Prospects for Social Justice and Sustainable Development

Geoeconomic Perspectives

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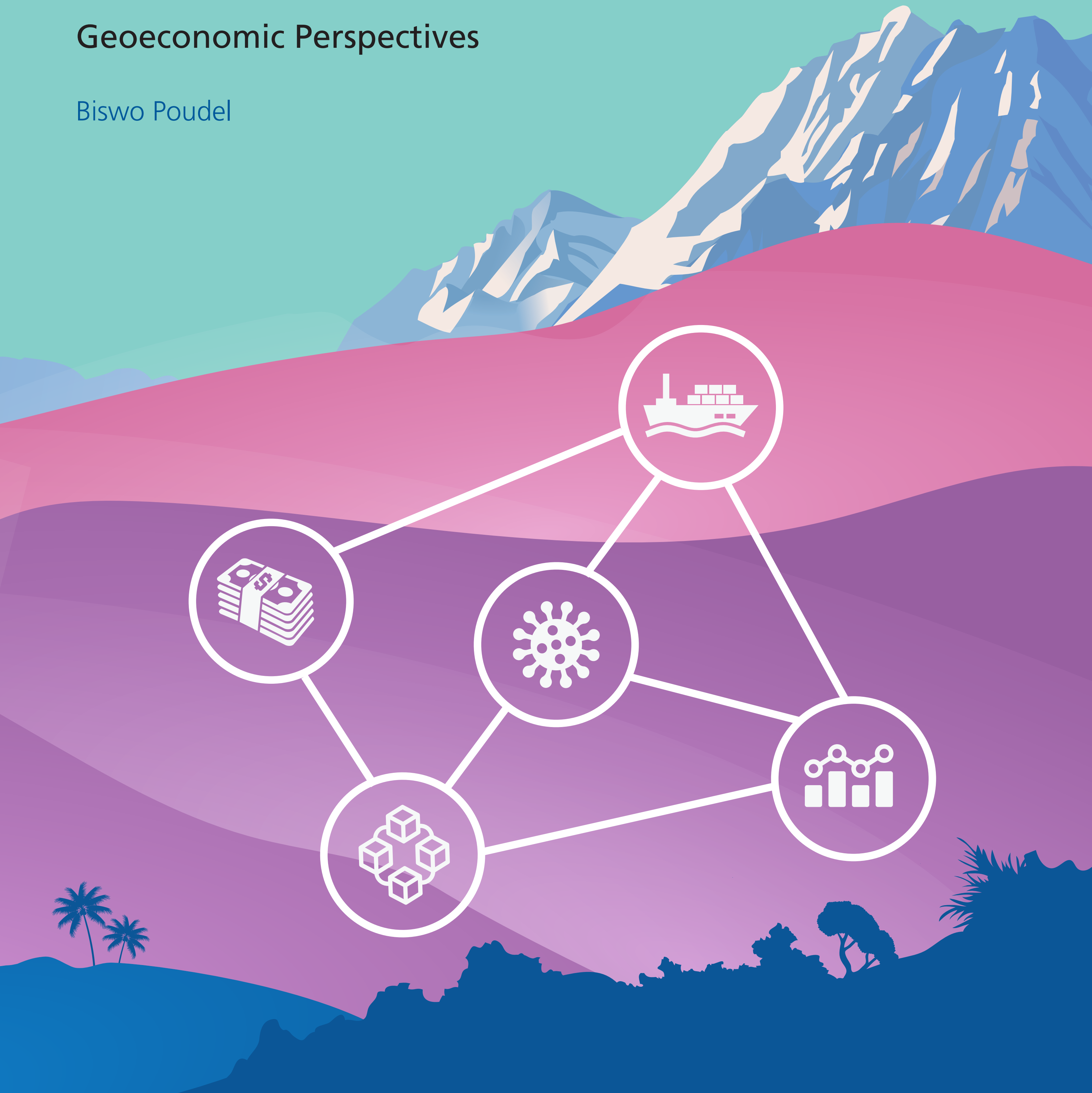

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Abbreviations

BIMSTEC	Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation
CNI	Confederation of Nepalese Industries
EIA	Environment Impact Assessment
FDI	Foreign Direct Investment
GSP	Generalized System of Preferences
ILO	International Labour Organisation
NC	Nepali Congress
NPC	National Planning Commission
NIRTTP	Nepal India Regional Trade and Transport Project
NTIS	Nepal Trade Integration Strategy
SDG	Sustainable Development Goal
WASH	Water, Sanitation, and Hygiene

Introduction

This paper illustrates Nepal's economic situation against the backdrop of geopolitical transformation in the country's neighborhood in the aftermath of the Covid-19 pandemic and offers recommendations for the way ahead. Nepal was already facing the consequences of global transformation in the industrial sector before the Covid-19 pandemic unfolded: Unskilled laborers are being increasingly made redundant by automation processes at an unprecedented speed. While the world is rapidly becoming digitalized, there is also a growing insight that there is a need for greening the economy. At the same time, demographic projection indicates that Nepal will be a country with a rather young population for some decades to come, while the populations in many developed countries have already started to age. The rise of China and India in Nepal's neighborhood has intensified confrontation and alarmed other actors in the region, and Nepal will not be left untouched by the strategic activities increasing in the neighborhood.

Against such a background, this paper discusses the impact of these activities cumulatively on the Nepali economy and offers recommendations on the way forward. The first chapter discusses Nepal's current economic situation in the given geoeconomic context, introduces readers to the industrial and other changes in Nepal in particular and the world in general, are facing, and provides information on Nepal's accomplishments regarding the Sustainable Development Goals (SDGs). The second chapter provides information on potential winners and losers as the country navigates through changes impending in its economic landscape. Chapter three discusses ways for the future such as diversification of supply chains and reduction of excessive dependence on one source, while simultaneously addressing social and economic inequalities that affect Nepal's aim to meet SDGs. The experience of the disruptions of the Covid-19 pandemic and the crisis following will also be taken up in the course of discussion.

Nepal's Economy and its Geo-economic Context

Nepal is a relatively small state with an underdeveloped economy. For a long time, the country was politically almost isolated and, hence, usually a mere footnote in the international discourses. It also is located in what can be termed one of the most remote regions of the world, with the mighty Himalayas rising behind and tall and rugged mountains occupying two-thirds of its territory. Even though, India and China, the two giant emerging economic and political powerhouses of Asia adjoining Nepal, it is not clear whether they compete over influence in the country or if Nepal is fruitlessly jumping from the fold of one neighbor to the other in the hope of getting noticed. While India values Nepal politically, partly because of Nepal's proximity to its most densely populated regions, including New Delhi, it is not clear how much it values Nepal economically. The East India Company and the British government, who ruled India until 1947, often prized Nepal as a buffer state and there is some evidence to suggest that they were not keen to see Nepal develop as an independent and vibrant economy capable of attracting people from its neighboring areas. Nepali planners have, since about the 1970s, as a consequence realized that its economic development must get its thrust from its own homegrown administrative initiatives.

One such initiative has been to promote industries using local raw materials such as agriculture-based, hydropower, and tourism industries. The 4th and 5th National Five Year plans (between 1970 and 1980) started to steer the government toward supporting industries that are based on agriculture, textile, and limestone (NPC, 2020). However, while the decade was considered an economic failure in the government's own evaluation (Pant, 1981), the annual budgets of the government have never failed to emphasize this initiative.

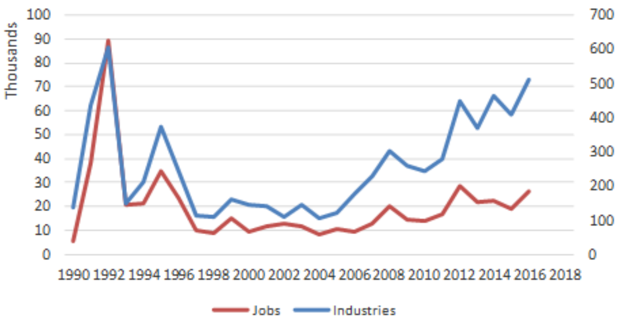
Other initiatives were, at least partly, formulated in response to the evolving socio-economic situation in the neighborhood. Evidence for this can be found in the financial sector reforms initiated in the 1980s. Nepal started the liberalization of its financial sector after some policymakers felt the country could get some fraction of finance-related businesses that were withdrawing from Hong Kong after its return to China. Nepal's economic liberalization attracted the attention of many foreign banks: Credit Agricole (France), Arab Bank (UAE), Indosuez Bank (UK), Grindlays Bank (UK) etc., all of whom opened their branches in the mid-80s. By the early '90s, Nepal had joint venture banks from Thailand, Bangladesh, India, Sri Lanka, and Pakistan (see Table 1).

Table 1: List of class 'A' Joint Venture Banks in Nepal

Bank	Year of Establishment
Indosuez Bank	**1986**
Grindlays Bank (Standard Chartered Bank)	**1987**
Everest Bank	**1994**
NABIL bank	**1984**
Bank of Kathmandu	**1995**
NMB Bank	**2008**
Nepal Bangladesh Bank Ltd	**1994**
Himalayan Bank	**1993**
State Bank of India	**1993**

The rise of banks also came with the increased ability to utilize quotas on textiles set aside by developed countries. Nepal's liberalization in the 1990s also spurred growth in the number of firms established (see Figure 1), set up partly due to the opportunities opened in advanced economies such as the USA by the implementation of a generalized system of preferences (GSP).

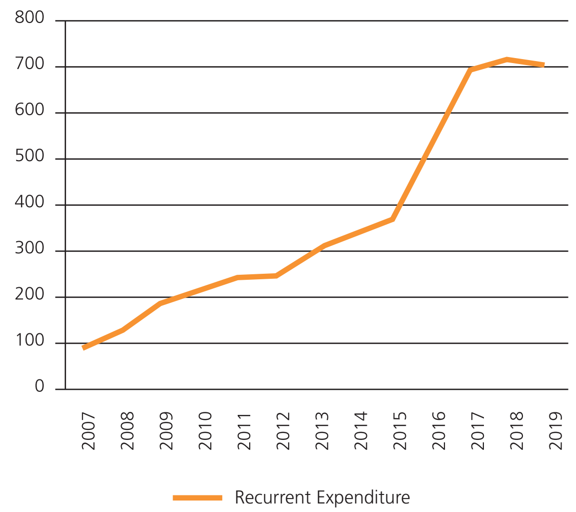
Figure 1: Firms and Jobs Created in Nepal (Source: Industrial Statistics, Department of Industry)



After the 1990s, however, Nepal began to face many economic and political changes. Both India and China liberalized their economies while boom in construction and manufacturing in the Arab countries and Malaysia offered jobs to Nepali youth, and remittance began to soar in Nepal. At the same time, Nepal went through a violent Maoist insurgency between 1996 and 2006, almost obliterating the progress made in the industrial sector in the early 1990s. Nepal's export to import ratio reached almost 50% in 1999 and began to decline further, reaching about 8% in 2019/2020. In the export sector, the biggest disappointment has been Nepal's failure to capitalize on the growth of China. For every dollar of export, Nepal imports goods worth 153 dollars from China (Department of Customs, 2019/20).

The growth in remittance-fueled domestic consumption had left three major impacts on the domestic economy: First, the government's revenue soared. But this increase has mainly been spent on financing its increasing recurrent expenditure (see Figure 2).

Figure 2: Recurrent Expenditure of the Government (in billion rupees)



Second, since goods and services from economies with efficient production capacity (such as China) are cheap, external trade has boomed without concomitant rise in the efficiency of domestic industry and generation of industrial jobs. Third, due to years of political deadlocks over the past decades there was little progress on reforms, including those related to opening up the economy, creating special economic zones, and the labour market. The combination of these factors has made Nepal's production sector uncompetitive that has not been able to benefit from rising demands in both China and India.

In such a context, an unanticipated economic shock such as the one triggered by the Covid-19 pandemic brings devastating effects. In many countries the pandemic has highlighted the risks of excessively relying on one single source for industrial and other imports. Realizing this, Chinese might want to relocate some production centres to India. However, given India's increasingly strict regulations against foreign investment from certain countries, Nepal might be in a good position to attract Chinese investments. Another important factor is the development of labour migration and remittances. Depending on the extent of the economic shocks in the destination countries caused by the crisis, many Nepalis working abroad lose their jobs and may return home, which would increase the pressure on the labour market at home that is providing too little jobs already. Still, the available Nepali labour and increased interest of foreign investors could also stimulate Nepal's industrial sector.

Impact of Future Transformation on Nepali Economy

In 2019 the International Labor Organization (ILO) published a report on the future of work (ILO, 2019). The report indicated that the automation of industries is accelerating, and the world is heading for a digital, green, and demographic transition. All of these trends are likely to affect Nepal. Digital transformation is likely to free up many unskilled labourers and since Nepal's immigrant workers are mostly unskilled (74.5%), there is a high risk of them being laid off due to automation (Economic Survey, 2019/20). Within Nepal, many firms have felt the brunt of rising minimum wage and lack of laborers at home. If the former affects Nepali economy adversely, the latter affects it positively. Therefore, it can be expected that the effects of the digital transformation are likely to affect Nepal's labor market more strongly than many comparable economies, though its cumulative effects are not unambiguous.

On the other hand, it is likely that Nepal's information technology sector will gain from the digital transition.

Many Nepali IT entrepreneurs are trained in the United States (USA), India, and Australia which are major destinations for Nepali students. They are likely to bring back relevant expertise as well as useful exposure and could therefore make Nepal's firms more efficient by helping their transformation and reducing the cost of production of many firms and may slightly offset the disadvantage Nepal currently faces as a landlocked country.

Overall, many transformations will take place in the context of digitalization: One example the country already has seen is the collapse of many photo studios dotting the small trading centers of Nepal after the advent of digital photography. The transformation of the world of work is also likely to perturb Nepal's current labor situation. All jobs associated with the internal combustion engine repair are likely to vanish as electrical vehicles replace hydrocarbon-fueled cars. Some firms in Nepal have already started using robots for simple tasks. Firms will likely go capital-intensive to avoid dealing with workers affiliated to labor unions. Firms have already started hiring from independent contractors to avoid legal provisions for long-term benefits. This may increase the size of gig economy domestically.

Nepal will also soon learn that technological shocks are the norm in the world. Economist Joseph A. Schumpeter famously described capitalism as a system that is driven by creative destruction. Old technologies will continue to be replaced by new ones. In the process some will lose, and some will gain. Countries like Nepal, with close to zero research and development expenditure and output, will have to play a catch-up game. To remain a passive observer of the productivity and efficiency revolution and still provide for workers at the disadvantage of such exogenous changes will remain a challenge.

If Nepal does not improve the efficiency of its manufacturing sector and becomes a competitive player regionally, the impact of future digital, green, and demographic transitions in India and China can have significant impacts on the country. Digital transformation in India may hurt Nepali workers' prospects of employment in the neighboring economy, whereas green transition may affect Nepal positively as India will demand cleaner energy from Nepal. If due to demographic transition, the number of laborers in India increases without a simultaneous increase in opportunities for them, a decreasing need of Nepali workers might be the consequence. Transitions in China may affect Nepal slightly differently due to the comparatively fewer linkages between the two economies. We will discuss this in more depth later on.

Factors for Sustainable Development Model

In the context of these transformations impending the central question here is: What a sustainable development model looks like and how it departs from the current development model Nepal is pursuing? To explore the answer, a look at the official version of sustainable development model is needed, which relies on the goals of the government of Nepal for the United Nations endorsed Sustainable Development Goals for 2030 (NPC, 2017).

The SDGs consist of 17 goals (and many sub-goals) and the National Planning Commission has derived its targets mostly from these goals (ibid.). Targets associated with poverty alleviation, such as ending extreme poverty, ending hunger, malnutrition, and the problem of children being underweight, as well as promotion of sustainable agriculture are part of SDG1 and SDG2. Similarly, goals associated with health and education such as achieving low child and maternal mortality rate, minimizing casualties from natural calamities, increasing universal health coverage, providing schools with water, sanitation, and hygiene (WASH) facilities, achieving gender parity in education etc. are part of SDG3 and SDG4. Goals associated with women empowerment include reduction of violence faced by women, wage equality, reduction of incidence of underage marriage among girls, empowering women to make their own decisions on sexual relations and contraceptive use etc. are specified in SDG5. Hygiene-related targets include providing increased access to drinking water and sanitation (SDG6). Energy consumption and energy efficiency will be enhanced according to targets specified in SDG7. Similarly, in SDG8, goals associated with providing full and productive employment and promoting sustainable economic growth include reducing unemployment level to maintaining the proportion of informal workers in non-agricultural sector at less than ten percent, having better access to banks, and larger coverage of insurance. Building more roads, more resilient infrastructure, and raising research and development expenditure are part of the goals outlined in SDG9. Goals associated with reduction of inequality (such as improved Gini coefficient, Palma ratio, etc.) are outlined in SDG10.

Likewise, goals associated with safe public transportation and better cities are outlined in SDG11. Goals associated with the reduction of fossil fuel energy consumption, consumption of wood, use of plastics, reduction of post-harvest loss, and reuse of glass and metal products are outlined in SDG12. Goals associated with combating climate changes such as reduction of GHG emission from the transportation, industrial, and commercial sector, preparing village level adaptation plan, and preparing climate smart villages are part of SDG13. Targets associated with the protection of terrestrial ecosystems including protection of forests and protected areas, their management by community user groups, and increased afforestation are specified in SDG15. Goals associated with creating peaceful and inclusive societies for sustainable development include ending all forms of child abuses, increasing transparency of the public sector, improving good governance and perception on corruption, and increasing women's role in decision-making etc. are specified in SDG 16. Other targets include the consolidation of global partnerships for achieving these goals (SDG17).

Hence the sustainable development envisioned covers a broad range of issues, including goals such as reduction of poverty and hunger, creation of decent jobs, reduction of intra-country inequality, increase in research expenditure, provision of better hygiene and education, creation of better settlements, setting up of climate-friendly villages, and develop peaceful and inclusive societies. These goals are both economic and political in nature. They also vary from the current models in that research and development goals, climate change mitigation, and the modes of adaptation have to be explicitly made part of the overall development planning of Nepal and many other targets – though, included in Nepal's annual programs before – have now been clearly identified.

The economic growth in the neighborhood and evolution of industrial relations predicted by the ILO's Future of Work report may affect Nepal's SDG goals differently. Economic growth in China, for example, made it cheaper to buy clothes and other household appliances for Nepali consumers. Fear that Chinese and Indian growth will be accompanied by higher demand for grains and other foods, thus increasing price regionally, has not happened yet. However, if such projections become a reality and the income of Nepali workers does not increase simultaneously, the SDG goals of Nepal such as ending hunger and poverty will be negatively affected. Overall, a scenario in which countries in the neighborhoods of Nepal grow while Nepal lags behind would likely hinder also the achievement of SDG-2, SDG-6, SDG-8, SDG-12 affecting other goals. Such adverse impacts would bring loss in a number of areas including loss of competitiveness in procuring food prices, of ability in purchasing raw materials and jumpstarting industrialization affecting the ability to create decent jobs, and ability to ensure sustainable consumption and production patterns because of both supply and demand shocks from the thriving neighborhoods etc. Nepal therefore must find a way to grow continuously and competitively to ensure that SDGs are met in the time expected.

Potential Winners and Losers

All transformations perturb the existing equilibrium and are rarely likely to be Pareto improving for all actors. In this section, we first identify the beneficiaries in the existing social system and show how they will be affected by the impending changes. We then identify the groups of people who are losing in the existing system and evaluate the impact of the impending transformation on them.

The major beneficiaries of Nepal's economic system today are traders and financial intermediaries, both of whom often work together. In 2016, the Minister of Health, Gagan Thapa, tried to reform the pharmaceutical sector and promote the growth of industries that have the highest domestic value added. At the time, the pharmaceutical industries in Nepal were steadily growing and beginning to account for almost fifty percent of total domestic consumption. The traders, many of whom were politically affiliated either with ruling or opposition parties, stood, vehemently opposed to restrictions on trade. They insisted that they could purchase medicines from other countries cheaply, benefitting both the customers and the traders. While Minister Thapa did initiate some reforms, the eventual winners were traders who lambasted him and were able to minimize the impact of his regulatory reforms as soon as the next administration took over.

Though trading does not have to be a monopoly, many traders have been able to act like de facto monopolizers by ensuring they get the sole license to trade in Nepal. Automobile traders are generally monopolistic. Many suppliers of the government, traditionally the largest buyer in the country, are also monopolies even though they may have passed through some competitive processes. Before the 1990s, the import of raw materials (such as those used in cement, textile, and iron industries) was also restricted and only a few monopolists possessed the right to import them. Even now, many importers are de facto monopolists, and they manage to garner a handsome profit from their trade.

The Nepali government started its industry promotion and import substitution initiatives in the 1970s. The opening of the Himal Cement Factory in Hetauda in 1976 was considered a milestone in Nepal's quest for industrialization by optimally using its own local resources. The cement industry generally continues to receive protection in various ways. However, the hydropower producers complain that such protectionist measures are making their cost of production expensive. For example, Sanima Mai Hydropower Company completed construction of a hydropower plant in eastern Nepal's Ilam district in 2017. According to them, they spent Rs 320 million in purchasing cement. Had they been allowed to use Indian cement without any restriction, the total cost would have been Rs 220 million. The plant had the capacity of 22MW and cost about Rs 150 million per MW. The cost would have decreased by Rs 4.5 million per MW had the tariff so blatantly not favored local cement industries[1]. Hence a protection in one sector that uses local raw material (limestone) affects the competitiveness of another sector that also uses local raw material (water).

Nepal's service sector is also rife with cartels, most prominently transportation sector cartels and financial sector cartels. The former often run by limiting the entry of new members in the designated routes and setting arbitrary prices. Some of them also collect money to pool risk in case of an accident involving a member's vehicle. Financial sector cartels involve banks, who famously engage in a kind of gentlemen's agreement to fix interest rates. They also oppose any policy to expand the total number of banks in the country. However, the weak capacity of the government has led to the overall impunity and many service providers feel emboldened to collectively increase the price of service and extract higher rent from the consumers. The transportation sector, in fact, was so brazen that it used to impose cartel right when the demand for transportation soared (Poudel, 2015). The construction sector also has a formidable cartel. In its extreme form, it involves bidding by a big firm in Kathmandu, and after winning the bid and getting mobilization fee in advance, the winning firm subcontracts it out to another smaller firm. Many of the big firms are also overtly associated with the political leaders.

[1] From the author's conversation with Tuk Prasad Paudel, Chairman, Sanima Engineering.

Labor unions, often affiliated with the political parties, are also an influential factor in labour relations and the organization of the economy in a bigger picture. Nepal has a history of highly confrontational labour disputes. However, lately many former pugnacious labor union leaders have become directly involved in politics, becoming members of parliament or ministers. It is generally agreed that labor relations have improved in the last few years as the leadership has changed, new labor-related acts have been enacted, and the overall political environment has become less combative.

Determinants of Resource Allocation

Each year in early June, Nepal's finance minister presents the annual revenue and expenditure plan of the government in the parliament, which, after a few rounds of discussions, is ratified. Around January, the process to prepare the next year's budget starts in the Ministry of Finance. After a tentative ceiling is approved by the National Planning Commission (NPC), ministries prepare their own wish list based on the budget ceiling provided. The final budget sometimes differs significantly from the list prepared by the ministries, though recurrent expenditures are inflexible and tend to be similar to the budget of the previous year.

Though budget allocation is determined by many factors, politics is the primary determinant. Politicians are trying to increase the prospects of their reelection, for which they have to appeal to voters, while affluent businesspersons can be of valuable support through financial contributions. Voters often demand improvements in the basic infrastructure like roads, health posts, and schools in their neighbourhoods. Roads are also prized by real estate businesses ordinary voters. Business interest groups try to allocate resources in projects that are likely to provide them with contracts. At the end of the spectrum are agents of large multinational agencies who bid for building transmission lines, large hydropower projects, roads or purchasing airplanes often promising significant contributions.

Top politicians, concerned about their reelection, often manage to get a disproportionate share of development budgets in their electoral region even if there are fixed rules of budget allocation for dividing the revenue between local, provincial, and federal governments (see, *rajaswa badfad sambandhi sifaris*, 2020-21). For example, for the budget year 2020-21, the budget sharing between different layers of government considered the following factors: population as per the census of 2011 (60%), area (15%), human development index (5%), need (5%), efforts made in collecting revenues (3%), state of infrastructure development (10%), and other special needs such as the fraction of population needing special care (2%).

This allocation rule, however, only accounts for less than one-fifth of the total federal expenditure each year. Recurrent expenditure of federal government traditionally accounts for three-fourths of the total expenditure which includes fiscal transfer as well, while new development projects are limited to the remaining fourth. In its extreme conservative form, the budget allocation comprises about ten percent increase in already existing items and introduction of a few dozens of new projects. Although attempts are made to align these projects with the goals of the five-year plan, the latter are known for their imperfection and incorrect forecast, and, at the end of the plan, unmet targets.

It is clear from the discussions above that political heavyweights skew the resource allocation. And as a consequence, since those heavyweights often come from the dominant castes, this form of reallocation benefits certain castes more than others. This partly explains the persistent underdevelopment in the Madhes and Karnali regions, where relatively few influential national leaders come from.

Business interest groups do not normally directly influence the budget allocation process significantly. However, they do influence the revenue generation process. The annual budget also proposes new taxes required to be approved by the parliament. One of the lines of the least resistance for this is raising tariff rates on certain imports, which subsequently benefits certain domestic business houses. However, in 2020, the proposal to change two tariff rates became controversial. One was the increase in the tariff of electrical vehicles. It was alleged that major importers knew of the tariff beforehand and thus imported cars just before the introduction of new tariff rates. Similarly, the government was also accused of reducing the tax rate of luxury chocolate items, benefitting certain business houses.

Overall, there is no evidence that geoeconomic factors affect Nepal's resource allocation at home. Partly due to its peaceful coexistence with its neighbors, Nepal does not significantly allocate resources to protect border areas. The allocation of budgets to the security sectors keeps changing, and does not show any bump due to a particular event in the neighborhood. Yet, there are also signs that Nepal does consider developments in the neighborhoods in its budget allocation when it might be opportunistic to do so for the overall development of the country. For example, when a sector grows in China, Nepal does not increase investments in that sector to profit from development. With India, it is often a different story. When India restricted import of refined palm oils in 2019, Nepal's palm oil processing plants flourished. Nepal had benefitted similarly in the past when India had restrictive trade practices, though never significantly. Nepal can theoretically benefit from enacting rules, regulations, tariff rates etc. that allow the country to take advantage of heterogenous policy regimes in different Indian states. But even to benefit from such opportunities, Nepal needs to start investing on the facilities that enable Nepali entrepreneurs to benefit from them. For example, Rudrapur in Uttarakhand has many industries and is close to Mahendranagar and Dhangadhi area of western Nepal. However, Nepali cities are not in a position to benefit from any policy changes in the neighboring states currently supplying intermediate goods to the factories in Rudrapur region, due to the lack of infrastructure.

Key Interest Groups

Against the backdrop of a massive import surplus, traders constitute Nepal's key interest groups. One example of how traders inhibit growth of industries is their stubborn insistence on allowing all kind of imports and, thus, discourage the local production of pharmaceuticals which has been discussed earlier. Trading now dominates all major industrial production activities by an order of magnitude.

Professional organizations representing Nepal's business communities are also mainly dominated by traders. As such, the leadership of many traditionally dominant business houses hardly bemoans the loss of competitiveness of local manufacturing plants due to the rise in the efficiency of firms in China and India. Big industrial houses have also established trading wings and generate major income by trading. Golchha, Jyoti, and Dugar Groups are major examples of such groups.

Though Nepal has a long tradition of exporting natural resources to India, no single dominant natural resources trading group has ever emerged. Tiwari (2012) provides data on trading between Nepal and India since the 1870s. At the time, timber accounted for more than a quarter of Nepal's total export by value. Until the 1980s, agriculture also accounted for a major fraction of Nepal's export to India. However, due to the nationalization of forests in the late 1950s, no single private trading group emerged as a dominant exporter of woods. Similarly, the export of sands currently constitutes a major source of income for many traders, particularly near the border areas. Sand and aggregates trading is distributed, and no single trading group can claim dominance over this trade. However, such traders have their own associations which collectively bargain for the welfare of the group. When the government introduced a new rigorous working standard (Guideline for Collecting and Using River-based Substances) in July 2013, these associations protested vehemently.

Water is another major resource of the country, but trading water is still in a very rudimentary state. Some firms have tried to brand and sell drinking water from the Himalayas, but they have not been successful so far. In the last decade, many traders have tried to benefit from Yarchagumba (Cordyceps Sinnesis, a rare caterpillar fungus) trading as the price started to increase in China. However, their trade is still small and distributed over many locations with a large number of beneficiaries. Apart from that Nepal does not have profitably extractable natural resources of significance.

The tourism sector also consists of independent hotel owners, tour operators, trekkers, etc. The only part of tourism industry where one sees some dominance of a few firms is air aviation (both helicopter and domestic airlines) and the trekking operation (where major operators such as Thamserku are prominent). In Chitwan and Pokhara, two prime tourism destinations of the country, most of the hotels are owned by locals where the average number of hotels is between one and two. The process of capital accumulation in Nepal is relatively slow in these firms, thus it will take a while before firm can dominate and benefit from the trade.

One sees emerging dominance of particular groups in the technology sector. For example, Ncell is one of the two major telecommunication firms, wielding monopoly or duopolistic power in many telecom related services. Internet provider firms also wield significant market power. Increasingly, digital cable service is also likely to be dominated by one firm (Dish Home). For a long period, Mercantile Trading wielded significant strength in technology-related business including in software trading.

The financial sector also has major players with monopolistic power. For example, remittance and banking industries both have dominant players such as the IME and Nabil. Brokerage service in share market is also dominated by a few providers such as the Online Securities, Naasa Securities, etc. In real estate, some groups (such as Civil, CE Construction) have increased in size but most of the real estate business is still very fragmented. Dominant traders have also emerged in the supermarket business (Bhatbhateni, Big Marts, etc). Due to the land reforms of the 1950-1960s, however, Nepal does not have a large land-owning class.

What can be inferred from this discussion is that in areas where license is restrictive, the initial barriers to entry are significant, and market dominance by a few players is relatively common. This is the case in banking, aviation, technology, and modern departmental store chains. On the other hand, in areas where technology is not an important factor, where licenses are easily available, and where capital requirement for entering a business is low, market is still competitive and consists of many players. Small agriculture-based industries, hotels, tourism-related services, and land transport are some examples.

There is a real risk that a group of profiteers, Nepali and foreigners, may identify profit opportunities in the licensed fields, but may make money just by trading license and not actually making significant investments. The telecom sector is one example. Apart from Ncell and Nepal Telecom, four other firms hold licenses. Some of these licenses are being traded outside the market. New entrants like CG Telecom allege that they have to buy license from these firms to enter the market.

So far, the dominant firms are not from one particular country. Ncell is from Malaysia. Nabil's share is owned by a Bangladeshi firm. Emerging big IT firms (Deerwalk, CloudFactory, Leapfrog, etc) are owned mainly by Americans and Canadians, with many owners rooted in Nepal. In the retail sector, so far, the major retailer Bhatbhateni is Nepali, though Big Mart (partly Indian), Mimiso (Japanese) are also increasing their presence. The dominant player in online trading is Chinese (Daraz). In hydropower, most of the technology providers (Electromechanical equipment, Civil Construction, including tunnel excavation) are Chinese, with Indian, and some European firms closely behind in equipment. Recently, firms holding license to develop relatively large hydropower plants are Indian.

Given the dismal amount of FDI attracted by Nepal so far, it is difficult to say any of Nepal's neighbours have strategically tried to enter any particular sector. However, it is likely that with Arun, Marsyangdi, and Upper Karnali hydropower project already in their hands, Indian firms would prefer to have a strong grip on Nepal's hydropower sector. The Chinese owners of Hongshi and Huaxin cement in Nepal, are now preferring natural resource extraction sector. There are no other sectors where firms from a particular country have a dominant position yet.

Influence of Interest Groups in Policy-making

Where license is restrictive and a few groups benefit from such licenses, the influence of the license holders in policymaking can be observed. Newspapers often concentrate on how these groups manipulate rates of tariff and excise, etc., benefitting from policy changes just before the annual announcement of government budgets. It should be clear that these groups try to manipulate both demand and supply and exploit their monopolistic power as much as they can in the market.

The financial sector is one of the prime examples of such restricted nonmarket behaviour. Buyers of ordinary share in secondary market often vehemently oppose any proposition to make it easier for the company's founders to sell shares. But it should be clear that restriction in the trading of promoter shares discourages founders of the company.

Foreign direct investment (FDI) also suffers from a parochial view of many local industries. When in 2017, Amul, an Indian dairy conglomerate, was trying to penetrate the Nepali market, leaders of the Nepali dairy industry opposed it. Local cement industries were also against Chinese cement industry giants trying to come to Nepal, though they failed at the end. Nepal's low FDI intake makes such attempts to block foreign investments even more ironic.

The service sector is slightly more receptive to foreign investment. Banking, insurance, and hotels, for example, initially welcomed foreign investment though the bar for initial investment in banking is rising. The service sector already has a strong network in Nepal which is difficult to replicate easily for foreign investors. Sometimes it is easier for foreign investors to penetrate this market using unconventional means. For example, rather than international giants such as Walmart or Carefour, the first foray into Nepali departmental store market was made by Alibaba's Daraz, an online marketplace platform. Not needing physical presence in Nepal's made it easier for Daraz to start its operation; otherwise, it would have run into headlong confrontation with the local giants like Bhatbhateni, which is profitably run and allegedly has strong political connections.

The social sector generally runs into difficulties while competing for government resources. The plight of the National Women Commission (Mahila Aayog) established in 2001 is a good case in point. Despite its doing a commendable job, it seems to be in a perennial struggle to fund its programs, expand them, and sometimes even in hiring commissioners. Other commissions looking after the welfare of the so-called untouchables and minorities also struggle to expand their programs. This has made achieving a sustainable momentum of progress difficult in the social sectors. Clearly, they do not have the strength or resources to influence the process of resource allocation adopted by the government. The gains Nepal made in the social sector after the 1990s thus appears fragile and increasingly reversible.

Outlook: Prospects of Diversification and Reducing Dependence

Imported goods are overwhelmingly sourced from India (see tables 2 and 3). Indian dominance in external trade statistics is obvious but given the geographic proximity of India, it is not clear whether changing its dominance in external trade can automatically benefit Nepal. Nepal's major efforts in diversification of supply chains lay in increasing production at home but such efforts have fetched mixed results. The implications inferred from promoting cement industries discussed earlier are case in point.

Until the 1970s, almost all construction materials in Nepal were imported from India. The early 1970s were marked by Nepal's effort to establish state-owned cement factories. The apogee of states fascination with cement industries was the massive investment it made in Udaipur Cement Factory. In 1991, the government set aside five percent of the total government development outlay on the factory. To support domestic cement industries, Nepal increased the tariff on imported clinkers and promoted use of home-grown clinkers in the domestic factories. But such efforts are not easy to replicate for other industries. Lack of local raw materials often means Nepal cannot significantly diversify supply chains for its intermediate goods. Nepal's total value added in local firms therefore remain very limited.

Can Nepal meaningfully diversify its supply chain? Needless to say, to successfully do so, the impediments that have hitherto hindered Nepal's industrialization will have to be removed first. To illustrate, a liberal regime in allowing firms to be set up in Nepal, a less cumbersome taxation policy and attractive repatriation program, and a more flexible labour hiring regulation – for example, in regard to foreign employment in fields where qualified labour is lacking – are all preconditions for making any headway in the right direction. But even these reforms can go only so far. Part of the problem is Nepal's main

Table 2: Top five countries by import

2014/15		2015/16		2016/17		2017/18		2018/19	
Import	**Export**	**Import**	**Export**	**Import**	**Export**	**Import**	**Export**	**Import**	**Export**
India	India	India	India	India	India	India	India	India	India
China	USA	China	USA	China	USA	China	USA	China	USA
Germany	Germany	UAE	Germany	UAE	Turkey	France	Turkey	UAE	Germany
UK	UK	Switzerland	UK	France	Germany	Vietnam	Germany	France	Turkey
Turkey	China	Thailand	Turkey	Indonesia	UK	Thailand	UK	Indonesia	UK

suppliers, India and China, are giants in terms of production of intermediate goods. Convincing them to set up a plant in Nepal and subsequently transfer technology requires deep understanding of the industrial processes and the advantage Nepal can offer to these firms in terms of cost reduction and/or market access.

In September 2020, the Confederation of Nepalese Industries (CNI) offered several recommendations to the government to stimulate investment in manufacturing[2]. They provide information on what the firms in Nepal now consider the greatest barrier to the growth of business. Below, we provide a brief note on their recommendation. The requirement on Relaxing Environment Impact Assessment (EIA): While EIAs are necessary for all firms, not least the firms that are likely to exploit natural resources such as water, limestone, and sand, the existing EIA requirements are regarded as too cumbersome and unclear to the extent that they discourage genuine investors.

a. Relaxing Land Limits: Nepal's much lauded land reform started in 1964. After that, imposing limits on land ownership has been a consistent feature of landownership regulations. This has limited the land use capacity of many firms. The price of land has also increased significantly in the last two decades, which has pushed up the threshold to profit from an investment higher. Relaxing regulations on the industrial use of land will require the government to amend the Land Act (1964), Foreign Investment and Technology Transfer Act (2018), and Industrial Enterprises Act (2019). The private sector also wishes to see the government's willingness to provide forest land for industrial use which calls for amending the Forest Act (2019).
b. Simplifying Industry Registration: Industrial Enterprises Act (2019) should be amended to ensure that the Department of Industry and Foreign Investment Board act promptly on ensuring simplified industrial registration.
c. Allowing Investment Directly in Capital Market: Foreigners, and especially non-resident Nepalis, should be able to invest in share markets and other bonds issued locally. This requires amending Foreign Investment and Technology Transfer Act (2019).

To improve Nepal's production capacity, the government should also address the issues pointed out by the World Bank's Ease of Doing Business Report. The report details the lacklustre performance of Nepal in the indicators related to issuing construction permits, paying taxes, and trading across the border. Many other studies also show that Nepal performs badly in criteria associated with trading across border. Though the construction of the dry port in Birgunj has alleviated the situation, Nepal's infrastructures at the custom points are considered underdeveloped.

Reduction of Dependence

Reduction of dependence needs to be accompanied by increased production at home. But increasing production at home requires capital to purchase machineries from abroad, skilled manpower to run the machines and manage processes efficiently, and availability of raw materials at a competitive price. We have already discussed how Nepal's low literacy and exposure to outside world, low capital base, and absence of raw materials at home prevented it from growing independently its manufacturing sector in the past.

Nevertheless, some sectors are in a more advantageous position than others. The agriculture sector can still be competitive if it uses modern yield-enhancing technologies which are generally cheap and sometimes freely available. Nepal's hydropower sector could contribute to fulfil India's increasing demand for peak time electricity and the need for green electricity to make its total electricity consumption cleaner. Nepal's mountain herbs are also prized in India and China, and therefore have a very high potential there. They can reduce imports of herbal products from India and China.

The failure of successive trade strategies and five-year planning also offer lessons on mistakes to avoid in the future. Nepal Trade Integration Strategy (NTIS 2016) identified the following factors constraining Nepal's overall trade: (a) Institutional capacity building for trade, including capacity for trade negotiations; (b) business environment for investment and trade; (c) trade and transport facilitation; (d) standards and technical regulations; (e) sanitary and phytosanitary measures; (f) intellectual property rights; and (g) issues related to

[2] From the author's conversation with Yadav Poudyal, General Secretary, Confederation of Nepalese Industries (CNI).

trade in services. These factors are correctly identified but there have been few improvements on these issues in the last five years, resulting only in not low FDI, but also weakened ability to negotiate concessions with Nepal's trading partners. For example, the government is negotiating with India to renew the trade treaty, but they still do not know what concessions to ask for.

Trade strategies also fail because other ministries and actors fail to deliver. Trade infrastructures are poor in Nepal and improvements slow. Harmonization of standards with major trading partners, including China, is still a distant goal. Good testing facilities and labs were proposed under Nepal India Regional Trade and Transport Project (NIRTTP), a project carried out with a soft loan from the world bank, which is still to be concluded and way past their original due dates. Issues identified long ago often remain in the same state and unsolved.

The changes in India and China in the aftermath of the Covid-19 pandemic may affect these processes in two important ways. India has an open, unhindered border with Nepal. India is also more likely than Nepal to be at the forefront of technological changes. Since India is on average more prosperous, any rise in wages in India attracts many workers from Nepal, and, eventually, wages in Nepal will also have to rise. This will make the construction of public goods in Nepal more expensive and put pressure on revenue collection. Revenue can be increased either by increasing taxes and tariffs or by encouraging more import which will be paid by the remittance. This, unfortunately, is already the situation we are seeing. Hence technological change in India is likely to reinforce the already existing dynamics.

The impact of technological change in China differs slightly from that in India as it does not create job opportunities for the Nepal's adult population. However, efficiency gain in China is likely to make importing from China more attractive and may help replace imports from India and diversify. However, if this strategy is followed by many countries at the same time, the Indian economy may struggle to maintain its relative positioning against China. As a consequence, the need for Nepali workers in the Indian job market might decrease, which would negatively affect the wages in Nepal's labour market. However, importing machinery from China may also become cheaper and, in connection with the low wage level in Nepal, may encourage entrepreneurs to start factories in Nepal and sell the products to both Nepal and India.

These are the two possible scenarios, but there are others. Any increase in Chinese influence in Nepal is likely be opposed by India. After a certain threshold, Chinese firms may face stiff competition from India. The rising geopolitical competition in Nepal might also result in both imports as well as FDIs, irrespective of their country of origin, likely being contested both from inside and outside of the country.

Response to economic shocks and instruments always brings a certain unpredictability, but it is more likely so in Nepal. Covid-19, in its aftermath, can have a strong impact on Nepal's medium size firms, and result In an even bigger lack in middle sized firms. Pakistan, for example, saw a similar situation in the aftermath of the Pokhran nuclear testing (Khwaja et al. 2008). In such a situation, unless vulnerable economic units are protected, they may interpret all kinds of economic liberalization, including the push to attract FDIs, very unfavourably. Difficult economic times are also liable to generate popular discontent and prolonged periods of political unrest.

Feasibility of Addressing Economic and Social Inequalities

Inequalities in Nepal are deeply rooted but could partly be addressed in the context of modernizing the society through urbanization and industrialization. Below we provide some examples.

In 1950, Nepal's social and economic inequalities were extreme. The caste system relegated many individuals to certain low-paying jobs. Land distribution was inequitable. According to the data from the Land Reform Office, three families owned more than 500.000 bighas (approx. 900.000 acres). Thirty-seven percent of the total arable land in Nepal were birtas (grant land) given to influential families who did not have to pay any tax in return to the state. A determined political transformation started in the 1950s culminating in the abolishment of the birta system that began an era where the government's professed goal was to provide education for all.

Urbanization also started slowly but steadily in the 1950s. Urban centres can become important tools of social transformation. For example, in the villages, it is difficult for people from the untouchable castes to start a restaurant business since people normally would not eat there. However, urban areas provide new opportunities and can break the cultural barriers. The rather materialistic, transactional relationship in the urban centres can help the marginalized communities to discard stigmas. Industrialization, which often starts in the urban areas, also tends to be meritocratic to an extent. Professions such as blacksmithing, tailoring, cleaning, and singing, all traditionally associated with the untouchables, can be monetized in cities and are then less discriminatory. Social movements are also easier to start in the town. Progressive judges and lawyers are more likely to be found there and government actions likely to be prompt (Miguel, 2005) and less time consuming.

Despite the prevalent backwardness, determined social changes have been easily implemented in Nepal. The abolition of Sati[3] in 1920 and slavery in 1924 was done almost unopposed. When Land Reforms were announced in 1964, they were also met with little apparent opposition. Legal reforms on behalf of the inheritance rights of women were introduced in the early 2000s and did not face strong opposition. When quotas for women and minorities in government positions were announced in the reformist era of 2000s, they were also questioned but not systematically opposed. Hence determined social movements are less likely to be opposed in Nepal than in other countries of comparable economic and social development. The point, however, is that the campaign must be properly designed and the debate in media appropriately conducted; with the right kind of preparation, such initiatives are likely to pass the legislative stage smoothly.

Opposition is likely to be faced in the implementation stage, with weak governance capacity being one of the major reasons. Another important question is whether economic reforms are as likely to be passed as social reforms. Social reforms normally cost most individuals less in monetary terms than economic reforms and speaking for social reforms often implies enhanced social prestige. Even if people are conservative inside their house, they may support social reforms outside. Thomas Jefferson's attitude toward slavery and ownership of slaves is an example of such contradictions.

[3] Ancient practice of immolation of widows.

Conclusion and Recommendations

Building a sustainable economic development requires clarity in both political and economic strategies. The strategies may draw lessons from the experience of other countries but should eventually be related to Nepal's own past strategies and draw from their experience. It should also be a function of Nepal's own social and economic configuration. In addition, Nepal also needs to develop a progressive alliance with its neighbours and beyond which are likely to benefit in a sustained way. The goal of these alliances should be in not allowing the initiatives and progress made lose momentum and increase mere dependence on them.

In this context, the final recommendations are:

1. Consistent with the recommendations from the ILO's Future of Work report, to reduce the impact of digital and other transformations on people with skills that are becoming obsolete, the government should invest in institutions that provide people of all age lifelong learning opportunity. To make technologies less invasive into one's personal life, regulations should be in place so that the distinction between personal and official work hours is not blurred.
2. Nepal must be open to cooperation between the member countries of the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC), work towards attracting Chinese investment in Nepal, smoothen its trade relations with India, and strengthen the regional trading relationship. It must also encourage industrialization at home using the foreign exchange from the increasing remittance flow and actively search markets for its domestic products.
3. Nepal should invest in improving its border infrastructure, set up special economic zones along the Nepal-India border, and try to supply intermediate goods to the industrial giants in India and beyond.
4. Nepal must also break its implicit oligopolistic regime, liberalize all sectors so that there is smaller concentration of a few families in businesses, get rid of trade monopolies and cartels, and reduce barriers to entry for the firms. It should, however, make sure that its ethnic composition is increasingly accurately reflected in the ownership of the new firms over time. That apart it should strive to reduce the social and economic inequalities which are likely to be exacerbated in the early days of economic growth, as observed by economist Simon Kuznets in what is now known as his Kuznets Curve hypothesis.
5. Pandemics historically tend to reduce inequality and increase prosperity in the short run (Scheidel, 2018). If it happens in Nepal after Covid-19, Nepal must work to make sure that such inequalities remain low over time by designing appropriate state institutions. To reduce future conflicts and disruption in economic growth, the progressive forces must come together to ensure that the government's economic policies, including those related to the FDIs, do not increase inequality and benefits from industrialization and economic growth are not concentrated in a few families.

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