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## Country Report

# Nepal

**September 2005**

The Economist Intelligence Unit  
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# Nepal

September 2005

## Summary

**Outlook for 2005-06** Direct royal rule is likely to continue, despite increasing domestic and international pressure on King Gyanendra to restore democracy. The main political parties are moving further away from reconciliation with the king and could align themselves with the Maoists rebels, especially if the unilateral ceasefire by the Maoists holds. Both India and Western governments will remain caught between extending military assistance to the government, which might give the appearance of condoning the king's suspension of democracy, and withholding support, which could strengthen the Maoists' position. GDP growth will remain weak, and the non-agricultural sector will find operating conditions difficult.

**The political scene** The king expanded the cabinet on July 14th to include more loyalists and defectors from the political parties. The main political parties and their supporters have continued to protest against direct royal rule, and many of their leaders have begun to advocate constituent assembly elections and a restoration of democracy without the king. The Maoists declared a ceasefire on September 3rd, after carrying out a series of attacks on government forces, including one on a military encampment in early August. Many civilians have been killed in the attacks. The anti-corruption body formed by the king has sentenced the former prime minister, Sher Bahadur Deuba, to two years in jail. The government has amended laws to regulate non-governmental organisations and to ban unions in the civil service.

**Economic policy** The government has announced an ambitious budget for fiscal year 2005/06 (mid-July to mid-July). Norway has pulled out of the multi-donor Melamchi Water Supply Project, but China and India have approved new aid for Nepal. The government raised administered oil prices in mid-August, and has opened liquefied petroleum gas (LPG) imports to the private sector.

**The domestic economy** The economy is estimated to have grown by 2% in 2004/05. Consumer price inflation has begun to accelerate, and measures to toughen regulations against loan defaulters have encountered a temporary setback.

**Foreign trade and payments** Exports to India have remained steady, but other exports have declined. Exports of readymade garments have fallen sharply. The trade deficit has narrowed and services receipts have dropped, owing to the downturn in tourism. Remittance flows have remained strong.

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## Political structure

<b>Official name</b>	Kingdom of Nepal	
<b>Form of state</b>	Constitutional monarchy	
<b>Head of state</b>	The sovereign, King Gyanendra, is head of state and supreme commander of the Royal Nepal Army. Since February 1st 2005 the king has ruled directly as chairman of the Council of Ministers	
<b>The executive</b>	Democratic procedures were suspended in October 2002, and a succession of interim governments have since been appointed by royal decree. The latest of these was dismissed on February 1st 2005, when a new administration, reporting directly to the king, was appointed	
<b>National legislature</b>	Bicameral: National Assembly (the upper house), 60 members (35 elected by the lower house, 15 elected by heads of local committees and others in the electoral college, and ten appointed by the sovereign); House of Representatives, 205 members elected for five-year terms from single-member constituencies. Both houses were dissolved in May 2002	
<b>Legal system</b>	The Supreme Court acts as the court of appeal and review, as well as having powers of original jurisdiction; it presides over 16 appellate courts and 75 district courts	
<b>National government</b>	The third interim government since the dismissal of the elected government in October 2002 was appointed by the king in June 2004 and dismissed on February 1st 2005. Since then the king has chaired a cabinet including two vice-chairmen but no prime minister	
<b>National elections</b>	May 3rd and 17th 1999; the election due on November 13th 2002 remains postponed	
<b>Main political organisations</b>	Nepali Congress (NC); Communist Party of Nepal (Unified Marxist-Leninist), or CPN (UML); Rastriya Prajatantra Party (RPP, National Democratic Party); Nepal Workers' and Peasants' Party (NeWPP); Nepal Sadbhavana Party (NSP); Jana Morcha Nepal; Nepali Congress (Democratic), or NC (D); Nepal Majdoor Kisan Party (NMKP); armed opposition—Communist Party of Nepal (Maoist), or CPN (M)	
<b>Chairman of the cabinet</b>	King Gyanendra	
<b>Vice-chairmen</b>	<b>Land reforms &amp; management, water resources Physical planning &amp; works, health, population, industries, commerce and supplies</b>	Tulsi Giri  Kirti Nidhi Bista
<b>Key ministers</b>	<b>Agriculture and co-operatives Culture, tourism and &amp; civil aviation Education &amp; sports Environment, science &amp; technology Finance Foreign affairs Forests &amp; soil conservation General administration Home Information &amp; communications Labour &amp; transport management Law, justice &amp; parliamentary affairs Local development Women, children &amp; social welfare</b>	Badri Prasad Mandal Buddhiraj Bajracharya Radha Krishna Mainali Prakash Koirala Madhukar Sumsher Rana Ramesh Nath Pandey Salim Miya Ansari Krishna Lal Thakali Dan Bahadur Shahi Tanka Dhakal Ram Narayan Singh Niranjan Thapa Khadga Bahadur Durga Shrestha
<b>Central bank governor</b>	Bijaya Nath Bhattarai	

## Economic structure

### Annual indicators

	2000 <sup>a</sup>	2001 <sup>a</sup>	2002 <sup>a</sup>	2003 <sup>a</sup>	2004 <sup>a</sup>
GDP (NRs bn) <sup>bc</sup>	379.5	411.2	422.7	456.2	495.3
Real GDP growth (%) <sup>bc</sup>	6.1	5.6	-0.6	3.2	3.5
Consumer price inflation (av; %) <sup>d</sup>	2.5	2.7	3.0	5.7	2.9
Population (mid-year; m) <sup>e</sup>	22.9	23.2	23.7	24.2	n/a
Exports fob (US\$ m) <sup>d</sup>	805.0	736.8	567.4	662.6	755.6
Imports cif (US\$ m) <sup>d</sup>	1,572.6	1,472.5	1,419.6	1,753.8	1,868.6
Current-account balance (US\$ m) <sup>bf</sup>	-129.8	-148.3	-270.4	-333.9	n/a
Reserves excl gold (mid-Dec; US\$ m) <sup>d</sup>	945.4	1,037.7	1,017.6	1,222.5	1,462.5
Public external debt (year-end; US\$ m) <sup>g</sup>	2,822	2,693	2,953	n/a	n/a
Exchange rate (av; NRs:US\$) <sup>d</sup>	71.1	74.9	77.9	76.1	73.7

<sup>a</sup> Actual. <sup>b</sup> Nepal Rastra Bank. <sup>c</sup> Fiscal years ending July 15th of year indicated. <sup>d</sup> IMF, *International Financial Statistics*. <sup>e</sup> Asian Development Bank. <sup>f</sup> Excludes grants. <sup>g</sup> World Bank, *Global Development Finance*.

Main origins of gross domestic product 2004 <sup>ab</sup>	% of total	Components of gross domestic product 2003 <sup>ac</sup>	% of total
Agriculture, forestry & fishing	37.5	Private consumption	76.1
Finance & real estate	10.5	Government consumption	10.6
Trade, hotels etc	10.0	Gross fixed capital formation	19.7
Construction	9.8	Change in stocks	3.9
Social services	9.4	Exports of goods & non-factor services	18.2
Manufacturing	7.4	Imports of goods & non-factor services	-28.8

Principal exports 2004 <sup>ad</sup>	US\$ m	Principal imports 2004 <sup>ad</sup>	US\$ m
Garments	138.0	Petroleum products	277.6
Woollen carpets	75.6	Vehicles & spares	88.3
Vegetable ghee (oil)	40.1	Other machinery & parts	77.1
Raw jute & jute goods	25.6	Textiles	60.9
Toothpaste	20.1	Thread	37.8

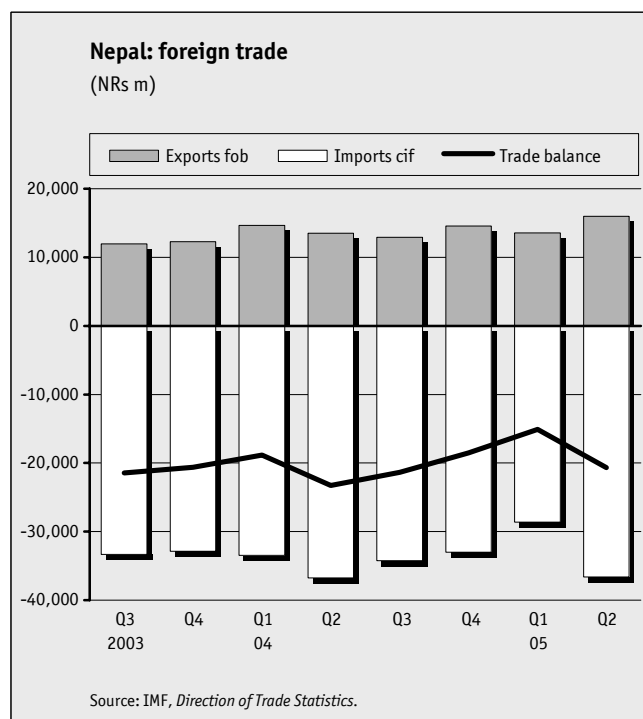
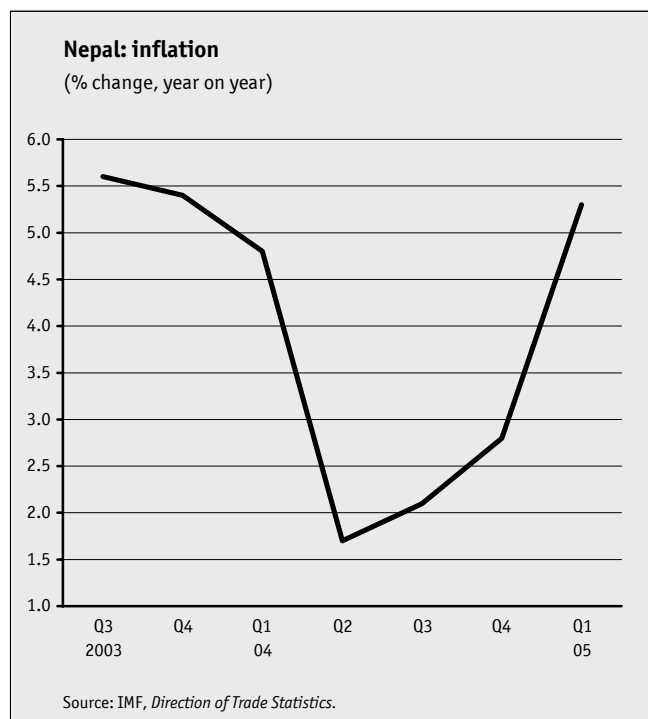
Main destinations of exports 2004 <sup>aef</sup>	% of total	Main origins of imports 2004 <sup>aef</sup>	% of total
India	57.4	India	58.8
US	17.8	Singapore	6.3
Germany	7.4	China	3.9
UK	3.1	Thailand	3.1
Italy	1.1	Malaysia	2.6
France	0.9	Indonesia	2.3
Canada	0.6	South Korea	2.2

<sup>a</sup> Fiscal years ending July 15th. <sup>b</sup> Central Bureau of Statistics (GDP at 1994/95 prices; estimates). <sup>c</sup> Central Bureau of Statistics (GDP at current prices). <sup>d</sup> Nepal Rastra Bank, *Nepal Foreign Trade Statistics*. <sup>e</sup> Trade Promotion Centre, *Nepal Overseas Trade Statistics*. <sup>f</sup> Provisional.

## Quarterly indicators

	2003		2004				2005	
	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr
<b>Prices</b>								
Consumer prices (2000=100)	113.9	114.6	112.3	113.5	116.3	117.8	118.2	n/a
Consumer prices (% change, year on year)	5.6	5.4	4.8	1.7	2.1	2.8	5.3	n/a
<b>Financial indicators</b>								
Exchange rate NRs:US\$ (av)	75.1	74.1	73.8	72.7	74.7	73.6	71.0	70.8
Exchange rate NRs:US\$ (end-period)	74.3	74.0	73.6	73.5	74.9	71.8	71.0	70.7
Deposit rate (av mid-month figure; %)	3.00	3.00	3.00	2.75	2.58	2.50	2.50	n/a
Discount rate (av mid-month figure; %)	5.50	5.50	5.50	5.50	5.50	5.50	5.50	n/a
Government bond yield rate (av mid-month figure; %)	7.00	7.00	7.00	6.50	6.50	6.50	6.50	n/a
Lending rate (av mid-month figure; %)	7.50	7.50	7.50	9.00	9.00	8.50	8.25	n/a
Treasury-bill rate (av mid-month figure; %)	3.66	3.85	3.81	0.82	0.63	2.40	2.94	n/a
Quasi-money (middle of last month of period; NRs bn)	164.5	171.6	177.2	182.2	192.8	193.3	194.7	n/a
Quasi-money (% change, year on year)	9.1	12.9	13.5	11.0	17.2	12.6	9.8	n/a
<b>Foreign trade (NRs m)</b>								
Exports fob	11,936	12,294	14,655	13,524	12,936	14,554	13,568	15,962
Imports cif	-33,390	-32,924	-33,497	-36,807	-34,309	-33,057	-28,651	-36,654
Trade balance	-21,454	-20,630	-18,842	-23,283	-21,373	-18,503	-15,083	-20,692
<b>Foreign reserves (US\$ m)</b>								
Reserves excl gold (middle of last month of period)	1,146.4	1,222.5	1,398.3	1,448.9	1,411.4	1,462.2	1,502.1	n/a

Source: IMF, *International Financial Statistics*.



## Outlook for 2005-06

### Political outlook

**Domestic politics** Nepal remains trapped in a complex political crisis and a protracted civil war that has derailed democracy and continues to inflict severe damage on the economy. The Economist Intelligence Unit believes that King Gyanendra will make every effort to remain in power over the forecast period, with few acceptable concessions being extended to the political parties. Two developments could, however, tilt the political balance against the king. The first is the unilateral ceasefire announced by the Maoist rebels on September 3rd, while the second consists of moves by the Maoists to align themselves with the political parties. The king has shown signs of wanting to return to a pre-1990 *panchayat* (appointed assembly) system of government. But direct royal rule is unlikely to result in political stability, owing to the widening differences between the monarchy on the one hand and the political parties and Maoists on the other. The Royal Nepal Army (RNA), which has remained loyal to the monarchy, could also develop political ambitions.

The political parties have a history of in-fighting and remain largely ignored by the king. The king also retains the option of arresting party leaders or rank-and-file members in the event that they begin to align themselves with the Maoists, who have been declared terrorists by the state. However, in a rare show of unity, seven major parties came together in May to demand the restoration of democracy through the reopening parliament and the formation of an all-party government. As result, the gap between the parties and the king has continued to widen. The Maoists have also begun fresh efforts to build bridges with the parties, which have indicated their willingness to negotiate, calling on them to join in their struggle against the monarchy. The conditions for talks between the parties and the rebels to take place have improved, as many party leaders now advocate elections to a constituent assembly, which is also the Maoists' main demand.

Rapprochement between the king and the political parties is possible, but the parties would first have to drop the idea of negotiating with the rebels and replace their current leaders, whom the king considers to be corrupt. An alignment between the parties and the Maoists would damage the monarchy, by uniting the opposition against direct royal rule. This could then force the king to make major concessions to accommodate the parties. Provided that the military backed him, however, the king would remain a strong force even under such a scenario. Failure to restore democracy could, however, create further political instability, particularly if there was a renewed upsurge in Maoist violence and an increase in social unrest triggered by the mass displacement of the rural population.

**International relations** India reacted strongly against the royal takeover in early 2005, but will continue to engage with the Nepali government through various forms of support. Lethal military hardware imports from the US remain suspended, and are unlikely to resume unless Nepal shows signs of moving towards democracy. China

remains a neutral supporter, having given some aid but without having made any commitment to provide military supplies. India and the Western governments will remain torn between supporting the monarchy, which could delay the restoration of democracy, or withdrawing support, which could strengthen the Maoists.

One concern is whether India might feel forced to intervene directly in Nepal, and whether China and the US would allow it to do so. It is, however, difficult to envisage a scenario in which direct Indian military intervention would be successful, although the Indian army has already bolstered its security on the border with Nepal. In the absence of Indian military intervention, China is likely to remain on the sidelines, and the US is unlikely to pursue a policy contrary to Indian interests. Links between Nepal and Pakistan appear to have strengthened since the assumption of royal rule, but this political relationship will remain of only secondary importance.

## Economic forecast

### Economic growth

The government forecasts GDP growth of 4.5% for fiscal year 2005/06 (mid-July to mid-July). However, this forecast, announced in the 2005/06 budget in July, is optimistic. GDP growth in 2004/05 was about 2%, and there has been no improvement in the main factors causing low growth—the conflict, political instability and low investor confidence. The prospects for economic revival therefore remain slim. The lifeline for the economy over the next two years will be remittances from Nepali workers overseas. In addition to shoring up the balance of payments, remittances have helped to sustain consumption. The current distribution system for remittances also appears to be highly efficient and resistant to political turmoil. Agricultural production, which accounts for almost 38% of GDP, will remain low, owing to poor rainfall during the rice-planting season (rice makes up 20% of total agricultural output). We expect GDP growth of 2-3% a year in 2005/06 and 2006/07.

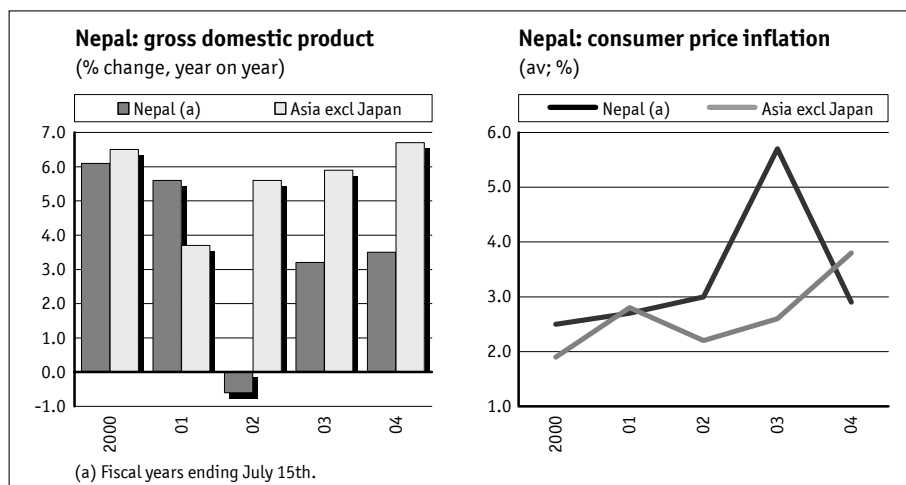
### Inflation

The government hopes to keep consumer price inflation below 5% in 2005/06. The rate has, however, begun to move up following increases in oil prices and supply disruptions caused by Maoist activities. The national urban consumer price index rose by 6.4% year on year to mid-May 2005, and will rise further in response to the mid-August increase in administered oil prices. Another factor that could push up prices is increased migration from rural to urban areas by people fleeing the conflict. This would contribute to a fall in agricultural output, while raising urban demand. (Producer price inflation is already running at a higher rate than consumer price inflation.) Consumer price inflation will remain well in excess of 5% in both 2005/06 and 2006/07.

### External sector

The Nepal Rastra Bank (the central bank) reported a current-account surplus in the first ten months of 2004/05. Merchandise trade has, however, become vulnerable, even though there has been a turnaround in exports to India. Both exports to and imports from countries other than India have slumped, and garment exports continue to fall. Tourism has also declined, sharply reducing the services surplus. The key component of the current account is transfers:

although the decision earlier this year to impose direct royal rule may reduce bilateral aid, inflows of private remittances are likely to continue to grow as more Nepali seek jobs abroad, if only to flee the conflict. Remittances were worth NRs53bn (US\$751m) in the first ten months of 2004/05. If the flow of remittances holds up, small current-account surpluses look possible in 2005/06 and 2006/07. Even if the balance of payments as a whole moves into deficit, which is not expected, an immediate payments crisis looks unlikely: in mid-May 2005 Nepal's foreign reserves of NRs131.7bn (US\$1.8bn) were sufficient to cover merchandise exports for 12 months.



## The political scene

### The king expands his cabinet and seeks legitimacy abroad

King Gyanendra, who imposed direct royal rule on February 1st 2005, expanded his cabinet on July 14th in an effort to make it more effective. He reduced the responsibilities of the two septuagenarian vice-chairmen, and added four ministers and eight junior ministers. The new team includes some “defectors” from the political parties and some controversial appointees from the pre-1990 *panchayat* (appointed assembly) era. Included in the cabinet is Prakash Koirala, the son of Nepal's best-known pro-democracy leader, B P Koirala, and a nephew of the Nepali Congress (NC) party leader, Girija Prasad Koirala. Salim Miyan Ansari, formerly of the Communist Party of Nepal (Unified Marxist Leninist), or CPN (UML), has also joined the king's team, together with Badri Prasad Mandal, who heads a faction of the Nepal Sadbhavana Party.

Among the junior appointees, Jagat Gauchan (physical planning and works) was convicted of manslaughter in the mid-1980s and Senate Shrestha (education and sports) faces corruption charges before the Supreme Court. Nikshya Sumsher Rana, one of the most vocal supporters of the February takeover, was also appointed as a junior minister. Another controversial appointment was Niranjan Thapa, who was involved in crushing the pro-democracy protests in 1990 as junior home minister. The cabinet expansion suggests that the king is willing to try what he thinks will work, caring little about building bridges with the political parties, at least in the short run. His

actions have provoked a growing chorus of criticism, characterised by damning comments made by the US ambassador to Nepal, James Moriarty.

The king continues to seek international support for the new regime. In June he attended the second summit of the G77, an informal affiliation of developing countries, in Doha, Qatar, and visited neighbouring UAE. In Doha he described his actions at home as efforts intended to safeguard democracy, peace and development, and said that they were yielding encouraging results. Crown Prince Paras has also been active in promoting the new government abroad, visiting Japan and South Korea in July.

From August 12th the king made a four-day visit to Nepal's eastern plains districts. State media said that he was there to assess the security situation and issue directives to district-level officials. State-run television showed him, often in military attire, hugging children and chatting with local people. He undertook a similar visit of the far western and midwestern regions of the country on August 22nd-28th. His main message to those living there was that the Maoist rebels could be defeated if the people united behind his government.

**Protests against direct rule  
gather strength**

Nepal's seven main political parties have continued to stage united protests against direct royal rule. On June 3rd the parties convened a meeting of former members of parliament (parliament was dissolved in May 2002). The meeting denounced the royal takeover, and endorsed a "road map" for restoring democracy that the seven parties had agreed in May. The parties also demand that the king restore parliament and let it find a solution to the political crisis, including the Maoist insurgency. On June 18th the parties decided to boycott the municipal elections, which the king plans to hold before mid-April 2006, arguing that participation would imply recognition of the authoritarian regime. Many party leaders have publicly endorsed the Maoist demand for constituent assembly elections, but insist that the rebels must give up violence if they want to form an alliance to press for democratisation.

On June 30th the seven parties announced that they would negotiate with the Maoists and forge alliances to press for the re-establishment of "total" democracy, meaning democracy without the king. In response, the Maoist chairman, Comrade Prachanda, asked the parties to form a negotiating team. The seven parties are the Nepali Congress (NC), the Communist Party of Nepal (Unified Marxist-Leninist), or CPN (UML), the Nepali Congress (Democratic), the Nepal Sadbhavana Party (Anandi Devi), the Jana Morcha Nepal (JMN), the Nepal Workers' and Peasants' Party, and a coalition of small leftist parties represented by the Bam Morcha (Leftist Front). The National Democratic Party (NDP)—a party of former royalist politicians—is not involved in this process, as result of a rift between those that support the royal takeover and those that advocate a return to democracy.

After nine days of discussion, on August 25th the CPN (UML) adopted a democratic republic as its goal in pursuing protests against the king's direct rule. It also adopted the slogan "Let us end absolute monarchy, let us establish total democracy through a constituent assembly". Three of 68 central committee members of the CPN (UML) voted against the decision. The NC, the largest party in the coalition, held its general convention on August 30th-September

2nd, and re-elected Girija Prasad Koirala as president of the party. The 60-year-old party has always regarded itself as a centrist party that supports the monarchy, but the recent convention formally dropped the party's allegiance to the system of monarchy in Nepal. Mr Koirala, himself a royalist, said that the party had been forced to make this change because the king had acted outside the constitution.

Activists representing a number of civil society groups took to the streets on July 25th to demand the restoration of democracy. They protested at Ratna Park, which is a no-protest zone, and were all either arrested or dispersed. Another mass meeting on August 5th attracted about 7,000 people, including senior party leaders. Most of the speakers advocated holding constituent assembly elections to resolve the political stalemate. Despite the government's efforts to quell political protests, the streets of the capital, Kathmandu, witnessed almost daily anti-government riots by students in the second half of August, and the protests are spreading to other major towns across the country.

### **Maoist rebels declare a unilateral ceasefire**

On September 3rd—days after the king asked the political parties to clarify their position on “terrorism” as a condition for the opening of political negotiations—the Maoists declared a unilateral truce and called on the parties to join their fight against the monarchy. The Maoists also asked the parties to adopt the rebel demand for the formation of an interim government to elect a constituent assembly—which would write a new constitution—and not to settle for a possible attempt by the king to restore parliament. The truce is to hold until December 3rd, but the rebels have warned that it could be called off at any time if the government extends its military activities or expands its military camps.

This is the third major truce since 2001—except for brief cessations of hostilities during major festivals—and was timed to have maximum impact. It came before Nepal's festive season, and offers a longed-for respite to the general population. It came after the late August declaration by both the NC and CPN (UML) that they, too, wanted total democracy. The ceasefire was also apparently timed to come before the start of the next UN General Assembly plenary session, which starts in September and which the king is seeking to address as part of his strategy to garner support for his fight against Maoist “terrorists”. The government response to the ceasefire has been cool: its spokesman, Tanka Dhakal, said that there was “no reason to be assured yet”. Referring to the Maoists as terrorists, the Mr Dhakal added the government would maintain its commitment to ensuring compliance with existing laws—a hint that actions against the Maoists would continue.

On July 18th Comrade Prachanda announced the reinstatement of the Maoists' ideologue and best-known personality, Baburam Bhattarai, to the party's standing committee. Mr Bhattarai had been disciplined in March over differences with Comrade Prachanda about how the two share power in the party. Mr Bhattarai's wife, Hisila Yami, and a supporter of Mr Bhattarai, Dinanath Sharma, were also given back their politburo positions. The leadership rift was seen as a contributory factor in the Maoists' military

setbacks in mid-2005, but their offensive campaign reached a new intensity prior to the start of the ceasefire.

On June 6th the Maoists blew up a passenger bus at Kalyanpur in Chitwan district, killing 35 civilians and wounding 72. Three of 12 armed soldiers in plain clothes were also killed. Prachanda issued a statement on June 7th saying that the attack was against the party's policy, and promised not to repeat it. However, four days later the rebels killed four soldiers and two civilians in another attack on a passenger vehicle in Kavrepalanchowk district. Several other attacks occurred in June, including one on June 7th that left 20 people dead.

On June 20th the rebels attacked Diktel, the headquarters of Khotang district in east Nepal. Three Maoists and five policemen were killed. The rebels damaged about a dozen government offices, including the jail from which they freed 61 inmates. (The government said that the Maoist captives held there had been moved before the attack). The Maoists attacked again on June 26th: the clash at Argakhanchi district, in west Nepal, left 12 security personnel dead and another 21 wounded.

The Maoists pulled off their biggest attack on August 7th, when they overran a military roadbuilding camp at Pili in Kalikot district, about 600 km west of Kathmandu. The Maoist western division commander, Pravakar (Janardan Sharma), said that his forces had lost 26 members, had killed 159 people and had taken 52 captives. He also claimed that the rebels had captured an 81 mm mortar barrel, a general-purpose machine gun, 20 light machine guns, 150 rifles and several thousand rounds of ammunition. The Royal Nepalese Army (RNA) recovered the bodies of 43 soldiers and a civilian contractor two days later, and said that 108 of the missing had reported to camp (the death count had reached 51 on August 19th, and 75 people were missing, of whom the Maoists were holding 60). The army said that some soldiers had been summarily executed and that some bodies had been mutilated. The camp contained around 225 personnel, of whom about 100 were non-combatants engaged in roadbuilding.

#### Nepal: the death toll

	Killed by the government	Killed by the Maoists
Feb 13th 1996-Oct 3rd 2002	3,849	1,952
Oct 4th 2002-Jan 29th 2003	688	337
Jan 30th-Aug 27th 2003	124	82
Aug 28th 2003-Aug 9th 2005	3,502	2,159
<b>Total</b>	<b>8,163</b>	<b>4,530</b>

Source: Informal Sector Service Centre.

The conflict between the government and the Maoists, which began in February 1996, had caused over 12,690 deaths by early August 2005. According to a human rights group, Informal Sector Service Centre (INSEC), the state had killed 8,163 people during the conflict, while the rebels had killed 4,530.

#### Tea production is paralysed, and industrial closures spread

A strike enforced by the pro-Maoist trade union paralysed tea production and transport in Jhapa and Ilam districts in east Nepal on July 16th for almost a month. The union's demands included a wage increase and the release of

workers arrested by security forces. The closure coincided with the peak plucking season and therefore achieved maximum impact in production terms, besides the lost wages of about 45,000 seasonal workers.

On August 16th the Maoists fire-bombed the Jyoti Spinning Mills, near Birgunj to the south of Kathmandu, causing damage estimated at around NRs150m (US\$2.1m) on August 16th. They set fire to two warehouses holding over 400 tonnes of finished yarn and set off explosives at the main factory, damaging three carding machines. The company is part of the Jyoti Group, one of whose directors was appointed as junior finance minister on July 14th. The Maoists had carried out a similar attack on the Reliance Spinning Mills in Sunsari district in eastern Nepal on July 16th, causing damage estimated at NRs350m.

The rebels also forced an “indefinite” closure of Unilever Nepal, a subsidiary of India’s Hindustan Lever, on August 17th. The company said it was unable to meet the demands of the pro-Maoist trade union, which included reinstating sacked employees, ending subcontracting and daily wage work and raising salaries by 25% every two years. The Maoists forced the closure of most industrial units in Bara and Parsa districts by making similar demands. On July 1st a major multinational company, Colgate Palmolive, closed down its Nepal operation, which had been manufacturing toothpaste for export to India. The company cited poor security and export difficulties as reasons for the closure.

### **The human rights situation remains poor**

Both conflict-related human rights violations and those against civil and political rights activists continue. In mid-July a human rights campaigning group, the Informal Sector Service Centre (INSEC), reported that the state had rearrested 34 detainees after the courts had ordered their release. On July 26th a UK-based human rights group, Amnesty International, issued a report detailing grave violations against children by both government forces and the Maoists. According to the report, children were being killed either deliberately or in indiscriminate attacks, as well as being illegally detained, tortured, raped, abducted and recruited for military activities. Amnesty also accused government forces of extrajudicial killing of minors. The group said that the Maoists had abducted tens of thousands of children for “political education” sessions; some of them had joined the Maoist forces. Estimates suggest that about 400 minors have been killed and another 20,000 displaced in the conflict. In an earlier report, Amnesty asked governments supporting the RNA to cease their assistance until Nepal had taken clear steps to prevent violations and had brought those responsible for abuses to justice. The organisation also demanded an immediate end to arbitrary arrests, and clarification of the position regarding over 1,000 people who had “disappeared”.

On May 27th King Gyanendra reconstituted the National Human Rights Commission (NHRC). Positions on the commission had fallen vacant after office-holders completed their five-year terms. The king reappointed the outgoing chairman, Nayan Bahadur Khatri, and four others. A group of 25 Nepali human rights groups have challenged the impartiality and independence of the NHRC. On August 11th the government formed a new body to co-ordinate human rights. The National Co-ordination Committee for Protection and

Promotion of Human Rights (NCCPPHR), which is headed by the foreign minister, Ramesh Nath Pandey, includes as members the chief of army staff, the attorney-general, and the chief secretaries and secretaries of several ministries. The NCCPPHR has the task of ensuring fulfilment of Nepal's international obligations, including those made to the Office of the UN High Commissioner for Human Rights (OHCHR). The OHCHR office in Nepal began monitoring operations in early May, and will be the OHCHR's largest field operation in the world when fully staffed later this year. On August 19th the OHCHR disclosed details of some of its investigations, and held the Maoists responsible for an attack on a bus in Chitwan on June 6th. It also added that the RNA had failed to protect civilians through its frequent use of public transport rather than its own vehicles (which has made public vehicles into targets for the rebels).

A UN special envoy, Lakhadar Brahimi, visited Nepal on July 10th-15th. He concluded that resolving Nepal's crisis rested on three critical elements: a return to constitutional order and multiparty democracy, an end to hostilities and an inclusive national dialogue working towards a negotiated solution to the underlying causes of conflict. The US ambassador to Nepal, James Moriarty, publicly chided the government on August 9th, warning that the country could slide towards "confrontation, confusion and chaos" unless civil rights and democracy were restored. Mr Moriarty asked how the government could claim to be maintaining fiscal discipline when two of its ministers were defaulters. Mr Moriarty's remarks came following a critical assessment of US policy towards Nepal by the most senior Democrat senator on the US Senate Judiciary Committee, Patrick Leahy, on July 28th. Mr Leahy accused the king of ignoring "repeated urgings by our ambassador, and other governments, to sit down with representatives of the political parties to develop a plan for the prompt restoration of multiparty democracy."

### **An anti-corruption body jails the former prime minister**

The extrajudicial Royal Commission for Corruption Control (RCCC), the powerful anti-corruption body formed by the king in February this year, sentenced the former prime minister, Sher Bahadur Deuba, to two years in jail on July 26th and ordered him to pay a fine of NRs90m (US\$1.3m). It also ordered a similar punishment for Prakash Man Singh, the minister of works and transport in Mr Deuba's cabinet, and handed down lesser fines and jail terms for four others. The sentences related to a contract for the construction of an access road to the Melamchi Water Supply Project, which is funded by a number of donor agencies. The biggest donor, the Asian Development Bank, ruled out corruption in its own, earlier investigation.

The RCCC said that Mr Deuba and Mr Singh had influenced contractor selection and that the government officials involved had failed their duties by not taking appropriate decisions. Both Mr Deuba and Mr Singh refused to testify at the RCCC, which they said was unconstitutional, and had no lawyers defending them at the trial. Both were arrested in April and were detained throughout the trial because they refused bail. Mr Deuba has appealed to the Supreme Court to declare the rulings null and void. The RCCC has levelled similar charges against a leading member of the CPN (UML). Such tactics, however, have not helped the king to crush the Maoist insurgency, as both his

main providers of arms, the US and India, have halted arms shipments in protest at the RCCC's rulings. Aid from other countries has also been reduced.

The RCCC has investigated other cases, and has imposed penalties. A report in a state-run newspaper, *The Rising Nepal*, said that the commission had ordered fines worth NRs1.2bn in revenue-related cases during five months of operation. On July 22nd it sentenced the chief of the Citizen Investment Trust, a public-sector finance company, to two years in jail for corruption while approving a NRs50m (US\$700,000) loan. On August 18th the commission apprehended and began investigating three tax officials for alleged corruption relating to value-added tax payments.

The legality of the RCCC remains an issue that the Supreme Court is looking into. A writ filed on August 10th argues that since the RCCC was formed under an emergency order, it would be illegal during a period of normalcy. The king imposed a state of emergency when he took over executive power in February, but issued a separate order to give continuity to the RCCC when he lifted the emergency at the end of April.

### **The government tightens its grip on DDCs and NGOs**

The government began appointing chairmen and vice-chairmen of the District Development Committees (DDCs) on June 13th, and filled positions in all 75 districts by early August. The DDCs, which are responsible for local development activities, are supposed to be elected bodies, but successive governments have opted to appoint officials, since the terms of the last elected DDCs expired in July 2002. Fresh elections are overdue, but remain postponed. The government had created new positions of regional and district administrators in early April. On August 22nd it gave the administrators the authority to transfer and assign government officials in their areas of jurisdiction.

On July 14th the government amended the Social Welfare Council (SWC) Act to include a clause empowering it to "direct" and "oversee" non-governmental organisations (NGOs) and to prepare and enforce a code of conduct. The law also allows it to nominate three members to the SWC, an umbrella body regulating NGOs, and to dissolve those not complying with the code. Nepal has over 30,000 NGOs, most of which were established after 1990, when restrictions on NGOs were lifted. About 18,000 of these and another 125 international NGOs are registered with the SWC. The government also amended the civil service law on July 14th, banning employee unions (only professional associations are allowed), introducing employment contracts and creating a "reserve pool" of senior employees.

## **Economic policy**

### **An ambitious budget is announced for 2005/06**

On July 16th the government announced a budget of NRs126.9bn (US\$1.8bn) for fiscal year 2005/06 (mid-July to mid-July). The outlay is about 26% higher than that in 2004/05, with NRs75.9bn (60% of the total) earmarked for recurrent expenditure, NRs37.2bn (29%) for capital expenditure and NRs13.8bn (11%) for debt servicing. With government revenue projected at NRs81.8bn and foreign grants at NRs18.7bn in 2005/06, the budget deficit is expected to amount to NRs26.4bn. In 2004/05 the government spent NRs85.7bn, with 66% of the total

allocated to recurrent expenditure, 18% to capital expenditure and 26% to debt servicing. The government's inability to carry out capital investment adequately helped to keep total expenditure down, thus avoiding a large budget deficit.

### Nepal: 2005/06 budget summary

(fiscal year Jul 16th-Jul 15th)

	NRs bn	% change, year on year <sup>a</sup>
<b>Revenue</b>	<b>81.8</b>	<b>14.7</b>
Indirect taxes	48.6	15.9
Direct taxes	15.2	21.6
Non-tax domestic revenue	16.4	4.8
<b>Foreign grants</b>	<b>18.7</b>	<b>67.2</b>
<b>Expenditure</b>	<b>126.8</b>	<b>25.7</b>
Regular expenditure	75.9	20.1
Capital expenditure	37.2	47.9
Principal repayment	13.8	9
<b>Balance</b>	<b>-26.4</b>	<b>-</b>

<sup>a</sup> Based on revised estimates for 2004/05.

Source: Ministry of Finance.

The government's revenue target for 2005/06 is almost 15% higher than the revised 2004/05 estimate of NRs71.3bn. The ability to meet the target depends on how the security situation and the political crisis unfold. Collection of excise taxes and value-added tax is poor, but the revenue target remains high even if this particular problem were to be remedied. The government's target for foreign grants in the new fiscal year is also ambitious, because some major donors have already announced cutbacks. In addition, the government plans to borrow NRs14.5bn from foreign sources.

The finance minister, Madhukar Sumsher Rana, set aside NRs18.8bn (about 15% of total budgetary spending) for defence and security, of which the army is to receive NRs10.9bn. However, successive governments have underestimated military spending, and 2005/06 is unlikely to prove an exception.

The government also announced a pro-private-sector stance, through tax breaks for companies listing on the stock exchange, a promise to amend the labour laws to make hiring and firing easier, and plans to set up special economic zones. It also decided to open up 23 areas, including film production, travel services and consulting businesses, to foreign investment.

### Norway reduces aid and pulls out of the MWSP project

In response to the royal takeover of government in February 2005, Norway cut bilateral aid by Nkr15m (US\$2.3m) for 2006, and indicated that it would not enter into new agreements with Nepal until democracy is re-established, the human rights situation has improved and peace negotiations between the government and the Maoists have resumed. The Nordic Development Fund also pulled out of the Melamchi Water Supply Project on July 20th. Norway had committed US\$9m to the project. The Asian Development Bank is committed to investing a total of about US\$200m in the project, the Japan Bank for International Co-operation US\$52m, the Swedish International Development Co-operation Agency US\$25m and OPEC US\$14m. In another setback for the government, the EU has suspended about US\$30m in aid for the

“Education for All” programme. An EU spokesman said that existing programmes would continue, but that projects at the planning stage would remain on hold as the EU monitored political developments in Nepal.

### **The Melamchi Water Supply Project (MWSP) controversy**

After more two decades of planning, work on the MWSP began after the Asian Development Bank (ADB) approved a US\$120m loan in December 2000. The US\$464m project seeks to bring 170m litres of water from the Melamchi river to the capital, Kathmandu, through a 26.6-km tunnel. Construction of a 20-km road to the tunnelling site began in October 2002. The contract with a South Korean-Nepali joint venture, Hanil Koneco, was terminated in May 2004 for non-performance. The government then appointed a Chinese-Nepali joint venture in January 2005.

The ADB's Integrity Division of the Office of the Auditor General (OAGI) investigated the contract based on an anonymous e-mail that claimed that the project was tainted by corrupt practices. The OAGI sent a mission to Kathmandu on May 29th-June 2nd to examine alleged irregularities in the cost-escalation clauses of the contract. On July 15th the OAGI concluded there were no irregularities and that the job had been awarded to the “lowest evaluated, substantially responsive bidder” in accordance with its procurement guidelines and loan documents. The ADB added that it had not found “evidence of collusion or any other corrupt or fraudulent activity”.

This is in stark contrast to the findings of the Royal Commission for Corruption Control (RCCC), which was established by the king in February. The RCCC found the former prime minister, Sher Bahadur Deuba, and five others guilty of corruption. The multilateral lending agencies have taken a dim view of the punishment handed out to Mr Deuba and others by the RCCC, whose rulings could jeopardise future lending to Nepal. The withholding of aid might force the king to restore some semblance of civil society, but many donors may well feel that until fundamental political reform is undertaken and structures are created to reduce corruption, there is little hope of addressing poverty and infrastructure development needs in Nepal.

### **China and India provide aid**

On August 15th China agreed to give Nepal NRs870m (US\$12.3m) in grant assistance. Unlike past aid, this is not tied to any specific project. Nepal's foreign minister, Ramesh Nath Pandey, and his Chinese counterpart, Li Zhaoxing, also signed four separate agreements in the Chinese capital, Beijing. The pacts cover pasture use by people living within 30 km of the border, issuance of multiple-entry business visas, waiving visas for bearers of official passports and permitting Nepal to use Chinese highways to transport goods between two points in Nepal's northern region. India has continued to support education, health and infrastructure, while military supplies remain under review.

### **Nepal liberalises LPG imports and raises oil prices**

The government opened up liquefied petroleum gas (LPG) imports to the private sector on May 25th. Companies involved in LPG supply can now import gas from the Indian Oil Corporation (IOC) rather than obtaining supplies on behalf of the state-owned Nepal Oil Corporation (NOC), and are also allowed to set their own prices. On June 21st the government raised the price of LPG by NRs100 (US\$1.40) per cylinder, taking the market price to

NRs900 per cylinder, although it still subsidises the fuel by about NRs130 per cylinder.

The NOC raised the prices of petrol, diesel, kerosene and aviation fuel on August 18th. The prices went up by NRs5 per litre, taking prices to NRs67/litre for petrol, NRs46/litre for diesel, NRs39/litre for kerosene and NRs53/litre for aviation fuel. The NOC raised oil prices on January 10th, but prices for some products were lowered in February in an attempt by the government to win public support. Since then, international oil prices have increased by over 50%. Prior to the price changes the NOC was losing about NRs550m per month; its losses have now been reduced to about NRs270m per month.

## The domestic economy

### GDP growth slows in 2004/05

The Central Bureau of Statistics (CBS) estimates that GDP (at factor cost) grew by 2% in fiscal year 2004/05 (July 16th-July 15th). Agricultural output rose by 2.8% and non-agricultural output expanded by 1.6%, with contractions in construction and tourism. Poor weather adversely affected agriculture, and political instability and the country's internal conflict caused the slowdown in the non-agricultural sector. Agriculture contributes about 38% of GDP but remains highly dependent on the monsoon, which had a poor start this year.

#### Nepal: gross domestic product

(fiscal years ending Jul 15th; % change year on year)

	2002/03 <sup>a</sup>	2003/04 <sup>a</sup>	2004/05 <sup>b</sup>
Agriculture, fisheries & forestry	2.5	3.8	2.8
Mining & quarrying	1.9	0.5	0.7
Manufacturing	1.9	1.7	2.7
Electricity, gas & water	23.1	2.5	7.9
Construction	1.7	0.1	-2.4
Trade, restaurants & hotels	3.3	6.0	-3.0
Transport, communications & storage	4.3	5.2	5.3
Finance & real estate	3.2	2.1	2.9
Community & social services	3.1	2.8	3.9
<b>GDP at factor cost</b>	<b>3.0</b>	<b>3.1</b>	<b>2.0</b>
<b>GDP at producer prices</b>	<b>3.3</b>	<b>3.3</b>	<b>2.5</b>

<sup>a</sup> Revised. <sup>b</sup> Estimates.

Source: Central Bureau of Statistics.

Public spending rose slightly in the first ten months of 2004/05. According to the Nepal Rastra Bank (NRB, the central bank), it rose by 11.1% year on year in the period, to NRs61bn (US\$870m), compared with an 8.1% increase in the same period in 2003/04. The government spent NRs43.2bn on recurrent expenses, and the remainder went on capital expenditure (NRs8.2bn) and debt repayment (NRs8.3bn). Pressure on spending remained low because of the inability of government to undertake development activities in many districts.

Government receipts (including revenue, foreign grants and non-budgetary receipts) grew by 13.3% year on year to NRs58.4bn in the first ten months of 2004/05. Revenue increased year on year by 12.3% to NRs52.1bn, a slightly

slower rate of increase than in the previous year, when it had grown by 13.4%. Foreign grants rose by about 19% to NRs4.3bn, but growth was slower than in 2003/04. The growth in revenue, coming amid poor security, is partly explained by improvements in revenue administration and governance.

### Consumer price inflation accelerates to 6.4% in mid-May

Supply disruptions and increases in oil prices are causing an acceleration in consumer price inflation. The national urban consumer price index was up by 6.4% year on year in mid-May 2005, compared with a 1.3% increase in mid-May 2004. Food and beverage prices rose by 5.8% year on year in mid-May 2005, compared with an increase of 0.6% in the year to mid-May 2004. Prices of grain and cereal products—including the staple, rice—rose by 7.1% year on year in mid-May 2005, compared with a year-on-year decline of 2.6% in mid-May 2004. The price of sugar rose fastest, by 20.3% in mid-May 2005. Non-food prices also rose by 7% year on year in mid-May, pushed up mainly by oil prices. Higher fuel prices caused transport and communications component of the consumer price index to rise by 14.3% year on year in mid-May 2005.

#### Nepal: national consumer price index

(1995/96=100)

Commodities	Mid-May 2004	Mid-May 2005 <sup>a</sup>
Food & beverages	147.1	155.7
Grain & cereal products	136.8	146.5
Sugar & related products	134.3	161.6
Non-food & services	162.4	173.8
Fuel, light & water	201.1	242.5
Housing goods & services	183.7	209.9
<b>Overall index</b>	<b>154.1</b>	<b>164.0</b>

<sup>a</sup> Provisional.

Source: Nepal Rastra Bank.

Wholesale prices rose by 9.5% year on year in mid-May 2005, compared with an increase of 1.7% in mid-May 2004. The index was pushed up by prices of oil and coal (up by 33.8%), chemical fertiliser and chemicals (up 19.4%), foodgrains (up 16.1%) and cash crops (up 18.2%). Import prices rose year on year by 11.8%; prices of agricultural goods were up by 9.9%, and those of domestic manufactured products rose by 5.4%.

## Financial and other services

### Banking reforms encounter a temporary glitch

On May 18th the cabinet approved stiff measures against loan defaulters—blacklisting “wilful” defaulters, confiscating their passports, barring them from public office and preventing them from disposing of assets other than to repay debts. However, implementation of the measures stalled following revelations by the *Kantipur* daily newspaper that one of the two vice-chairmen of the cabinet was a defaulter. As chairman of a manufacturing firm, Himalayan Plastics, 20 years ago, Tulsu Giri had taken out loans that were never repaid, and he and the company have been on the Credit Information Bureau (CIB) blacklist since November 2001. The company owed the Nepal Bank (NBL, the country’s second-largest bank) NRs17.4m (US\$250,000). Dr Giri left the country

in 1986 and returned days before the royal takeover in February this year, following which he was appointed to his new position. The CIB blacklist contained 1,732 defaulters in mid-July, including some of Nepal's largest industrialists and even royal relatives. The Ministry of Finance began sending out instructions to government ministries to follow up on banking reforms in late August after Dr Giri had negotiated terms of repayment of his loan with NBL.

**The central bank negotiates a management contract**

On July 18th the Nepal Rastra Bank (NRB, the central bank) extended the contract for foreign managers to run NBL for another month. The consulting arm of the UK-based Bank of Scotland has been managing NBL since July 2002, and its contract was due to expire on July 21st. Having failed to reach agreement on fees and achievement targets, the NRB extended the contract by a month, and then by two weeks on August 19th and a further two weeks on September 5th. NBL employees began to protest against changes in working conditions on August 29th, following which the management suspended ten union leaders. In response, the unions declared a strike at all NBL branches. The central bank facilitated a settlement on September 3rd, after which the bank resumed business.

The management contract to run the Rastriya Banijya Bank (RBB), Nepal's largest bank, comes up for renewal in January. In July 2004 NBL and RBB accounted for NRs24.1bn (US\$340m) of the NRs29bn total of non-performing loans in the banking sector.

**Nepal Telecom lowers tariffs and resumes mobile services**

The state-owned telecommunications carrier, Nepal Telecom (NT), annulled tariffs for incoming mobile calls and lowered some general tariffs on July 7th. It was allowed to resume post-paid mobile services (which had been shut down on February 1st) in Kathmandu on May 2nd and in some other towns on July 17th. In early August NT had 52,000 post-paid mobile customers, but another 23,000 accounts—possibly those on the security watch list—remained suspended. The government permitted NT to resume services to 173,000 prepaid mobile users on August 22nd, after court action by NT to clarify the legal status of the shutdown. NT is thought to have lost NRs3.5m a day in revenue as a result of the shutdown.

NT announced the launch of new wireless phones on July 7th using Code Division Multiple Access (CDMA) technology, but the roll-out was blocked by litigation. The lawsuit by two lawyers claimed that NT did not have permission to operate CDMA phones. Interestingly, government officials that had confirmed attendance also failed to appear at the CDMA launch ceremony. NT claims that it has the necessary permission, and plans to distribute 100,000 phones in Kathmandu and 75,000 phones each in Biratnagar and Bhairahawa, before expanding to 1m phones nationwide.

**A private mobile operator tests services**

The hold-up of NT mobile services and CDMA phones has been godsend for Spice Nepal (SPNL), which held a "soft" launch to test its technology on August 9th. SPNL has plans to provide 10,000 mobiles in Kathmandu before expanding to other cities. The company is a joint venture of Nepalis (with a 20% stake), including King Gyanendra's son-in-law, Raj Bahadur Singh, and VISOR, an

investment company registered in Kazakhstan. Some commentators have linked the problems at NT and the delay in permission to resume mobile services with the imminent entry of SPNL.

## Tourism

### Tourist arrivals fail to recover

Tourist arrivals were down by 22% year on year in the first seven months of 2005. Nepal was under a state of emergency between the beginning of February and the end of April, when visitor numbers fell sharply. The post-emergency revival has been weak. Total tourist arrivals increased by 4% year on year in July, bolstered mainly by visitors from India, but arrivals from other countries remained low. Generally, tourist arrivals from countries other than India are low in June-July, a period when hotels offer special discount packages to attract Indian tourists.

#### Nepal: tourist arrivals by air

	2004	2005
Jan	22,552	19,032
Feb	24,456	14,001
Mar	31,198	20,137
Apr	30,402	18,879
May	22,278	20,816
Jun	18,670	18,840
Jul	18,736	19,505
<b>Total</b>	<b>168,292</b>	<b>131,210</b>

Source: Nepal Tourism Board.

### Another airline begins international flights

Air Nepal International, a private airline, began international operations on July 24th. Air Nepal flies wide-bodied Boeing 767 aircraft on routes with the busiest air traffic. It has permission for twice-weekly flights to Thailand and Malaysia, and thrice weekly to Doha, Qatar. However, Martin Air, a Dutch airline, ended weekly direct flights to Kathmandu on August 25th. It had begun the service in 2004.

## Foreign trade and payments

### Trade declines with all countries except India

Export revenue grew by 5.3% year on year to NRs47.5bn (US\$674m) in the first ten months (mid-July to mid-May) of fiscal year 2004/05 (mid-July to mid-July). The import bill declined by 4% to NRs106bn in the same period. The figures for export and import growth in the first ten months of 2003/04 were 7.2% and 7.8% respectively. Exports to India grew strongly, by 25.4% year on year, to NRs32bn, but the gain was offset by a 21% decline in exports to other markets. Imports (excluding those from India) fell by almost 21% year on year, while those from India rose by about 10%. The merchandise trade deficit narrowed to NRs58.6bn in the first ten months of 2004/05 from NRs65.4bn in the same period of 2003/04. India's share of Nepal's trade rose to 65.4% in the first ten months of 2004/05, from 56.5% in the year-earlier period, while trade with other countries dropped to 34.6%. Oil remains Nepal's major import from India. Oil imports rose by 33.2% year on year to NRs21.3bn in the ten months to

mid-May 2005. Other major imports from India were vehicles and spares, medicines, chemicals and industrial raw materials.

Exports of readymade garments have dropped steadily since the beginning of the year, reflecting Nepal's inability to compete with larger global producers, notably India and China. The expiry of the World Trade Organisation's Agreement on Textiles and Clothing at end-2004 was the main reason for the downturn. Previously, sales had been adversely affected mainly by domestic production disruptions.

#### Nepal: foreign trade

(NRs m; mid-Jul to mid-May)

	2003/04	2004/05 <sup>a</sup>
Total exports fob	45,140	47,522
To India	25,483	31,959
To other countries	19,657	15,563
Total imports cif	110,508	106,087
From India	62,533	68,526
From other countries	47,975	37,561
<b>Trade balance</b>	<b>-65,368</b>	<b>-58,565</b>
With India	-37,050	-36,567
With other countries	-28,318	-21,998

<sup>a</sup> Estimates.

Source: Nepal Rastra Bank.

#### The balance-of-payments surplus shrinks

Nepal had a current-account surplus of NRs25.9bn (US\$370m) in the first ten months of 2004/05, owing mainly to a narrower trade deficit and an increase in transfers, mainly remittances. The money sent by Nepali workers abroad rose by 7.9% to NRs53bn, compared with NRs49.1bn in the same period of 2003/04. Pension receipts rose by about 72% to NRs10.5bn in the ten-month period to mid-May 2005 as a result of increased payments to former Gurkha servicemen. However, receipts from services shrank, with tourism receipts declining by 33% to NRs9.7bn, compared with around NRs14.5bn in the year-earlier period. Travel inflows were almost balanced by outflows.

The financial account reported a deficit of NRs25.8bn in the first ten months of 2004/05, with sharp drops in both investment assets (including trade credits) and liabilities (including loans). Nepal had a balance-of-payments surplus of NRs5.6bn in the first ten months of 2004/05, compared with a surplus of NRs13.7bn in the corresponding period of 2003/04, reflecting lower foreign loan inflows.

#### Foreign-exchange reserves remain healthy

Foreign-exchange reserves remain sound. Total reserves were up by 5.2% year on year to NRs131.7bn in mid-May 2005. Convertible-currency reserves rose by 13.8% to NRs124.3bn, resulting mainly from a decrease in imports and an increase in remittances. The non-convertible reserve (consisting mainly of Indian rupees) shrank by 54% year on year to NRs7.2bn. According to the Nepal Rastra Bank (the central bank), foreign reserves are sufficient to cover about 12.4 months of merchandise imports.