The Public and the Private Sectors Controversy in the Nepalese Economy*

Narayan Khadka

Nepal is a Himalayan Kingdom located between two emerging powers of Asia, India and China. The unique geographical position of Nepal between two politically, economically and socio-culturally different countries has drawn the interest of the super-powers in the politics of Nepal. It is due to Nepal's strategically important geographical location. The northern border of Nepal is flanked by high Himalayas and on the other three sides her border is with the three northern states of India. Nepal has a long, open border with India of approximately 1,400 km. The geographical location of Nepal places her in a landlocked position, the nearest Indian port (Calcutta) is 900 km away from the capital city of Nepal.

Economically Nepal is one of the least developed countries in the world. According to the World Development Report (1984) the per capita income of Nepal is estimated to be US $ 170. The low level of per capita income could be attributed to the structure of the economy, the topographical structure and geographical location and the history of politics. In terms of the economic structure, Nepal is predominantly an agricultural country. The agricultural sector accounts for 93% of the total employment, about 64% of the total GDP contribution and 70% of the total earnings from exports. The predominance of the agricultural sector has not only been the mainstay of the Nepalese people but it is also a basis of shaping Nepal's culture, tradition, politics and social relations. But all three structural relationships would not be a problem had this sector not been beset with stagnation at a low level and growing socio-economic inequalities. It is facing some complex problems. First of all it is the subsistence sector which is confronted with the problems of unprecedented growth rate in population. For instance, the intercensal growth rate between 1971 and 1981 is estimated to be 2.65% p.a.; this is remarkably higher than that between 1961 and 1971 which was 2.07%. The population growth rate between 1971 census and 1976 sample survey was estimated to be 2.12%. Some other problems are, the traditional and static nature of cultivation with heavy dependence on the monsoon, and the limited scope for expanding the size of landholdings: this is more acute if seen in the regional perspective, and the growing ecological imbalances. All these problems have created interregional migration from the hills to the Terai and from rural areas to the urban areas. This has a serious implication on the regional inequality and the ecology. The most crucial problem is the marginalization of small farmers and the landlessness of the marginal ones. According to one estimate less than 1% of the households were landless in 1972. As most of the marginal farmers have to mortgage their land for getting credits either for supporting their family or for agricultural purposes, the debt problems become accumulated. This can easily lead to a loss of land. This problem is more serious in the Terai region than in the hills because the average size of landholding and degree of land concentration is much higher in this region.

The topography of Nepal also poses an insurmountable obstacle to development. As Nepal is a mountaineous country with a rugged terrain structure, the development of transport and communication faces almost an unconquerable challenge. Development of modern means of communication in the hills and in other remote areas is almost non-existent. And again, the country is physically divided into three geographical regions. These regions have extreme inequalities in terms of availability of arable land, productivity, availability of natural resources and distribution of population. A unique feature of Nepal's geographical location is her landlocked position. As mentioned earlier Nepal is a landlocked country (some people prefer to call India-locked) with a long open border with India. These features have a tremendous impact on the underdevelopment of Nepal.

The lack of an adequate political and institutional base in Nepal is also a factor of underdevelopment. This could be seen in historical perspective. The period between Nepal's emergence as a nation state in 1768 (the king of Gorkha conquered Kathmandu valley and established a Shaha dynasty in this year) until the first quarter of the 19th century was the period of territorial expansion and integration. Nepal fought two major wars, one with the British East India Company in 1814, and the other with Tibet in 1790. The internal political situation was more chaotic, full of court intrigues and sophistry. This eventually led to the emergence of the family oligarchic rule by the Rana in 1846. This family ruled for more than 100 years (1846-1951) tyrannically by hereditary Prime Ministers, who, "by eclipsing royal authority, had enjoyed a veritable monopoly of political power".(1) This was perhaps the darkest period in the political history of Nepal.

The political situation in the aftermath of the Rana rule did not help much to create an atmosphere to develop the economy. The period between 1951 and 1959 was a period of political instability. As the democratic movement of 1951 restored the position of the king as a constitutional monarch, there appeared political conflict between the palace and the political parties, mainly with the Nepali Congress Party which was instrumental in overthrowing the Rana rule in 1951. This conflict ultimately ended up with the royal announcement of holding a general election based on universal adult franchise and in a multi-party framework. This general election gave a massive victory to the Nepali Congress Party. However, after an 18 month experiment with the parlamentary system of government, the late king dissolved the Nepali Congress government in December 1960. After a brief period of direct rule he introduced a unique political system called 'Panchayat', in 1962. This proved to be a set-back to the process of institutionalizing development in Nepal because the introduction of the 'Pancayat' system has blocked the process of mass participation and mobilization for national development. It has created division among the population, i.e. between those who believe in the multi-party system and those who work for the 'Panchayat' system for the fulfillment of their own vested interests. Since the very beginning the whole machinary and resources of the panchayat system is used to supress the oppositional forces. Hence, it has failed to channelize the concerted efforts of the Nepalese people for national development.

Need for Industrialization

On account of heavy population growth which is putting pressure on the scarce land, underemployment and unemployment problems, the poor performance of the agricultural sector, falling export earnings and consequently huge trade deficits, problems of interregional inequalities and environmental degradation, crowding urban areas and above all, the wide-spread poverty and partial meeting of the minimum basic needs, it has been urgent for Nepal to make fast and sustainable efforts to develop the industrial sector. It is only through industrialization that "would create extensive employment opportunities, absorbing excess labour leaving the rural sector, it would raise the output per head and bring standards throughout the economy and, significantly, it would induce necessary and desirable changes in social and cultural attitudes and institutions through the modernizing impact of imported organizational methods and techniques".(2) Nepalese economic problems until the fifties were not as serious as they are now. The economy was self-reliant in many ways. Per capita availability of land was reasonably adequate. Meeting of the minimum basic needs in the democratic period, was, however, not the main reason why the Rana governments failed to take steps to industrialize the country. It was because of their indifference and conservative attitude that no efforts were made in this direction. It was only in the thirties that the then government took some steps and as a result some enterprises were established in the private sector. However, most of these enterprises were motivated by the windfall demand created by the pre-war situation, most of them geared the structure of their production to the war-time situation. The outbreak of the 2nd World War gave War gave an impetus to the production of industrial goods, mostly agro-based. But as the war ended many of these firms collapsed or were liquidated. The government failed to capitalize the tempo of industrial development that was taking place at that time. The need for rapid industrialization was felt only after Nepal achieved democracy in 1951. However, the country had not even the minimum infrastructural base for the promotion and development of industries on a sound footing. Hence, the government could not do anything for some time except amending the Nepal Company Act of 1936 to make provisions for the incorporation of companies. Only with the formulation of the First Five Year Plan in 1956, the government could allocate some funds for the promotion of industries in Nepal. Towards the last phase of this plan the government enacted the first Industrial Policy in 1957. It also created a development bank in 1959, to provide institutional finance and to make technical and managerial services available to entrepreneurs.

Ever since the government undertook certain measures to industrialize the country, two fundamental problems made themselves felt. These problems are: what are the priorities sectors, and what should be the respective spheres of the public and the private sectors. This issue is not so simple as it seems, particularly in the Nepalese context. This will be discussed in the subsequent section.

Development Planning and Sector Demarcation

Before 1951 industrialization in Nepal did not receive any priority from the Rana governments. The comparatively better developed infrastructural base in India attracted the attention of some Indian entrepreneurs to exploit the cheap availability of some raw material on the Terai-region of Nepal. But this failed to provide momentum to the industrial sector because of the war situation. So only with the formulation of the development plan the government attempted developing the industrial sector. The foreign aid commitment from some donors made this attempt possible.

In view of Nepal's political philosophy and geographical location the directive principles of the development planning is to develop the industrial sector based on a mixed economic framework. According to this framework both public and private sectors are allowed to play complementary and supplementary roles. The First Five Year Plan (1956-61) attached significance to the private sector and stated that wherever the private capital could play an effective role, the government would provide entrepreneurial skill, assure profitability and enact suitable laws to encourage it.(3) But towards the end of this plan the government received aid for establishing industries in the public sector. This broke the deadlock of industrialization.

However unspecified and vague the sector demarcation in the Second Three Year Plan (1962-65) was, there was some sort of 'equal treatment' in respect to financial resources. For instance, of the total outlay of Rs. 190 million allocated for industrialization, the share of total outlay to public and private sectors was Rs. 90 and Rs 100 million respectively. The vague allocation of resources did not consider the nature of the sector demarcation. As mentioned above some consumer goods industries were established in the state sector incidental upon foreign aid and thus the government failed to encourage the private sector. The government's policy was not clear in this respect as the same type of industries were planned to be established in the private sector also. This sectoral competition may promote healthy market mechanisms but from a resource allocation point of view it may not attain allocative efficiency in view of the limited market. However, one good policy in regard to the industrial development was the reformation and improvement of some of the existing industries(4) in the private sector.

The sectoral segregation in the Third Plan (1965-70) was largely motivated by two considerations, the social objectives laid down in the constitution and the pragmatic approach. The social objective aimed at was the attainment of equal opportunity and equality in the distribution of physical resources. The plan stated, "the government will take the steps to streamline the private sector if operating in the basic industries in consonance with the national interest. But from the view point of their growing necessity they will be established in the public sector."(5) Industrial planning and development was judged on the rational of export promotion and import substitution. Industries with high demand (consumer goods industries) were reserved for the private sector restricting thus the role of the state sector mainly to the 'basic' sector. Some consumer goods industries previously established were put in the state sector. But contrary to the policy of encouraging certain types of industries which were planned by the government for the private sector as priority industries, some other types of industries were allowed to be established in the private sector. This shows the "adhocism" and faulty industrial planning with regard to sector demarcation.

The fourth and fifth plans made minor adjustments in sector demarcation. The effective role of the private sector was again emphasized in the fourth plan. This plan made a list of some 32 enterprises based on local raw materials, skill and entrepreneurship to be set up in the private sector. In accordance with the plan some 205 industrial licences were issued. But unfortunately only 12 enterprises were established in the private sector, mostly medium- and small-scale industries. The role of the public sector was to be kept at a minimum in this plan.

The fifth plan made a systematic and comprehensive approach in determining the public sector responsibility mainly in the defence and other socially desirable sectors and thus left all other areas of activities to the private sectors.

The Industrial Policy (1974) announced a number of fiscal, financial and administrative incentives to the private sector. The private sector, however, did not show any positive response; most the incentives offered by the government were not utilized at all. In the public sector too, four manufacturing enterprises, vis. rosin and turpentine, cement, magnesite and paper and pulp industries were established. Realizing the institutional constraints in enthusing the private sector the government planned to establish five more industrial districts in industrially potential areas in the Terai region. But apart from the demarcation of the industrial districts and a feasibility study of a few manufacturing industries to be set up in the public sectors, most of the targets laid down in this plan also failed. The Sixth Five Year Plan (1980-85) stated the objectives of creating a viable industrial sector for absorbing the manpower and also of attempting to be self-reliant in daily necessities and in the supply of some of the building materials. As stated in the plan, "during the sixth plan period, the private sector will be encouraged to play a leading role in the productive fields like agriculture and industry and in commercial activities". Regarding public sector industries the plan emphasized the completion of certain manufacturing industries and the reorganization in the ownership pattern of the existing public enterprises. To bring organizational changes into the public sector the government decided to transfer the ownership of these to the private sector provided the private investors were willing to invest or a strong demand for private ownership existed. Some state-owned enterprises have been dissolved and the business conducted by them have been given to private businessmen. The Sixth Five Year Plan (1980-85) stated, "enterprises not falling under the domain of the state sector will be transfered to the private sector on the ground of their reasonableness".(6) Since the implementation of this plan the climate for industrial development has been largely changed by liberalizing the foreign exchange regime and trade. It also attempted to create the environment for boosting private and foreign investment.

Like the other five Five Year Plans the Sixth Plan also failed to enthuse the private sector and also could not improve the efficiency of the public sector undertakings. The midterm evaluation of the sixth plan shows that no satisfactory progress has been made in regard to both, public and the private sector industries. The public sector industries are suffering from low production, low capacity utilization, higher production costs and labour problems. Hence, all the major targets of the sixth plan like capital financing, technical services etc. were far below the target laid down in the plan.

The Seventh Five Year Plan (1985-90) and the Industrial Policy

Like all the previous plans the government has criticized the low efficiency of the public sector enterprises. These industries are continously becoming a drag on the scarce resources of the government. In this context it is stated that, "it is indeed high time that the government owned corporations be run ably and efficiently after making suitable improvements in the management. Excessive government control and interferences in them should be abolished and the managers should be given a free hand in conducting corporation business. Every corporation should have a clear notion of what the government expects from it".(7) In regard to the role of the private sector the government realized that the existing constraints did not permit the viability of large scale industries. It was deemed that only small scale industries which are labour intensive could be developed. The Seventh Plan has reiterated its confidence in the full fledged growth of the private sector industries. It is maintained that, "an atmosphere which is suited to the economic development has to be created... For this purpose government interferences and control in the investment activities of the private sector and in the price-fixing process of goods and services and means of production will be kept at the minimum".(8) The government realized for the first time the need for a integrating industrial policy with the macro-economic policy. The Seventh Five Year Plan (1985-90) has spelled out the economic policy which will be corrected to stimulate savings, investment and productive activities so as to regulate the supply of goods and services through private initiative. Though much emphasis is given to the growth of the private sector the government will attempt to "evolve an excellent rapport between the public and the private sectors". Although the government has laid down an ambitious target and strategy in encouraging the development of the private sector by providing monetary and fiscal incentives, the overall economic condition has not improved despite the 25 years of governmental efforts. In providing the incentives to the private sector the other six plans were not lagging behind, but in a deteriorating economic condition the expectation of the entrepreneurs is also dismal. There is little hope of making successful ventures in this type of atmosphere. Hence, the hope pinned down by the government on the gradual promotion and development of the private sector for economic development has been belied. This is due to a number of constraints to industrial development which will be explained in the following section.

Constraints to Industrial Development

The review of the various five year plans and the industrial policies implemented at various times demonstrates, that the "public-private-controversy" has moved through three different phases. In the early phase more emphasis was laid on the promotion of the private sector industries. In the second phase, approximately between the third and fitfth plan period, an attempt was made to develop the industrial sector on a balanced approach, i.e. attempting to assign both supplementary and complementary role to the private sector. In the third phase, i.e. from the last phase of the fifth plan onwards, the government had a deliberate policy of encouraging again the private sector. However, due to a number of obvious constraints which are commonly found in most of the less developed countries, there was, more often than not, overlapping in the planned spheres of the private sector by the state sector. Quite a few import substituting enterprises are now in the public sector which were originally planned for the private sector. As the state bears a moral responsibility to deliver the goods to the society, some of the basic needs are to be urgently fulfilled. The generosity of aid donors has helped the government to undertake the industries supplying basic needs.

But even with the growing size of public sector industries the contribution of the industrial sector to the national economy is very insignificant. The contribution of the organized and formal sector to the GDP is estimated to be about 5%. An equal percentage contribution is made by the large number of cottage industries that make up the informal sector. The formal sector (which is registered with the department of industry) which consists of some 50 state-owned enterprises and roughly about 3,528 small-scale private firms, contributes to less than 1% of the country's total labour force. The sector-wise breakdown of the labour force indicates that some 50 public sector enterprises have a total labour force of 3,500 persons, i.e. less than 0.4% of the economically active population. The private sector enterprises (majority of these are small-scale and under sole proprietorship) whose number is estimated to be 3,528 has engaged about 5,000 persons.(9) The vast number of cottage industries, i.e. the informal sector whose number is estimated to be 376,632 (according to 1972-73 survey) absorbes approximately 1,040,510 persons. Economically speaking this is little misleading as most of the persons engaged are unpaid workers, the service of the owner or the family members working in the industry is unaccounted.

The low level of contribution of the industrial sector to the national economy has a lot to do with the stage of industrial development, structural transformation and the composition of output. The structure of the industries both the formal and informal sectors, shows a rudimentary or early stage of industrial development. Apart from the public sector enterprises, the majority of the companies fall into the category of agricultural processing industries. The pattern of industrial distribution by principal economic activity shows that out of the total of 3,528 enterprises about 2,805 belong to food, tobacco and allied industries. The rest is scattered over a wide range of economic activities. The second highest number of enterprises falls into furniture and other wood products activities. This shows that a large part of the industrial output is derived by processing agricultural raw materials. A considerable part of the products are not marketed.(10) The nature of the industrial activity in Nepal could be seen from table 1.

The indicators like legal status and number of persons engaged in the cottage industry sector shows that of the 376,632 persons some 239,429 had a total capital investment of Rs. 100 only. There were only 1,772 firms, i.e. 0.47% having a capital investment between Rs. 100,000 and Rs. 200,000. Similarly, about 99.92% of these firms were under sole proprietorship, i.e. owned by the family or individuals. Employment-wise these firms were employing only between 3 and 5 persons each. All this indicates that Nepal's level of industrial development is still at the primary stage.

A number of constraints could be attributed to the slow pace of industrialization in Nepal. The classical factor endowment problems are obviously the dominant factors of industrial backwardness of Nepal. As the per capita income of Nepal is low and stagnating, the capacity to save is minimal even considering the high income inequalities among different income groups in different regions. However, the low saving - investment equilibrium trap could not be a major constraint so far, as the mobilization of entrepreneur's savings is concerned. The government-owned industrial development bank is providing credit to the extent of 85-90% of the proposed equity capital, and at a very nominal interest rate (depending upon the nature of the industry). If the industries which are planned by the government as the priority industries are to be undertaken by the private entrepreneurs, the government-owend bank provides the required finance. In some cases interest free loans are extended and other facilities like tax holidays, easy availability of foreign exchange are also provided. But despite this cheap loan facility no entrepreneurship is promoted. One of the important constraints is that the domestic market is limited to urban areas and its periphery. The geography of the country is such that the transportation cost does not make the products saleable in all parts. The limited market factor is again enforced by the competitiveness of the Indian and other foreign goods. The open border with India overpowers all the institutional and legal measures to check the easy inflow of commodities from India. Compared to the industrial capability of India, Nepal's industrial sector is very weak and hence cannot enjoy economies of scale at least in the current situation. Many industrial units operating in Nepal are running at 60% (on an average) of the installed capacity. Hence the protection policy or the infant industry argument for Nepal is ineffectuated because of the open border with India. This has more or less compelled Nepal to think over the comparative advantage argument in a regional cooperation framework.

The import substituting strategy adopted by Nepal is not effective due to her open border with India. Except one or two goods like the production of cigarettes and sugar etc., there has been heavy penetration of Indian goods, both legally and illegally. This has been hampering the operation of some industries established as import substitute. In order to check this trend Nepal adopted the policy of easy imports or almost free imports from overseas countries. The continuous increase in imports from India itself shows that this physical constraint is posing a serious problem to Nepal's desire for rapid industrialization. Similarly, the strategy of export promotion which was given priority since the fourth plan (1970-75) also did not show any hopeful sign. Even if the industrialized countries provided a preferential treatment to Nepalese primary goods in their markets, Nepal would not enjoy the benefits of such an arrangement. The cumbersome administrative procedures in transit arrangements (from Nepal to Indian port) and the high transportation costs make Nepalese goods less attractive and less competitive in the international markets. There are other costs as well involved in export procedures to overseas countries like high incidence of theft and damage, cost of handling and storing, costs of indirect payments to the personnel etc. As estimated in one study, the total costs (both direct and indirect) of these constraints amount up to 200 million US $ per year, equivalent to 8% of Nepal's GDP in 1981-82. This physical handicap on the contrary, contributed to widening the trade deficit which was estimated to be 270.3 million US $ in 1982-83. This means that in view of Nepal's landlockedness and her problem of open border with India, the industrial promotion policy adopted by Nepal is to be rethought.

Another classical constraint to industrial development in Nepal is the lack of skilled labour. Nepal's labour force was estimated to be 7.87 million in 1976, of which 5.45 million were economically active. But the vast majority of the surplus labour is without any skill. In many of the industrial fields the required (skilled) labour is fulfilled by the immigrants or temporary labour coming from India. It could be easily seen in the booming construction sector, particularly since the seventies. This has political as well as economic implications. The influx of Indian labour has caused the flight of capital on the one hand and on the other it has caused tension in the Nepal - India relation. The shortage of Nepal's own industrial labour with skill has caused problems to industrial development. Although a nation-wide statistic on industrial manpower is not available, the study done by one organization shows that, "unskilled labour accounts for 56% of the private sector industrial labour force, semi-skilled workers for 24%, administrative staff for another 18% and highly skilled workers for less than 1%"(11) This means that the country's own industrial labour force is almost insignificant. This could be considered as one of the most crucial constraints to Nepal's industrial development.

Similarly, the low level of technological development and the socio-economic infrastructural constraint have also hindered the process of industrial development. The transport and energy sector has not been developed to the extent that they make industrial ventures attractive and feasible. Whatever infrastructural facilities are built they are unable to generate backward and forward linkages to the national economy of Nepal. As most of the road networks are on the Terai region (on both technical and financial viability grounds) the production structure and consumption pattern of which has been geared to the Indian border market, the existing infrastructural facilities could not generate sufficient economic activities. In fact, this made the flow of goods to and from the border regions further possible.

Nepal also lacks mineral resources. Whatever is found that is also not feasible to explore on financial ground. The only natural resource potential is the hydro-power (the estimated capacity is 8,300 MW) and so far only less than 1% is exploited. The per capita consumption of electricity is one of the lowest in the world and the meeting of the industrial demand for electricity is both expensive and scarce.

As stated earlier a large number of enterprises are agro-based, that means the growth of these industries depends upon the performance of the agricultural sector. But the trend of agricultural production is so erratic over the years that since the beginning of the eighties Nepal is facing hard times to balance her population growth and food production. This has a serious and dampening effect on the structure and growth of the industrial sector.

There are some other constraints as well which hinder the process of industrial development in Nepal. The rugged nature of the topography and consequently the virtual inaccesibility of many areas have rendered manyfold problems. The most critical consequences of this constraint are: a) financial and technical problems of exploiting natural resources, b) the limited scope of penetration and integration of pocket market centers. The combination of these factors form a vicious circle as the inability of market penetration hinders the operation of economic activities in the physically inaccessible parts of the country and hence, the population has no opportunity to engage in activities which generate purchasing capacity. This is a disincentive effect on the prospect of industrialization in Nepal. Similarly, Nepal's landlocked position further complicates internal physical constraint. Export promotion as a motivating factor of industrial development is seriously constrained by transshipment problems: delays, uncertainty and high transportation costs have a very low or negative impact on the outward oriented industrial strategy.

Related with the internal physical constraint to industrial development is the problem of regional inequalities. Since many interior parts of the country have no modern transportation network, most of the industrial units are concentrated in the Terrai region. This region is comparatively better off than the hills and mountains. The industrial dispersal shows that the highest number of industrial establishments were located in the central development region followed by the eastern development region. Of the total number of industrial firms of 3,528, these two regions(12) had 1,787 and 745 resp. If a district-wise industrial dispersal is made then it is found that some of the remote districts in the far western development region have no industrial establishments at all. Manufacturing industries having more than Rs. 200,000 investment in machineries indicate that of the 742 different manufacturing industries(13) 446 were in the central region and 155 in the eastern. The mid-western and far western regions have 31 and 36 resp., of which only 17 and 26 resp. are in operating condition. The difference in regional dispersal adds to the problem of regional inequality in population, size of landholding, per capita arable land and productivity. As it is, the problem of internal migration is becoming serious for Nepal. Inequality in industrial development exacerbates further the problem of ecological imbalance.

The internal physical constraint and consequently the pattern of industrial dispersal have another dimension. The type of industries, pattern of production and capital investment indicators reveal that most of the industries are consumer goods oriented with a high turnover, a secured amount of profit and a low degree of risk. The disintegrated and ineffective market condition in the country as a whole has motivated the entrepreneurs to meet the demand of the city dwellers where there already exists a road network and an effective demand condition. It means most of these industries serve the interests of only 5% of the total population. Economies of scale again are limited by the size of the market. Hence, barring a few private sector industries, the supply of some of the basic needs commodities is done by public enterprises following a multi-part tariff policy. In remote areas where people lack adequate purchasing power, the public enterprises are following a subsidized price policy. This purchasing power condition and the need to subsidize the products is a determining condition of the respective spheres of public and private industries.

There are institutional constraints as well. Since the fifties the government has formulated and reformulated industrial policies on several occasions. A number of incentives and concessions were offered to the private sector but no significant achievement was made. Even in the Industrial Policy of 1981 and the Industrial Enterprise Act and Act Relating to Foreign Investment and Technology, the government offered all possible monetary and fiscal incentives embracing a number of concessions on income taxes, interest rates, excise duties etc. Special incentives and privileges were offered to the small-scale and cottage industry sector. But the problem is that there is no institutional base of support to enforce and strengthen these incentives and concessions. There are two basic problems in this regard: Firstly, there is no consistency in the government policy regarding fiscal and other incentives. At the implementation level there is bureaucratic control and delay, of course the misuse of licences and facilities by the entrepreneurs are very often a big problem. And again, there is no coordination of the fiscal incentives with the macro-economic policy. Secondly, institutional support, i.e. industrial information analysis, training, technical advice is not existent. Government's industrial policy has failed to enthuse entrepreneurship among the middle class. Nepal has a handful stock of entrepreneurs who have been primarily engaged in trade and commerce which have a high turnover and secured profits. As the economy is replete with the foreign aided money which has failed to generate trickle down effect. A large part of the income generated by foreign aid is spent to meet the demand of the higher income groups (the bureaucrats, politicians, technicians and other elites) for luxury goods. Hence, the failure of the government to coordinate commercial and industrial policy has also created a negative impact on the industrial development. All these, classical constraints, physical barriers and institutional hindrances prove that the industrial promotion and development in Nepal is inhibited by both, demand and supply constraints.

Sector Demarcation: Some Issues

With the implementation of the Sixth Five Year Plan (1980-85) the government has laid special emphasis on the development of the private sector industries. The domain of the private sector was largely extended, even in areas like the supply of essential consumer goods in a sector like agriculture. As mentioned in one government document, "major service areas in which the private sector can contribute: a) production and distribution of improved seeds, b) supply of chemical fertilizers, c) providing plant protection services to the farmers, and d) supply of simple veterinary services. Individuals willing to provide such services will be trained by departments concerned in their respective vocations. Credits will also be made available to them for buying equipments, supplies and other requirements."(14) The heavy emphasis on private sector development is motivated by factors like the incurring of heavy deficit and problem of control in the public enterprises, mobilization of private capital for meeting the growing economic challenges, and so justifying more foreign aid from the western donors and international financial institutions which support the furtherance of the market economy. But in the present politico-economic situation of Nepal the government is facing a paradoxical problem. This situation is that whenever the government plans to establish certain industries the immediate question is that of ownership. Who should own the industry, the state or private entrepreneurs. If the private sector is not willing to undertake the proposed industry, the government has to take initiative to establish it under its own ownership. But the question of control becomes paramount in the state-owned industry. The problem is how to control the public sector industry in the best national interest. Any additional industrial unit in the state sector means additional financial burden. If the private sector is willing to establish the planned industry(ies) the government has to provide a lot of incentives and facilities. This will certainly involve fiscal burden to the government. So the question is wether or not to provide a free hand to the management of state resources. And additionally, the economic and social equity issues are also involved in the public and private sectors controversy. Centered around this issue is the problem of selecting the right industrialization strategy. For instance, in the sixties and until the mid-seventies Nepal gave greater value to the import substituting strategy. This meant that, "excessive administrative regulations gave rise to bureaucratization, corruption, uncertainty and delays and thus discouraged productive private initiative".(15) As the adoption of this strategy allows biases against exports and agriculture, and the absence of a strong home demand for manufactured goods, the private sector was not motivated despite a large number of fiscal and monetary incentives offered by the state. As a consequence the government established some essential enterprises in the public sector. The expansion of the public sector industries in a number of consumer goods continued till the end of the seventies dispite the fact that the government made again a shift in emphasis from import substituting to an export-oriented strategy. Industries like textiles, brick and tile and rice export etc. were established in the public sector. Interestingly, the planned industries in the private sector did not appear even if the government was willing to supply the major percentage of the required capital finance. As mentioned above, Nepal's landlockedness and 1,400 km open border with India produces a disincentive effect on the private sector development. As mentioned, "this open frontier has several consequences for trade policies towards Nepal. One consequence is that Nepal cannot have 'free trade' with the world outside India in the sense that she cannot have the volume of imports and exports that is determined only by world market prices at her borders."(16) This factor has a serious disincentive effect on both export promotion and import substituting strategies. So Nepal is suffering on both fronts. In view of this constraint the planners of Nepal are talking about adopting resource based industrialization strategy but have not yet identified the resource potentials of the country.

Regarding the question of promoting the private sector one pertinent issue is who are the potential entrepreneurs willing to undertake industries planned by the government. Going by income groups, the potential entrepreneurs could be the landlord class, as land has been the traditional source of accumulation of wealth and capital. According to government statistics "about 6% of farmers own almost 44% of the land while 55% of small farmers have only 12% of the land."(17) But as investment in real estate is more attractive than in industries, this landlord group is least interested to invest in the industrial sector. This group lacks the risk bearing capacity and the idea of potential investment. Moreover, investment in land still carries a symbol of social status in Nepal. It gives economic power and hence political prestige, i.e. the chance of being in power.

Due to the supply of a huge amount of foreign aid to Nepal as well as the opening of many avenues through aid (i.e., creation of projects, offices of international agencies) a new group, i.e. technocrats and bureaucrats are emerging as potential savers. However, the wealth accumulated by them is not legally exposable. The slow dying out of the caste system is another obstacle in mobilizing the capital of higher caste people. Potential investors mean the traditional business community.

The question of selecting the potential investors has a tremendous impact on the aspect of social equity and income distribution in Nepal. As any prospective industrial venture will be tapped by a few influential business families, it is going to enlarge the gap of income inequalities among the population. As the government has granted huge concessions and privileges it is that small group of families which reaps the benefits. This group not only enjoys the benefits but also influences government's commercial and industrial policies to its favour. This is very much similar to the Indian situation. As described by Pranab Bardhan on India's case, "even the ostensibly adverse government policy of an elaborate scheme of industrial and import licences has been allowed to be turned to the advantage of the industrial and commercial interests they were designed to control: the richer industrialists, having better connections and better access, have got away with the lion's share in the bureaucratic allocations of the licences, thus pre-empting capacity creation and sheltering oligopolistic profits"(18) In Nepal the proprietary of the industrialist class influences bureaucratic allocations of licences and quotas but there has a so been the misuse of these facilities. A arge part of the fund supplied by the government are divested to other undisclosed business activities. The mobi ization of the initiative and capital of the prospective private investors are directed in the trading sector, whatever investment is made in the manufacturing sector it is mainly geared to meet the needs of the urban popu ation through the vulnerable bureaucracy of the government. This is in fact an obstacle in setting up industries planned by the government. The shyness of the private capital in Nepal in sectors which involve little risk or entrepreneurship is proved by the classic case of the garment export industry. As some industrialized countries granted concession or preferential treatment to the exports of cotton garments from Nepal, there has been a boom of this industry. But a large number of these goods are produced in India and exported illegally under the seal 'Made in Nepal'. Although some percentages of these goods are also produced in Nepal the ownership of the industry is vested in the hands of aliens, mainly Indians. Legally the licences are issued in the name of some Nepali nationals but the actual ownership and control is vested in the hands of the foreign entrepreneurs. This poses the question, if such development of the private sector is desirable?

The political sociology and industria development through the private sector is another issue which needs some explanation. Since the introduction of the Panchayat system a powerful business class has been able to stake its interest through bribing the politicians. As the Panchayat system had no direct mass participation and proper accountability until 1981, (in 1981, three democratic elements were introduced in the constitution, e.g. direct election on the basis of universal adult franchise but without political parties, election of the Prime Minister from the national assembly, and the cabinet is to be accountable to the national assembly and not to the King) only vested interest groups were in this system. The political ideology of the Panchayat system was to denounce the multy-party system of the government and its supporters. This gave an immense opportunity to the business class to get their interest fulfilled through licences, quota allotments and contracts by giving monetary benefits to the people in the government. This is clear from the suspension and removal of ministers from time to time. This business-politics embodyment has made it difficult to extricate the interest of the business community for a more healthy growth of the industrial sector.

The public sector controversy lies in identifying the areas where the government can ably and efficiently deliver the goods to the society. The bureaucratization and control by the parent ministry, the overstaffing problem, the vague combination of conflicting macro- and micro-economic objectives and the absence of public accountability of the public sector enterprises have complicated the public ownership problem. Now the government has realized that its bureaucracy is not properly trained to assume greater responsibility for managing an increasing number of public sector enterprises. And hence, the public - privat controversy is still an unresolved issue in the mixed economic framework of the Nepalese economy.

Conclusions

The government of Nepal has been attempting to streamline the respective spheres of public and private sectors on pragmatic considerations, i.e. reserving certain social overheads and defence sectors for the public sector and leaving all other activities to the private sector. Sectors reserved for private investment are those where the market mechanism could be governed by the pricing system. But on two specific grounds, a) the easy supply of economic and technical assistance from the socialist countries, and b) failure of the private sector to respond government's industrial policy, the government of Nepal established some consumer goods industries in the public sector. This is expedient upon the need for delivering certain basic goods to the society for which the state bears a moral responsibility. It is quite frequently happens that some private sector industries are set up which were not at all planned by the government. Nepal's experience suggests that with the creation of certain industrial pre-requisites the government has been providing incommensurately high incentives to the private sector. This growing and heavy emphasis on the private sector not so long ago could be attributed to the prospect of getting more foreign aid from the western capitalist countries, inefficient functioning of the public sector industries, and diversion of private sector resources into unplanned and perhaps undesirable activities. But in a shortage economy with numerous constraints to industrial development the incommodiousness of the private sector with government's priorities and policy is obvious.

The public-private sector demarcation has often been treated by the government in isolation and with overemphasis on the industrial sector. Government's pre-occupation with industrial sector on modern line (with imported technology) has created distortions in the economy. The under-utilisation of the existing infrastructural capacity, growing food problems, huge trade deficits, and balance of payment problems are the consequences of this isolated approach. As industrial development is very much a part of the overall economic objectives, the government should adjust the macro-economic priorities. The adjustment of these priorities involve the creation of gainful employment opportunities in the rural sector, meeting the basic needs of the common masses, integration of national markets, reduction of regional and income inequalities, prevention of environmental losses, reduction of heavy dependence on foreign aid etc. On the basis of these national economic priorities the strategy of industrialization should be chalked out. This strategy could be called a self-reliant industrialization strategy which aims at more rational and equitable dispersal of industries, linking directly the industrial sector with the agricultural sector, giving industrial protection and facilities to those industries which are labour intensive, which use available domestic resources and are basic needs oriented. The macro-economic objectives of this strategy should be to prevent a dualistic structure of the economy, creating a balanced distribution of population and resources, and reducing the gap between rural and urban areas.

Regarding sector demarcation what the government should do is that public sector should undertake the task of building roads, generation of power and establishment of other social overheads. As investment in these sectors creates employment and thereby some purchasing power in the hands of the rural masses, the demand for certain basic needs is created. Once demand is created it motivates the private sector to supply those basic needs goods. Once a tempo is generated, government has to see that the private sector gets the opportunity to develop and expand without any obstacles. But attention should be taken by the government in establishing the infrastructural and social overheads in those areas which serve the majority of population.

Notes

* I am thankful to Prof. D. Rothermund for his constructive comments on an earlier draft. However, the author is solely responsible for any errors or shortcomings that remain here.

(1) R.K Shaha: Nepali Politics Retrospect and Prospect. New Delhi Oxford University Press, 1975, p.1.
(2) D. Colman/ F. Nixson: Economic Changes in Less Developed Countries. Philip Alan Publishers Ltd., 1978, p.180.
(3) See: Draft Five Year Plan (1956-61), Government of Nepal, p.6.
(4) These industries were Morang Hydro Electricity Company, Raghupati Jute Mill, Morang Cotton Mill, Birgunj Match Factory, Nepal Cigarette Factory an Morang Sugar Mills (See: HMG/N 2nd Three Year Plan 1962-65, National Planning Commission, Kathmandu, p.62).
(5) Third Five Year Plan (1965-70), Ministry of Economic Planning, 1965, p.89.
(6) HMG/N National Planning Commission: Sixth Plan (1980-85), Part 1, p.180.
(7) HMG/N National Planning Commission: Basic Principles of the Seventh Plan 1985-90), Kathmandu, p. 29.
(8) Ibid., p.29.
(9) Central Bureau of Statistics: Statistical Pocket Book, Kathmandu, 1982, p.90.
(10) Of the estimated production in monetary terms of Rs. 303,792,000 of all the cottage and small-scale firms, about Rs. 51,868,000, i.e. about 18% is for home consumption.
(11) See: UNIDO: The Potential for Resource Based Industrial Development in Less Developed Countries, Nepal, 1984, p.63.
(12) Nepal is administratively divided into five development regions, 14 zones and 75 districts. The five development regions are: Eastern, Central Western, Far Western and Mid-Western.
(13) See: Ministry of Industry: Industrial Profiles, Manufacturing Industries 1983-84. Kathmandu, 1984, p.203.

(14) HMG/N Ministry of Finance: Local Level Aid Coordination Meeting on Agricultural Development, Sept. 16, 1984, p.17.
(15) I Liitle/ T. Scitovosky/ M. Scott: Industry and Trade in some Developing Countries - A comparative Study. London, Oxford University Press 1970. Quoted by Hubert Schmitz: Industrial Strategies in some Less Developed Countries: Some Lessons of Historical Experience; in: Raphel Kaplinsky (ed.): Third World Industrialisation in the 1980s: Open Economies in a Closing World. London, Frank Cass., 1984, p.3.
(16) R. Islam/ A.R. Khan/ E. Lee: Employment and Development in Nepal, in: Asian Empoyment Programme (ARTEP), Bangkok, ILO, 1982, p.80.
(17) HMG/N: Local Level Aid Coordination Meeting on Agricultural Development, op.cit., p.18.
(18) P. Bardhan: The Political Economy of Development in India. Basil Backwell, 1984, p.41.

Tab. 1: Employment, Gross Output and Value added in the Manufacturing Sector *

Area of Activity	No. of Enterprises	Employment No.	%	Gross Output Rs. 1000	%	Value Added Rs. 1000	%
Tobacco & allied indust.	2,805	25,317	50.6	3372085	85.6	329256	61.9
Textile, wearing apparel & leather	121	3,820	7.0	74431	1.9	27305	5.1
Wood, paper & allied industr.	325	5,105	10.2	131859	3.3	37996	7.1
Chemicals, pharmaceutic. & allied industr.	26	1,129	2.3	22450	0.6	10223	1.9
Non-metallic mineral prod.	97	6,019	12.0	20960	0.5	9303	1.7
Metals fabrication	64	1,233	2.5	41467	1.1	10431	2.0
Jewelery, curios	6	151	0.3	4966	0.1	4483	0.3
Miscellaneous (a)	84	7,340	14.6	171737	6.9	103385	19.4
TOTAL	3,528	50,120	100.0	3939955	100.0	532432	100.0

* Inconsistencies in the statistics are due to source.

(a) Miscellaneous includes industries like fruit processing, cigarettes, and jute processing.

Source: Census of Manufacturing Establishments in Nepal 1976-77. Central Bureau of Statistics, Government of Nepal. Compiled by UNIDO, The Potential for resource-based industrial development in the least developed countries. Nepal No. 7, 2 May 1984, p.3.