

## Some Challenges in the Economic Development of Nepal

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### INTRODUCTION

Nepal is listed as one of the least developed country in the world with per capita income reaching only to US dollar 180 in 1989. Of a total of current estimated 19 million people living in Nepal, a large majority of them are living at a physiological subsistence level, they are all struggling to get out of poverty. Population has been growing at a rate of 2.6 percent per annum adding more than 490,000 mouth annually. People in industrial world live nearly one and half times more than the life of Nepal. Life expectancy at birth in Japan was estimated to be 76 years, while in Nepal it was simply 52 years.

Table 1 presents the picture of some selected countries. These basic indicators reflect that the living condition in Nepal must be unthinkable low in comparison to other nations.

Table 1  
Basic Indicators of Some Selected Countries

Country	Popula- tion (millions) mid-1989	GNP Per Capita (US Dollars) 1989	Average Annual Growth (percent) 1965-89	Life expec tancy at birth (Years) 1989	Population Growth Annual Average (percent) 1980-89	Urban Pop <sup>11</sup> (Per- cent) 1989	Population per Physician 1984	Adult Illiteracy Rate 1985
Nepal	18.4	180	0.6	52	2.6	9	30,220	74
Bangladesh	110.7	180	0.4	51	2.6	16	6,730	67
India	832.5	340	1.8	59	2.1	27	2,520	57
China	1113.9	350	5.7	70	1.4	53	1,010	31
Pakistan	109.9	370	2.5	55	3.2	32	2,910	70
Sri Lanka	16.8	430	3.0	71	1.5	21	5,520	13
Philippines	60.0	710	1.6	64	2.5	42	6,570	14
Thailand	55.4	1,220	4.2	66	1.9	22	6,290	9
Malaysia	17.4	2,160	4.0	70	2.6	42	1,930	27
Korea, Rep of	42.4	4,400	7.0	70	1.2	71	1,160	..
Japan	123.1	23,810	4.3	79	0.6	77	660	a
United States	248.8	20,910	1.6	76	1.0	75	470	a

Note : a = Less than 5 percent.

Source: World Development Report, 1991.

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The diversity across countries in measured per capita income level is very high. Per capita income in the United States in 1989 was US dollar 20,910. This is a difference of a factor of 116 in living standards. The difference is too great to believe.

Annual growth in per capita income is also diverse. From 1965-89 income rose 0.6 percent per year in Nepal, 7 percent in Korea, 5.7 percent in China, 4.3 percent in Japan, and 1.6 percent in the United States. With such a small base of US dollar 180 per capita in Nepal, if the present growth rate of Nepal is to continue, it will take 106 years, 146 years, 817 years and 789 years to reach to the level of today's India, Sri Lanka, Japan, and the United States respectively.

Adult illiteracy in Nepal is one of the highest in the world. Only one adult is literate in every four adults. Population in Nepal is growing faster than the country could manage to supply the necessities to its increased population. Population is still growing at an alarming rate of 2.6 percent per year. None of the indicators give us any sign of relief.

In Nepal only 9 percent of the people live in the urban areas. Most of the villages in the mountains are not connected by road transport; many people living in the mountains still have to walk for days to carry necessary goods such as salt, oil and clothing, etc., and these goods still has to be carried on their back. Modern facilities such as transport, communication, hospitals, educational institutions, are very few. And, whatever there are they are mainly concentrated at few urban centers. A good transport or communication system or a good health care center can hardly be found in any of the rural areas. Only the poor people who cannot afford to come to urban areas stay in rural areas.

People in the rural areas are mostly illiterate. More often, after taking care of farms and cattle, parents may allow their children to go to study in schools. Many village students have to walk miles and miles away to reach to schools. This is more true for secondary schools. Primary schools are located more or less in each village and within a radius of 2 to 3 miles. But many scattered villages have to share a secondary school. Primary Schools are free of tuition. But, for the farmers, tuition is a tiny fraction of the total cost of sending their children in school. Poor people cannot afford their children to stay till they become high school graduates. Many school age children do not join the school at all. The children are very good helping hands at the farm, sending the children even primary school is burdensome to very many poor farmers. From the age of 7 or 8 children start working, they start looking after cattle and they do baby sitting of other siblings and they relieve the adults for adult work. Those who are lucky to join primary schools, many of them are forced to drop from the school before going to secondary schools due to the severe economic problems. And those who are high school graduates also hardly stay in rural areas. They come to urban centers either to look for job or to continue study and settle down there. The landlords also spend most of their time of the year at the urban centers and go to rural areas only at the time of harvesting to collect their share. In other words, people in the rural areas are poor and illiterate small farmers, and landless laborers.

Confronted with such gloomy picture of the country, it is easy to become pessimistic about future progress. In such a situation the basic task of the newly evolved democratic government is not only to provide the people a sense of aspiration but the

concrete means of overcoming the helplessness and misery from a lack of food, shelter health and protection.

## CHALLENGES WITHIN A CHALLENGE

### To Increase Productive Capacity of the Nation

Basically there are two processes that lead to increase productive capacity of a nation. One is to accumulate capital and the other is to move into technological progress, however, are not independent. Accumulation of capital alone cannot work effectively in putting the economy in motion without the adaptation of technological innovations, nor technological progress can be achieved without any capital investments on the development of human resources. So, the bottom line is that, one needs to draw policies which not only lead to accumulate capital but make sure that the portion of capital goes to develop appropriate human resources, so that the growth can be set in motion.

But the question arises whether we really need economic growth or should we be more satisfied with the policy that brings majority of people come out of starvation. Certainly the second proposition catches more points on the scale of policy evaluation, morally and politically. But, one also has to ask whether it is a viable economic proposition or not.

As said before, without capital investment we cannot increase the productive capacity of nation. One way to accumulate capital is to increase domestic savings. To increase domestic saving, one needs to sacrifice more current consumption in the hope of even more future consumption. But it is a harder proposition to ask for curtailing more consumption from majority of starving people. They simply cannot. Their current consumption is far more essential than the hope of more future consumption. Therefore, saving has to come from the rich. It is generally argued that the rich have higher propensity to save. The argument that proportionately more saving may be coming from the very rich than the less rich has some economic justification. Out of every increment of income proportionately more goes to consumption to the poor than to the rich. So the savings may be higher if increment accrues to the richer than to the poor. Eventually when national and per capita income would be high enough, redistribution of income can be made possible through tax and subsidy programs. Thus, more uneven distribution of income in the economy is justified to make that economy grow faster.

However, there are mainly two arguments that do not support this hypothesis. First, the rich people are not motivated to invest locally. This is not an irrational behavior on the part of individuals. They act according to their optimizing behavior. They may invest a small fraction of their incremental income locally, while most of their saving they like to invest in some prosperous country where the return of capital is high. It pays them to go in search of higher yielding international financial markets. The private capital thus actually moves out of the country from a developing country to a more developed country. That is, improved efficiency of foreign capital causes investment funds to be siphoned away from poor country entrepreneurs (Gertler, Rogoff, 1990). Second, whatever goes to the consumption to the rich, in that also more

goes to the conspicuous consumption and imported goods. That will discourage the local producers. It also further deteriorate the already deteriorated trade balance.

This leads us to think more to go after the policy that make the poor better off even if the country's investment may not increase significantly in the beginning. It however, should pay sufficiently in the long run. This is because, whatever the poor could save from their incremental income, they would like to invest locally. They will not have enough money to go out and search of the international financial market. But this may be easy said than done. Increase in voluntary saving cannot be expected from the poor. In such a situation the only way is to develop a scheme for compulsory saving which may come in the form of tax. If such tax could be used for the direct benefit to the tax payers themselves and if they can feel that they are being benefitted, they may not oppose for such tax. This will ultimately can improve their quality of life.

On the other hand, the policy of encouraging even more unequal distribution of income is not only unattractive on social and political grounds, it does not seem well justified on economic grounds either. But it dose not mean that we should give up to attract local private capital for productive investment. The only thing necessary is to create better environment to make the rich discouraged from conspicuous consumption and make their investment attractive for local investment. Since, it is always better to attract local capitalists to invest in the already known surroundings, local capitalists should be given guarantees for the security of their capital which otherwise would be exported and they should be provided with incentives for investment of their resources in the manner most conducive to economic development.

### **To Increase Agricultural Productivity**

The provision of agricultural products is crucial to the survival and growth of economy, particularly when the economy is not heavily endowed with natural resources. Nepal lacks readily accessible natural resources. So improvement in agriculture is even more necessary to the general economic development of Nepal. Further, agricultural export is an important source of foreign exchange in Nepal.

It is widely accepted that the application of new agricultural technologies in farm practices are preconditions for sustained improvements in levels of output and productivity. Where land is extensively cultivated and labor is scarce, introduction of mechanized agriculture can increase farm yields and the introduction of labor shaving machinery can have a dramatic effect on the volume of output per worker. But labor is not scarce in the rural areas of Nepal, labor is abundant and capital is scarce. The introduction of heavily mechanized techniques will simply accelerate more rural unemployment without necessarily lowering per unit cost of food production. Furthermore, with small land parcels mechanization of farming is even more difficult.

By contrast, improved seeds, irrigation and fertilizers also increase yields by improving the quality of existing land. They do not necessarily require large capital inputs or mechanized equipments. They are therefore particularly more suited for Nepal. Similarly credit facilities to the small farmers could ensure that they will get required inputs in lime and productivity will not be hampered unnecessarily.

But according to Economic Survey, the credit facility could not be extended to the small farmers who really needed that. Even from small Farmers Development Program which was specifically designed to facilitate small farmers, only about 7.7 percent of them could get credit facilities (MOF, 1990). The point is obvious, but it highlights one of the gravest problems affecting development programs in general and rural development in particular. It is unfortunate but hardly surprising that the existing banks are rarely accessible to the needy farmers. The poorest peasants are often afraid even to seek loans from the banks in the fear that the banks will seize their land. Likewise, small farmers are hesitant to enter into contracts with government agencies; they are not confident that they understand all the ramifications of such contracts and they fear that they might somehow be tricked. The large farmers take the benefit out of the government programs directed to help the small farmers. Because small farmers do not come forward, and because bank officials have to show the progress of their work, the bank officials also turn to extend loans to large landowners. Large landowners, thus, obtain access to low-interest government credit, while small holders are forced to turn to the costly traditional money lenders, if they get credit at all. The inevitable result is that the small farmers face greater difficulties to secure the required inputs to go with the modern methods of agriculture.

Beside those technical factors, prices also play important role to affect agricultural growth. Agricultural growth depends on the growth of inputs into agriculture. Price of inputs come in through their effect in making farmers use such inputs more abundantly and exploiting available technology in the process. The ratio of prices of output and the prices of inputs will determine the use of inputs and thus may be very important to affect the agricultural production. Also, the price of agricultural products itself will affect agricultural growth. For example, in the interest of consumers particularly the urban dwellers who are the most vocal and critical about the actions of the government, the agricultural prices have been artificially kept low in Nepal, which could have worked as disincentive to the producers. Obviously what matters is the relative prices and not the absolute level of prices.

Further, the low productivity is also due to factor that are peculiar to agriculture. The most important of these is the prevailing system of land tenure. Even after introducing a land reform program in Nepal, Land ownership is concentrated in the hands of a few large landowners, while the mass of the rural population consists either of tenants, generally share croppers or of farm laborers who have no legal relationship to the land they till. According to the Sample Census of Agriculture of 1981, less than 9 percent of households were still holding about 47 percent of the total land holdings in Nepal (Yadav, 1987). The situation has not changed there after. The economic consequence of such a system of land tenure are as devastating as the social and political consequences. Tenants who have no security of tenure can have no interest in improving its fertility- even if they understood how this could be done. Similarly, lack of technical know how and managerial skills may also be equally responsible for low level of agricultural productivity in Nepal.

This necessitates the ongoing land reform program be revitalized more aggressively and not repeating the mistakes of the past. Land reform should be aimed not only to help tenant cultivators transform into owner cultivators, but also to secure

access to need inputs to all farmers. Furthermore, government should engage in developing effective programs to facilitate the larger farmers as well, so that, they will also not feel left out completely in the effort of development of the country. To achieve a balance growth rather than lopsided one, no one should be left being to pursue development. Once they do not see themselves profitable of being large land owners, some of them may want to come out of agriculture. They may turn out as good entrepreneurs, if favorable environment is created to them. Once they are able to channel their surpluses into some productive uses, that will help the nation to build up broader industrial base.

### To Create A Favourable Environment for Entrepreneurs

Industrialization has always been considered the very basis of economic development. Rapid growth has been seen as the means to that industrialization. The overall industrial development is expected to create the climate for a healthy economy. Industrialization has remained the key factor for most of the developed world for their development. This is a statistical regularity and it may be unlikely for Nepal to deviate from that regularity. But one thing is clear that the situation of Nepal is not very comparable to that of developed countries at their beginning phase either. Further, industrialization may be a must, but creation of a suitable environment for industrialization is even more important before we try to initiate the process of development. Once the threshold of a conducive environment is passed the process can run by itself.

But with a very low level of saving and reluctance of inviting foreign resources whether from the part of government in the fear of foreign dominance and other reasons or turning down from the part of foreign entrepreneurs themselves due to unattractive opportunities of investments, the development of private enterprise has been crippled in Nepal. In Addition to lack of financial resources, the development of industries has been paralysed by the lack of external economies as well. The most important of the external economies are such essential overhead facilities as transportation and power. A transportation network is essential for the establishment of a national domestic market, for the collection of primary products, for processing and export, for the distribution of industrial products throughout the country and so on. Nepal is a mountainous country. In many parts of the country the only means of transport is still the trail ways. Most of the villages are not touched upon by any kind of transport. A total of 7362 Km. motorable road of which only 40 percent was black topped, the other 60 percent was just fair weather road existed in Nepal by 1991.

It is generally argued that the slow growth in agriculture has been a drag on industrial growth. One way in which agriculture sector affects industrial development is through the supply of agricultural raw materials. But more important fact is that the industrial development is not possible unless the effective demand for domestic goods can be increased. The effective market for manufactured goods is extremely small. The rich are very few, and their preference is basically for imported goods. The poor are numerous, but they have very limited ability to buy goods and services. This necessitates the policy to be directed to raise the effective demand of the

majority of people. However, This strategy should be worked out from outside the framework of industrial policy.

It is argued that the size of manufacturing is a major factor to influence the contribution of manufacturing in the national income of Nepal (Koirala, 1987). But because of its low per capita income the country does not have enough savings for the bigger industries. This suggests that the policy be directed improve the smaller rural industries which will not only help rural employment but also help to raise the income of the smaller entrepreneurs. Further, once the income is increased, these smaller entrepreneurs are the ones who will invest locally, in contrast to the very rich for whom it may pay to go in search of higher yielding international financial markets. But for the smaller entrepreneurs they will have no choice other than to invest locally. They cannot go in search of higher yielding international markets with their small amount of saving. Also, they may not be very touched with imported luxury goods. So, with a view to increase productive employment opportunity an effective demand creation in rural areas, small industries and cottage industries needs to be given special attention. Cottage industries so far are very unorganized. Although some attention seems may to have been provided for the access to supply necessary inputs, raw materials, credit and marketing facilities through Cottage Industry Development Committee and Cottage Industry Sales Emporium, they are yet to prove that they are for the benefit of majority of needy entrepreneurs and not simply other ladders to bureaucratic structure. The data are too little and unreliable to judge the performance in cottage industry sector.

In the policy of encouraging small industries, there are some problems too. With small industries in place, it will not only be very difficult to exploit the economies of scale but it will also be very difficult to adopt modern efficient technology. Nepal cannot completely rely on the cottage and small industries. If so, the country can never catch up other nations in its way to development. This implies that, the country needs to create an environment in which bigger and smaller industries coexist for different lines of production. Bigger and smaller industries should be complements of each other and not in competition with each other.

### **To Exploit Nation's Comparative Advantage**

Nepal does not have lot of mineral resources, nor it has a lot of lands. What it has is its people. Nepal has the characteristics of a typical labor-surplus economy. It may, therefore, be safely assumed that Nepal's comparative advantage at least so far, lies in labor intensive rather than capital intensive activities. But as in many other developing countries, the labor in Nepal is unskilled. This leaves us in a dilemma whether to derive comparative advantage from labor intensive activities now or postpone current comparative advantage in search of better opportunity in the future. In one hand, there is no guarantee that future will turn over the comparative advantage in the country's benefit. While in the other, it does not make sense to let the country specialize only in unskilled labor activities while letting foreigners alone reap the rewards of their higher skills, technology and capital. But in any case, Nepal cannot loose if it chooses to improve its labor force to higher skills as quickly as possible.

The comparative advantage can be extracted from the product that intensively embodies in it. Hydro-power represents Nepal's most important natural resource and in the long run there can be no second thought that Nepal must develop industries based on its exploitation. Industries that could become attractive with abundant hydro-power as a source of energy are heavy industries such as steel mills and mineral based industries. Unfortunately, easily accessible minerals other than Magnesite, Gems and Zinc have not yet been located on a large and economically feasible scale in Nepal. That means, with the lack of complementary resources such as minerals, Nepal still needs to draw its comparative advantage from the labor intensive activities such as tourism, carpets, garments, etc.

### **To Transform Unskilled to Skilled Manpower**

Much of the appeal of basic human needs derives from the link to the notion of investment in human capital. Human capital is generally considered to be the knowledge and skills that are embodied in the labor force. Many kinds of education, health and other social expenditures can improve the quality of human resources. When such expenditures are directed towards the poor, as for instance, in providing education or rural community health programs they become ways to reduce poverty by increasing the productivity of the poor.

Human capital accumulation depends upon the fraction of total savings per worker that is allocated to education, on the job training, health etc. Increased productivity of labor results from improvement of nutrition and health as well as investment in human capital-education and on the job training.

Recent works on growth theory emphasize more than ever the impact of investment in physical and human capital on long term economic growth Barro (1989), Lucas (1988), Rober (1989). The development of human capital allows the productivity of labor to grow over time and enhanced efficiency of labor affects output. This creates a role in the long-run growth process for policies that affect efficiency of resource use such as openness to trade, regulation of financial intermediation, investment of infrastructure, health and education as well as development of institutional environment. Improving policy along these dimensions can raise the long run rate of growth of output as well as increasing the level of output (Easterly, and Wetzel, 1989). But, for the poor to be reached appropriate forms of service must be emphasized primary schools instead of universities, village clinics in stead of intensive care units in urban hospitals.

### **HOPE, MORE HOPE AND CREDIBLE COMMITMENTS**

#### **A Need to Think in a Long Term Perspective**

The mechanism of growth in terms of real per capita income of a country is essentially a gradual increase in its productive capacity. Increase in productive capacity basically implies the increase in productive capital per head which further implies the use of improved techniques in the production process. The introduction of improved techniques is often connected with the increase in capital, since improved technique



often has to be applied together with new capital equipments. Consequently the increase in productive capital is commonly regarded as the most essential condition for real income growth. Such an increase must be financed by savings which in the early stage may be borrowed or secured as grants aid from abroad. But economic help in the form of loans and grants to promote economic progress is no substitute for the domestic efforts of savings. Such help, in fact, actually do more harm than good. Foreign assistance may not be dependable. The loans and grants may be tied up to the fulfillment of certain conditions regarding their use to serve more to the interest of the lending countries and the country getting loan cannot use it freely according to its need. For the country to advance with continuous self sustained growth, the necessary funds must essentially come from domestic savings.

### **A Need to Think for the Mass**

Growth in agricultural product is unlikely to exceed 4-5 percent per year even with a greater effort in agriculture sector. Its accelerated growth depends on exploiting more fully the existing production potential and continuously raising that potential through technological change. This require sustained rapid growth in the use of inputs such as seeds of better quality, fertilizers, pesticides, farm implements and machinery, though not impossible, it is a very difficult task. On the other hand, the rural population is expected to continue to increase at about 2-3 percent per year. This implies that the production per head in agriculture cannot be expected to increase by more about 2-3 percent per year in near future in Nepal.

One needs not to be too pessimistic either. If the agriculture is directed to lead to increase the income of the mass, not on the effective demand for the industrial goods can increase but further accumulation of capital is also possible. This means that the industries can develop smoothly without much of effort there after. In the mean time the government may help to create a favorable environment to prospective entrepreneurs who want to leave agriculture to enter into industries. Because of the increased effective demand, the manufacturing sector starts growing with the target of rural people as its consumers, and as capital starts accumulating at an accelerated rate, it will divert traditional farming into more modern farming techniques. And since it also has to replace people who moved out of agriculture to enter into manufacturing, agriculture is then expected to enter into mechanization.

### **A Need to Eradicate Poverty**

An important line of policy to reduce poverty is to focus directly on reducing the concentrated control of assets. Land reform is one such policy that directly addresses the rural poor. The basic purpose of land reform is to transform tenant cultivators into small holders who will then have an incentive to raise production and improve their incomes. A farmer's attachment to his land is profound. Nepal tried a version of that policy. However, the purpose of land reform could not be achieved where the economic system prevented small farm holders from securing access to much needed critical inputs such as credits, fertilizers, seed, marketing facilities and agricultural education. Even with the land ceilings large land owners managed to keep to land for themselves, somehow. On the other hand, small land owners had always a problem of getting

required fertilizer or seeds. Even today, they don't have easy access to credits, fertilizers or improved seeds, they don't have sufficient incentive for agricultural education, nor they have any incentive to look for marketing facilities. There are plenty of evidences that had been adopted with the stated objective of helping the poor, but in fact the more affluent member of society disproportionately benefitted from those programs. For example, Economic Survey 1990 admits that the large scale farmer benefitted proportionately more than small farmers from input subsidies, from credits of low interest and from many other facilities (MOF, 1990).

Majority of people in Nepal still have a problem of overcoming the basic human needs. This situation demands the policy to be addressed to raise the incomes of the rural poor-small farmers and landless laborers. These groups represent the large proportion of the total population. They constitute the poorest segment of the society and they are the ones who have also been bypassed by the progress of the past. Our major development objective, therefore, should be to generate a desired pattern of overall and broad based economic growth with special emphasis on accelerating the growth of income of the poor. Development in Nepal will have no meaning if the rural poverty cannot be eliminated.

While developing the policy it should be kept in mind that no policy will be better than the one that addresses the issue directly. The real issue here is to eliminate poverty from the mass. So, the new development strategy must not count on the idea that poverty can also be attacked indirectly through the growth rates filtering down to the masses, but it must be based on the pressure that poverty must be attacked directly as far as possible. But Wherever the direct attack is not feasible and as long as the two policies do not contradict to each other, the second choice which also would act indirectly to eradicate poverty, should be allowed to work.

## CONCLUSION

The fundamental to any policy action for an economic development is to lead the nation towards an increase in its productive capacity. But the productive capacity does not increase by itself. It needs a rigorous efforts and commitments of political and social institutions of the country.

No one will expect present gloomy Nepalese Economy, the economy of disgust and hunger to the majority of people to undergo a turn of 180 degrees to the economy of prosper and richness to everybody with the evolution of democratic form of government. There is no such magic stick in the hands of the new government that can make everything prosper painlessly. However, we should not be very pessimistic either. If the policies are headed in the right direction, there is no such thing which Nepal cannot perform if the government is committed to act for the benefit of the people. The economy runs the politics, and politics will lead the economy. They cannot be separated to each other and specially it is more true in a poor country like Nepal. However, the question is to detect what is the right direction to move on. We cannot go and copy the policies that some prosperous countries of today chose decades or centuries ago, neither we can go outright choose the current policies of these prosperous countries of today. We can and should learn the lessons, but we have to run our economy is our own way

looking around our own environment, our limitations and exploiting all the opportunities of today. It will be too costly to miss even a single opportunity. It is never too late to begin. There are serious political institutional and power structure problems involved in any reorientation of development strategy toward greater concern for the very poor. But, we always have to look in long term perspectives. The economy runs the politics, but politics should give the vision on it. A political myopia may ruin the economy and a myopic politics can never last long.

The progress of the economy is of vital importance to the people of Nepal. Most of the people are desperately poor; their hopes for better life depend greatly on the success or failure of the development effort of the new government. Confidence in the government is a pre-requisite to good performance of the economy. Economists may disagree for the best policy; but one thing is certain - whatever the policy is chosen for Nepal that should induce a long term benefit to the majority of people. Fine tuning in the policy may be necessary to cope with certain unforeseen circumstances, but the commitment to overall prosperity and the long run vision should never be abandoned. This requires a stable government with proper visibility of the future. A stable government implies that the policy grows out of the popular will or at least is not seriously inconsistent with it.

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