reduction in the cost of transport in the region as a whole but particularly along certain routes like Tansen, Walling, Syangja and Naudanda on this Rajmarg.[38]

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35 Ibid., p.129.

36 Ibid., p.(i).

37 Gorkhapatra (Kathmandu), 11 April 1970 and 7 May 1972.

38 Blaikie, et. al., Ch.II, n.102, pp.167-171.

Other benefits are of long-run nature. This highway has certainly affected the traditional pattern of farming in Pokhra, as these 'arteries' have facilitated the inflow and outflow of new inputs and outputs on a more economical and profitable way. This would lead to redistribution of income in the valley and expansion of commerce in the hills.

Another major impact has been on the Nepalese tourist industry. This valley is naturally beautiful and attracts maximum number of tourists.. The forward and backward linkages created by this potential industry are ought to vitalize the economy.

A study on the general economic impact of this highway revealed that the road has generated increasing amounts of commercial freight at a much cheaper cost. Haulage charges gradually came down from Rs 250 to Rs 120 per metric ton during 1968-1970. The prices of all imported commodities have fallen. Revenues of the Nagar and District Panchayats all along the road have gone up significantly. Prices of exportable items have gone up. For instance the price of ghee, a major export of Nepal, went up nearly 25 per cent while the price of oranges went up ~~to~~ by 400 to 500 per cent. This reflects the increasing demand of Nepalese exportable items.[39]

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39 Goil, R.M., A Study of the General Economic Impact of Sidhartha Rajmarg, (Kathmandu: ICM, 1971), pp.16-60.

Mahendra Rajmarg (East-West Highway)

The geography of Nepal had forced her people to pass through India while going from one corner to another of Nepal. This was proving too expensive. In order to minimise this hardship, this road was conceived and built.

It may be noted that at the initial stage India hesitated to take up this ambitious project. Subsequently China expressed its intense interest to construct 100 miles of the highway in the eastern sector. The very idea of the Chinese experts working so close to India's open border made India to revise its attitude. As a result, Nepal persuaded China to withdraw its offer. This was indeed an outstanding achievement of the Indian diplomacy.[40]

India agreed to construct a total of 410 miles out of 640 miles of the highway. Remaining distance in the West were to be completed by the UK, the USSR and the US. This highway has been divided into three sectors Eastern, Central and Western.

The work on Eastern sector was taken up in April 1967. It consisted of 300 kms. starting from Mechi to Janakpurdham.[41] The east west highway linking Mechi in the east with Mahakali in the west is expected to be completed in 1988.

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40 Narayan Sriman, <u>India and Nepal : An Exercise in Open Diplomacy</u> (Popular, Bombay), pp.123-124.

41 <u>Link</u> (Delhi), 2 January 1977.

This highway passes through important centres in the eastern Nepal such as Dhulabari, Damak, Bebasi, Itahari, Kosi barrage, Lohan, Janakpurdham and Jaleshwar. Constructed under Asian Highway Standard this road consists of 44 major bridges including Bagmati and Kamala, 85 minor bridges and 900 culverts.[42]

Butwal-Nepalganj section (central sector) of the highway for which an agreement was signed on 15 June 1972 between HMG and GOI is expected to be completed in 1985-86. India is building this road at an estimated cost of Rs 100 crores. Two portions of the sector, a 79 km. stretch between Butwal and Shivapur and a 35 km. section between Kheri Khola and Kohohalapur have already been completed and handed over to the HMG.[43] This central sector will pass through Pipra, Shivpur, Bhalubang, Lalmati, Jankundi and Shamsherganj.

A study on socio-economic impact of this highway has found out that this highway has made the social mobility faster. It has lowered the cost of transportation. The extent in reduction of transport cost is explained by the fact that a bag of grain from Dhulahari to Ayabari costs only 75 paise which used to cost Rs 5 before this roadway was built. The study revealed that this Rajmarg has levelled up the prices of main agricultural products throughout the entire region and cultivators get a better and fair

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42 Shastri, Ch.II, n.124, pp.255-60.

43 Nepal News (Nepalese Embassy, New Delhi), 29 November 1983.

price for their produce.[44] This will, to a large extent, facilitate the movement of grains from surplus (terai) areas to deficit (hills) areas which has been a chronic disease in the Nepalese economy.

In itself, the Rajmarg is of utmost importance as it would, on completion, form part of the Asian Highway network A-2 linking Manila and Istanbul through this landlocked kingdom.[45]

Kathmandu-Trisuli Road

This was constructed mainly to facilitate the building and completion of Trisuli Hydel Project. Until the jeepable road was completed by 1962, it was not possible to transport heavy machines, large quantities of material like cement, steel and timber to project site from the nearest available centre. The nearest railway head is 180 miles away at Raxaul from where these materials were brought into Trisuli.[46]

Road Transport Organisation (RTO):

The Tripartite Agreement under RTO among Nepal, India and the USA was concluded in January 1958. The ostensible purpose of the RTO was to facilitate the rapid survey and construction of key roads of 1173 km. in Nepal.[47]

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44 Singh, S.K., Socio-Economic Impact of Mahendra Rajmarg-Eastern Sector (ICM, Kathmandu, 1974), pp.17-33.

45 The Hindu (Madras), 8 March 1976.

46 Shastri, Ch.II, n.124, p.260.

47 DAVP, n.32, pp.9-10.

But it was dismantled in 1961 after completing only 320 km. of motorable roads on the plea of the irreconcilia-bility of the approaches of the three parties to the problem of road building in Nepal. The real reason for its abolition, however, was that the goals and policies of the three parties vis-a-vis Nepal's development and external relations were no longer compatible after King Mahendra's takeover of the government on 15 December 1960.[48]

Other Roads

Besides the above major road projects, the GOI have cooperated with HMG in the construction of smaller roads like Kakrawa-Lumbini Road (8 km.), Balaji Road (3 km.), Tripureshwar-Thankot Road (9 km.), Janakpur Town Road (4 km.), Dakshinakali Road (19 km.), Hanuman Nagar Rajbiraj Road (13.5 km.), Kosi Gandak area roads, Kathmandu Godavari roads (16 km.).[49]

Civil Aviation:

The first communication project which still continues to be of utmost importance to Nepal's economic development was the construction of the Gauchar Airport in 1954. This was developed into a permanent all weather airport, equipped with a metalled runaway, terminal buildings and ancillary facilities. The cost incurred has been about Rs 70 lakhs.[50]

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48 Mishra, B., "Foreign Aid Politics in Nepal", Commerce, 20 June 1981.

49 Link, n.41, and Economic Times (Delhi), 29 December 1983.

50 DAVP, n.32, p.13.

In the 1960s GOI helped in the development of five more airports at important commercial and tourist centres, viz. Biratnagar (Rs 29 lakhs), Janakpur (27.4 lakhs), Simra (5.5 lakhs), Bhairawa (21.58 lakhs) and Pokhra (1.6 lakhs).[51]

In July 1972, a new agreement was signed between India and Nepal in New Delhi, which permitted the Royal Nepal Airlines Corporation (RNAC) to operate international air flights via Calcutta and New Delhi. India was permitted to operate similar services via Kathmandu.[52]

V. Posts and Telecommunications

In 1951, the modern communication system was virtually non-existent in Nepal. People, in general, lived in isolated pockets. A move to improve communications in Nepal by India was widely welcomed in Nepal.

In 1956, Nepal became a member of the Universal Postal Union. Besides helping Nepal in setting up a General Post Office at a cost of Rs 12 lakhs, a Foreign Post Office in 1968 and in the reorganisation of her postal services, the GOI have been extending her cooperation to HMG in the development of telecommunications as well.[53]

In 1950 and 1964 a radio telephone link was provided between Kathmandu and Delhi and Kathmandu and Calcutta, respectively. In 1968, a teleprinter link between Kathmandu

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51 Link, n.41.

52 Gorkhapatra (Kathmandu), 27 July 1972.

53 DAVP, India-Nepal Cooperation 1952-1972, Government of India, New Delhi, p.11.

and Calcutta was also set up. To link Biratnagar, the industrial and commercial chart of Nepal, with Calcutta an overhead trunk telephone line has been laid between Biratnagar and Jogbani. This has put Biratnagar in direct contact with Calcutta through Forbesganj across the border.[54]

A list of recent Indian aided agreed and completed projects on transport and communication in Nepal is given below:

(1) February 1972, inauguration of Kathmandu-Bombay direct radio telephone, telegraph and telex circuit.

(2) 29 December 1974, inauguration of telephone exchange in Bhadrapur at a cost of Rs 0.6 million with a capacity of 250 connections.

(3) 14 February 1975, inauguration of telephone exchange in Janakpurdham, costing Rs 8 lakhs with a capacity of 200 lines.

(4) 22 February 1975, a 16 km. Kathmandu-Godavari road was inaugurated which incurred a cost of Rs 9.5 million.

(5) 25 February 1976, inauguration of a 293 metres long bridge on the Rapti river at Bhaluway at a cost of Rs 96 million.

(6) 11 May 1976, opening up of a 46 km. metalled road from Ranipanwa to Trisuli.

(7) 12 January 1977, inauguration of a 1300 line automatic airconditioned telephone exchange installed in Biratnagar.

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54 Link, n.41.

(8) 7 November 1977, inauguration of Kamala bridge (640 metres long) on the Kamala river on the Mahendra Highway. It cost Rs 40 million.

(9) On 16 September 1978, in a Memorandum of Understanding signed between ~~the~~ Nepal and India, India agreed to construct a railway line to Udaipur at the cost of Rs 20 crores.

(10) In 1983, a co-axial cable link between Birganj in Nepal and Raxaul in India was completed. This has opened 36 communication channels between India and Nepal.[55]

VI. Education

India never overlooked this important aspect of the Nepalese economy while extending aid to Nepal. India gave shape to Nepal's projects in educational fields by building up University, setting up archives and training youths in various fields. India built various hostels, libraries, teacher-quarters, laboratories in Nepal's only Tribhuvan University.

On 2 November 1972, GOI handed over laboratory equipment worth Rs 70,000 to the Zoology, Botany and Chemistry Departments of Tribhuvan University as a gift from the ICM.[56] On 27 December 1972, a hostel constructed for research scholars at the Tribhuvan University costing Rs 6 lakhs was

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55 Various issues of (i) Nepal Press Digest (Kathmandu); (ii) Main Economic Indicators (Nepal Rashtra Bank), and (iii) Ministry of External Affairs, Annual Report, Government of India.

56 Gorkhapatra (Kathmandu), 3 November 1972.

inaugurated.[57]

'India's cooperation in the development of education in Nepal has been unique. Perhaps more than 90 per cent of Nepal's experts in different fields have been trained in India. The schools and colleges of India welcome Nepali students irrespective of their merit and qualification', commented a Nepali paper.[58]

India,while deeply understanding the archaeological values of Nepal and in a bid to preserve these valuable items sent a number of archaeological experts from India. The services of an archaeological advisor were made available in 1959. India set up a National Archives Building in Nepal.

India will provide Nepal Rs 3 crores for the construction of an international archaeological museum at Lumbini, the birth place of Lord Buddha.[59]

VII. Health

To ensure good public health, India's help has been available to Nepal in both preventive and curative fields. Under the scheme of providing drinking water supply to various towns and cities all over Nepal, schemes such as in Birganj (1962), Amelkhganj (1962), Biratnagar (1964), Janakpur and Pokhra (1966), Bhairawa and Bhaktapur have been set up.[60]

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57 Ibid., 28 December 1972.

58 Swatantra Samachar (Kathmandu), 1 January 1973.

59 Times of India (Delhi), 9 February 1984.

60 Link, n.41.

The most important scheme in this field has been Sundari Jal Water Supply Scheme in Kathmandu city. It supplies additional 32 lakh gallons of filtered water a day and was built at a cost of Rs 126.4 lakhs. India aided Rs 19 lakhs Rajbiraj water supply plant was handed over to Nepal on 5 March 1976.[61]

India has played a significant role in the development of Paropkar Shri Panch Indra Rajya Laxmi Devi Maternity Home and Child Welfare Centre in Kathmandu. Indian aided hospitals have been completed at Kailai, Rajbiraj, Dhangadi, Taulihawa, Ilam and Gulmi. First three hospitals consist of 25 beds. India trained a number of medical personnel under the technical cooperation scheme.[62]

On 15 February 1974, an agreement was signed between India and Nepal for Indian assistance of Rs 1.2 million (IR) for the expansion of the above Indra Rajya Home Kathmandu.[63] Construction of an out-patient department wing at the Bir Hospital in Kathmandu has started and the total cost of this project which includes building and equipment, including equipment for an operation theatre is expected to be Rs 6 crores.[64]

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61 <u>Times of India</u> (Delhi), 6 March 1976.

62 <u>Link</u>, n. [redacted] 41.

63 <u>Gorkhapatra</u> (Kathmandu), 16 February 1974.

64 <u>Annual Report, MEA</u>, Ch.III,n.29, 1983-84.

VIII. Forestry, Veterinary and Horticulture

India, in order to preserve forest resources of Nepal, extended knowhow in respect of specific methods of forestry development. On 31 August 1960, India and Nepal signed an agreement to develop forestry in Nepal at a cost of Rs 15 lakhs (IR) which was increased to Rs 32 lakhs in 1961. Under this agreement services of Indian experts were provided for preparing working plans for these forest divisions. The Agreement was renewed in June 1967.[65]

A forest institution with an annual intake of 50 foresters and 25 forest rangers was set up at Hitauda. GOI gave over Rs 34 lakhs for it.

Under the veterinary assistance programme, for the first time, a full-fledged veterinary service consisting of 14 hospitals and 18 dispensaries was set up to meet the needs of the whole country.

In addition, India made available Rs 40 lakhs for the modernization of Central Veterinary Hospital in Kathmandu, establishment of 32 veterinary hospitals and breeding centres in different districts, establishment of a central laboratory for the manufacture of needed vaccines for the prevention of rinder pest among cattles.[66] On 13 June 1970, the Central Veterinary Dispensary in Tripureswar in Kathmandu was inaugurated which cost Rs 2.3 lakhs.[67]

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65 DAVP, n.53, p.21.

66 Ibid, n.32.

67 Gorkhapatra (Kathmandu), 14 June 1970.

India has been rendering assistance to develop facilities in horticulture where there had been very little development hitherto. Though embracing large varieties of terrains and climate propitious for the development of fruit cultivation, Nepal had hitherto little tradition of fruit growing. Under horticulture assistance scheme of Rs 40 lakhs, establishment of research stations at Pokhra, trial orchards at Dhunibesi, Trisuli and Daman, orchards-cum-nurseries and fruit plantation have been undertaken. Fruits and vegetable preservation have already made strides.[68] Fourteen stations, including five research stations have been set up so far.[69]

Recently, a high level Indian delegation has identified areas where fruits like peaches, plums and mangoes and vegetables like potatoes and mushrooms can be grown on a commercial scale to raise production and improve the economic condition of Nepalese farmers. This team favoured an integrated approach to production, storage, marketing and processing.[70]

IX. <u>Aiding Industrialisation in Nepal</u>*

The role of industrial sector in Nepal's economy is not significant. Its contribution to Gross Domestic Product (GDP) of Nepal is only 10 per cent against 66 per cent of agriculture.

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68 DAVP, n.32, p.23.

69 <u>Times of India</u> (Delhi), 18 July 1983.

70 Ibid.

*A more detailed study will be done in the following chapter on "Indian Private Investment in Nepal".

Industries, mostly cottage enterprise, employ hardly 1 per cent of the labour force.[71] India's policy has been to make Nepal economically independent through industrialization. Three industrial estates which have been set up with India's assistance are Patan at the suburbs of Kathmandu valley, Nepalganj and Dharan. These house a large number of traditional and non-traditional industries. Since 1960, these estates have grown into thriving centres. These industries produce goods like cotton and nylon hosiery, dry cell batteries, plastic products, hardwares, electrical goods, woollen carpets, curious and wooden and steel furniture.[72]

Nepal and India have already exchanged letters to expand Patan Industrial Complex at an estimated cost of Rs 17.4 lakhs.[73] A 17 shed industrial estate constructed in Nepalganj at a cost of Rs 5.14 million came into operation from March 1975.[74] The Dharan industrial estate constructed at a cost of Rs 2.8 million was handed over to Nepal on 15 December 1975. The estate accommodated factories producing leather shoes, laundry soap, cotton thread, zorda, tobacco and metal goods.[75]

A Memorandum of Understanding was signed on 16 September 1978 between Nepal and India for further collaboration in the industrial development of Nepal. Under this understanding

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71 Gandhi, U.S., "Nepal and the World", The Illustrated Weekly of India, 4 September 1982.

72 Link, n.41.

73 Economic Times, Special Supplement on Nepal, 29 December 1983.

74 Gorkhapatra (Kathmandu), 8 March, 1975.

75 Ibid., 16 December 1975.

Rs 180 crores is to be invested jointly in various industrial projects in Nepal. This includes a Rs 80 crores cement plant at Udaipur in Nepal and a Rs 60 crores paper plant in far western Nepal.[76] A clinker plant in Lakshmipur in Nepal will produce 3,000 tonnes of clinker with 50 per cent of it to be converted into cement for domestic consumption and the balance to be exported to India for grinding at Samastipur in Bihar.[77]

Feasibility studies for the industrial estate of Rajbiraj and the expansion of the Butwal industrial estate have been completed and construction work would start in 1985.[78]

X. Exploitation of Water Resources

The water resources that flow from Nepal to India not only symbolize a common heritage but actually represent the reality of vast untapped opportunities of common advantage. The main aim of this cooperation is to get on with joint projects to tame and harness the turbulent Himalayan rivers for flood control, irrigational purposes and the construction of hydroelectric projects. Nepal is favoured with many snowfed large rivers with considerable catchment area and noticeable rapids, which by virtue of its flowing through many gorges and

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76 The Statesman (Delhi), 27 September 1978.

77 Times of India (Delhi), 25 September 1982.

78 Annual Report, MEA, Ch.III, n.29, 1983-84.

valleys, offer a tremendous potentiality of development of hydro-electric power.[79]

There are an estimated 6,000 rivers and streams in Nepal and the total length of these rivers and streams exceeds 45,000 kms. The hydro-power potential of the country as estimated by HMG is 83,400 MW. As against this, the present demand for power both industrial and domestic on the basis of existing distribution lines in Nepal is placed around 300 MW. On the other hand, the power generated in the Kingdom, presently, is hardly 87 MW which is likely to rise to 281 MW by 1987.[80]

With the present installed capacity, the per capita availability in Nepal is below 24 units per year against about 175 units per year in India.[81]

Among the different major projects undertaken by the joint efforts of the two countries, the Kosi Project and the Gandak Project in the field of multipurpose river valley projects and Trisuli, Pokhra, Devighat projects in the field of hydroelectricity are worth mentioning. The projects like Karnali, Pancheswar and Rapti are yet to start.

The Kosi Project

The Kosi rises in Tibet at an altitude of 18,000 feet and flows through Nepal and Bihar before it touches the Ganga near Kursela. The people of Kosi belt (both Indians and Nepalese) invariably suffered from the flood created by this

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79 Thapa, M.B., "Prospects of Hydro Power in Nepal", Industrial Digest (NIDC, Nepal), 1968, p.51.

80IIFT, Ch.III, n.47, p.94.

81. The Hindu (Madras), 14 February 1981.

river. The devastating flood of 1953 made the harnessing of this river more urgent. As a result an agreement between India and Nepal was signed for a multipurpose project on Kosi river. This included flood protection, irrigation and power. The real problem of this river is its constantly shifting habit. So, to confine the river to a set course, two lines of embankments, each of 75 miles long was taken up in 1955 and completed in 1969.[82]

The barrage with a length of 3,770 feet and with 56 gates is located near Bhimnagar. Its main purpose is to divert the water to feed the eastern and western canal system. This was completed in April 1965.

The eastern canal system would provide irrigation to 14.04 lakh acres of land in Purnea and Saharsa districts and the western canal system envisaged irrigation of 7.73 lakh acres of land in Darbhanga and Monghyr in Bihar and 70,000 acres in the Saptari district of Nepal.[83]

There was constant difference between Nepal and India on the question of paying compensation for lands acquired in Nepali territory for the construction of western canal. However, it was resolved in November 1973 when India agreed to give compensation at the rate of Rs 10,000 per bigha of unirrigated lands and Rs 12,000 per bigha for irrigated lands. Two hundred and eighty hectares of land have been acquired for the said canal for which India will have to pay compensation of

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82 Rawat, Ch.II, n.9, pp.206-07.

83 Ibid., p.207.

Rs 4.5 million. This is 40 per cent more than the estimated amount. The cost of canal has gone up from 1961 estimate of Rs 135 million to Rs 416.2 million. The canal will be 107 miles long.[84]

India sanctioned Rs 2.12 crores for the rehabilitation scheme of the people displaced by this project. A power house, with an installed capacity of 18,000 KW has been started in the main eastern canal. As much as fifty per cent of the generated power has been earmarked for use in Nepal.[85]

The Gandak Project

The Gandak multipurpose project had been planned to build on snowfed perennial river known as 'Sapta Gandaki' in Nepal and 'Narayani' or 'Gandaki' in India. This river enters into the plains at a place called Tribeni near Indo-Nepalese border in Champaran, Bihar. It is a densely populated valley and one of the most fertile agricultural tract of Nepal and North Bihar.[86]

An agreement signed on 4 December 1959 envisaged: (1) construction of a barrage across the river near Balmiki-nagar (Bhaiselotan), (2) excavation of the main western canal system, (3) main eastern canal system, and (4) construction of a power house in Nepal. The barrage located about 2500 ft. below the existing Tribeni Canal head regulator has a total length of 2,425 feet about half of which is in the Indian territory and the other half in Nepal.[87]

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84 The Chetana Weekly (Dharan), 18 November 1973.

85 DAVP, n.32, p.49.

86 Rawat, Ch.II, n.9, pp.212-13.

87 Ibid., p.213.

The Western Canal system has been designed to irrigate 11.35 lakh acres of land in the Saran district of Bihar and about 8.03 lakh acres in U.P. It has a main canal of 120 miles out of which 11½ miles will fall in Nepal and 68 miles in the Gorakhpur and Deoria in U.P. and the rest in Saran, Bihar.[88]

In May 1974, it was agreed to start the above canal in October 1974. This section will be located in Nawal-Parasi district and will make available irrigation facilities for 40,000 acres of land. The second section irrigating 66,000 acres will be located in Rupandehi district.[89]

The main eastern canal system which was to irrigate 14.12 lākh acres in the Champaran, Muzaffarpur and Darbhanga in Bihar has a total length of 155 miles. However, the construction had been delayed because of difficulties in land acquisition, shortage of construction materials and changes in the alignments, which had increased the irrigable area from 103 thousand acres to 116 thousand acres in Nepal.[90]

As per the project a hydel power house at Surajpura with an installed capacity of 15 MW has been constructed on the eighth mile of the main western canal which borders the township of Valmikinagar in Nepalese territory.[91] This power house commissioned in June 1979, was handed over to Nepal in

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88 Ibid., p.214.

89 <u>Gorkhapatra</u> (Kathmandu), 23 May 1974.

90 <u>Matribhumi</u> Weekly (Kathmandu), 24 October 1972.

91 <u>Nepal Times</u> (Kathmandu), 27 April 1970.

August 1981. This has been built by the Bihar Government on behalf of the GOI for the extensive benefit of Nepal at a cost of Rs 10 crores. It has already supplied 42.5 million units of electric power to Nepal and would irrigate 60,000 acres of land in Nepal.[92]

The Chatra Canal

A major irrigation project in Eastern Nepal - the Chatra Canal Project for which an agreement was signed on 1 November 1964 has also been implemented. This project is designed to irrigate 2.12 lakh acres of land in Sunsari and Morang districts in Nepal. It has been executed through the River Valley Project Department of Bihar. The construction of the main canal, a branch canal and the head regulator of the project was completed in 1975 at a cost of Rs 125 million.[93]

The Trisuli Hydel Project

Based on the Indo-Nepalese agreement of 20 November 1958, the Trisuli Hydel project was completed on 17 November 1971. It consists of a diversion dam power channel, balancing reservoir and a power house. This project cost Rs 12.17 crores. The power is being transmitted to Kathmandu Valley through 18 miles long high tension transmission lines. It has an installed capacity of 21,000 KW.[94]

The Pokhra Project

Pokhra, economically a very potential area, remained undeveloped and neglected for many years. The hydel station at Pokhra was commissioned on 1 November 1967. This has

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92 Hindustan Times (Delhi), 1 September 1981.

93 The Statesman (Delhi), 9 February 1981.

94 Gorkhapatra (Kathmandu), 18 November 1971.

ensured the supply of electricity to small industries in the Pokhra Valley where oil and coal were very costly.[95]

The Devighat Project

This project was a firm commitment of the GOI. But this could not make any headway for quite a few years. Among various reasons attributed to it, the most noteworthy is the misunderstanding created by Sikkim issue. When Sikkim was merged into India, there was an adverse reaction in Nepal, as a result of which GOI became very sore and this project remained unattended.

However, very soon the confusion could be wiped out as a result of which the formal signing was done in June 1978 and the project was formally launched on 3 February 1981.[96] This was constructed by National Hydro-Electric Power Corporation (NHPC) under India's technical and economic programme. It was completed in a record time of less than four years, a year ahead of schedule. It was formally inaugurated by King Birendra on 8 March 1984.[97]

Located at about 70 km. northwest of Kathmandu, the Rs 50 crores project with an annual generating capacity of 85 million units of power has enabled Kathmandu to become self-sufficient in power. This 14.1 MW project utilizes the tail race waters of the existing Trisuli power station. This has three units of 4.7 MW each. The power generation from the

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95 Shastri, Ch.II, n.124, p.262.

96 Hindustan Times (Delhi), 10 February 1981.

97 Times of India (Delhi), 10 March 1984.

station is evacuated through a 40 km. long double circuit transmission line to Chabal in the Kathmandu Valley.[98]

New Proposals:

Nepal and India agreed upon joint execution of three major multipurpose river valley projects to harness the water resources for irrigation and power generation for the benefit of both countries. This decision was a major breakthrough. Proposals on the three projects, the Pancheswar, the Rapti and the Karnali were hanging fire for a long time. Now, they all have been given a green signal.[99]

The Pancheswar Project

This project on the Mahakali river which marks the border of western Nepal with India, has not been started as yet. In March 1976, both the governments decided to set up a joint committee of experts for the investigation of this project.[100]

As regards this, India's stand is that since the Mahakali is a border river, the benefits of this project cannot go exclusively to Nepal as sought by it. Nepal's feeling is that it had been cheated in the Kosi and the Gandak projects and it fears to be so even in case of Pancheswar and Rapti.[101]

India has offered to meet the entire cost of Rs 74 million for technical investigation of this project. It has

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98 Ibid.

99 The Statesman (Delhi), 5 February 1983.

100 Times of India (Delhi), 24 March 1976.

101 The Hindu (Madras), 13 June 1983.

also suggested to Nepal that the sharing of the costs and benefits of the scheme be discussed at an appropriate stage in accordance with established international procedure. This is, however, not acceptable to Nepal.[102]

However, an agreement was signed in October 1980 for the execution of this 2 million KW project at a suitable site with power station on both sides of the border. Both sides agreed to accept a consultant from the World Bank which would be acceptable to both.[103]

The Rapti Project

The same syndrome is obstructing an agreement on this project. Nepal seems unwilling to recognise the downstream irrigation requirements of India. India on the other hand does not want to forego downstream benefits. The dam across the Rapti will automatically deprive India of said benefits. In the circumstances, India's interest in the project would be limited only to flood control benefits and not irrigation and power.[104]

India views with concern projects being executed by Nepal to divert small rivers like Bagmati, Kankai and Kamala flowing from time immemorial into Indian plains adjoining Nepal and irrigating huge tracts of fertile land. Nepal has taken the stand that the small rivers are entirely for its own benefits. This may create serious political problem.[105]

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102 Ibid.

103 Annual Report, MEA, Ch.III, n.29,1983-84.

104 The Hindu, n.101.

105 Ibid.

The project is about 250 km southwest of Kathmandu. Unlike India's earlier proposal for the Rapti Project at Jalkundi, Nepal prefers its own scheme of multipurpose project near Balopang about 80 km. upstream of Jalkundi. This 80 metres high dam is proposed to generate 36 MW of energy and irrigate 68 thousands hectares in the Deokhuri valley, Kapilavastu and Banke districts. It is estimated to cost Rs 100 crores.[106] The Canadian Development Agency has already started doing survey of this project.[107]

<u>The Karnali Project</u>

The biggest among the Himalayan water resources harnessing projects is the Karnali (Chisapani) project. It will have a power generating capacity of 3,600 MW by controlling the Ghagra river. It will be sixty times bigger than the biggest hydro power project now in operation in Nepal.[108]

India will, in consultation with international experts, prepare the detailed report on this project. Both the countries have agreed that after meeting Nepal's need of electricity, the surplus will be sold to India at a 'mutually agreed' price.[109] This project will be financed by the World Bank and will cost Rs 2,000 crores. A World Bank team visited Kathmandu in February 1983 to make preliminary technical investigation of

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106 *Times of India* (Delhi), 30 January 1976.

107 *The Statesman* (Delhi), 5 February 1983.

108 *The Hindu* (Madras), 14 February 1981.

109 *The Statesman* (Delhi), 9 February 1981.

this project with the help of Nepalese and Indian experts. The team also worked out a draft terms of reference for the project. This is the third feasibility study carried out by the World Bank so far. This terms of reference has been made for the approval of the coordination committee, consisting of official representatives of both the countries.[110]

There have been a number of surveys done by Nippon Koei Company of Japan and Snowy Mountain Hydro-Electric Authority of Australia (1972) on this giant project.[111] HMG has been displaying its deep interest in making this project a reality. HMG formed the Karnali Project Direction Commission in May 1973 and an Indo-Nepalese Joint Commission on this project was also set up.

On the basis of additional survey, study and review undertaken with UNDP assistance, the site of the Karnali Project has been selected at a place about 2 km. below Chisapani. UNDP conducted this survey following conflicting expert opinion opinions by the aforesaid two companies.[112]

The magnitude of costs has been the major factor hindering the early start of project. Other sources of finance like World Bank have already been explored and approached. To make this project a visible success, the obvious way is to undertake multipurpose projects and sell

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110 The Hindu (Madras), 13 June 1983.

111 Gorkhapatra (Kathmandu), 8 August 1973.

112 Ibid., 18 August 1977.

water as well as electricity. India not only needs both but is also the only possible buyer. Indeed when the HMG appealed the World Bank for this project, the Bank shrewdly sought an assurance that India would buy the expected 3,600 MW of electricity that can be stepped up by an additional 1,000 MW. There could hardly be a more authoritative affirmation of close interdependence.[113]

Nepali official newspaper wrote that 'the success of the Karnali project depends chiefly on India's formal commitment to buy the surplus power'.[114]

Chandra Pumped Canal:

India is presently assisting Nepal in the [redacted] extension of pumped canal of Saptari and the distribution system of the Western Kosi Canal at the cost of Rs 12.5 crores (IR).[115]

Under this project water will be pumped from western Kosi canal into the eastern canal to facilitate irrigation of some 15,000 hectares of additional land.[116]

XII. India's Economic Assistance to Nepal (Grant and Loan)

India has concentrated her aid in only a few countries. Of about twenty developing countries in the region the countries of aid preference have been Nepal, Sri Lanka, Malaysia, Afghanistan, Bhutan, Bangladesh and Philippines which have claimed over 82 per cent of the total aid.[117]

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113 Dattaray Sunanda K., The Statesman (Delhi), 6 April 1982.

114 Rising Nepal (Kathmandu), 5 September 1977.

115 The Statesman (Delhi), 9 February 1981.

116 Hindustan Times (Delhi), 6 April 1982.

117 Vohra, n.8, p.120.

Over the past three and a half decades, India has been Nepal's biggest donor in building a variety of projects. Naya Samaj, a Nepali paper, remarked: "Nepal cannot achieve success in its development campaign in the absence of India's cooperation and goodwill." In fact it was India that helped Nepal to set in motion the wheels of development in the initial stage.

India's aid has been mostly in grants, the loan element being very small. Loans have been extended to make possible for Nepal to begin industrial ventures with Indian capital.

Table I presents the extent and enormity of India's aid to Nepal during 1972-82. Though authorization looks very attractive, the utilization seems to be weak and lacking. Among the factors attributed to such limited digestion of aid, the lack of proper economic environment, the inadequate administrative and financial institutions, the imperfect monetary and fiscal policies, lack of proper planning and resource allocation and deficient technical experts are preponderant.

For project assistance, at least disbursement or utilisation depends on physical progress of construction. Besides, it is delayed by the number of conditions and administrative requirements to be fulfilled by the recipient. So, the process of utilisation may be expedited by scientific project planning and appropriate provision of technical assistance in support of capital contribution. It should be kept away from usual 'red tapism' and bureaucratic thoroughfare.

TABLE I

INDIA'S ECONOMIC ASSISTANCE TO NEPAL

(Value in Rupees crores)

Year	Authorised		Utilized	
	Loans	Grants	Loans	Grants
1972-73	-	9.0	0.1	7.20
1973-74	5.0	9.0	0.1	7.90
1974-75	5.0	8.98	5.0	8.52
1975-76	20.0	9.6	15.7	7.90
1976-77	10.0	10.44	7.0	9.95
1977-78	-	9.63	14 (lakh)	8.21
1978-79	-	9.35	1 (lakh)	8.35
1979-80	-	14-65	-	13.58
1980-81	-	14.22	-	5.85
1981-82	-	15.75	-	15.75
Total :	40.0	110.62	28.45	93.21

Note: External assistance to Nepal, excludes the grant expenditures of Kosi and Gandak schemes being executed by the Bihar Government and the grant expenditure on training of Nepalese scholars in India.

Source: Report on Currency and Finance, Reserve Bank of India, Bombay, 1972-73 to 1981-82, vol.II.

Upto March 1972, the grants authorised were Rs 91.2 crores (IC) whereas utilization was only Rs 87.9 crores. Similarly, the loan authorized was Rs 1 crore and utilization was Rs 0.4 crores in the same period. During 1972-73 and 1981-82, the grants authorized and utilized were Rs 110.62 crores and Rs 93.21 crores, respectively. In the same period the loans authorized and utilized were Rs 40.0 crores and Rs 28.45 crores, respectively.[118]

A glimpse at the following Table II will give us some idea about the utilization and authorization of both grants and loans upto 1981-82.

TABLE II

INDIAN AID 1950-51 TO 1981-82

(Rs crores - IC)

	Authorized Aid	Utilized Aid	% of utilized to authorized Aid
Loan	41	28.85	70.36
Grants	201.82	180.11	89.24
Total	242.82	208.57	85.89

From Table II it is clear that the ratio of utilization to authorization of grants is higher than the same ratio of loan. This can mainly be attributed to the fact that grants

118 Report on Currency and Finance, Reserve Bank of India, Bombay, 1971-72 to 1981-82, vol.II.

are made available without stringent terms and conditions. Besides, Nepal has been getting abundant multilateral loans at terms more favourable than India.

India's contribution to Nepal had been more than 50 per cent of the total foreign assistance received by Nepal. Presently it is about 16 per cent. This decline is not absolute but it is a relative decline. In other words, this decline is not because of India's cut down in aid but because of two major factors. Firstly, Nepal's plan size since then has gone up more than three times of what it was in 1970-71. Total plan outlay of Nepal during its Second Five Year Plan (1962-65) was Rs 600 million and Rs 25000 million in the Third Plan (1965-70). This has gone up to Rs 9170 million in Fifth Plan (1975-80) and Rs 2,23,000 million in the Sixth Plan (1980-85).[119]

Secondly, Nepal began receiving assistance and soft-loans from many other countries and international financing agencies such as World Bank, Asian Development Bank, United Nations Development Project, etc. which relegated the position of India as a donor to a lower rank.

This is shown in Table III, the total bilateral aid of the countries which was Rs 227.26 million in 1971-72 went upto Rs 1277.30 million in 1982-83, whereas the multilateral aid which was just Rs 14.78 million in 1971-72 went upto Rs 331.00 million in 1982-83. The loan elements have shown tremendous increase in case of multilateral loan to Nepal.

119 Poudyal, Ch.III, n.34, p.9.

TABLE III

ECONOMIC ASSISTANCE TO NEPAL : BILATERAL AND MULTILATERAL

(Value in Rupees Million)

Fiscal Year	Bilateral			Multilateral			**
	Aid	Loan	Total	Aid	Loan	Total	GDP (Current Prices)
1970-71	270.69	32.46	313.15	-	-	-	8938
1971-72	227.26	26.92	254.18	14.78	11.97	26.75	10369
1972-73	167.40	22.19	189.53	12.86	25.19	38.11	9969
1973-74	214.00	33.52	247.52	8.62	54.35	62.97	12802
1974-75	244.64	31.94	276.58	38.16	72.03	110.19	16571
1975-76	307.68	23.07	330.75	52.03	122.87	174.90	17394
1976-77	344.91	26.01	370.92	47.70	138.30	186.00	17280
1977-78	372.55	84.23	456.78	94.03	297.53	391.56	19732
1978-79	457.40	81.47	538.87	141.95	308.70	450.65	22215
1979-80	696.80	149.60	846.40	108.80	385.30	494.10	23351
1980-81	707.10	151.00	858.10	161.80	542.30	704.10	27452
1981-82	799.60	109.90	909.50	193.70	620.00	813.70	30539*
1982-83	1277.30*	256.80*	1534.10	331.00	1762.90	2093.90	-

* Estimates
**Upto 1970-74 GDP series are old and onwards new.

Source: Economic Surveys, Ministry of Finance, Kathmandu, Nepal.

It was just Rs 11.97 million in 1971-72 which increased to Rs 1762.90 million in 1982-83. Whereas in case of total bilateral loan it was Rs 26.92 in 1971-72 and Rs 256.80 million in 1982-83.

Table IV shows that though the Indian cash grants to Nepal increased from Rs 4.55 million in 1974-75 to Rs. 58.1 million in 1981-82 (first eleven months), it was far outplaced by the multilateral cash grants. This cash grant which was just Rs 5.57 million in 1974-75 touched a wonder height of Rs 245.3 million in 1981-82 (first eleven months). The multilateral cash grants were jointly contributed by the UNICEF, UNESCO, WHO, SATA, UNDP and misc. This made Indian contribution relatively much smaller.

The formation of Nepal Aid Group in 1976 under the auspices of the World Bank has led to a significant increase in aid to Nepal from its member countries and agencies. The Group consists of UK, USA, Germany, Japan, Switzerland, France, Austria and Canada and four UN agencies such as World Bank, UNDP, IMF and ADB. The major purpose for forming this Group was to institutionalise external aid and to minimise the cause for friction among the aid giving friendly countries with competing ideologies and systems.[120] India is not a member of this Group, but still its contribution has been the largest for years.

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120 Times of India (Delhi), 10 January 1977.

TABLE IV

FOREIGN CASH GRANTS TO NEPAL : BILATERAL AND MULTILATERAL

(Value in Rupees Thousands)

Donors	1974-75	1975-76	1976-77	1977-78	1978-79	1979-80*	1981-81*	1981-82*
U.S.	24542	58843	27833	46948	36265	33473	62355	86312
India	4552	6839	12331	4934	36091	41284	32080	58144
China	9704	12283	9771	5015	2438	-	-	-
U.K.	8373	4678	2144	333	8500	9287	24301	46541
Japan	2893	823	5248	2015	7641	-	7488	800
UNICEF	58	344	2002	3358	3667	14585	3379	3482
UNESCO	74	69	84	288	2135	5200	767	4410
WHO	680	565	595	504	852	458	228	700
SATA	-	-	-	493	200	76	2599	107
UNDP	124	2277	3311	4615	2481	2174	24040	23404
Misc.	4642	3732	8737	12608	31350	7168	102745	213239
Unclassified	-	-	-	-	-	86830	-	-

*During the first eleven months of the fiscal year.

Sources: Main Economic Indicators, Nepal Rashtra Bank, Kathmandu, Nepal August 1977 to August 1982.

During 1961-71, India undertook projects in Nepal at a feverish speed, recording a rise of 300 per cent during the quinquennium 1961-66 over the previous period and a further rise of 150 per cent during the period 1966-71 as shown in Table V. It, however, showed a decline during the period 1971-76 and again increased in 1976-81.

The following Table V tells the story of India's aid operation in Nepal since the Sino-Indian hostilities in 1962. After a marginal decline recorded during 1962-63, the aid commitment almost doubled in 1963-64. This further elucidates the strategic importance of Nepal and India's perseverance to bring Nepal as closer as possible.

TABLE V

Five Year Period	Aid Committed (In Rs. lakhs)	Percentage increase or decrease over the previous period
1951-56	442.00	-
1956-61	552.00	+22
1961-66	2065.00	+300
1966-71	5049.00	+150
1971-76	4422.00	- 32
1976-81	5802.00	+76.3

Source: Annual Reports, MEA, Ch.III, n.29, 1951-52 to 1982-83.

The sudden fall in India's ever-increasing contribution during 1971-76 has been mainly because of its active involvement in the reconstruction work on the war-ravaged economy of Bangladesh. The Indian grant to Bangladesh which was just Rs 25 crores in 1971-72 increased to a huge sum of Rs 165.17 crores in 1972-73. In the same period Indian loan recorded an increase to Rs 34.83 crores in 1972-73 from Rs 19 crores in 1971-72.[121] This was further affected by the world-wide oil price hike in 1974.

After 1977-78, Indian aid commitment to Nepal has been showing a constant rise.

The deep variation in aid commitments in 1960s and comparatively smaller variation in 1970s, is because in 1970s most of Indian aid to Nepal has been maintenance aid as against the earlier infrastructural aid.[122]

XIII. Indian Technical Assistance

The transmission of knowledge usually called technical assistance is not merely a matter of technology in the narrow sense, but includes managerial and administrative skills and arrangements. The process of providing technical assistance involves a number of steps - agreeing on the project, finding competent personnel to carry it out and assuring through on the spot arrangements that an actual transfer takes place.[123]

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121 *Annual Report*, MEA, Ch.III, n.29, 1971-72 to 1972-73.

122 Vohra, n.8, pp.78-79.

123 Thorp, Ch.III, n.7, pp.70-71.

Again, the type of this assistance depends on the stage of development of the recipient country. There are two main channels of passing along skills and knowledge, one channel sends advisors, trainers and demonstrators, the other brings students and trainees.[124]

Technical assistance in different forms has been the hallmark of Indo-Nepalese economic cooperation. India undertook this mainly because of Nepal's least developed character, very low income and high illiteracy rates which were caused by location, climate, lack of natural resources, social and political organisations and scattered population. Further, this was aimed at increasing the domestic stock of skills and productivity and to strengthen and supplement Nepal's capacity to produce new skills view its education system.

The implementation of Indian aid programme in Nepal is secured through deputation of Indian experts, provision of training facilities in India to the Nepalese nationals and supply of necessary equipment for completion of projects undertaken in Nepal. Deputations from India include planners, engineers, architects, teachers and professors for the educational institutions mainly in the Tribhuvan University.[125]

Training places provided to the Nepalese nationals in India form part of the larger regional-multilateral aid programme of Colombo Plan, which is a very major source of

124 Ibid., pp.72-76.

125 Vohra, n.8, p.83.

aid to Nepal from this country. Upto 1976, Nepal was provided 3,334 training places at an expenditure of Rs 37,485 lakhs under this Plan.[126]

Between 1952-76, the number of Nepalese students trained in India under Technical Cooperation Scheme of Colombo Plan reached 3668 in which 31.6 per cent were engineering students, 14.4 per cent were in the field of education, 13.4 per cent in agriculture and 7.8 per cent in the medicine.[127]

This, however, was not a permanent solution. It was, therefore, necessary that Nepal should, in a phased manner, build up its own training institutions so that the need for sending personnel out of Nepal is progressively reduced. With this objective, India set up three training institutions, viz. the Rural Institute at Patan, Engineering School in Kathmandu and Forest Research Institute at Hitauda.[128]

XIV. Critical Overview:

Highways: The two capital projects (Tribhuvan Rajpath and Gauchar Airport) had military as well as political and economic aims.[129] India's denial that the military consideration played a major role in Indian aid programme is disputable. While building airfield India sent a team from the Indian Airforce and not from the Civil Aviation Department to study Nepal's requirements. When a Member of Parliament

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126 Ibid., p.84.

127 Times of India (Delhi), 15 January 1977.

128 DAVP, n.32.

129 Mihaly, n.17, p.50.

asked for information of the team's findings, he was told by the Deputy Minister for Defence that it was not 'in the public interest' to disclose them. If the projects had only economic significance, there would have been no possible reasons for secrecy.[130]

Strategic considerations were undoubtedly of great importance, but they were not always paramount. To the Nepalese Government the highways have strengthened the strategic and security networks and provided a venue for the extraction of revenues in the form of tolls and user taxes for the state coffers. To the landlord and the privileged group highways have facilitated reinforcing their positions of power and education of their children.[131]

Pointing out the environmental loss, Stiller and Yadav argue, "Construction of mountain roads, whether over bridges or along the river valleys usually opened the land for landslides and contributed to the overall erosion problem in Nepal ... deforestation followed faithfully along the routes that were newly opened up."[132]

The Nepalese alleged that the construction of the roads has only succeeded in facilitating the extension of the Indian market. This is a very onesided argument because the benefits arising out of these roads would far more offset

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130 Ibid., p.90.

131 Poudyal, Ch.III, n.34, p.117.

132 Stiller, L.F. and Yadav, R.P., Planning for People (Sahayogi; Kathmandu, 1970), p.170.

the loss in Nepalese trading interest. This is simply because in Nepal industries are few and uneconomic.

XV. Water Resources:

Two decades ago, a giant and beneficial project like Karnali would have cost $358 million and now it would cost a whopping two billion dollars at current prices. The two countries have unnecessarily allowed twenty years to elapse on a project as vital as Karnali without coming anywhere near an agreement.[133]

Both the Kosi and Gandak agreements aroused intense bitterness in Nepal. Opposition accused the government of 'bartering away Nepal's future', 'sell out of national sovereignty'. India desperately needed flood protection from these rivers whereas Nepal did not have capital to harness these rivers. In other words, Nepal had to comply with what India asked for at that critical juncture.

Further, a frequent allegation by the Nepalese side is that it had been 'cheated' by India and that the larger share of the facilities in irrigation and power had been taken by India.[134]

The official National News Agency of Nepal in a press release stated that Nepal has been denied many of the benefits of which it is entitled under the Kosi Project Agreement. This river is eroding 40 to 50 bighas of land in Nepal every year,

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133 Times of India (Delhi), 4 August 1983.

134 Kumar, D.P., Nepal : Year of Decision (Vikas; Delhi, 1980), p.201.

but even after 20 years there is no concrete step to check such erosion. The barrage and canal have been constructed close to the border in the Terai. But compared to the area irrigated in India, the irrigation facilities for Nepal are negligible. Most of the benefits are centred on the Indian side. Projects beneficial to India have already been completed. The huge loss of life and property which this river used to cause in Bihar every year has been ended for ever. Irrigation of 18.34 lakhs acres of land in Bihar has been started whereas in Nepal only 25,000 acres is irrigated in Saptari district by eastern canal project. The western canal can irrigate 9.4 lakh acres but it will irrigate only 35,000 acres in Nepal.[135]

Nepal realized hardly any benefits in the original agreement of 1954. The flood control in Nepal was only over a tiny area. Thus, Nepal was manoeuvred into signing away its rights over invaluable resources for truly 'a mess of pottage'. This policy of extracting maximum terms from Nepal undermined trust and contributed to a heritage of bad policy.[136]

The Indian Cooperation Mission in Kathmandu was often alleged to have exhibited a marked lack of determination to push through projects which did not have some obvious military

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135 Gorkhapatra (Kathmandu), 12 September 1974.

136 Rana, Ch.II, n.13, p.648.

or political value to India. The rapid construction of Tribhuvan Rajpath has often been compared with the virtually non-existent progress on the minor irrigation work projects.[137]

Delay in the completion of Indian aided projects like Gandak in Nepal was one reason behind the Indian unpopularity. 'Nearly 12 years have passed since the Gandak project agreement was concluded, ... there is no indication when the project will be completed which should have been commissioned in 1971.'[138]

Some of these allegations are well founded. India being a big country should always try to understand the sentiments of a small country. Water being the only firm resource-base of Nepal, she feels highly sensitive if anyone tries to misuse it. India can eliminate these doubts of Nepal only by being forthright in its stance towards water resources planning and development in Nepal. Further, India can always do the justice to Nepal by sharing these resources on the basis of international norms and procedures.

The waterway from Calcutta to Nepal's river banks through the common rivers will make a great difference to Nepal's export and import trade. It is estimated that transportation cost will be reduced by as much as ninety per cent. The cost of transportation by trucks from Calcutta to the border is almost Rs 6000 (IR) per ton whereas whaterway freight will be only about Rs 600 (IR) per ton.

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137 Mihaly, n.17, p.93.

138 The Matribhumi Weekly (Kathmandu), 3 October 1972.

The National Social Reform Centre of Kathmandu has already made various studies on the feasibility of navigation on water ways. The studies undertaken have found it possible to operate steamers and rafts right from Nepal's rivers (Kosi, Gandak and Karnali) to Calcutta's Hooghly river.

One of its reports says that a 600 ton steamer can easily sail in six feet water draught. For rafts, even less water draught - 3 to 4 feet - is enough. The water draught in the upper regions of Ganga river is found to be 10 to 15 fit, suitable for bigger steamers. The Gandak river of Nepal is the best for navigational purposes because of high water flow. Steamers can use the rivers ten months and 7-8 months a year in case of Gandak and Kosi rivers respectively. The proposed waterway has to pass through the Farakka barrage of India that controls the Ganga water flow. The report suggested the use of waterway only up to a point in Bihar which will lower two-thirds of the 800 km. distance from Calcutta port to Nepal Central Border. It points out that the inland river route is already in use from Calcutta to Mokama in Bihar.

The same route can be used for Nepalese cargo with current facilities at Calcutta port with some additional facilities at Dhulian, Putimari or Karagola of Bihar. From this point, the import cargo can be transported to their destinations in Nepal by rail or trucks.[139]

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139 Shreshta, Aditya Man, "Nepal Wants to Use Indian Water", Bangladesh Times (Dacca), 18 April 1982.

Further, the Karnali, Gandaki and Kosi together contribute 40 per cent of the dry season flow of the Ganges. It would be possible to raise the dry season flow at Farakka to an estimated 75,000 cusecs from the present figure of 55,000 cusecs, if there comes up some concrete agreement between India and Nepal pertaining to storage of water in Nepal. This will certainly reduce India's confusion with Bangladesh in the sharing and augmentation of Farakka water during the dry season.[140]

India says that Nepal has not submitted a concrete proposal on which India can act upon. But Nepal feels that unless India shows willingness to let Nepal use the waterways, there is no point in preparing such proposal. Nepal is so small and helpless that it cannot afford to exploit them on its own.

However, in the field of flood forecasting, a draft agreement has been submitted by the GOI to the HMG, for the setting up of hydrological and meteorological stations in the catchment areas of the principal common rivers of the two countries. These stations would provide invaluable assistance in the forecasting.[141]

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140 Times of India (Delhi), 3 February 1979.

141 Annual Report, MEA, Ch.III, n.29, 1981-82.

The implementation of Karnali, Rapti and Pancheswar should be expedited as more delay would only escalate the cost and create further confusion. Seeing the benefits arising out of these projects Nepal should not feel over-sensitive as these are the prerequisites for her industrial growth. For India a prudent way to exploit these projects would be only through frequent consultations with the HMG.

XVI. Efficacy of Indian Aid

How effective is Indian aid is a subject of controversy. The very yardstick of efficacy is a relative factor and to a large extent subjective. In some of the projects undertaken, the acquisition of goodwill has been clearly emphasised. Other projects like the building up of infrastructure are designed to contribute to economic development. In the former category building of sports facilities, hostels have been quite attractive enough. In the latter case, grandiose river valley projects may be cited as illustrations.

Some economists are of the view that over longer periods, the use that is made of the initial increase in output becomes more important. Even if the short-run productivity of aid is high, the economy may continue to be dependent on external assistance indefinitely unless the additional output is allocated so as to increase saving and reduce the trade gap.[142]

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142 Chenery Hollis B. and Strout Alan M., "Foreign Assistance and Economic Development", American Economic Review, no.4, Part I, September 1966, p.724.

The efficacy of development aid depends to a considerable degree on a relationship of mutual confidence between donor and receiving country that is sometimes only conceivable in a bilateral context.[143]

The role of external assistance in socio-economic transformation of a society is dependent on the governmental policies, the stage of economic development and the commitment of the people towards certain national priorities laid down by the government. The Indian aid helped Nepal to bridge the strategic gap between development investment and domestic mobilization but still the necessary capital formation has not been made by Nepal.[144]

Foreign aid as a percentage of resource balance is still 90 per cent in Nepal. In other countries this ratio is much lower. It signifies that other countries rely more on private capital flows and factor incomes from abroad than foreign aid.[145]

Some scholars have maintained that aid substituted domestic savings in capital formation in Nepal. It actually reduced the need to mobilize national saving. At the same time, 'it has reduced the internal capacity of the nation to create

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143 Zeylestra Willem G., Aid or Development (Sijthoff-Leyden, 1975), p.71.

144 Ramakant, n.11, p.254.

145 Panday, D.R., "Foreign Aid in Nepal's Development" in Foreign Aid and Development in Nepal (Integrated Development System, Kathmandu, 1983), p.278.

capital out of its own resources'. As a result the rate of savings had been very low and even at the low rate of savings 'a significant part of the saving was not invested... but used for what can best be described as public hoarding'.[146]

The infrastructure built by India in terms of roads, communication, power and irrigation, has immensely benefited Nepal, the economic and strategic considerations notwithstanding. A scholar has maintained that there was no question of being apologetic in the allegation that Indian aid was mainly to check the growth of Chinese influence in Nepal because Chinese aid to Nepal was also directed to thwart Indian influence in Nepal.[147]

This social overhead capital created by the Indian aid has more impact in the long run than in the immediate short run. Indian aid utilization and its sectoral distribution has been designed in keeping with Nepal's development priorities as envisaged in its Plans. While undergoing cooperation, India participated in all varieties of projects whether grandiose or modest. It is true that India benefited from all these projects as they created demand for subsequent imports of raw materials, components, spare parts, etc. On the other hand, Nepal could save foreign exchange which otherwise would have incurred in completing these projects on its own.

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146 Rana, P.S.J.B., "Role of Foreign Aid and Trade in Economic Reconstruction" in Mundi, ed., Nepal : An Assertive Monarchy (Chetna; Delhi, 1977), p.179.

147 Ayoob, Ch.II, n.68(a), p.134.

Generally, development aid is hardly conceivable in a way that does not entail advantages to the donor country. There is widespread misunderstanding that such advantages automatically reduce the efficacy of aid.[148] This is true only if the tangible advantages are more to the donor than to the recipient countries.

XVII. Flexibility in Indian Aid

India's economic and technical assistance are highly flexible and suitable to Nepalese economy. Nepal could not adjust with the wholesale transfer of sophisticated technology and trained personnel from the West. Nepal was 'over advised' and 'under-nourished'. Taking advantage of its infant nature, the Westeners' sophistication dominated the development scene often forcing the Nepali bureaucrats into direction of little relevance to the country's needs. This was gradually realised when more and more foreign trained Nepalese mainly from India returned to Nepal. It was crucial for Nepal to have appropriate or intermediate technology which India with similar socio-economic background could provide.[149]

XVIII. Nepal's Absorptive Capacity

Absorptive capacity refers to the ability to use capital effectively.[150] Three indices can be used to estimate absorptive capacity: (i) Increase in volume of investment, (ii) raising her saving, notably in maintaining or in widening

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148 Zeylestra, n.143, pp.16-17.

149 Banerjee, Ch.II, n.137, p.561.

150 Chatterjee, Ch.III, n.5, p.12.

the deviation between the average and marginal rate of savings, and (iii) a judgement on a country's overall administrative and developmental organisation.[151]

A noted economist stated that the capacity to absorb capital is more limited on a low level of development where a higher proportion of technical assistance must precede a large capital inflow. With a rising level of development, the marginal rate of savings will increase.[152]

Nepal has been facing the problem of aid indigestion which is primarily caused by her small absorptive capacity.[153]

The poor resource base of Nepal has never permitted her bigger domestic savings. The investment targets for the Sixth Plan had envisaged an increased rate of 22.5 per cent of the GDP in 1984-85 from 13.1 per cent of GDP in 1979-80. But a very meagre increase has been recorded in 1983-84. The savings are still as below as 7.3 per cent of the GDP which by any means is a shocking feature after three and a half decades of continuous external assistance. This fairly displays the low absorptive capacity of Nepal.

External assistance is absorbed and quickly expended but mostly not in projects and productive sectors that will percolate down to the mass. Most of them enter into the already warm pockets of a few privileged class.

151 Rosenstein Rodan, n.2, p.84.

152 Ibid., pp.83-84.

153 Upadhyay, Ramesh P., "Foreign Aid and Program Budgeting" in CEDA, Ch.III, n.46.

Besides, this low absorptive capacity is attributed to haphazard intermingling between foreign aided programmes and other regular investment programmes, inadequate supply of manpower, delay in releasing budget and the late arrival of advisors and duplication of project works.[154]

However, the country's administrative and developmental organisations are also in poor shape. There have been some institutions like Nepal Industrial Development Corporation, Trade Promotion Centre and various 'Sajha' organisations to promote economic development. But most of them are not effective to carry out the assigned role. This is further because of frequent changes in political setup and interference. A lack of decision making backed up by rampant corruption, a conflict between foreign trained personnel and orthodox Nepalese, have certainly deteriorated the absorptive capacity.

So, in order to increase the absorptive capacity, Nepal has to train more countrymen in the various skills. The dependence on foreign experts should be increasingly made more selective and should have the final aim to replace foreign expertise by Nepalese expertise.[155]

The absence of a well defined operational strategy and logistics to meet the growth target has severely hampered Nepal's achievement. This raises serious doubts about the relevance of Nepalese planning efforts to the actual development

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154 Pant, Thakur N., "Foreign Aid and Agricultural Development in Nepal" in <u>Foreign Aid and Development in Nepal</u>, n.145, p.176.

155 Upadhyay, n.153.

of the economy. Plan fulfilment has regularly fallen short of the target. This lack of performance is covered up by pointing out the shortage of resources, particularly capital, drift in weather conditions and unfavourable economic conditions in other countries.[156]

As a result the pressure on Terai is also growing more acute due to stagnant production and continuous influx of people from the hills and mountains. It could be foreseen that a stage will come when all the forests in the Terai will be eliminated creating a severe ecological disbalance and a crisis in the economy.[157]

The problem in Nepalese planning apparently lies with the process of implementation where policies and programmes are approved which have nothing to do with or are contrary to the planned objective. The economic scene is replete with cases of new policies and programmes, being launched with the introduction of each fiscal year, depending on the fancy of individual minister engaged in a game of musical chairs. In addition, inefficiency, waste, corruption and malpractices in resource utilization have been rampant.[158]

Under the circumstances one would have to assume that planning and development is not something that is taken seriously by the Government and this may be the principal

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156 Poudyal, Ch.III, n.34, p.22.

157 Ibid., p.123.

158 Panday, D.R., "Economic Reality", Seminar, No.274, June 1982, p.29.

source of the present economic malaise. Except perhaps for a brief period in the early 1960s, planning has not met with genuine interest and support at the political level. In Nepal planning has nothing to do with decisions on the allocations of values or resources in the society.[159]

Nepal has not attained the 'phase I' development of a recipient country.[160] Her growth rate is below a reasonable target rate, so the focus of policy should be on increasing output, implying an increase in the quality and quantity of both physical and human resource inputs. In the phase II the focus of development policy should be increasingly on: (a) bringing about the changes in the productive structure needed to prevent further increases in the BOP deficits, and (b) channelling an adequate fraction of increased income into saving.

Nepal requires a gradual shift to direct taxes in its tax structure to promote equity in the society.

Historically, foreign aid has financed every year at least 60 per cent of the development expenditure, only 60 per cent of which goes to capital formation. All in all, foreign aid around which 'a complete sub-economy has grown up has been a good business for Kathmandu'.[161]

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159 Ibid., p.28.

160 Chenery and Strout, n.142, pp.725-26.

161 Stiller, L.F. and Yadav, R.P., n.132, p.58.

Indeed a supra economy has been created on account of foreign aid. The government plans, economic policies and even budgets bear little relevance to the nation's economic reality or the needs of the people. They are pursued with an eye in the aid donors on the one hand and the self-seeking attitudes of the ruling class, on the other.[162]

The aid has created rampant corruption and has only enhanced the position of upper social class.

After all, Nepal's present political setup is an anarchronism even in comparison to its own immediate surroundings. Such a regime can feel itself at ease only in a condition of rampant corruption, because it thus hopes to at least postpone the crisis by doing so and by playing to the human cupidity of a few.[163]

There is a definite urban bias both in terms of location of the project and the benefits accruing from the project. This has helped Kathmandu city graduate into a metropolis and has benefited aristocracy, the landowning nobility, the administrative, business and technical elites and the panchas in the upper echeleons of the political power structure.[164]

In this vitiating background, Nepal now should further revamp its machinery towards people oriented programmes. India has already made strides in reducing Nepal's intractable

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162 Panday, n.158, p.29.

163 "Letter from a silent participant" in n.145, p.xix.

164 Misra, Chaitanya and Sharma, Pitamber, "Foreign Aid and Social Structure", n.145, p.6.

poverty and breaking the feudalistic social structure.

XIX. Trade Versus Aid

Nepal has been asking India for more trade rather than aid. This is because she has often been misled into believing that the acceptance of more imports by India is the equivalent of an equal aid from India.

This is grossly oversimplified proposition. Trade can supplement aid only if the large foreign earnings have come from higher selling prices so that earnings are increased without any offsetting drain on domestic resources and labour. In a sense the foreign consumer is unwittingly providing added assistance.[165]

Nepal has two alternative strategies to increase her exports and other trade relations. Firstly, her export earning may be increased by the use of otherwise idle labour and resources. This would be a net addition in her GNP. Secondly, to a large degree, Nepal's expansion of exports can be based on capital and labour which might otherwise be used for some domestic purpose. Such a shift into exports does not increase GNP, but alters the production pattern by increasing exports rather than goods for domestic markets. This also changes the consumption pattern in Nepal by reducing domestic products consumed.

This can be a highly useful rearrangement, for a country like Nepal since it may permit large scale, more specialized production and increase the variety of goods available to

165 Thorp, Ch.III, n.7, p.288.

producer and consumer. The present resource base may not permit Nepal to do so but she must try to accelerate her capital formation in order to see this 'trade not aid' dream to be a reality.

Before resorting to such proposal, Nepal should further understand that the expansion of capacity to produce and export manufactured goods must be the result of either Indian aid or domestic savings. Since the domestic saving is still low, Nepal must go on for Indian aid till it achieves required level of development which commences more and more production of manufactured goods in Nepal. This can largely be done through encouraging private foreign investment in which India has been showing considerable interest.

India should also realise that there is no point in giving aid to Nepal by one hand and take away the same via trade with other hand. This has been more noticeable by the present alarming trade deficit of Nepal with India. This has been happening because of adverse movement of terms of trade vis-a-vis Nepal which involves loss of external purchasing power. So, India must conceive and implement some trade preferences which would make the import barriers more liberal and favourable to Nepal.

XX. Aid and Economic Development in Nepal:

Some of the Nepalese scholars expressed the view that in the Nepalese context foreign aid is development and development is to a large extent foreign aid.[166] The external

166 Pradhan, Bina and Shrestha, Indira, "Foreign Aid and Women" in Foreign Aid and Development in Nepal, n.145, p.99.

assistance as a percentage of Gross Domestic Product (GDP) has risen fairly consistently during the last decade. It has practically doubled during the last ten years from 2.20 per cent (1972-73) to 5.69 per cent (1980-81). In spite of the increased levels of external assistance, the economy has not shown very encouraging signs. Development expenditure levels have constantly gone up but the effects on important productive sectors like agriculture and industry have not been evident. The lack of impact on output in spite of increased levels of development expenditure could only suggest very high capital-output ratio and projects with long gestation period.[167]

However, the role of external assistance in the overall foreign exchange situation has been extremely favourable. Nepal's export earnings have not been able to meet more than seven months of imports. Had it not been foreign assistance, the balance of payments would not have been favourable.[168]

Poor people are hardly benefited by aided projects and external assistance. This is because poor people lack both economic power (land based) and organisation power (government controlled) which are the means of access to the projects. So, an effective land redistribution measures, the elimination of the sources of continued exploitation like the money lenders, and increase in their political awareness would certainly help in percolating these benefits to the poor mass also.[169]

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167 Banskota, Mahesh, "Foreign Aid and the Poor" in Ibid., n.145, p.40.

168 Ibid., p.41.

169 Ibid., pp.60-61.

India's aid has been directed to increase the productive capacity of Nepalese agriculture. Out of the 30 foreign aided agriculture and irrigation projects in Nepal, 17 projects were built by India. India has provided better seeds and implements for the agricultural development in Nepal.[170]

Despite the cumulative efforts made at national and international level the performance of the agriculture sector in Nepal has been lackluster and baffling. Investment in this sector has been steadily increasing over the decades, yet agricultural production has registered a meagre increase of 0.7 per cent per annum - a rate considerably below the population growth of 2.6 per cent per annum over the decade 1971-81. This has mainly been responsible for the sluggish growth in the economy.[171]

Within agriculture, the food sector which occupies nearly 85 per cent of the total value of agricultural production, increased only by little over 1 per cent per annum. This was also mainly due to an increase in the areas under cultivation. This has seriously affected Nepalese exports which are, nevertheless, dependent on agriculture.[172] It appears that the government does not have a strategy for agricultural development.[173]

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170 Shastri, Ch.II,n.124, pp.367-68.

171 Pant, n.154, pp.155-58.

172 Ibid., pp.155-58.

173 Sharma, Kul S., n.145, p.214.

In spite of India's relentless efforts to provide more and more irrigation facilities in Nepal, the total land with irrigation scheme, does not exceed 15 per cent of 3.1 million hectares during the wet season. This shows Nepal's heavy dependence on erratic monsoons. This has made it difficult even to stabilize production.[174]

The irony is that Nepal is nowhere near enjoying the standard of living of most of the third world countries,[175] and is very far from W.W. Rostow's 'takeoff' stage.

On the balance, the impact of Indian aid to Nepal has not been as effective as expected. This is mainly because of the lack of foresight in both the countries. Political factors have been coming into the way of smooth and proper implementation of Indian aided plants and projects. Sometimes small lapses are also blown out of proportion by the political vested interests thereby creating a permanent scare in the relationship. The impact of Indian aid could have been more had the absorptive capacity of Nepal been higher and advanced. Besides, the lack in proper planning and presence of leakages of aid in Nepal have made the Indo-Nepalese cooperation more complex.

There have been lapses on both sides. India is not totally absolved of such lapses. India should have given more emphasis on the distributive and sharing aspects of

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174 Pant, n.154, p.159.

175 Panday, D.R., n.145, p.293.

the benefits arising out of the projects. The nagging Kosi and Gandak projects could have been made less controversial by convincing Nepal in the location of projects. Moreover, had the Government of India directly participated in the construction and supervision of the Kosi and Gandak projects the present imbroglio and doubts would certainly have been minimal. Bihar itself being a backward state could never fulfil the aspirations of Nepal in the construction of these two major projects. These projects set the pace of Indo-Nepalese economic cooperation. The present apprehension in Nepal towards India could have been minimized had the Government of India played slightly farsighted role by equitably distributing the benefits of major projects on the basis of standard international norms, procedures and conditions.

CHAPTER V

INDIAN PRIVATE INVESTMENT IN NEPAL

I. Private Foreign Investment

In the preceding chapter while dealing with aid to Nepal we realised that the aid even if extended in very large quantum would not alone solve the economic problems of Nepal. Aid cannot be a permanent source of finance in Nepal. There is need to increase the private foreign investment as this type of investment will have certain more far reaching effects than the generously donated aid.

A noted economist remarked that public capital is generally a transitional arrangement. It should be gradually replaced by private foreign investment.[1]

The most significant contribution of private foreign investment is likely to come from external economies. This investment brings to the recipient country not only capital and foreign exchange but also managerial ability, technical personnel, technological knowledge, administrative organisation and innovation in products and production technique - all of which are in short supply.[2]

This type of investment has more immediate and effective impact on an essentially agrarian economy. It is achieved through the direct employment of wage and salary earners, purchase of local materials and equipment and payments of taxes

1 Meir, Ch.III, n.85, p.370.

2 Ibid., p.373.

to the local government.[3]

It is also contended that a poor region would gain more through inflow of foreign capital because the marginal product of capital would be greater in the poor than in the rich region and hence global impact would be increased.[4]

Historically private capital has played a crucial role in the development of what are now highly developed industrialised economies.

II. Nepalese Industrial Performance : A Critical Overview

The development of modern industries is a recent phenomenon in Nepal. In 1935, 'Udyog Parishad' was established with the objectives of 'promoting crafts and industries, improving agriculture and commerce and developing mining and other works that can be done with indigenous raw materials such as vegetables, wood, herbs, etc.'[5]

The Second World War stimulated a number of industries in Nepal. Between 1936 and 1942 a large number of industries were set up in the Terai region mostly in Biratnagar and Birganj areas. These industries mainly consisted of consumer goods like rice and oil mills.[6]

But in the immediate post-war years most of them went into liquidation. These industries actually did not lead to the

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3 Shastri, Ch.II, n.124, p.230.

4 Gray, H. Peter, The Economics of Business Investment Abroad (McMillan, 1972), p.41.

5 Shrestha, B.P., The Economy of Nepal (Vora, Bombay, 1967), p.157.

6 Rawat, Ch.II, n.9, p.220.

development of domestic capital investment, chiefly because Rana regime showed least interest in the development of the country. The Ranas always considered any technical innovation and development as a source of instability to their regime.[7]

With the launching of First Plan, Nepal entered into planned process of industrialisation. Since then, the industrial sector has been receiving rapt attention of the government.[8]

Of the 176 units operating in the country, as many as 100 i.e. nearly 57 per cent belong to small and cottage sectors. The large scale industries are 12 in number, comprising one factory each manufacturing biscuits, sugar, tea, cigarettes, jute, woolen and acrylic yarn, leather shoes and pharmaceutical products and two units each of manufacturing cotton textiles and bricks. Nearly 50 per cent of the manufacturing activities is confined to the food, beverages and tobacco group.[9]

A glance at Table I would reveal that the Nepalese industries are still in a nasce-nt stage. They have not been consistent enough to show a particular trend in their production.

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7 Poudyal, Ch.III, n.34, p.69.

8 Acharya, R., "Institutional Arrangement for Industrial Promotion in Nepal", <u>The Economic Mirror</u> (Kathmandu), March-April 1983, p.16.

9 IIFT, Ch.III, n.47, p.85.

TABLE I

PRODUCTION OF SELECTED INDUSTRIES

Products	Units	1971-72	1972-73	1973-74	1974-75	1975-76	1976-77	1977-78	1978-79	1979-80	1980-81
Jute	Metric tonnes	12,938	13,709	12,888	12,265	15,904	16,809	16,347	15,520	14,777	16,264
Sugar	Metric tonnes	7,559	10,627	14,197	11,925	10,632	16,251	26,507	27,200	14,158	12,020
Cigarettes	00,000	2,235	2,282	2,521	30,013	24,468	17,737	16,337	20,686	16,424	18,113
Matches	000 Gross	527	587	662	649	679	658	677	724	699	626
Soap	Metric tonnes	239	363	139	891	970	1,855	1,317	1,121	1,174	2,631
Shoes	Pairs	69,983	79,394	84,494	70,044	59,079	54 ,855	59,031	55,779	70,299	81,845
Leather	000 pieces	170	187	13	-	665	1,096	1,256	1,320	1,857	1,802
Cotton Textiles	100 metres	-	-	-	-	4,211	5,225	3,889	2,429	3,489	5,317
Cement	Metric tonnes	-	-	-	-	26,933	42,794	35,850	21,019	29,163	32,326

Source: Nepal Rastra Bank and Department of Industry, Kathmandu, Nepal.

All the products shown in the table have been highly erratic in their production performance. For instance, in case of sugar production the 1971-72 production of 7,559 metric tonnes gradually increased (with slight fluctuation in-between) to 27,200 metric tonnes in 1978-79 and drastically fell to 12,020 metric tonnes in 1980-81.

These industries have not been successful in offering industrial products in adequate quantities. This had inadvertently forced Nepal to increase imports of the products from India and other countries. In other words, despite of so much of emphasis by the HMG, the performance of the industrial sector is dismal and appears to be bleak at least for a next decade.

Despite of so much of plans and publicity of the HMG, the contribution of industrial sector to Gross Domestic Product (GDP) is only 10 per cent and only 1 per cent of the total labour force engaged in this sector.[10]

The President of the Federation of Nepalese Chambers of Commerce and Industry (FNCCI) said in its Thirteenth Session (11 June 1979), that 'ambiguous rules and regulations, vague programme and policies and faulty implementation of programmes have dampened the entrepreneurial spirit in the country.'[11]

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10 Sainju, M.M., "Wither Industrialisation Strategy", Nepal Industrial Digest, NIDC, Kathmandu, 1982, p.2.

11 Commerce, 7 July 1979.

Stiff Indian Competition

Nepal also faces a very competitive and relatively efficient industrial sector of India for potential market.[12] In the face of increasing competition from relatively cheap mass manufactured products imported from India and elsewhere, certain distinctive small scale industrial, oneeof considerable importance in the urban areas of West Central Nepal, have suffered a major decline, in some case almost to the point of total elimination.[13]

Inconsistent Government Policies

After reviewing the industrial development in retrospect, it would be amply clear that, (1) effective import substitution programme is not yet launched, 2) most of the existing industries either suffer from low efficiency of import dependence in production, and 3) the move from consumer to intermediate and capital goods is not initiated effectively.[14]

The setback witnessed by the industrial sector was mainly due to the fact that a) planning objectives had not been able to guide industrial development pattern in an effective manner, 2) there was lack of intersectoral coordination and supportive institutions to help private industrial development and foreign investment was not made attractive.[15]

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12 Sainju, n.10, p.2.

13 Blaikie, et. al., Ch.II, n.102, p.189.

14 Economic Times, Special Supplement on Nepal, 29 December 1982

15 Ibid.

The vascillating industrial policy of HMG, the totalitarian tendency of ministers and top ranking officials, corruption and the desire to amass wealth overnight were factors which had contributed to the industrial backwardness of Nepal.[16]

Power and Corruption

Only a few industrialists who have connections with the higher power echelons or who are capable of bribing the persons in power have been able to avail of the facilities and undue concessions not even provided by the industrial policy. This is chiefly due to inept administrative system, lacking competence, integrity and honesty in effectively executing the discretionary operational measures.[17]

Government's own actions have been quite contrary to its policy and pledges. This amounted to the loss of faith by the entrepreneurs in government pronouncements and policies and have focussed their investment activities in ventures that assure quick profit, like land speculations, trade, etc.[18]

The corruption at both lower and higher levels while handling the necessary files of entrepreneurs has followed a 'circular causation with cumulative effects' which by and large is the major hurdle in the road of development of Nepal.[19]

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16 Samiksha Weekly (Kathmandu), 6 November 1972.

17 Poudyal, Ch.III, n.34, p.111.

18 Ibid.

19 Ibid., p.112.

Institutional Drawback

The Nepal Industrial Development Corporation (NIDC) was established in 1959 to facilitate industrial development in private sector by providing financial and technical assistance.[20]

The performance of NIDC during more than two decades of its existence has raised eyebrows. Its figures show that it has invested vastly more in the tourism sector than in forest based industries or in rural and cottage industries or mining industries. Tourism has replaced jute as the prime foreign exchange earner. Yet its effect on national economy is not pronounced, as most of the earnings are spent on procuring items from abroad.[21]

Moreover, the institutional infrastructure is yet to develop in an effective manner to promote industrial development in Nepal.

Unemployment and Capital Intensity

The failure of the Nepalese manufacturing to expand employment seems to have been mainly caused by the existing policies which provides loans for investment in fixed assets at low interest rates, the over-valuation of exchange rates and concessions to the import of capital goods. They have lowered the cost of capital and encouraged the use of capital

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20 Nepal Industrial Digest, NIDC, Kathmandu, 1982.

21 Commerce, 7 July 1979.

intensive techniques. This has been further affected by foreign aid donors who usually encourage capital intensive technology in Nepal.[22]

Historical Drawback:

Due to historical reasons entrepreneurial expertise has not yet developed in Nepal like other developing countries. Ranas, the kingpins of Nepalese investments, always neglected Nepal. They were basically interested in investing in India and abroad which was more profitable. They found India to be politically more stable place and less risky. Nepal did not provide the avenues to them. The post-war failures further discouraged them to invest in Nepal.

III. Indian Private Investments in Nepal

Private foreign investment has been generally shy in Nepal. Prior to 1950, very few private ventures took place in Nepal. Among the factors which inhibited private foreign investments, political instability, landlockedness and poor infrastructure facilities, shortage of trained labourers, low purchasing powers and ineffective government policies were quite noticeable.

The industries which sprouted during 1936-42 were mostly funded by the Indian capitalists. These industries included jute, sugar and matches. But the loss in the post-war period created crisis and concommitant loss of confidence among the investors.[23] Firms which had not ploughed back any of their profits for modernisation began to be bankrupt.[24]

22 Poudyal, Ch.III, n.34, p.98.

23 Rawat, Ch.II, n.9, pp.220-21.

24 Mihaly, Ch.IV, n.17, p.12.

The result of first Indo-Nepalese private collaboration was Biratnagar Jute Mill set up in 1936.

After the Second World War, a number of joint stock companies were set up in Nepal by Indian merchants in collaboration with local initiative and capital. An agreement restricting the participation of foreign capital upto 50 per cent of the equity and debenture capital was reached.[25]

In order to make the industrialists of both the countries aware of each other requirements and opportunities in technological and commercial fields, India organised an industrial exhibition in Nepal in 1965.[26]

The GOI further allowed concessions to the desirous Indian investors in Nepal. The Finance Act of 1966-67 provided for a tax concession of 25 per cent on the dividends received by Indian companies on such investments. Further, it extended concessions of royalties, commissions and fees payable on such enterprise.[27]

In February 1962, an agreement was signed between one of the largest business houses in India - the Birlas - and the HMG to establish a cotton textile mill at Hetauda. As an incentive Nepal provided a 12-year tax holiday and 8 years of excise exemption and guaranteed no nationalization for 41 years.

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25 Rawat, Ch.II, n.9, p.224.

26 Ibid., p.226.

27 Report on Currency and Finance, Reserve Bank of India, Bombay, 1966, p.26.

Further, Nepal assured Birlas of full compensation in case of such an event.[28]

However, in 1967 the construction of mill building had to be given up following an increase in cost of production reportedly due to revaluation of Nepalese currency in 1966.[29]

In September 1963, a six-member team of Federation of Indian Chambers of Commerce and Industry (FICCI) visited Nepal to explore industrial prospects in Nepal and showed willingness to set up some industrial units there. The HMG offered to provide them with land, foreign exchange, tax relief, power and tariff protection.[30]

Golcha is the second major business house from India who have been actively involved in the industrialisation of Nepal. It established woollen factory with 4800 spindles involving an investment of Rs 20 million. Since 1964 this firm has been running a catechu mill with a capacity of twenty tonnes per day at Nepalganj.[31]

However, this business concern had to forgo its proprietorship of these units as it was declared a defaulter in the repayment of a yen loan secured on the Government's security.[32]

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28 Rawat, Ch.II, n.9, pp.229-30.

29 Tribhuvan Nath, The Nepalese Dilemma, 1960-74 (Sterling, Delhi, 1975), p.72.

30 Jha, Ch.II, n.8, p.237.

31 Rawat, Ch.II, n.9, p.230.

32 Tribhuvan Nath, n.20, p.65.

The Prabhat General Agencies took on lease Nepalese forests for a period of twenty years to manufacture five thousand tonnes of resin and one thousand tonnes of turpentine each year. To start with, company put a capital of Rs 5 lakhs which was later increased to Rs 5 million in five years. The products are used by paper, soap, textile, paints and chemical industries.[32]

Another private investor Sahu Jain Group received the permission to open a sugar mill near Krishnanagar with a daily capacity of crushing one thousand tonnes of sugarcane in 1963. A starch and glucose factory owned by M/s Dhirajlal Brijlal of Calcutta have been permitted to instal the same in Nepal with the capital of Rs 5 crores. This firm will produce 1270 tonnes of starch and glucose per annum.[33]

To overcome the major hurdle of capital, GOI and HMG signed an agreement in September 1964, providing for a loan of Rs 1 crore (IC) at a rate of 3 per cent interest. This was mainly to promote small and medium scale industries in Nepal.

In addition to the above mentioned Indian ventures in Nepal, the following ventures were undertaken by the Indian private investors in Nepal upto 1966.

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33 Rawat, Ch.II, n.9, p.230.

TABLE II

Sl.No.	Name of the Party	Total Capital Investment (Rs lakhs in NC)	Loan Advanced by the NIDC (Rs lakhs in NC)
1.	Messrs Indo-Nepal Industrial Corporation, Simra	280	60
2.	Messrs, Dharatidun (P) Ltd., Nepalganj	16	9.12
3.	Cold Storage and Ice Making Plant	14	7.06
4.	Messrs Ashoka Textile (P) Ltd., Biratnagar	45	6.07

Source : Indian Trade Journal, Delhi, 1 June 1966, p.A733.

Another Indian industrialist N.A. Bidya was permitted to establish a factory for producing flour as well as vegetable ghee at a cost of Rs 12.5 million in Hitauda. NIDC agreed to give a foreign exchange loan amounting to Rs 8.5 million to finance the import of machinery as well as some raw materials.[34]

In January 1977, Birla Group of industries obtained a licence for the establishment of a sugar factory in Kapilavastu district in Nepal in collaboration with a private Nepali industrial firm. Fifty per cent shares are held by the Nepali firm. The capacity of sugar factory will be one lakh bags annually.[35]

34 New Herald (Kathmandu), 1 May 1970.

35 Nepal Today (Kathmandu), 10 January 1977.

At present Indian private sector investment in Nepal is being confined to seven ventures, one each in brewery, manufacture of ghee, production of dry cells, conversion of wood into splinters and in hotel business and two engaged in mining operations.[36]

IV. <u>Nepalese Incentives to Private Foreign Investment:</u>

In the First Plan, Nepal invited foreign capital for large scale industries subject to the condition that the participation of foreign capital 'will safeguard independence and integrity of the Nepalese economy and will give adequate assurance to the investors regarding their fair return and guarantee.'[37]

The 1957 Industrial Policy of Nepal specified that all industries other than those manufacturing arms, ammunitions and explosives would come under domestic or foreign private enterprises on conditions of mutual agreement regarding repatriation of profits and capital. It exempted foreign investment from double taxation.[38]

The Industrial Policy of 1962 further removed all the restrictions on the private foreign investment. The foreign investors were entitled to remit upto 10 per cent of their investment in the form of profit and equality of

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36 IIFT, Ch.III, n.47, p.85.

37 First Five Year Plan, HMG, Kathmandu, pp.56-57.

38 Shrestha, n.5, p.261.

treatment was ensured by the Industrial Enterprises Act 1961. Nepal declared income tax concessions for ten years, exemption of excise duty to new units, exemptions on import of machinery, parts and raw materials, repatriation profits and capital upto 25 per cent.[39]

The Industrial Enterprises Act of March 1974 provided further relief to foreign investors. Unlike the earlier concessions, this new act permitted only ten per cent of the capital and 25 per cent of the profits to be taken in the form of convertible currency.[40]

Under the New Industrial Policy of 1982, the Industrial Enterprises Act and Foreign Investment and Technology Act have been promulgated. Two major facets of this new policy are encouragement to private sector and attracting foreign investment. In the latter case the objective is to promote capital inflow, generate technical expertise and improve productivity. Foreign investment may take the form of either totally foreign owned enterprise or with Nepalese foreign collaboration.[41]

Foreign investment is said to be encouraged through government protection, no nationalization pledges, remittance in foreign currency of all profits earned and twenty per cent per annum of invested capital. Prior to this, the foreign investors could remit ninety per cent of the declared profit and twenty per cent of invested capital per annum only after a period of five years.[42]

39 Rawat, Ch.II, n.9, pp.224-25.

40 Times of India (Delhi), 26 July 1978.

41 Economic Times (Delhi), 29 December 1983.

42 Poudyal, Ch.III, n.34, p.110.

Unlike the past, the foreign investors are free to invest in the medium and large scale export-oriented industries in Nepal. Restriction is put only on the cottage and small scale industries.[43]

V. <u>Constraints on Indian Private Investment</u>

It is ironical that while Indian business houses have been fairly successful in setting up joint ventures in a number of countries somewhat afield, their progress ~~is~~ in the neighbouring countries has been negligible.

Indian private investment is very negligible in Nepal compared to the potentiality of Indian business houses. There are several factors which have hindered the growth of Indian private investment in Nepal.

First and foremost is the frequent changes in the HMG's policies with commitments and policies moving in all directions.[44] Further, the numerous fluctuations in exchange rates, absence of monetary institutions and rediscounting facilities in Nepal made the ventures unattractive in Nepal.[45]

Sometimes the very Industrial Policy of Nepal appeared to be a constraint. For instance, cottage and small scale industries still play a major role in Nepalese economy. In view of the limited purchasing power of the majority of the people and the small size of the domestic market, the prospects of establishment of big industries in the country are limited.

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43 Shastri, P.B., "Industrialisation in Nepal", <u>Nepal Industrial Digest</u>, NIDC, 1982.

44 Poudyal, Ch.III, n.34, p.115.

45 Shastri, Ch.II, n.124, p.231.

The landlocked nature of the country also makes it difficult to set up industries catering exclusively to export markets. Under the circumstances, to meet the demand of the scattered local markets, labour intensive small and cottage industries seem to offer maximum scope. But in the Industrial Policy of 1982, HMG has put a reservation of ownership and investment in cottage and small scale industries to Nepalese nationals only. This has certainly discouraged the Indian investors.[46]

Secondly, the inadequate infrastructure, the under-developed energy sector, roads and communication made the Indian private investors think twice before they finally moved into Nepal. This created a whole range of problems from the procurement of raw materials to the marketing of final products. This argument is amply substantiated by the fact that major chunk of the industries of Nepal has been concentrated in Eastern Terai mainly in Biratnagar area as this area provided an easy intercourse with India in terms of marketing and availability of raw materials and free use of Indian currency.

Far from encouraging Indian investors, Nepal's National Panchayat passed an official resolution in 1965 ruling that no foreigner will be allowed to set up new mills and factories in Nepal within three miles radius of the border.[47]

The third factor contributing to the shyness of Indian private investment in Nepal perhaps lies in the fact that till

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46 IIFT, Ch.III, n.47, p.86.

47 Tribhuvan Nath, n.29, p.66.

now it has been more profitable for Indian businessmen to trade with Nepal rather than to invest directly in it.

Fourthly, despite the best intentions and promising opportunities, it is not easy to visualise any significant inflow of Indian capital into Nepal because generally capital outflows occur only when areas for domestic investment are fully saturated i.e. local capital becomes surplus or cannot be efficiently utilized at home. This is far from being the case in India.[48]

Further investment in manufacturing capacity will presuppose the existence of an adequate local market or the imminent establishment of such a market for the end production. Both these have limited possibilities in Nepal because of low purchasing power among the people.

Fifthly, we find that the Nepalese circles are generally averse to Indian investment in Nepal. When the Nepalese Prime Minister advised the Nepalese industrialists at the Sixth Session of the FNCCI to establish industries in collaboration with foreign capitalists, there were widespread repercussions in the press.[49] 'In the light of the manner in which Indian businessmen have been continuing their economic exploitation of Nepal, we wonder whether we should encourage foreign capitalists in Nepal. The industries set up by Indians have not benefited Nepal. The huge profits made by

48 Financial Express (Bombay), 24 September 1982.

49 Matribhumi Weekly (Kathmandu), 16 May 1972.

them are repatriated abroad without payment of taxes. This will only foster a semi-colonial economy in Nepal',[50] commented two noted papers in Nepal.

These allegations are not totally baseless. There are many instances in which Indian investors' selfish and harmful motives and attitudes have been exposed.

Though Indian industrialists on their own set up some industries in Nepal, their main purpose was not so much the industrialisation of Nepal as the evasion of income tax on their black money in India and quick profit from such investments. Therefore, they concentrated on setting up synthetic fibre and stainless steel plants which were totally irrelevant to the needs and requirements of Nepal. They were further exposed when the famous Birla Brothers, backed out of their commitment to set up a textile industry despite a threat from the Nepalese government to take legal action against the firm.[51]

India must try to understand and improve its participation in the Nepalese industrial development through its private sector financial clique. It should increasingly make efforts to minimise the Nepalese apprehensions and hostility towards Indian capitalist class. This, after all, is a product of past experience in which Nepalese felt that they were deprived of fair deal by the participating Indian capitalists.

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50 Jana Jagriti Weekly (Kathmandu), 21 May 1972.

51 Jha, Ch.II, n.8, p.238.

In a broader parlance Nepal will have to shed some of its inhibitions regarding India which it has always viewed - occasionally with some justification - as being too overbearing and contemptuous of Nepalese needs and sensibilities. In a sense, Nepalese view of India is not dissimilar to the Indian view of the West. Unless certain adjustments in perceptions are made, Nepalese experience vis-a-vis Indian investment is likely to remain similar to that of Indian experience vis-a-vis Western investment in India during the last few years.[52]

VI. India's Joint Ventures in Nepal

The term'joint venture'has been defined as a form of association, including commercial and industrial collaboration, in which two or more countries share responsibilities for the operation of a company by providing risk capital, goodwill, knowhow and managements in an agreed manner.[53]

It is generally felt that the cost of private investment and technology transfer has been very high. Many of these investments and transfer of technology have also been inappropriate. Recognising the need for cooperation among developing countries, India, although a capital scarce country, began a policy of permitting Indian investment in a selective manner to go to various developing countries.[54] India could pursue this by virtue of the fact that it possesses a pool of

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52 Financial Express, n.48.

53 IIFT, India's Joint Ventures Abroad, 1977, p.3.

54 Ibid., pp.(1) and (ii).

technically trained personnel and experienced managerial talent.

The first Indian joint venture abroad was sanctioned as far back as 1959 through the Birlas in Ethiopia. But it was only from 1970 onwards that the GOI recognised the role of Indian joint ventures abroad as part of the export promotion strategy and as an instrument for forging close economic ties with other developing countries.[55]

An important byproduct of this system, it enables India to find markets for its capital goods,products and also gives it a base for earning foreign exchange in the years to come. This is an element of the export expansion drive undertaken by India.[56]

Very largely the objective is to limit the contribution to share capital by way of equipment and services. Thus, intending Indian investors export machinery against equity which is treated as exports.[57] It did not allow equity participation in the form of cash unless some very special conditi-tions warranted otherwise.[58]

GOI insists that Indian companies should not take more than 49 per cent of the equity and they should try to give training to local parties.[59] The policy insisted on taking

55 "Indian Joint Ventures Abroad", India Backgrounder, vol.II, no.47 (99), 20 February 1978, p.1041.

56 IIFT, n.53, p.1.

57 Ibid., p.2.

58 Balakrishnan, K., "Indian Joint Ventures Abroad", Geographic and Industry Pattern", Economic and Political Weekly, 29 May 1976, p.M-35.

59 IIFT, n.53, pp.2-3.

Indian made original equipment in lieu of equity in the foreign operations.[60]

As on Ist July 1982, over 288 joint ventures involving an investment of over Rs 1200 million or US $133 million were actively operating in about 36 countries, including developed market economies.[61]

In most cases the ambivalent attitude of Nepal has been the major impediment. She is keen on acquiring technical knowhow and domestic manufacturing capabilities and is politically also on good terms with India. However, her 'small nation fear' about possible political domination through business and economic domination need to be alleviated.

In this atmosphere too, the Indian joint ventures have walked into Nepal with full of promise and aspirations. Table III gives a clear indication that gradually the Indian joint ventures are making strides in Nepal. So far nine joint ventures have been undertaken in Nepal by India. Following ventures are worthnoting.[62]

<u>Metallic Project</u>

The cost of zinc and lead project being set up at the food hills of Ganesh Himal (Central Nepal) has been revised to Rs 12.5 crores (NC) from original Rs 9.6 crores (NC). This is likely to be completed in schedule. In this venture HMG and Nepalese people will control fifty per cent of the

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60 Balakrishnan, n.58, M-35.

61 <u>Workshop on Indian Joint Venture, Abroad and Project Exports (Report)</u>, FICCI, New Delhi, 31 July 1982, p.1.

62 <u>Economic Times</u> (Delhi), Special Supplement on Nepal, 29 December 1982.

TABLE III

INDIAN JOINT VENTURES IN NEPAL

Sl. No.	Name of the Indian Collaborator with the address of Overseas Venture	Field of collaboration	Indian Shareholding	Date of approval/ Date of production in brackets
1.	M/s Oberoi Hotels (India)Ptv.Ltd, Calcutta OA M/s Hotel Soaltee Oberoi, Kathmandu, Nepal.	Hotel	8.48% Total cost N Rs.98.5 million	7.5.1977 (Nov.1978)
2.	M/s Hyderabad Asbestos, Cement Products, Ltd., Hyderabad. OA M/s Nepal Company Ltd., Thapathali, Kathmandu	Exploration of Minerals	25% of total equity N Rs 6 million	5.10.77
3.	M/s ITC Ltd.(Hotel Div.), Hotel Maurya, New Delhi	Hotel	8.04% of total equity N Rs 7.40 million	12.10.1977 under implementation
4.	M/s Orissa Industries Ltd.Rourkela. OA - M/s Nepal Orind Magnesite (P) Ltd., Kantipath,Kathmandu	Mining of magnesite and manufacturing of refractories	50% total equity N Rs.41 million	11.7.1978
5.	M/s Chemical Construction Co. Pvt. Ltd., New Delhi	Vegetable ghee	25% total equity N-Rs 10.34 million	18.9.1978
6.	M/s Union Carbide India Ltd., Calcutta	Dry Batteries	77.4% total cost of project I-Rs 17.7 million	19.12.1980
7.	M/s Mohan Meakin Ltd.,New Delhi OA - M/s Himalayan Brewery, Kathmandu	Manufacture and Bottling of Beer	20% total equity N. Rs 8.26 m.	28.12.1981
8.	Triveni Engineering Works.Ltd., New Delhi	Sugar Mill	Total equity Rs 215.75 lakhs. Indian equity Rs 105.75 lakhs.	28.7.76
9.	Upper Ganges Sugar Mills,Calcutta	Sugar Mill	Total equity Rs 200 lakhs Indian Rs.100 lakhs	22.11.76

OA - Overseas Address
Source: Workshop on Joint Ventures Abroad and Project Exports (Report), FICCI, New Delhi, 31 July 1982, Annexure I, pp.75-77.

total authorised equity capital of Rs 5 crores (NC), 25 per cent by Hyderabad Asbestos Cement Products Ltd., a Birla concern and the remaining 25 per cent by Golden Moffit and Associates, an UK company. It is learnt that the HMG will eventually hold about 49 per cent of the total account.

UCIL Tie Up

A joint venture between Union Carbide India Limited (UCIL) and entrepreneurs in Nepal will set up Nepal Battery Company (NBCL) with a capacity of 12 million dry batteries per annum on a single shift basis. Situated in Balaju, Kathmandu, the cost is estimated at Rs 2.25 crore (NC) and is expected to be completed in 1984. The UCIL which has an experience of 60 years in this business, will be extending technical knowhow in several areas. These include, among other things, work control methods, product standards, pollution control procedure and ancillary package. This is a total transfer of technology supported by continuous training of NBCL personnel.

Nepal Orind Magnesite Pvt. Ltd.

This project is located at Lamo Sangu and is jointly promoted by HMG and Orissa Industries Limited (Orind) at the cost of Rs 32.8 crores. This has an annual capacity of producing fifty thousand tonnes of dead burnt magnesite. For technical knowhow, an agreement with Harbinger Walker, an American Company has been reached. In the total equity capital of Rs 9.87 crores (NC) both HMG and Orind will invest fifty per cent each. The project is under implementation.

Himalayan Brewery Ltd.

It started production in 1983. This Rs 2.85 crores (NC) project is co-promoted by the HRH Prince Shobha Shahi and Associates and famous Mohan Meakin Group of India. It has a licenced capacity to produce fifteen thousands hectro litres of beer a year.

Hotels:

India's famous Oberoi Hotels Pvt. Ltd. is building a hotel. This will incur a total cost of N. Rs 98.5 million. Indian party is fully responsible for managing and running the hotel. No dividend has so far been declared on account of restrictions imposed by the financial institutions. N Rs 27.4 lakhs earned as technical know-how fee has been capitalized towards equity. The Indian party has also received N Rs 21 lakhs as managerial fee and bonus shares of the value of N Rs 4.24 lakhs.

The Messrs ITC Ltd. (Hotel Division) was to build a hotel and was likely to go into operation by November 1982.

Others

An Indo-Nepalese collaboration on vegetable ghee is also under implementation. This has been possible because of M/s Chemical Construction Company Pvt. Ltd. of Delhi.

VII. Potential Areas of Joint Ventures

Nepal offers good prospects for joint venture projects for Indian entrepreneurs. Basic socio-physical infrastructure is now available in this land-locked country. Nepal is making a concerted bid to attract foreign investment. The political climate is more propitious. However, India has not been able to take advantage of this situation. Her investment in Nepal is still insignificant.

As a least developed country, Nepal is not faced with quota restrictions in the western markets in respect of a number of products. The quota under this GSP scheme remained practically unutilized. This situation can be taken advantage of by Indian entrepreneurs to locate export-oriented units in Nepal.[63] And this can cater very well to the export markets available in the USA, EEC and Japan under GSP scheme.[64]

As the Indian currency has been treated as soft currency, Indian investors enjoy an advantage compared to investors of other countries.[65]

The following industries[66] offer scope for Indian investment in Nepal.

Processed Fruits:

The country's fruit production is estimated to rise from 24.45 lakh tonnes (1982) to 32.15 lakh tonnes in 1985. Although about 30 units are engaged in producing jam, marmalades and juices, most of them are in the small and cottage sectors. The increasing hotel sector, constitutes a sizeable market for this venture.

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63 IIFT, Ch.III, n.47, pp.11-12.

64 Hindustan Times (Delhi), 23 September 1982.

65 Economic Times (Delhi), 29 December 1982.

66 IIFT, Ch.III, n.47.

Mushrooms

It is another potential area of joint venture. The agro-climatic and the terrain of the country appear to offer prospects for mushroom farming on a commercial scale in the kingdom.

Leather, Hides and Skins

These constitute a significant export item of Nepal. Goat skins of Nepal are considered to be of very high quality and find markets in developed countries. Presently there are seven units engaged in the processing of hides and skins, four units manufacturing leather shoes and two more units engaged in manufacturing leather chappals. This area offers immense scope for Indian investment in setting up integrated complex of goat farming and manufacturing leather goods for exports.

Skimmed Milk Powder and Baby Food

Though Nepal is rich in dairy products most of her requirements are met through Indian imports under quota system. A tremendous scope prevails for investment in this field.

Forest Products

About one-third of Nepal is covered by rich forest resources. The existing forest based industries in the country are limited to seasoning of wood and manufacture of plywood and corrugated wood. Indian investors with such a vast experience can always open up forest based industries with corresponding afforestation programme, for the manufacture of paper and paper pulp, plywoods, resins, gums, terpentine, match, toys, etc.

Herb:

Nepal is a prime exporter of medicinal herbs. An opportunity is open for Indian entrepreneurs to get involved in an integrated scheme of production and processing of herbs for exports.

Jute Carpet Backing

Nepal produces as well as exports raw jute, jute cutting, jute bags and jute ropes. It has annual production of more than 67 thousand tonnes. However, it wants to diversify its production in order to face the external challenge. Indian investors can help Nepal in the manufacture of jute carpet backing which would fetch Nepal higher units value for its export product.

Textiles

Though there are ten textile mills producing 30-40 lakh metres textiles per annum in Nepal, at present, this meets only a small portion of the domestic demand of 178 million tonnes metres per annum. Scope exists for increasing the production through handloom, powerloom and mill-made products with the help of Indian investment.

Cement

Nepal produces only 29 thousand tonnes of cement per annum against the total requirement of two lakh tonnes. The balance is usually met by import from India. The proposed Indo-Nepalese venture in cement to be set up at Udaipur will meet both domestic demand as well as exports to India. This Rs 106 crores (IC) project producing 1200 tonnes a day would have a total equity of Rs 26.5 crores to be shared by the two countries in the ratio of 45:55 per cent. The Export-Import (EXIM) Bank of India might finance the project.[67]

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67 Hindustan Times (Delhi), 12 April 1984.

Manufactures

The country offers scope for setting up assembly and/or manufacturing plants for bicycles, radios and transistors, electrical goods, tools, agricultural implements, pipes, tubes and sheets of different metals, soaps, razer blades, glassware, crockery and furniture.

Oilseeds:

Linseed, groundnut (peanut) and mustard are grown in substantial quantities throughout the country and though there are numerous mills, a large portion is exported to India for processing of unprocessed. Indian investors can easily take up this attractive avenue of processing oil-seeds.[68]

Nepal has tremendous untapped resources. On the Kathmandu-Kodari highway built by China, geologists sent to Nepal under the UN auspices have reported deposits of bauxite, copper, lead, zinc and tin. India can help Nepal to establish non-ferrous metal industries for which the demand in India is quite high.[69]

VIII. Joint Ventures - Some Promising Ends

Indo-Nepalese joint ventures in the industrial development of Nepal have a promising future. Although several joint ventures have been initiated, they have not yet made any significant strides.

Joint ventures must be conceived with the idea of securing the vast Indian market and India serving as a source

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68 Investing in Nepal, NIDC, Kathmandu, 1968, p.10.

69 Banskota, Ch.III, n.6, p.117.

of uninterrupted supply of required chemical and auxiliary materials at the most favourable prices. While this is so, Nepal's primary intention is to reduce the trade deficit and to utilize local capital, skill and resources and create more employment opportunities to absorb surplus agricultural labour.[70]

Further, industrial development in Nepal would not only yield benefits in terms of higher income and employment to the people of Nepal but also lessen the dependence on India for imports and change the structural weakness of the country emanating from its preponderant dependence on agriculture.

The Planning Commission of Nepal in its industrial programme contained in the Draft VI Plan blamed the open and unrestricted international border for narrowing down the scope for the free growth of industries in the Kingdom and asked for the scientific control of the open border to enable local industries to flourish.[71] More recently, the submission of a report on population by H.B. Gurung, former Finance Minister of Nepal, has highlighted the population problem created by the open border system. In other words, the open border system has started to be questioned, if not challenged, mainly by the Nepalese. The issue of presence of Nepalese in India and Indians in Nepal have been a nagging irritant in the general Indo-Nepalese relation.[72]

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70 "Indo-Nepal Joint Venture", Commerce, 20 October 1979.

71 Banerjee, Ch.II, n.137, p.605.

72 Muni, S.D., "Nepal", World Focus, Annual Number, November-December 1983, p.95.

The presence of Indians in Nepal can largely be dealt with under the framework of Indo-Nepal Peace and Friendship Treaty while the issue on the Nepalese in India can be solved to a large extent by further industrialisation of Nepal.

The flow of Indian capital in the making of advanced sectors in Nepal can be interpreted as an alternative to massive labour migration from Nepal to India. This will enable the labour force to be easily absorbed in the advanced sector in Nepal. The social benefit from the foreign investment in the advanced sector is greater than the profits on the foreign investment. Because the wages received by the newly employed in this advanced sector would exceed their formal real wages in the rural sector. This excess will be added as a national gain. The economies of scale created by these ventures will further provide Nepal with many social overhead benefits.

This will, to a large extent, solve the migration of Nepalese labour into India which often creates misunderstanding and identity problems among the Nepali speaking Indian citizens generally referred to as Indian Nepalese. Further, this will give a distinct Indian identity to these more than six million Nepali speaking Indians born in India who have nothing to do with Nepal, Nepalese economic and political plans and programmes. These Nepali speaking Indians only by the mere coincidence of having Nepali as a common mother language, have often been intermingled and misinterpreted as 'Nepalese' - categorically meaning citizens of Nepal - in utter disregard to their utmost loyalty, deep rooted dedication and profound patriotism towards their motherland - India. This sometimes disturbs their sentiments and challenges the very fabric of their existence. Moreover, these Nepali speaking Indians keep a distinct demarcation vis-a-vis Nepalese from Nepal.

Further, the Nepalese domestic consumer may also benefit through the lower product prices when the investment is cost reducing in a particular industry. If the industry is product improving or product innovating, consumers benefit from better quality products or new products.

Indian foreign aid has already acted as a major pace-setter by creating the social overhead capital and infrastructure necessary to attract a subsequent flow of private capital from overseas. So, the central problem now is of creating a favourable climate and minimising the deep rooted apprehension that the inflow of private capital entails nothing but foreign domination. Nepal can put up all-out efforts to ensure the former aspect whereas India can do a lot in minimising the latter.

From Nepalese side, a progressive liberalization of policy towards private foreign capital is needed. These incentives devices include assistance in securing information on investment opportunities, the provisions of supplementary finance, more infrastructure facilities, protective tariffs on commodities that compete with these produced by foreign investors, exemptions from import duties on necessary equipment and materials, the granting of exchange guarantees, tax concession schemes and special legislation for the protection of foreign investors.

The attraction of private foreign investment now depends less on fiscal action and more on other conditions and measures that guarantee protection of the investment. It is necessary to allay the investor's concern over the possibilities of discriminatory legislation, exchange control and the threat of expropriation. It is most important to raise the investors profit expectations.[73]

On the other hand, India has to introduce suitable flexibility in her foreign economic policies with her vast experience in the field of management and technology.

The Indian private investors must be aware of the developmental objectives and priorities of Nepal and understand how their investment fits into Nepal's development strategy. With rising per capita income created by private investment, the Nepali consumers will be able to buy more consumer products in India.

However, a large influx of foreign investment might positively affect Nepal's terms of trade through structural changes associated with the pattern of development. In other words, this increase in private foreign investment would escalate the industrial production in Nepal which, on the

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73 Meir, Ch.III, n.85, pp.376-77.

one hand, would help reduce the imports of such products and on the other hand, can be exported if produced in adequate quantum. This will change the trading character of Nepal, which now mostly imports manufactured goods and exports primary goods, obviously adversely affecting the terms of trade.

India and Nepal have been meeting for the speedy implementation of several projects listed in the Memorandum of Understanding of September 1978.

A multi-disciplinary team from India visited Nepal in 1979 to identify areas for setting up joint ventures. At the discussion, the Nepalese side maintained that only a dynamic economic relationship of constructive inter-dependence based on environmental realities rather than ad hoc adjustment would ensure a durable and peaceful political relationship.[74]

The President of FICCI offered the assistance of Indian entrepreneurs to Nepal in imparting training on planning, monitoring and coordination of industrial projects. Nepal has invited the Indian private sector to set up joint ventures in that country not only to meet the internal requirements but also to cater to export markets. Nepal welcomed the industrial tie-ups in power plants, pumpsets, match making, small-scale iron and steel plants, textiles, leather and leather products, fruit process and bio-gas development.[75]

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74 Commerce, 20 October 1979.

75 Hindustan Times (Delhi), 23 September 1982.

Recently a team of industrialists led by the President of Punjab, Haryana and Delhi Chambers of Commerce and Industry (PHDCCI) after having extensive discussion with the industrial circles of Kathmandu returned with a firm hope that there is scope for joint industrial ventures in Nepal. Eleven areas have been identified for possible joint ventures and transfer of technology from India to Nepal. These include chemically treated timber components for cooling towers, a flexible pouch-packaging system, an electrical distribution system, computer softwares, rubber rollers for flour mills, canvas shoes, manufacture of raw materials for rubber industry, cycle tyres and tubes, transformers, oil filters and automobile filters.[76]

For consideration of HMG the PHDCCI study suggested that one window approach for all clearances and tying up of incentives, stable fiscal policy for at least five years, review of duties collected on Indian equipment and raw materials and refund of the same to local entrepreneurs to remove anomaly which makes Indian products uncompetitive vis-a-vis products from other countries. It further asked for concessional duty for commercial vehicles, assured availability of power at stipulated rate for a pre-fixed period of, say, five years, liberal depreciation and reduction of NIDC commitment charge of 0.75 per cent for large projects.[77]

76 The Tribune (Chandigarh), 10 May 1983.

77 Special Supplement on Nepal, Economic Times (Delhi), 29 December 1983, pp.i-v.

For consideration of the GOI, the delegation recommended allowing some percentage of imports in India of products of Indo-Nepalese joint venture in view of the small size of the Nepalese market, special dispensation to facilitate setting up of units in Nepal for export to third countries and creation of a Nepal desk in Commerce Ministry.[78]

A slight change in the stipulation of Indo-Nepalese Trade Treaty of 1978 is also desirable. The protocol of this Treaty stipulated that all goods containing not less than 80 per cent Nepalese materials or Nepalese and Indian materials can be exported to India free of basic duty and without any quantitative restrictions. A reasonable cut in the above percentage will facilitate use of cheaper third country inputs available in Nepal. This would have not only reduced the cost of production but also the goods could have been made more competitive.

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78 Ibid., p.v.

CHAPTER VI

CONCLUSION

An analytical study of Indo-Nepalese Economic Cooperation provides us with a close and durable picture of economic relations between two developing countries in which one country is relatively less underdeveloped than the other. In such a relationship it is not unusual to anticipate the emergence of irritations at times. As a noted Nepali scholar puts it: "It is precisely because we meet at so many points that there have been so many points of differences. We should not be disappointed by this nor compare invidiously this friction, arising from intimacy, with the smooth and easy flow of other relationships." Differences, both political and economic in nature are inevitable to make the bond of friendship more strong and durable. Mutual esteem, tolerance and perseverance from both the sides are required.

The first Indo-Nepalese Treaty on Trade and Commerce signed in July 1950 has undergone substantial changes as incorporated in the subsequent Treaties of 1960, 1971 and 1978. These changes were in tune with the needs of time and experience.

The operations of these treaties were usually characterised by problems and challenges arising out of the developing nature of both the countries. Political inhibitions, external exposures, misinterpretation of the provisions of the treaties and mistrust and suspicions made the implementation more difficult and erratic. Nepalese invariably complained of procedural delays, inadequate transit facilities and even went to the extent of raising these bilateral issues in the international forums much against the spirit of this cooperation. On the other hand, India was hard hit by certain Nepalese economic policies such as Gift Parcel Scheme and Export Exchange Entitlement Scheme. The former scheme was immediately wound up as it became counter-productive to Nepal also. The latter scheme remained a bone of contention between India and Nepal for more than a decade. Nepal lately realised that contrary to her massive economic expectations she was literally reduced to a mere entrepot between India and other countries. The EEE scheme brought about only a false sense of growth. It distorted the patterns of trade and investment in Nepal. Contentwise this scheme benefited only a small chunk of people in Nepal. Nepal maintained double standard. On the one hand it alleged that the scheme was fully exploited by Indian businessmen and on the other hand insisted on the continuation of this scheme much to the distress of India. India increasingly felt the brunt of this hazardous policy as goods imported far in excess of Nepalese demand found easy way and market in India. India lodged its unhappiness. At this stage, Nepal appeared to have resorted to some sort of bargaining that either two separate treaties on trade and transit be signed or else the continuation of this hazardous scheme be permitted.

The signing of two different treaties on Trade and Transit in 1978 was of great help and importance to Nepal. India extended a number of concessions and facilities. However, the Nepalese side have always been demanding something more than what the existing treaty permits. India sometimes fails to fulfil that as it has got its own limitations as a developing country. This brings up widespread confusions. These confusions can largely be cooled down by making the provisions of the treaties more flexible and practical. Besides, India should recognise Nepal's genuine needs and extend facilities unilaterally.

Trade is crucial to both Nepal and India. India's share in Nepal's total trade was (ninetyeight per cent) till the mid-sixties. This share has drastically come down to forty-seven per cent in 1982-83. The direction and composition of trade has changed. The content of manufactured goods has further increased in the Nepalese import from India. But Nepal's exports to India are still limited to rice, ghee, animal foodstuffs and wood.

In the recent years, the export of rice from Nepal has been showing a grim picture thereby deeply hampering their already chronic balance of trade deficit. The well publicised Nepalese policy of trade diversification has become an illusive success. The whole aim behind this policy was to reduce Nepal's dependence on India by reducing its trade deficit. But contrary has emerged. Though they have diversified their trade relations with countries other than India, this policy has substantially failed. In other words, a huge balance of trade deficit has emerged.

The balance of trade problem between India and Nepal has taken a more intricate and worsening dimension in the past few years. The first and foremost factor behind this huge deficit is an emerging system of unequal exchange between India and Nepal. This is because of the very nature of composition of trade where Nepal has undeniably remained as a primary goods exporter and India an exporter of manufactured goods. Doubtlessly, India has been a gainer in this trade relation. However, it is Nepal's favourable balance of payments position which has so far covered this massive trade deficit. Nepal's concern in this deficit trade has been aired through all possible channels.

Nevertheless, Nepal can still reduce this deficit by intensifying its export promotion and import substitution schemes by encouraging private entrepreneurs. India, with such a vast experience can extend help to Nepal in the field of development of intrastructure for the promotion of Nepal's foreign trade. India can further help augment Nepalese entrepreneurial skill by liberalising its imports, offering better transit facilities and providing more favourable terms of trade. Setting up of more and more import substituting industries in the field of processing and other basic goods requirements in Nepal would provide relief to this acute problem. Besides, Nepal can resort to developmental activities in the fields of horticulture, hydro-electricity and tourism more expeditiously to narrow this deficit.

While pointing out the irritants in the trade relations, we found that some of the irritants are mere political overtones prompted by some adverse elements while some of the irritants are incidental in nature. When India temporarily stopped the export of petroleum products in 1975 because of world-wide oil price hike, Nepalese misunderstood it and blew it out of proportion. They did not mind in linking this with the earlier protest they had shown to the merger of Sikkim in India. India never had an intention to create hue and cry in Nepal by making petroleum products in short supply. India was forced to do so by the global situation.

However, Nepal's massive protests against the merger of Sikkim in India can be understood in the context of a small nation syndrome and Nepalese frequent assertion of identity, independence and sovereignty.

The deflection of trade and smuggling has acquired a significant dimension. Nepal has been a source of most of the smuggled goods for which Indians seem to have considerable demand. Nepal and India have realised the gravity of this menace. But both of them have failed to take any stringent and effective measures to deal with this flourishing illegal trade. This is mainly because of the long open border in which complete vigilance and checkings are impossible. Ironically, Nepal continues to be a centre of foreign goods and in India smuggled goods are openly sold in some of the markets (like Siliguri in Darjeeling District) which have close proximity to Nepalese borders.

The excise duty refund by India to Nepal had been devised as a relief to Nepal's imports from India. But the sole purpose has been defeated by the HMG's policy of extracting these revenues arising out of these refunds thereby depriving the Nepalese consumers of the spread effect of this refund. At the same time HMG's policy to do so has rendered the Indian goods incompetitive in the Nepalese markets.

Indian aid to Nepal has been basically guided by strategic factors, need for economic progress and the maintenance of political stability in Nepal. Indian aid to Nepal has multifaceted dimensions. The development of transport and communication with Indian aid has economically integrated the various corners of Nepal. Nepal has gained in terms of infrastructure, foreign currency earning, agricultural and industrial development and potentiality for tourism. However, the slow progress in the construction of other roads and communications as compared to quickly completed Tribhuvan Rajpath and Gauchar Airport have made Nepalese to think and believe that India tends to complete only the strategically important constructions quickly and more seriously.

In the fields of education, health, forestry, industry, veterinary and horticulture Indian aid has proved to be highly useful. India's continuous effort in making Nepal self-reliant in hydro-electricity by exploiting her water resources have borne fruits. The recent completion of Devighat project is a glowing example of it. The three projects, including a major project, the

Karnali, still have to materialise. In spite of frequent consultations for a decade or so, the progress has been tardy. The Karnali involves massive investment as well as the convergence of interests at both national and international levels, which in today's highly politicised scenario, is not easily conceivable.

The inequitable distribution of benefits in the Kosi and the Gandak projects are still referred by Nepalese as India's neglect of Nepalese interest. While conducting the deliberations on giant projects like the Karnali, they explicitly display their apprehensions that this project too may go the Kosi way. This is fairly conceivable on the part of a small nation like Nepal where water resources constitute the mainstay of the country's resources. India can eliminate these doubts of Nepal by being forthright in its stance towards water resources,planning and development in Nepal. India can always do justice to Nepal by sharing benefits from these projects on the basis of international norms and procedures. The Karnali should be given a starting touch as early as possible as it would be equally useful for India's power hungry industries too. Nepal should also fix a reasonable price for the consumption of surplus power by India.

The waterway from Calcutta to Nepal's river banks can be developed and be made navigable. This will reduce the transportation cost by a significant amount. If some concrete measures are taken to store the water of rivers like the Karnali, the Gandak and the Kosi in Nepal during the wet season, it would highly enhance the dry season flow in Farakka and reduce Indo-Bangladesh confusion on this issue.

India's economic assistance to Nepal has been mostly in grants. The loan element is very small. Presently, India's contribution to Nepal is about sixteen per cent of the total foreign assistance received by Nepal. It was more than fifty per cent a decade ago. But Indian aid has always been on the increase. So, this decline is shown by percentage is relative and certainly not absolute. It appears to be declining because of increasing total plan outlay of Nepal and a sharp increase in the quantum of assistance to Nepal by international financing agencies.

The efficacy of Indian aid, for that matter any foreign aid, is again a relative factor as there is no particular yardstick to measure this. Further, this is, to a large extent, a subjective factor. However, generally Indian aid has proved to be effective in some sectors like transport and communications and in some others like Gandak and Kosi projects they have not been so effective as expected. India has also benefited from these projects directly and indirectly. India having a similar socio-economic background like that of Nepal has been extending such technologies which are flexible in nature and appropriate to the Nepalese needs and conditions.

However, the creation of 'supra economy' by way of massive and unbridled corruption and the low absorptive capacity have made Nepal further vulnerable to any economic contingencies. This misuse of aid is something which India cannot go on tolerating for long. Nepalese planning are still not in tune with what the country actually needs. There seems to be incoherency in the whole system, a lack of cooperation and coordination between the planners, financers and the actual implementing groups. As a result of this, a sharp division has arisen between the Terai and the Hills in terms of agricultural production, localization of industries, ethnic composition, sharing of economic benefits and in the composition of tertiary, mainly services sector. This along with further deterioration in the ecological balance created by massive deforestation may lead Nepal to a very acute economic and political crisis within a decade or so.

If Nepal's demand for 'trade and not aid' is a really avowed and a well conceived proposition, then it has to change its whole economic strategy. Leakages should be stopped. It has to increase its presently poor domestic savings and capital formation. Besides, it must put more stress on private foreign investment. India, on its part, should now act more judiciously as the present trade deficit of Nepal vis-a-vis India is indicative of the fact that India gives aid by one hand and takes away the same via trade with terms of trade favourable to India.

The fruits of economic development of Nepal whatsoever have failed to percolate down to the poor mass as these people have no voice at any stage of decision-making. An inherent discontentment is looming around and accumulating which may pose a severe threat to the present system.

Indian private investment in Nepal has always been seen in the perspective of Nepalese industrial development. Nepalese feel that the Indian investments have remained generally shy in Nepal. This is basically because of two reasons. Firstly, Indian private entrepreneurs were engaged in India as it provided a potential market for their investments. Besides, India had already developed basic infrastructure and congenial atmosphere for the private investors. Secondly, Indian private investors tried their ventures in Nepal but failed to go ahead because of constraints prevailing in Nepal. Among these constraints, the most important was the frequent changes in HMG's policies. Poor infrastructural facilities, inattractiveness of Nepal as a potential market for their products, and adverse attitudes of Nepalese business magnates further kept away the Indian private investors. However, Indian private investors also cannot be fully absolved of these constraints. There are instances in which Indian investors' selfish and harmful motives and attitudes have been exposed.

Nepalese industries are still in a nascent stage. The contribution of industrial sector in the total GDP of Nepal is ten per cent only as against India's more than twentytwo per cent. Among the factors which have hindered the growth of this sector, the most notable are stiff Indian competition, inconsistent government policies, misuse of power and corruption and historical and institutional drawbacks.

Nevertheless, Nepal has been trying to take some important measures to encourage more foreign investments. This indicates that Nepal has started realizing the fact that broad-mindedness and far-sightedness in the economic policies would certainly boost the industrial activities in Nepal.

Whatever be the past, the present and future are more important. Nepal will now have to shed some of its inhibitions regarding India. It should resort to progressive liberalization of policy, development of more and more infrastructure, provisions of supplementary finances, tax concessions and protection to the private investors. On the other hand, Indian private investors should not lose the sight of development of Nepal while feeling overwhelmed by the liberal policies of the HMG.

However, another form of Indian private investment i.e. joint ventures are gradually gaining momentum in Nepal. It signifies a healthy development in the Indo-Nepalese economic cooperation. There are more potential fields which can be brought into the arena of joint ventures such as processed fruits, mushroom, leather, hides and skins, skimmed milk powder, forest products, jute carpet, textiles, cement, oil seeds and hotel. These areas, if jointly exploited and developed, are bound to yield fruitful results. These joint ventures must be conceived with the idea of securing the vast Indian markets. Besides increasing the income in Nepal, it would reduce the dependence on India which Nepal always strives to achieve.

The presence of Nepalese in India and Indians in Nepal is gradually acquiring nagging dimension. More and more controversies regarding this are emerging. The presence of Indians in Nepal can largely be dealt with under the Indo-Nepal Peace and Friendship Treaty of 1950. The massive migration of Nepalese to India can be stopped to a large extent by opening up more and more advanced sectors in Nepal with the help of Indian industrialists. Further, this will not only redistribute the income in Nepal and create ample economies of scale in Nepal but would also provide a distinct identity to India-born Nepali speaking people residing in India.

Moreover, frequent consultations and exchange of experts and capitalists would do a lot in arousing interest for more and more participation by the Indian private investors.

The whole process of cooperation is a two-way traffic. Gains are based on how optimally one utilizes the given opportunity and resources. What matters is the trust and mutuality of interest. The element of suspicion and mistrust could have been largely eliminated by this time, if both India and Nepal had seriously tried to find out each other's needs, perceptions and goals.

Politically, the emergence of India as the major power in the South Asian region is something Nepal cannot overlook. The emergence of Nepal as a 'cock-pit of international politics' has obviously made India more and more concerned. India cannot easily ignore its northern frontier being used by powers inimical to India. After all, India has its strategic stake in this Himalayan Kingdom. So, it is quite natural on the part of India to guide Nepal in a friendly manner without intervening into its internal affairs and sovereignty.

On the other hand, Nepal might have been less assertive if India's official response to certain Nepalese needs and demands had been as prompt and willing as political assurances. Frustrated by Indian procedural obstructiveness, the Nepalese are sometimes tempted to suggest inadequate goodwill. Delays and excuses from the Indian side make them wonder if Delhi is seriously interested in strengthening economic cooperation. A real bond of economic cooperation is yet to be made, though a firm basis has been laid.

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