

Political Economy of Conflict, Cooperation and Economic Growth: Nepalese Dilemma

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Abstract

Conflict among feudal factors led by the King, working people in trade and industry led by political parties, marginal, poverty trapped people threatened and mobilised by Maoist rebels in Nepal creates a very unproductive environment where investors and entrepreneurs do not get any productive opportunity. Non-cooperation among competing political and economic forces has brought Nepal into crisis and growth disaster. The major reason for conflict is short-sighted horizon of these players who try to maximise their own current share on GDP taking its size as constant over time. It has discouraged productive economic activities and transfer of better technology and knowledge and resources from abroad with dangerous consequences to the economy. A solution is offered here in terms of a contract in more objectives and specific growth oriented rules that bound each of them to the policy initiatives in which each of these groups has incentive to stick for peace and prosperity and for adoption and use of knowledge and technology for growth.

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1. Introduction

Capital, labour and technology have been central factors in determining the rate of economic growth in the classical, neo-classical and endogenous models of economic growth. Both theoretical and empirical studies abound on how these variables impact on economic growth and why these growth rates vary from one country to another even if they have similar rates of saving, endowment and growth rates of labour, and the level of technology¹. These models rely on competitive markets where factors are paid according to their marginal productivities. Very little discussion is found in the literature, however, on how conflicts among various economic agents in the economy reduce the rates of economic growth as seen in growth disaster countries and how the cooperation among them can generate spectacular rates of growth in growth miracle countries over time. Persistence of conflicts and violence paralyzes markets and stops investment and production activities and creates economic crises. It destroys existing infrastructure and prevents creation of new ones. Why big economies are able to control such violence but small ones not? This paper aims to analyse the role of conflict and cooperation in economic growth with the help of a simple game-theoretic model and illustrates its application using the Nepalese dilemma on impacts of conflict on economic retardation and prospect of cooperation on growth. Section two introduces a political economy model² to analyse the effects of conflicts and

¹ See Ramsey (1928), Harrod (1939), Domar (1947), Solow (1956), Cass (1965), Koopmans (1965), Lucas (1988), Romer (1989) for theories and Madison (1991) Mankiw, Romer and Weale (1992), Barro and Sala-i-Martin (1995), Temple (1999), Bhattarai (2004) for empirical studies.

² See Gunning (1986), Bardhan (1997), Easterly (2001) for studies on riots and ethnic conflicts and Schumpeter (1942), Myrdal (1982), Sen (1983), Przeworski and Limongi (1993), Wittman (1989), Easterly (2001), Virwimp (2003) on models of development and democracy and Mehrling (1986), Besley and Coate (2003), Maskin and Tirole (2004) for models of political economy.

cooperation in economic growth. The political economy structure of Nepal is presented in section three with further analysis of solution on the conflict in section four. The conclusion of the study and recommendations along with references are given in the last section. Appendix contains graphical representation of the model of conflict and growth, salient features of the Nepalese economy in comparison to her South Asian neighbours.

2. Political Economy Model of conflict and Cooperation

Take a developing economy that produces Y amount of total output in each year using labour, capital and technology inputs. This Y includes both private (C) and public (G) commodities and services. The government fails to provide private goods as it does not know preferences of households and technology of firms and market fails to provide public goods because of positive and negative externalities in consumption and productions. Public goods including education and health, neither market nor the government are not provided sufficiently and efficiently. Public sector goods (G) are provided by tax revenue (T) and the consumption C equals the output net of taxes ($Y-T$). This economy is inhabited by N number of people in total and n_1 , n_2 or n_3 numbers in three different groups each with distinct positions and roles in the economy with consumption c_1 , c_2 or c_3 and public goods g_1 , g_2 or g_3 and corresponding utility levels $U_1(c_1, g_1)$, $U_2(c_2, g_2)$ and $U_3(c_3, g_3)$ respectively. Questions such as who should decide the level of tax, $T = \{T_1, T_2, T_3\}$, and how it should be collected and how should G be allocated among the sections of communities, $G = \{g_1, g_2, g_3\}$, are the major sources of political disagreement and conflict among power contenders. Some arrangements and allocations are growth

enhancing and others are growth retarding. In fact inequality in the distribution of public goods according to the need of people and insecurity of personal freedom and protection of property rights to tax payers is the major issue of conflict.

At the higher level of echelon there are $n1$ number the elites, feudal landlords or hereditary rulers. Their wealth and power more owes to their hereditary status, assets or claims than to their competence, creativity and productive contribution to the economy. Members of this group, through well knit connections and favour, often take the whole of the state machinery as their own private property despite themselves being an insignificant minority of population. Workers and rebel, who do not really have an access to this machinery perceive that this group is parasite that sucks their blood and takes a large share of the Y because of administrative or property rights they have established on resources of the economy and protected by laws and regulations they promulgated over generations using their dominance on state machinery. In many instances these rulers protect their position in the society through loyal armies or military and clever strategic networks spread throughout the economy. Kings at the centre and feudal landlords or tribal lords at the local level represent these groups. This group uses this political power and connections to oppress opponents and to secure economic gains. They enjoy more both of private luxury goods as well as public goods. Power is proportional to the size of army and amount of defence goods which are funded by the tax revenue mainly raised from the income of workers.

Then there are $n2$ numbers of middle class working people that make the majority of population. They are self-employed as farmers, entrepreneurs or traders; a small fraction of them work in service sectors; others work for organised political parties. Politically members of this group are influenced by ideas of democracy,

freedom and individual liberties; economically they are keen to achieve more by using their talents and capabilities on the basis of a fair playing field in their trades; socially they communicate to each other through media, newspapers, journals, conferences, mass-meetings and rallies. A significant diversity and heterogeneity among them appears due to economic, ethnic, religious and cultural backgrounds. They are divided on the basis of their origin or profession and are individually very vulnerable to whims of rulers though collectively they belong to the most powerful economic group in the economy. Since they are divided on the basis of their origins, beliefs, professions or personal interests, coordination among them is very difficult. Rulers take advantage of this fact and keep a policy that divides them and makes them even weaker by making them play against each other using subtle tactics of pecuniary or political favours. It is in their interest to make this group economically and morally corrupt and weaker to challenge rulers' hereditary claims to the power.

Then there are n^3 numbers of people who have been economically marginalised, lack decent jobs or occupation and have been struggling to meet their basic needs. They have little education or professional skills or property to be economically self-dependent. They face serious income uncertainty and are struggling to meet their basic needs problems. Because of these weak economic reasons, people in this group can easily be mobilised by radicals for a little payment of money for their livelihood. Such marginalisation occurs for several reasons. First one relates to declining inheritance of family property. In a traditional economy and family system each successive generation climbs down the property ladder more often than climbing up. Upon the death of a property holder parent, his/her property is divided equally among children. Thus hereditary property diminishes in each generation according to the number of children in the family. Secondly, they have growing burden of debts

incurred for purchasing food, clothes, medicine for activities for survival or for social activities such as weddings or funerals. It is possible that a child in such family is born in debt, grows in debt and dies leaving more debt to its children. They never recover from it and cannot invest in any human capital enhancing activities. Thirdly, children of little educated parents have harder time to get a decent opportunity of education; they drop out in early stage of education cycle and do not have necessary qualifications to compete for jobs and professions in a modern sector. There is very little learning in family setting as none of the parents of such children are likely to happen to be educated. Fourth, they spend more on feasts and festivals whenever they have some savings and have very little collateral to borrow from formal financial sectors. Fifth they hardly have anything to sale except their labour. A significant number of them are found squatting to public lands for a long time without any entitlement or property right to their house or gardens. This puts down their morale, bargaining power and collateral position in the market. Sixth, the state is often not able to provide public goods including education, health and job insurance to poor who remain very insecure and vulnerable through out their lives.

The global economy impacts this economy through trade and flows of capital, ideas and technology. The benefits of these links flow according to the economic powers of these groups, elites benefit the most from international contacts than people in the working group. Part of their activities involves maintaining good external contacts for economic or personal reasons. The marginal group hardly have any access to these international factors.

2.1 Division of Income and Power

The level of growth and development of this economy depends on interactions among these groups. In an ideal and egalitarian society share of income for each

group depends on the relative proportion in their population such as

$$s_i = \frac{n_i}{n_1 + n_2 + n_3} Y \text{ where } i = 1..3, \text{ } s_i \text{ denotes the share of income } Y \text{ for group } i \text{ which}$$

is in proportion to their size in population $\frac{n_i}{n_1 + n_2 + n_3}$, where $Y = Y_1 + Y_2 + Y_3$ and

$C_1 = C_2 = C_3$ and $g_1 = g_2 = g_3$. The real economy, that has evolved over hundred of years, since this primordial society, is far from this ideal scenario. The rulers have used opportunity of tax and spend on public goods to alter their own shares as manifested in their palaces and buildings, lands and business and entitlements from state provisions. The dynamic factors originating from economic relations have distorted the distribution as there has been a tendency among the ruling group to accumulate more economic resources and take ownership of new sources of economic growth as the utility of each group depends on income that they get, which further depends on the degree of concentration of the political power.

How does economic power relate to the political power? In democracy each citizen of a country, even with unequal endowments, should have equal political power, $p_i = \frac{1}{N}$ for a population size of N , which they can use to make collective

choices³. However, an individual vote would not take its meaning unless it is

expressed collectively $P = \sum_i^N p_i$ where P is the total power and N is the total size of

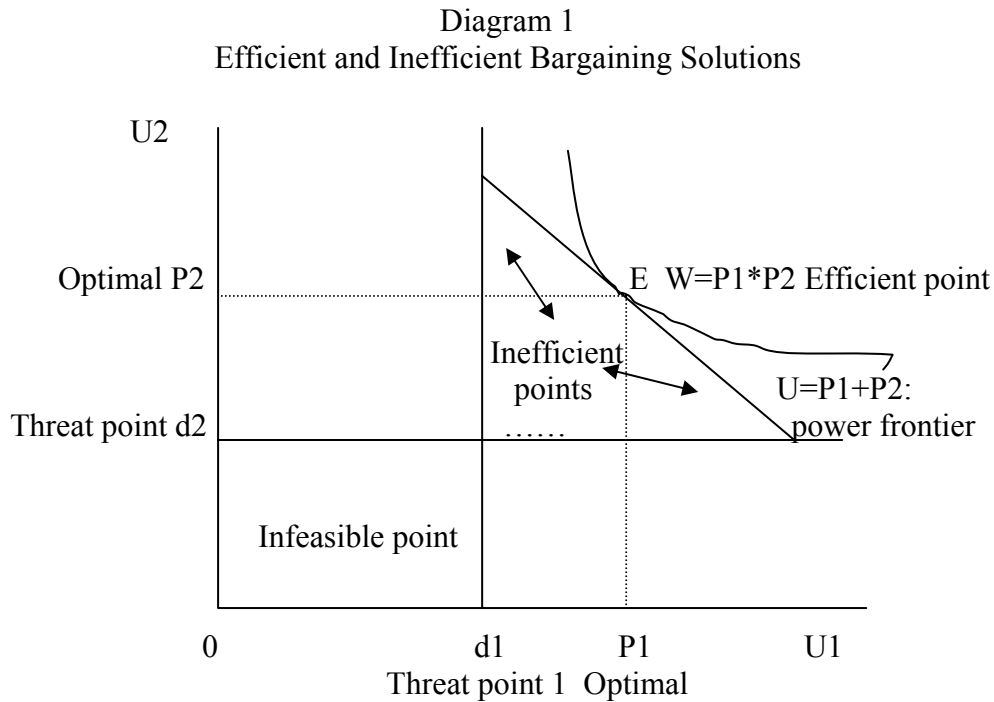
population. There is no society in the world where all individuals have the same opinion on any one issue. Therefore this power is often clustered around the groups of individuals with same or similar opinions. In the context of above analysis with three

³ Such political power can mitigate the inequality caused by the market. In evolution of the election system with one person one vote were behind the adoption of the social democratic system by majority of Western economies, as their economies industrialised in the last century and adoption of general welfare system in the second half of the 20th century.

groups in a developing economy each specific group has its utility function that it tries to maximise, $U_i = P_i$ where P_i represents the political power it commands from individuals subscribing to views and ideas that this of group represent. When the power is normalised to one, $\sum_{i=1}^3 P_i = 1$, then it becomes important to know how this power is distributed among various contesting groups in the economy. Economic growth is enhanced when this power is used efficiently through a social contract that has consent of each section of the society. Misuse of power causes conflict and retardation.

There is a constant struggle in the division of power between elites, workers and paupers. As an increase in the power of one group reduces power of another group, each of them continuously tries to increase its own power. People become more rational with more education and are ready to challenge any source of power that are not directly linked to votes of common people. Real support for the aims and objectives of a group is the real source of powers, which can be increased or reduced by force or coercion for sometime until the fundamentals are realised. At any point of time there is an efficient power sharing bargaining solution that maximises the social objective function subject to the unit power constraint. Maximising a social welfare function with arguments of power for each group of the economy $W = P_1 P_2 P_3$ subject to the power constraint $U = P_1 + P_2 + P_3$ can generate optimal distribution of power among sections. In a real situation each group has a reservation or threshold level of power, represented by the numbers of votes of committed followers, which it is available to that group in any circumstances. The amount of additional part of support fluctuates depending on circumstances of the economy and is closely monitored. Each of them to tries to increase power if an opportunity exists. If this reservation

power or the disagreement point in power-sharing agreement is added to the above problem, the efficient solution is obtained by maximum Nash product $W = (P_1 - d_1)(P_2 - d_2)(P_3 - d_3)$ subject to power constraint $U = P_1 + P_2 + P_3$ where d_i represent the disagreement point as illustrated in diagram 1 below .



Further, in a three party situation with Elites (E), Workers (W) and Rebels (R) there are six possible coalitions: three absolute power singletons $\{E\}$, $\{W\}$ and $\{R\}$; two intermediate coalitions $\{E,W\}$ and $\{E,R\}$; and one grand coalition $\{E,W,R\}$. In a winner takes all arrangement the singleton prevails whenever one of the above group manages to win others. When any one particular party cannot clearly win majority votes, two or all of them can form a coalition on the basis of power-sharing agreement. Such agreements tend to be very unstable as each of the coalition partners has an incentive to deviate from the agreement realistically or unrealistically in aspiration of control over all power. The grand coalition is more a theoretical possibility rather than

a practical solution. If this can assure political stability, that can be very vital for achieving the higher rate of economic growth.

2.2 Role of conflicts and cooperation in the growth process

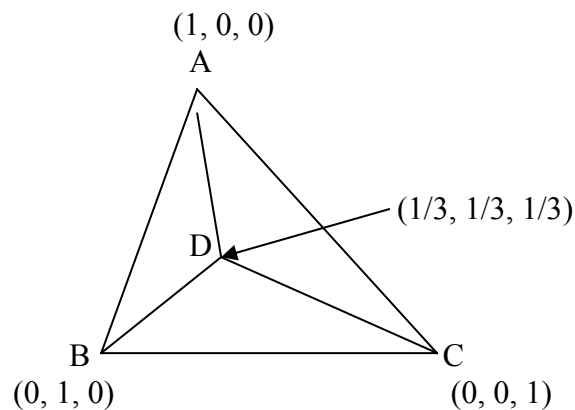
There were very little differences between rulers and common people in the agricultural society. Such differences tend to grow with the development of industry and commerce which not only opens new opportunities but also creates new base of taxes. The gap in the living standards of people between the rulers and the common people rises continuously. This further intensifies the desire of the ruling group to remain in power and increase its economic strengths by investing in securities, insurances and new businesses that would further expand their power. Reforms in such system are unavoidable for a stable and growing economy. Democracies have produced better solution for dynamic economies than communism (Schumpeter (1942) Downs (1957), Myrdal (1982), Sen (1983), Perkins (1994), Przeworski and Limongi (1993), Huber et. al (1993), Shleifer and Treisman (2005), Gunning (1986), Wintrobe (1998), Morris (2001), Paldam (2002), Verwimp (2003), McMillan and Zoido (2005)). Working people are the real producers of goods and services in the economy. They are often free to carry out their ideas in actions independently but have to solicit for permits, licences to carry business and pay taxes to rules to be able to conduct their business. Decisions of rulers can either promote their business or harm their business depending on incentive structure that it generates.

One can think of two different scenarios for conflict and cooperation in this economy as presented in Figures 1 in the appendix. The conflict scenario in part A at the end takes a static and dull view of the economy in which size of economy is considered to be fixed. Each group struggles to maximize its share from this constant share. The balance of low income trapped economy means the share of income going

to rulers, workers and paupers remains about the same over time with the ratio of their numbers remaining about the same. Such a static outlook of an economy is cause of disaster and growing number of marginal people in the economy. Probability of massive protests and revolution rises as the intensity of poverty rises and economic prospects of workers do not improve.

All these three groups listed above involve in bargaining continuously. Their bargaining positions can be explained using a Nash Bargaining triangle.

Diagram 2
Nash Bargaining Triangle

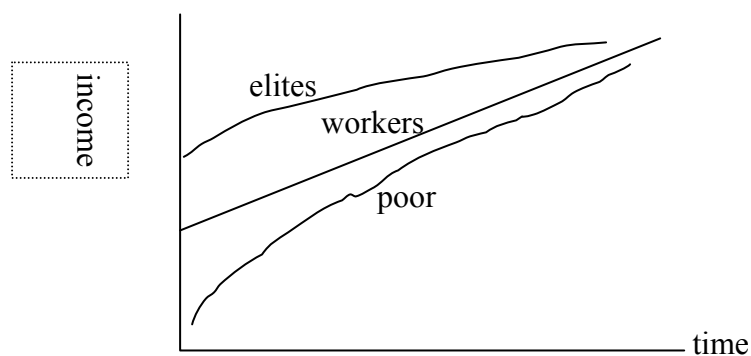


In this bargaining triangle the position A represents a dictatorial position of the ruler, which assumes all powers and represses all people to stabilise and increase his power. At point B the working group retain all power, eliminate the traditional power of Kings. Point C represents rule of extreme rebels. Given the nature of economy non of these three extremes are possible solutions in itself and the bargaining solution is dividing the national income among these three groups as shown by point D. Once such bargain is struck it would be optimal to establish a set of rules that binds each party and let economy move from scenarios A to scenario B in Figure 1 in the appendix. Whether this solution is stable one depends on the gap between the expected outcome and the bargaining result achieved by each party. It is more likely that bargained contracts are broken by one or another party demanding a revision on

the contract made earlier according to the new situation. Emergence of new sectors of economy, beginning of new organisations and opportunities, several other reasons may cause such contract to be violated. One group may become stronger than another group to warrant more share in the bargain. Possibility of continuous conflict deters stability of the economy and productive activities.

The far sighted scenario (Figure 1 part B) offers a better solution. Here fundamentals of markets hold, there is some link between the marginal productivity of workers and their remunerations. Entrepreneurs are encouraged to start new businesses and take advantage of latest available technology. Such economy opens opportunities for paupers to upgrade themselves to belong to the working group through means of education and training. It also appeals to elites who join hands with the working group rather than being idle rent-seekers as in the static world. Both these factors raise the proportion of the middle group people relative to those of rulers and paupers.

Diagram 3
Growth of Income and Transition to a Steady economy with Coordination



The nature of the solution should look like something as presented in Diagram 3. This solution is not automatic. It may take one generation or two to transform the structure of economy and relative position of these three groups as shown in this diagram. It is possible to achieve this by putting reasonable rates of taxes on the income of rulers and property owners to raise revenue that can be used to finance on education and

skill of children from the poor income group along with reforms regarding their fair access to employment and other economic opportunities.

There is more pessimistic dynamic version of the solution to the above game which shows a continuous deterioration of the economy. Permanent conflicts, chaos, and lack of law and order situation due to continued terror and violence in which infrastructure and properties are destroyed, morality and creativeness of investors is harassed. There is massive capital flight and emigration. Such economy is trapped into a vicious circle of poverty.

3. Structure of political economy of Nepal

Nepal is one of the poorest countries in the world; 60 percent of its people live in absolute poverty, below the subsistence level. Power contenders are King, political parties and Maoist rebels representing elites, workers and marginal groups as presented in the model outlined in section two. The political conflict has affected prospects of growth in Nepal as in many other developing economies of Asia, Africa, Caribbean and Latin American economies (see figures 2-5 in the appendix). King is interested in maintaining the status quo along with his hereditary power, various political parties have plans and programmes for growth but squabble each other in forming and operating the government and the Maoists are committed to establish a dictatorship of proletariat by eliminating class enemies that include both King and workers running the political parties and have coerced the marginal poor people to join their army for violence and terror in the process of peoples War. An account of each of these elements is given below in order to apply the bargaining model stated in the above section.

3.1. The King

King has remained a dominant political power ever since the creation of modern state of Nepal but many people hate the traditional and hereditary nature of King and think that to be a major reason for backwardness of the economy. It is true that about 200 years ago then King P. N. Shah unified this country from 22 and 24 kingdoms scattered in the Western and Eastern parts of current Nepal. He was a popular King because he directed and fought wars with soldiers in the battle fields. Despite being popular in his brevity in war he was less farsighted in setting the hereditary rules by which the eldest son of a King would automatically access on the throne upon his demise. Hereditary King does not have to be aware of real aspirations, problems, objectives and constraints of common people as he neither has experience of tough competition in business or entrepreneurship nor has enough knowledge of recent technologies or ideas that can promote economic growth. Such rules have made the Kingship very unpopular among people. Because of his vested interests in maintaining traditional values and culture that has divided the Nepalese society by casts, ethnicity, economic classes and made them uncritical and subjugated secondary citizens, his ability to be a role model for coming generation is limited. He misused more of this power than used it for productive purposes. This was part of the reason why Ranas were able to relegate them to status of dummy Kings during 104 years of tyrant and autocratic rules during a period of Industrial revolution in the West. Kings came in forefront of Nepalese politics after Ranas relinquished power under the pressure of democratic movements in 1951. Despite that King has not learnt enough lessons and continues betraying people whenever any opportunity arises in which he could have made a difference in the lives of the common people. King has never shown any real initiative for a free, fair and liberalised democratic system and

prosperous economy. He is happier in concentrating all powers in him and maintaining a status quo regarding freedom and democracy. He enjoys more a dictatorial regime and absolute power rather than a democratic regime. The history of Nepal is full of stories on conspiracy and assassinations in the Royal family as the Royal massacre of 2002 is very recent in the memory of many people around the world. The glories of Kings in ancient India and Nepal are just myths as far as their relevance in concerned in solving economic problem of current time. The King is simply a dictator who assumes power because of the royal military. Various political events since 1950s such as seizure of elected multi-party government in 1960 and imposition of authoritarian Panchayat regime from 1960 to 1990, re-instalment of dictatorial regime with dissolution of elected parliament and government in 2002 and 2005 are clear evidences for this assertion. Kingship is a regressive not progressive force for the economy and has always betrayed common people. Even though people secured Kings Position as constitutional monarch in 1990, the current King has acted against this good faith while dismantling the elected government and strengthening and elongating the dictatorial regime further in recent years. For a check and balance, it might have been appropriate to warn the government that was inefficient in fulfilling its promises and forgotten the aspirations of people but no one would support the tendency towards dictatorship as justifiable move. It is generating widespread protests from political parties and rebels against the King. People are also concerned because the resources of economy are being spent on managing these conflicts rather than investing in economic growth.

3.2 The political parties

Winds of movements for democracy, socialism and desire for modern economic prosperity blew to Nepal from the UK, the Western Europe and the United States

through the Indian subcontinent during the time of the movement of freedom and independence in South Asia in 1940s. Ideas of a constitution that guarantees individual freedom and defines state machinery with a clear division of power among legislature, executive and judiciary; has provision of regular free and fair election of representatives in all levels of the government; makes the bureaucracy responsible to elected officials came along with greater emphasis on individual freedom and property rights for a free, open and liberal society and a growing economy. The appeal to Marxist-Leninist ideas of class-struggle, classless society and dictatorship of proletariat in line of the Bolshevik revolution in the Soviet Union and communist revolution in China had less impact in Nepal till early 1960s was evident from the overwhelming majority of the Nepali Congress party in the first parliamentary election held in 1960. Communist ideas spread more after King imposed dictatorial regime dissolving the democratically elected multi-party parliament in 1961. It took thirty years for people to fight back their rights and to curb on the absolute dictatorial power of the King. A successful movement of restoration of democracy in 1990 was seen a very positive political development. It was consistent with a move towards more liberalism in India and China. Nepal was up to date in terms of political system with the rest of the world. This was made possible through a united front made by the social democrats (Nepali Congress) and leftist parties (Communist party of Nepal) representing the major political forces in the country.

The Nepali Congress Party had remained at the forefront in the movement of democracy and socialism in Nepal as practiced in many European countries. Its ideology is also influenced by the socialist groups of India. It was started by BP Koirala in late 1940s and has remained one of the strongest party through-out the democratic movement in Nepal, has support of liberal minded people and

professionals and has remained continuously in direct conflict with Kings regarding the supremacy of elected parliament over monarchy. The influence of the Communist Party (Marxist-Leninist) increased during the Kings' dictatorial regime between 1960 and 1990. Initially the King had used them strategically to counterbalance the growing power of the Congress party. Communists did not hesitate to compromise to remain themselves under the King though he was their topmost class enemy under the communist ideology. In terms of ideology the Congress party was committed more towards the liberalism and democracy than the Communist Party. For an outsider there seems to be a little difference between them as both of them have accepted constitutional monarchy and were aspiring for a socialist economy. This apparent contradiction in the main group of Nepalese communists who participated in the process of multi-party democracy with a constitutional monarch has given a rise to the more extreme leftist parties such as Nepal Peasants and Workers' Party (NMKP) and the deadliest Nepalese Maoist party of rebels after 1990. There are other minor parties representing the interests of ethnic groups such as Sadbhavana and rightist royal elements such as Nepal Rastriya Prajatantra Party. Though each of above parties claim to represent farmers, traders, entrepreneurs, employees of public and private sectors and other people in the working group at national, district and village levels, the Nepali Congress Party and the Communist Party of Nepal (CPN-UML) were the prominent ones in terms of influence and the two main contenders of political power in the parliamentary democracy that started in 1990.

The government of the Nepali Congress had taken good initiatives to reform economic policies after it came to power in the beginning of 1990s winning the general election under the multi-party system. For internal stability, prices were stabilised adopting careful balance in the budget deficit by introducing VAT to

broaden the tax base, exchange rates were left to the market, trades and financial sector were liberalised and made more competitive; system of licences and quota was dismantled and Nepal became a member of WTO, more expenditure was allocated to the education and health sectors, many public enterprises were sold to the private sector to enhance efficiency. The basic needs including provision of drinking water and electricity were among the top priority and there were policies for balanced development of communication and transportation networks. Despite these measures these parties promised a lot for reducing poverty but achieved very little. Problem further increased because of increase in corruption and lack of discipline in many politicians and distorted economic decisions and raised concerns from the opposition and rebels. No party could hang on to power continuously. The Communist Party and the party of royalists have also formed their own or the coalition government in the parliament when the Congress lost its majority in 1996.

It is clear that none of the parties have been able to retain their clean and clear image in front of the people. Each of them has suffered from the lack of discipline within their organisation and in government and has used power for corruption and malpractices. They have forgotten the promises they made to the people in the election once they were in office and busy in the power struggle. Though there had been some progress in liberalisation of the economy, in education, health and transportation sectors, the poor growth record shows that these parties did not make enough efforts for growth and investment in the economy; their focus was more on distribution rather than in economic growth. They were weaker in implementation and were more corrupt than people in the Congress government. Despite these weaknesses, the freedom of expression and liberty that the system provided to common people had given an open environment in which people could think about their future. These

economic and individual freedoms were taken away when the King snatched people's power in 2002.

3.3. Maoists

The Maoist ideology entered in Nepal during King's dictatorial regime between 1960 and 1990; the policy of playing against India with China and vice-versa might have attracted some development aids manifested in roads or transportation networks from China but they came along with the Maoist ideology. Despite theoretical contradiction communists strategically accepted King as their leader and strengthened their organisation while following rules set by the absolute monarch. This was the genesis the Maoist movement and radical rebels in Nepal though it is true that Mao himself was not clear what the Maoism stood for. The Chinese Communist Party has already abandoned this ideology as early as mid 1970s. It is an irony that while the Maoism has been discarded as an ideology in the mainland China with its swift transition to the more efficient market system with property rights and individual freedom on economic activities resulting in unprecedented rates of economic growth, the Maoist rebels are becoming stronger and more effective in creating violence and terror in the name of so called Peoples War in Nepal. In principle Maoism was revision on the Soviet model of Marxist-Leninist and Stalinist ideas and was a cult that preached "equality, opposition of bureaucratism and corruption, an idealisation of frugal lifestyles, a denial of individual selfishness and devotion to the public good, a demand for mass participation in political administration, championing of mass criticism and the rights to rebel, and a theory how a new ruling class emerges within the Party" (Walder (1987)). It is said that this cult creates "a paranoid view of political world among its followers by branding as traitor for someone who has insufficient enthusiasm in the worship of Mao, a mentality that encourage the treatment of

enemies as non-humans subjectable to any form of humiliation or torture, a notion of democracy that enforces slavish conformity to a single dictator.” In Nepal such extreme Maoist party was formed under the freedom of expression and organisation provided by the Constitution of Nepal of 1990. It had six (out of 235) parliamentarians in the first parliament and all of them committed to protest the parliamentary system from inside the parliament. They boycotted the second general election in 1996 and started Peoples War using any means of terrorism. They have formed a parallel government, looted arms and ammunitions from military barracks, killed people and created fears and tensions in the minds of people. They destabilised the whole system and created confusion and uncertainty among common people including entrepreneurs, traders and business people. They have strongholds in remote poverty belts of Nepal and mobilised the marginal groups massively for terror activities. More than 12000 people have been killed in last 10 years because of the violence and terror created by Maoists and brought the country to a bloody civil war. Peaceful country of Buddha has become very frightening war zone, full of explosions, riots and attacks. This conflict has reduced the rates of investment and saving and economic growth in Nepal. It seems that it is not possible to solve current impasse without bringing Maoists into the main-stream of the political economy of Nepal. More failure in bargaining means more violence and more terror.

4. Nepalese Dilemma: Conflict Resolution and Cooperation for Growth

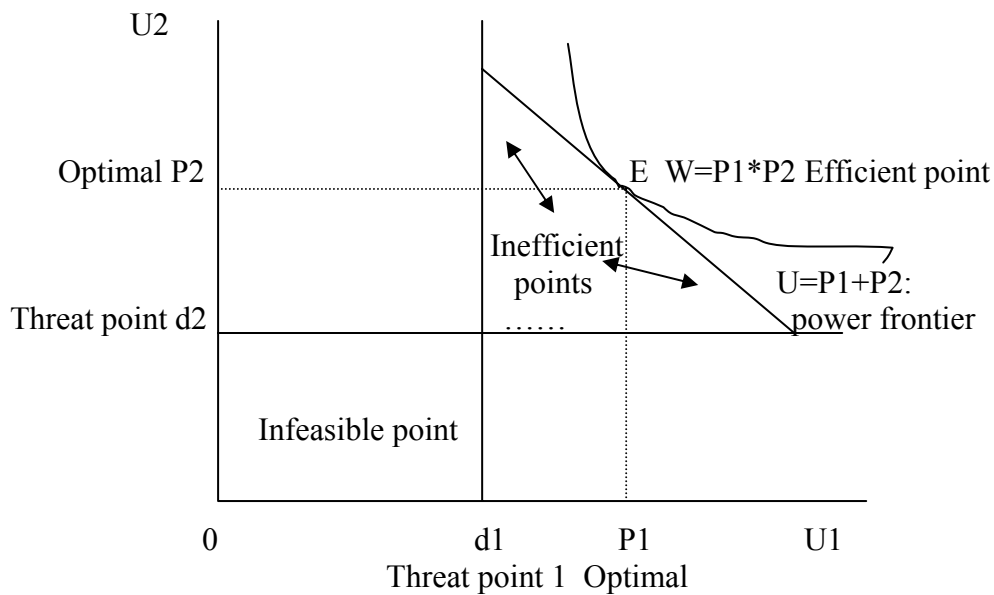
Nepal is in conflict and crises because of inherent contradiction among three political economic forces mentioned in the previous section. King wants to increase his power, political parties want to form their own governments but have proved incompetent

while they had an opportunity to do so, and Maoists want to eliminate both of them and create their own state. Conflicts and growing internal tensions have reduced investment and other economic activities, deterred donors to continue developmental activities in Nepal and frightened tourists from visiting Nepal. It has created hatred among people and demoralised investors and created sense of fear among consumers and producers. Cumulative effect of all these political disagreement is leading to a civil war and permanent crises. It is urgent to sort out his problem before any initiative for long run growth. How can a bargaining model be applied successfully to solve this problem? If there is no agreement among these three, this economy will further face a situation of dynamic deterioration. Nepal will be left permanently in poverty and crises. Entrepreneurs and skilled workers will abandon the country, science and technology will not reach out there, it will not benefit from the rapid space of globalisation, it will remain isolated and a basket case of poverty. Any solution that does not satisfy each of these parties is bound to fail. Application of force and coercion may suppress the situation for a while but the problem will rise again.

It is clear from above analysis that King (K), parties (P) and rebels (R) do not have ability to run the government own their own. The singletons $\{K\}$, $\{P\}$ and $\{R\}$ are not feasible solutions, politically, economically or socially; two intermediate coalitions $\{K, P\}$ and $\{K, R\}$ have been tried out and failed; and one grand coalition $\{K, P, R\}$ seems the only solution that has not been put in practice efficiently. As stated in section two at any time there is an efficient bargaining solution for such strategic economic problem where parties maximise their social objective function subject to the unit power constraint ($\text{Max } W = P_1 P_2 P_3$ subject to $U = P_1 + P_2 + P_3$ as given in section 2). If this reservation power or the disagreement point in power-

sharing agreement is added to the above problem the efficient solution is obtained by maximum Nash product $W = (P_1 - d_1)(P_2 - d_2)(P_3 - d_3)$ subject to power constraint $U = P_1 + P_2 + P_3$ where d_i represent the disagreement point. In a two party case solution looks like in diagram 4.

Diagram 4
Efficient and Inefficient Bargaining Solutions



Returning to three-pronged Nepalese dilemma each party is pivotal for the bargaining solution. King should understand that returning to absolute monarchy is inconsistent with democracy and for the growth of the economy and be satisfied with the titular position as practiced in the many of the western democracies including Britain, Denmark and Spain. Political parties should put economic growth in top priority and adopt efficient and prudent policies taking a view of long horizon. Maoists should reconsider not to introduce failed ideology in Nepal if they are really concerned about uplifting the lives of marginal and poor people taking lessons from the failure of communism and move towards market based allocations and greater democracy and socialism both in Russia and China (Walder (1987), Perkins (1994), Shleifer and

Treisman (2005)). The grand coalition that all agree will be one which can come with a solution, at least in the long run in which, $c_1 + g_1 = c_2 + g_2 = c_3 + g_3$ where each have prospects of having equal sum of private and public consumption. This can occur only when the tax revenues from the high income group pays for the public goods of low income groups. The solutions of this bargaining problem may be summarised in terms of following points.

- a. Make “a grow Nepal contract” and put growth as the first objective of the political economic system. Put a system that promotes economic growth and remove features that are harmful for economic growth. Make sure that fruits of growth are distributed more evenly among people.
- b. The parliament should decide a tax rate on income of the King and he should pay these taxes without any hesitation. The King should not be treated more than an ordinary citizen for tax purposes and he should be elected but not hereditary. If King does not heed to people’s demand he should be overthrown and his land and palaces should be used for starting schools and universities to educate children from the poor background.
- c. Political parties should run their organisations in true spirit of democracy and have a system of punishing corrupt party officials according to amount of such corruption. Any citizen should be able to make a case against such corruption.
- d. Extra resources should be channelled for education, health care, job security of the marginal groups. Maoists should abandon their arms as well as the violence and terror as a means of achieving their political objectives. They should not threaten common people.
- e. The nation should give each citizen an equal starting point by means of education and training and let their creativity and productivity prosper

according to their abilities through competitive system and elimination of corruption.

- f. Each party should respect the fundamental human rights and individual freedom. It should commit itself to establish the rule of law, strengthen laws for property rights, establish liberal system of tax and transfer, ensure transparency in use of public funds and system of eliminating corruptions.

Cooperative solution can improve the situation significantly and let economy to move on the path of prosperity. The Ninth and Tenth Plans of Nepal in NPC (1997, 2002) contain details on the Nepalese economy but they lack sufficient analytical structure required by the challenge of the time. To my knowledge Bhattarai (2000) goes one step towards detailed economic modelling of the Nepalese economy taking account of the structure details of demand, supply and production and trade sides of economy. Acharya (2000) suggests measures necessary to institutional set up for a parliamentary democracy suitable to Nepal. Panday (1999) points regarding implementations of plans and Hutt (2005) on recent problems are noteworthy.

The international community can contribute significantly in solving this conflict on the basis of collective experiences that has been accumulated over years in solving these types of problems around the globe. Many lessons can be learnt from the experience of democratic struggles and transformation in many of the Western countries in the past and Eastern countries in recent years, and particularly on how the adult franchise and the market economy can offers better solutions for growth, technical progress and redistribution than by authoritative regimes.

5. Conclusion

Conflict among feudal factors led by the King, working people in trade and industry led by political parties, marginal, poverty trapped people threatened and mobilised by Maoist rebels has created a very unproductive environment where investors and entrepreneurs do not get any productive opportunity. Non-cooperation among competing political and economic forces has brought Nepal into crisis and a growth disaster. The major reason for conflict is short-sighted horizon of these players with constant sum view who try to maximise their own current share on GDP taking its size as a constant. It has discouraged productive economic activities and transfer of better technology and knowledge and resources from abroad with dangerous consequences to the economy. A solution is offered here in terms of a contract in more objectives and specific growth oriented rules that bounds each of them to the policy rules in which each of these groups has incentive to stick for peace and prosperity, adoption and use of knowledge and technology for growth. This is possible if they take a more optimistic grow-Nepal strategy to maximise the growth rate of the economy.

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Figure 1

Short and Far-sighted view of growth and development dynamics in an economy

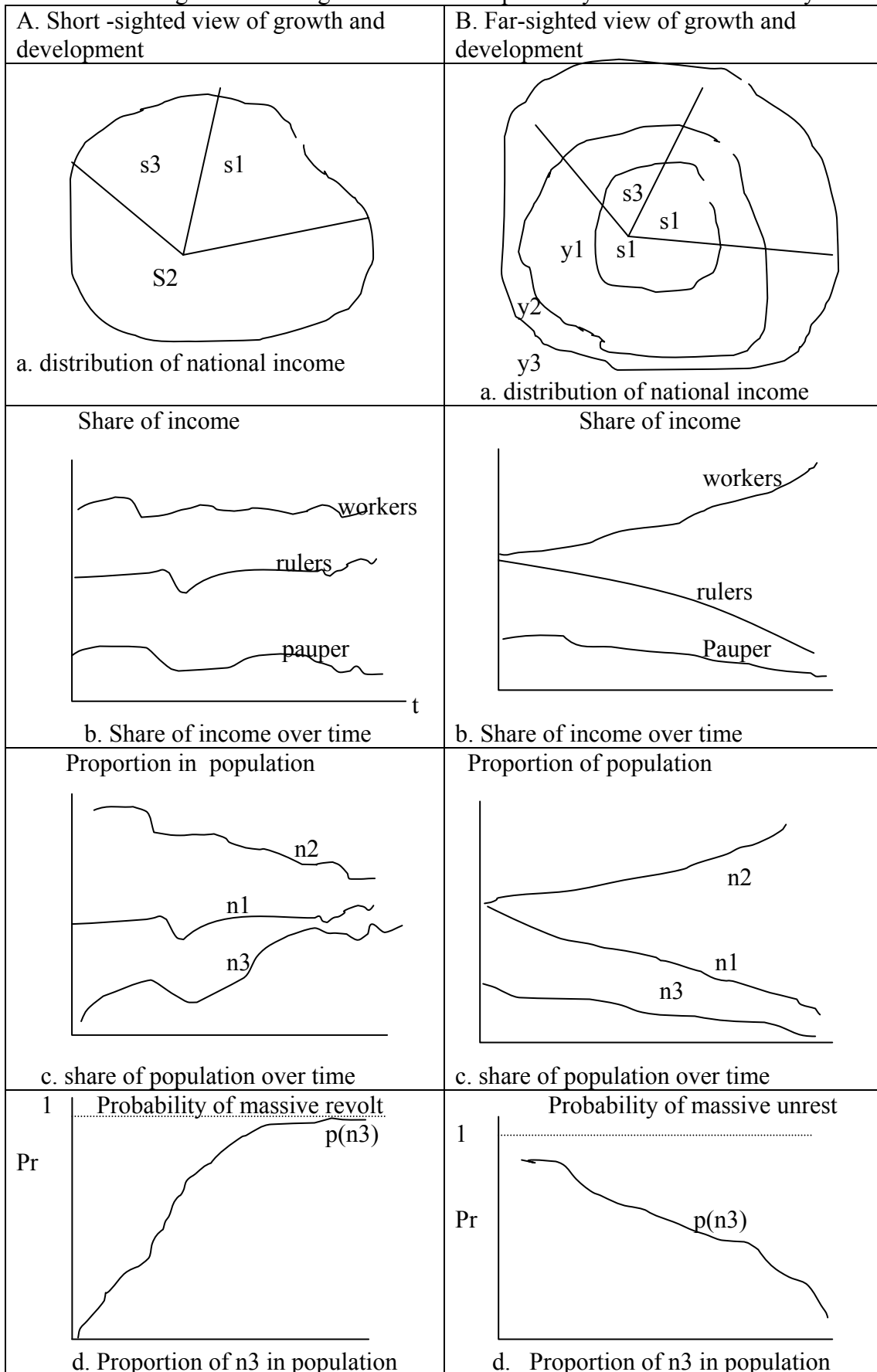


Figure 2
Levels of Income and Size of Government under Kingship, Democracy and Rebels

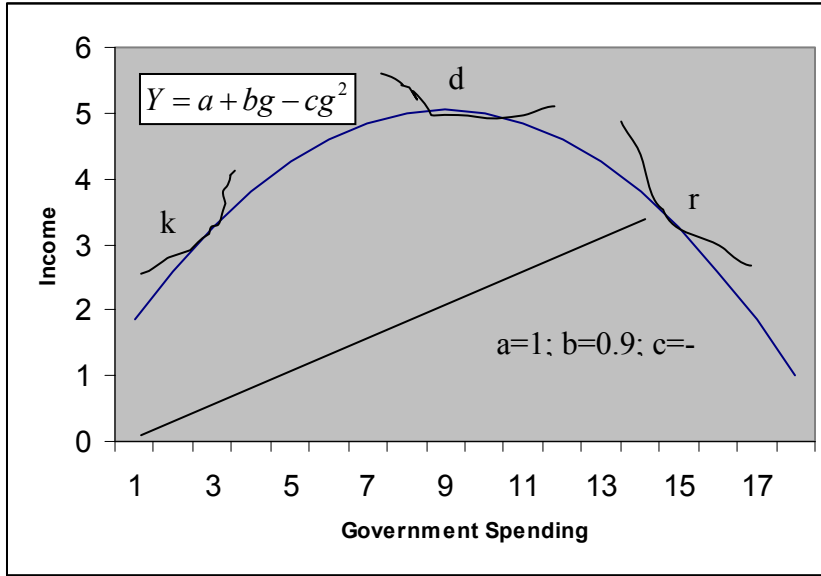
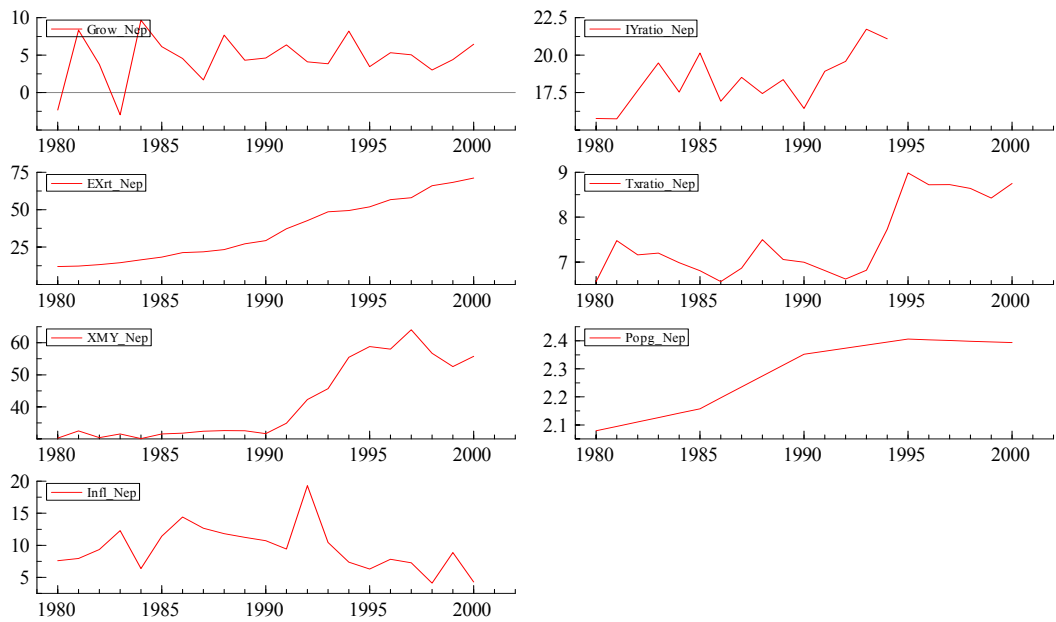
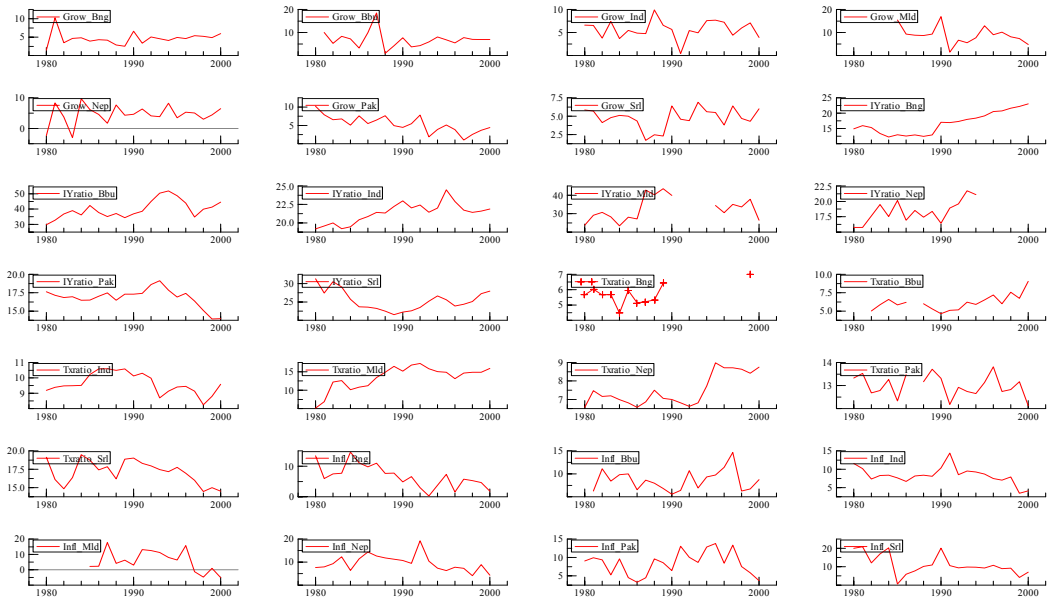


Figure 3
Growth of Output, investment and tax ratios, inflation, exchange rate, trade ratio and population growth rate in Nepal



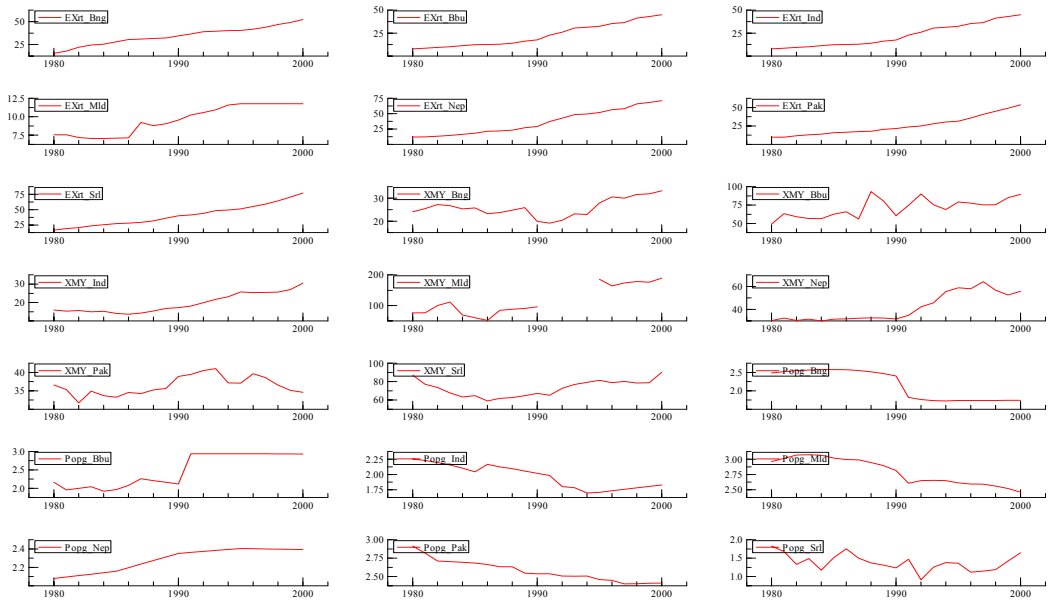
Graphs drawn using the PCGive.

Figure 4
Growth, investment, tax and inflation in South Asia



Graphs drawn using the PCGive.

Figure 5
Exchange rate, trade ratio and population growth rate in South Asia



Graphs drawn using the PCGive.