

# BTI 2016 | Nepal Country Report

<b>Status Index</b>	1-10	<b>4.74</b>	# 90 of 129	
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	scale	score	rank	trend

This report is part of the Bertelsmann Stiftung's Transformation Index (BTI) 2016. It covers the period from 1 February 2013 to 31 January 2015. The BTI assesses the transformation toward democracy and a market economy as well as the quality of political management in 129 countries. More on the BTI at <http://www.bti-project.org>.

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**Key Indicators**

Population	M	28.2	HDI	0.540	GDP p.c., PPP \$	2370.1
Pop. growth <sup>1</sup>	% p.a.	1.2	HDI rank of 187	145	Gini Index	32.8
Life expectancy	years	68.4	UN Education Index	0.452	Poverty <sup>3</sup>	% 48.4
Urban population	%	18.2	Gender inequality <sup>2</sup>	0.479	Aid per capita \$	31.3

Sources (as of October 2015): The World Bank, World Development Indicators 2015 | UNDP, Human Development Report 2014. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$3.10 a day at 2011 international prices.

## Executive Summary

In the last two years, the political confusion about the formation of a democratically legitimated government cleared up, and elections to a new Constituent Assembly (CA) were held, while the political standstill over the drafting of a new, permanent constitution continued. There were hopes that the political stalemate that had prevailed in the CA since 2012 would end with the November 2013 poll and the election of Sushil Koirala of the Nepali Congress (NC) political party as new prime minister, with 405 out of 601 votes, after the parties failed to agree on a consensus prime minister. But the CA again failed to meet the deadline, 22 January 2015, to pass a new constitutional draft. The most contentious issue is the demarcation and naming of states in a new federal setup. Other contentious issues relate to the form of government, the electoral system, protection of preferential rights, the independence of the judiciary and arrangements for the transitional period after the promulgation of the new constitution.

While Nepal during the review period was stuck in political turmoil and constitutional deadlock, the economy experienced relatively strong growth. Following a dip in economic growth in 2013, fuelled by political uncertainty, economic growth recovered again in 2014.

Despite the formation of a new government in 2014, replacing the interim government of Chief Justice Khil Raj Regmi, major policies remained unchanged and the political learning curve remained rather flat. However, uncertainty about the future in early 2015 should not obscure several achievements made on the long road to post-conflict state restructuring since 2006. After more than a year without an elected assembly and a democratically accountable government, Nepal conducted legislative elections in November 2013, and NC leader Koirala was sworn in as the country's 37th prime minister in February 2014. Later that year, Nepal hosted the South Asian Association for Regional Cooperation (SAARC) summit, demonstrating its credibility and reliability in regional politics. Despite ongoing political instability, economic and development indicators rose between 2013 and 2015. This progress was made despite rather than because of politics, and largely rests on the continuing increase of remittance income. At the same time, Nepal

maintained poor rankings in terms of its human development and investment climate. Overall, the financial situation is volatile, and while economic growth and improvements in human development may be real, they are also fragile. In fact, the national economy remains highly dependent on agriculture and remittances resulting from large-scale labor migration of Nepali workers to India, the Gulf region, Southeast and Northeast Asia. In addition, during the review period, some new sources of economic vulnerability surfaced. These included the depreciation of the Indian Rupiah (IRP), to which the Nepali currency is pegged, resulting in a negative impact on the government's fiscal position and added inflationary pressures. Moreover, for the coming years, the economic outlook is less favorable than it used to be because agricultural output will be slowed down by a weak monsoon and the political situation certainly will remain fluid.

## History and Characteristics of Transformation

Nepal's contemporary political history has been shaped by recurring episodes of mass mobilization and anti-regime contention. Until 1990, Nepal's political system was that of an authoritarian monarchy based on an exclusive and oligarchic social order. However, a pro-democratic people's movement brought down the royalist Panchayat system and transformed Nepal into a constitutional Hindu monarchy and a multiparty democracy in 1990.

However, this transition did not establish a stable, well-functioning and consolidated liberal democracy. Rather, Nepal experienced a series of weak governments with ineffective governance and the emerging democratic regime remained highly defective. As a consequence, in the late 1990s, a Maoist rebellion erupted that affected almost all 75 districts of the country. The insurgent movement found support, especially among the impoverished and largely disadvantaged masses of the rural population, but internal armed conflict contributed to a further decline of democracy and human rights in the country. Moreover, in 2001, King Birendra and the entire royal family were murdered under mysterious circumstances, and the dead king's brother, Gyanendra, was crowned king on 4 June 2001.

Disappointed by the lack of success in combating the insurgents, King Gyanendra staged a royal coup in 2004/05, claiming full sovereignty and assuming executive authority. The restoration of royal authoritarianism led to the emergence of a broad opposition movement consisting of the Seven Party Alliance (SPA) and the Maoist insurgents. Finally, broad-based anti-regime contention orchestrated by the main opposition parties and civil-society groups in April 2006 forced King Gyanendra to reinstate the dissolved parliament.

The newly formed multiparty government concluded a comprehensive peace agreement with the Maoists that opened the way for the new interim constitution, which came into force in January 2007. On the same day, an interim parliament including Maoist representatives was formed, and, in April that year, the Maoists also joined the government. It took another year before popular elections to a Constituent Assembly (CA), in April 2008, in which the CPN-Maoist finished as the

strongest party. The monarchy was abolished, and a new Federal Democratic Republic of Nepal was promulgated in May 2008.

However, the years that followed these elections were disappointing in many respects, as the old power struggles between political leaders started once again. It was only in early 2009 that the CA could start its work on the new constitution. Even though the 2007 interim constitution established a secular, federal and republican state, deeply entrenched differences about the ideal form of the future state impeded agreement between party leaders, which in turn inhibited the CA's ability to reach consensus on key constitutional articles.

After four extensions of its initial two-year tenure, the CA was dissolved without promulgating a new constitution, in May 2012. Rather, both the coalition government under Prime Minister Baburam Bhattarai (August 2011 - March 2013) of the Unified Communist Party of Nepal (Maoist), and the nonpartisan government of Acting Prime Minister Khil Raj Regmi (chief justice of Nepal since May 2011) that governed the country from March 2013 until February 2014, proved unable to break the constitutional deadlock.

In November 2013, however, the caretaker at least succeeded in holding new elections for the CA. These elections saw an impressive comeback of the Nepali Congress (the main opposition party under the Panchayat system and the ruling party for most of the period 1990 - 2006). After the CA assembled in January 2014, a multiparty coalition was formed under the leadership of Prime Minister Sushil Koirala (Nepali Congress) in February 2014.

Since then, Nepal has had a regular government, although there is still no successful conclusion of the constitution-making process in sight.

Yet, taking into account the drawn-out process of democratic reform in Nepal, which began in 1950, the current uncertainty should not be seen as an indication of total failure. Given the time lapse between the proposal for Constituent Assembly elections in 1950 and their realization in 2008, the ebbs and flows of the political process over the last two years should be seen as one phase in a much longer project of reimagining how Nepali national identity, sovereignty and development goals should be asserted in an equitable manner that includes all citizens. Without a doubt, the post-2006 political system is the most open and the most inclusive that Nepal has experienced so far, and the situation in terms of effective protection of political freedoms and civil liberties has certainly improved.

The BTI combines text analysis and numerical assessments. The score for each question is provided below its respective title. The scale ranges from 1 (worst) to 10 (best).

## Transformation Status

### I. Political Transformation

#### 1 | Stateness

Question  
Score

Ever since the unification of the country in the late 18th century, stateness has been linked with the religion, language and culture of the so-called upper Hindu castes (Tagadhari), especially the Brahmans (Bahun), who dominate politics, the judiciary, the media and all other spheres of public life. This changed little after the downfall of the Panchayat system in 1990. Moreover, public life and law and order were eroded by the Maoist insurgency as well as the counterinsurgency efforts of the Royal Nepali Army.

Monopoly on the  
use of force

6

After several years of a multidimensional crisis of stateness, driven by a Maoist rebellion and a royal putsch, the peace process since 2006, albeit slow and fragile, has helped to strengthen the state's monopoly on the use of force in many parts of the country. Furthermore, the 2006 Comprehensive Peace Agreement and subsequent tenures of the Constituent Assembly (CA), from 2008 to 2012 and again since 2013, provided a platform for wide-ranging public debate over both the real and ideal nature of Nepali stateness.

Although the legitimacy of the state's overall sovereignty or territorial claims within its international borders is uncontested in principle, the very nature of the state's internal power structures – both geographical and political – has been up for debate in the post-conflict period. These problems have been exacerbated by the extremely close relationship between Nepal's civilian government and the armed forces, which has only increased since the Maoists took power and a significant number of their ex-combatants were integrated into the Nepal Army (NA) from 2012 - 2014. Rather than enabling legitimate democratic control over the country as a whole, the politics of impunity and militant ethnic and regional movements have now become the main threat to the state's monopoly on force. Finally, concerns have arisen over the activities of Indian border security forces in uniform acting beyond their jurisdiction. In addition, along the northern border with China's Tibetan Autonomous Region,

Chinese border troops have allegedly overstepped their jurisdiction by occasionally entering Nepali territory.

Since 2008, Nepal has not been a Hindu kingdom, but a “secular, inclusive and fully democratic” republican state. The interim constitution of 2007 for the first time recognized the nation as having “multiethnic, multilingual, multi-religious [and] multicultural characteristics.”

However, people of Indian ancestry living in the Tarai (Madhesi), members of numerous ethnic groups (Janajati), and the so-called untouchable castes (Dalit) continue to face manifold discrimination from high-caste Hindus (often referred to as “hill elites” because they live in the central hill region) who still dominate bureaucracy, political institutions, the cultural system and the economy. Many public officials maintain strongly held, more or less private beliefs that Nepali citizenship should be defined by competence in the Nepali language and adherence to Hindu religious beliefs. Such attitudes are strongly contested by politically active members of the Madhesi (inhabitants of the Madhesh, or Terai, region) and adivasi janajati (indigenous nationalities) movements, who demand a reformulation of the nation-state’s symbolic rhetoric and its concomitant citizenship policies. Since 2007, these identity-based movements have made significant gains in broadening notions of the nation-state and the basis for citizenship. However, since 2010, they have faced increasing resistance from counter-movements that deploy similar identity-based rhetoric to “protect” the privileged citizenship status of erstwhile dominant groups. The standoff between these two views of the nation-state contributed significantly to the inability of the CA to promulgate a constitution that could, on the one hand, recognize as legitimate the demands of marginalized groups, and, on the other, ensure equality and justice for all citizens. Therefore, the existing citizenship agreement remains fragile and contentious.

With the abolition of the “Hindu state” and Hindu kingship as central tenets of national self-definition, religious freedoms have expanded. While Maoist rhetoric demands a totally secularized political system, other political parties and actors remain deeply influenced by the legacies of the Hindu caste system, which also maintains a significant influence on citizens’ ability to access state resources and participate in political institutions. This is particularly so for members of the previously untouchable dalit communities, as well as adivasi janajati individuals. It is also so for women, who are seen as inferior from the Hindu religious perspective, which continues to pervade the overwhelmingly male, high-caste Hindu ranks of the civil service. Moreover, due to the ongoing blockade within the CA, efforts toward a deep-reaching reform of the legal system to lessen the influence of Hinduism on it are still lacking.

State identity

6

No interference of religious dogmas

6

The administrative system is moribund, riddled with corruption and urgently in need of reform. As in most South Asian countries, various indicators, such as the ability of the state to tax the economy, indicate a weak state capacity in Nepal. While the administrative structure of the state extends beyond maintaining law and order, the country's weak administration is unable to provide equitable access for all citizens to administrative services. Especially in rural areas, the infrastructure is too weak to provide a sound administrative basis for political, social and economic development. In urban areas as well, electricity and water are rationed by municipal providers. Citizens seeking to avail themselves of basic state services such as birth and death registration, healthcare and education – let alone legal redress – encounter labyrinthine procedures over which individual incumbents often have undue discretionary influence. Decision-making is often highly centralized, both geographically (i.e., petitioners from all over the country often must come to Kathmandu to attain their objective) and individually (lower-level functionaries are often unwilling to take responsibility for decisions, so power is concentrated at the top levels).

Basic  
administration  
4

A general restructuring of the civil administration has been under discussion for years. So far, however, the CA has been unable to achieve a basic consensus on the future federal restructuring of the Nepali state and the necessary overhaul of administrative structures. Due to the ongoing discussion over the future federal state system, administrative restructuring will not take place before the ratification of a new constitution.

## 2 | Political Participation

In November 2013, for the first time since 2008, general elections for a new CA took place. These multiparty elections were conducted more or less properly. But, as the election was boycotted by an alliance of more than 30 fringe parties, led by the Communist Party of Nepal-Maoist (CPN-M), it was a manifestly disputed means of filling political posts.

Free and fair  
elections  
7

To counter threats by boycotting parties to disturb the poll, the caretaker government deployed more than 140,000 security personnel in all 75 districts of the country. There had been incidents of election violence ahead of the poll. The CPN-M enforced a strike in three western districts and banned other parties from campaigning in Bardiya district, and party cadres engaged in numerous low-intensity clashes. But, in the end, the CPN-M refrained from using violence or obstructing the vote, and turnout was close to 70%. Initially, the United Communist Party of Nepal-Maoist (UCPN-M) rejected the outcome of the election, alleging fraud. Eventually, the party agreed to remain in the CA and participated in the formation of a coalition government led by the Nepali Congress party.

Numerous national and international observation teams reported that the 2013 elections were free and fair, although cases of intimidation and booth capture were reported. The Sidney-based Electoral Integrity Project, in its 2013 report, rated the quality of the election at the same level as the elections in Paraguay and Albania (also in 2003) and significantly better than, for example, in Kenya, Honduras or the Ukraine. While electoral laws and procedures as well as the vote count and the neutrality of electoral authorities were evaluated relatively high, aspects such as fraudulent voter registration, unregulated campaign finances, and irregularities during the voting process were seen as especially problematic. In contrast, candidate registration, media coverage and the drawing of district boundaries were seen as minor (but relevant) problems.

From June 2012 to January 2014, there were no democratically elected political representatives. Since then, democratically elected political representatives have had the power to govern, which is, however, informally constrained in various ways. For one, various political parties, including those that boycotted the election and are therefore not represented in the CA, exercise veto power. Secondly, although the Nepalese Armed Forces (NAF) are traditionally under government control, day-to-day monitoring is weak. Third, the CPN-M has had problems in replacing its militant outlook with adherence to democratic norms. On the one hand, the political parties that decided to boycott the 2013 election could be seen as “veto groups”; on the other hand, integrating these groups into the constitutional process in one way or another and giving them the opportunity to veto the constitutional process seems mandatory in order to achieve sustainable peace-building.

On a positive note, the urgent task of integrating the former People’s Liberation Army (PLA) into the Nepalese Army (NA) has seen some progress in the post-2006 period and especially between 2010 and 2014. Furthermore, despite allusions to the possibility of a military coup in recent years, top brass have not raised explicit challenges to government policies, and in fact defied requests by opposition parties to back a dismissal of the Maoist Bhattarai government (2011 - 2013). It is widely assumed that India has strongly discouraged any army involvement in politics at this stage. Other potential veto groups, such as landowners and business elites, enjoy sufficient access to political parties, the CA and the cabinet and hence can try to influence policymaking through institutionalized politics. Therefore they do not count as “veto groups” as defined in the BTI. Finally, there are veto actors at the local levels (landowners, traditional elites, groups or individuals with control over means of violence and coercion). However, since the political system is still highly centralized, these actors do not exercise a veto over local democratic decision-making; what they can do, however, is to block the implementation of policies at the local level.

Effective power to govern

6

Members of the Maoist-affiliated All Nepal National Independent Students Union-Revolutionary (ANNISU-R) were responsible for extortion, intimidation, and school-bus burnings. The law-and-order situation remains problematic, mainly in the Tarai region, where criminal groups were responsible for abductions to obtain ransom.

Freedom of association and assembly is guaranteed by the interim constitution of January 2007. Before the 2013 elections, incidents were reported in which breakaway Maoist groups threatened candidates and voters. Occasionally, there are reports of clashes between different party groups in rural areas. Nevertheless, individuals are free to join political and civic groups, and many people possess multiple affiliations. For the most part, such groups operate freely, and mass rallies and programs are common, both in urban centers and far-flung district headquarters. Most exceptions have involved the Tibetan community, members of which have repeatedly been detained and arrested for staging protests and holding cultural festivals that invoke the Dalai Lama. This differential treatment is largely due to Chinese pressure on Nepal, which, in violation of both international law as well as its own interim constitution, often does not view the rights of Tibetan refugees as equivalent to those of its own citizens.

Association /  
assembly rights  
7

Nepal has a vibrant media, with scores of print dailies, weeklies and monthlies in the national language of Nepali, as well as English and several ethnic and regional languages. Community radio has also expanded rapidly as an important source of news and information for people around the country, especially in rural areas. Growing electric grids, complemented by satellite and mobile technology, have also fostered a diverse and contentious public sphere in which many different voices are increasingly heard at both local and national levels. The 2014 Reporters Without Borders Press Freedom Index ranked Nepal at 120 out of 180 countries (2013: 118 out of 179). There also were credible reports about how activists from various boycotting parties employed aggressive tactics towards journalists who criticized the boycott, especially in the run-up to the 2013 elections. Such incidents demonstrate that, despite the overall positive trajectory in this domain, freedom of expression may be subject to highly localized conditions. The reaction of the government was less than halfhearted.

Freedom of  
expression  
7

### 3 | Rule of Law

While the 2007 interim constitution included detailed provisions regarding the separation of powers, the fact that Nepal did not have an elected assembly between May 2012 and January 2014 meant a significant weakening of horizontal accountability of the prime minister and his cabinet. In addition, in the absence of a functioning legislature, and facing ongoing legislative deadlock (both before May 2012 and after January 2014), the government had to depend on presidential ordinances to authorize funds for government expenses and implement its policies.

Separation of  
powers  
5

Suddenly, the role of Nepal's ceremonial president, Ram Baran Yadav, was both more concise and highly controversial. It remained unclear if the president was willing (or able) to exercise any kind of control over the prime minister. Finally, when the main political parties agreed to install Khil Raj Regmi as acting prime minister of a nonpartisan caretaker government in early 2013, the separation of powers was severely undermined, because Regmi kept his position as chief justice of the Supreme Court. This undue convergence of executive and judiciary authority only ended with the election of NC politician Koirala as prime minister by the CA on 10 February 2014. There is intense debate about the precise nature of the separation of powers in the next constitution (to be drafted by the CA). Concerned about the power of conservative forces to block reforms, the Maoists have pressed for a presidential system with a popularly elected president as head of state and chief executive. Their opponents in the Nepali Congress and the UML favor a parliamentary system. Given the insurmountably fragmented nature of Nepal's political landscape, the proposed compromise of a semi-presidential system is very likely to perpetuate legislative and executive paralysis.

Nepal has a territorially and functionally differentiated judicial system. The Supreme Court is the highest court of the country, which exercises judicial review and oversight regarding the lower courts. The independence of the judiciary is supposed to be ensured by law. The interim constitution had created the Judicial Council as an exclusive authority for dealing with some of the most important issues relating to an independent judiciary. The chief justice is appointed by a constitutional council comprising the prime minister, three ministers, the current chief justice, the house speaker and the leader of the opposition. However, from the dissolution of the CA in May 2012 until the formation of a new CA in January 2014, this council was unable to meet and, therefore, justices whose term had expired could not be replaced.

Although the judiciary exercised considerable power by the impeachment of several political leaders on corruption charges, the judiciary system suffers from functional deficits and remains inaccessible to the majority of the Nepalese people due to insufficient geographical dispersal and scarce resources, both within the system and among those seeking juridical protection of their rights.

In addition, the judicial system suffers from a number of other problems, including a lack of citizens' awareness and delays in the system. According to assessments by the Nepal Bar Association, corruption is deeply rooted in the court system. A large number of pending cases; undue delays in the implementation of court decisions; and controversial appointments of judges, resulting from a lack of transparency and from political interferences in the appointment process, together contribute to an overall impression of a judiciary that is highly impaired by political interference and corruption.

Independent  
judiciary

5

One significant limitation on the courts' jurisdiction results from the government's ability to grant pardons or suspend sentences for criminal convictions.

Many Nepalese appear to perceive the courts above the district level as more reliable than other state institutions. The Supreme Court has also been able to convict several political leaders on corruption charges. The fact that this has been possible, and the Supreme Court's ruling against the extension of the CA's term beyond May 2012, despite considerable political opposition, point to a relatively high degree of autonomy from the political sphere.

A lack of effective legal consequences has been and still is a serious obstacle in ensuring the rule of law and protection of human rights. The inclusion of provisions in the interim constitution, such as the unrestricted authority of the government to grant pardons, enabled the political elite to sweep past misdeeds under the carpet.

Feeding into a broader culture of impunity is Nepal's failure to effectively prosecute any crimes committed by the security forces during the civil war and in the years since 2006. So far, neither the crimes of the Maoists or the security forces, nor the political responsibility for these crimes by the different governments, have to date been the subject of investigation.

Corruption in Nepal is entrenched in politics and business. Funds, including aid money, are routinely stolen at all levels of government, and corruption scandals frequently make the news. Political parties continuously dispense patronage to members and supporters, both in terms of material resources and administrative favors. The business sector is well adapted; companies long ago learned to work through the system, and some indeed profit from it. The result is a self-perpetuating system: Endemic corruption results in weak rule of law, which in turn renders corruption a matter both of necessity and convenience for parties, civil servants, citizens and businesses.

The nation's anti-graft body, the Commission for the Investigation of Abuse of Authority (CIAA), occasionally arrests high-level government officials on corruption charges. In recent years, prominent politicians were convicted on corruption charges and jailed, including the former Nepali Congress ministers Govinda Raj Joshi and Khum Bahadur Khadka, along with Jay Prakash Gupta, the Madhesi Janaadhikar Forum (Republican) leader and minister for information and communications in Mr. Bhattarai's cabinet. Overall, however, corrupt officeholders or authorities who abuse their office can do so without fearing legal consequences. This is especially the case with local officials, whereas at the national level, there are at least frequent reports in the media, which trigger adverse publicity.

Prosecution of  
office abuse  
3

In principle, the constitution provides full protection for civil and political rights and an impressive catalogue of economic, social and cultural rights. In reality, violations of human rights in Nepal take many forms. As a consequence of the political confusion since 2008, and the dissolution of the CA in May 2012, many positions in high-level commissions went unfilled for years, including the Commission for the Investigation of Abuse and Authority and the National Human Rights Commission. Moreover, there is a complete lack of political commitment to foster systematic investigation and prosecution of grave and well-documented human-rights abuses during the ten years of civil war (extrajudicial executions, forced disappearances, rape and torture). In August 2012, the government submitted ordinances for the establishment of a Disappearance Commission and a Truth and Reconciliation Commission to the president. However, many human-rights activists and the U.N. Office of the High Commissioner of Human Rights warned that these contradict fundamental human-rights principles as they allow for full amnesties even in the case of grave and gross human-rights violations. Due to the controversies surrounding the ordinances, the president has not yet signed them.

Civil rights  
4

Even though the government maintained effective control of the security forces, there were reports during the review period that security forces committed human-rights abuses. According to various reports by human-rights groups (Human Rights Watch, Amnesty International), as well as U.S. State Department's reports on the human-rights situation in Nepal, non-state armed groups attacked each other, civilians, state officials, and members of several ethnic groups, though the number of these groups and incidents declined in 2012/13. Nevertheless, the law-and-order situation remains difficult. For example, in 2012 a Supreme Court justice was shot in broad daylight in the capital of Kathmandu. Beyond the legacy of the civil war, systemic weaknesses in the rule of law encourage rights violations. For example, criminal gangs, mafias and small armed groups (the boundaries between them are fluid) often enjoy various degrees of political protection. The police frequently use disproportionate force to quell political protests, but do little to enforce order during frequent violently enforced shutdowns (bands). Levels of protection also significantly depend on class and caste status. Caste-based discrimination as well as sexual violence often go unpunished.

#### 4 | Stability of Democratic Institutions

Democratic institutions exist at the national level, but they are unstable, somewhat contested and – because of the perpetual political controversy and the resulting deadlock – of little effectiveness. The most important step towards the stabilization of democratic institutions was the CA election in November 2013, which allowed for a reconstitution of the selection committee that is responsible for the selection of Supreme Court justices, the Election Commission and other important bodies.

Performance of democratic institutions

5

Since the disbanding of the elected village councils in 2002, there have been no democratically elected representative bodies at the local level. The lack of democratically legitimized bodies on the regional and local levels adds to a picture of a democratic system that is limited to a set of national institutions.

Political parties suffer from an absence of democratic structures and norms in many respects. Disadvantaged segments of society have won a voice in the process, thanks to the proportional election system, but they are still playing a minor role in the higher reaches of the parties.

Most political actors support the 2007 agreement on democratic transition and institutions. This was confirmed by the elections to the Constituent Assembly in April 2008 and, again, in November 2013. Even the Communist Party of Nepal-Maoist, which decided to boycott the poll, confirmed its commitment to the constitutional process.

Commitment to democratic institutions

5

However, legislative deadlock and ineffective governance undermine the CA's authority and weaken its legitimacy. The inability to successfully conclude the constitutional process and the difficulties of forming a stable and effective government provide an entree for conservative critiques of the constitutional process as a whole. One indicator of this is the re-emergence of royalist parties as a significant political force in the 2013 election.

#### 5 | Political and Social Integration

Nepal's system of political parties is fractionalized, polarized, based on factionalism and elite-dominated. Thanks to the proportional aspect of the elections to the Constituent Assembly (CA), disadvantaged groups are at least adequately represented in the assembly, but the same cannot be said for the government, political parties, administration, judiciary, media, education system or business. The traditional parties – Nepali Congress and CPN-UML – have strong social roots but face difficulties recruiting and maintaining the allegiance of cadres from dalit and janajati backgrounds and lack adequate democratic and participatory mechanisms. Most political parties remain personality-oriented organizations with authoritarian power

Party system

3

structures. All power is concentrated in the party headquarters in the Kathmandu Valley; any participation at the local level or in rural areas is very limited. None of the established parties makes any effort to achieve balanced popular participation in its own leadership posts or in the country's political institutions. The upper Bahun and Chetri castes (especially the former) dominate in all areas. Despite promises of revolutionary social transformation, the Maoist parties have fared only slightly better at democratizing their ranks. The Maoists may have a greater support base at the local level due to their protracted mobilization in rural areas during the civil conflict, but they have rapidly lost legitimacy over the past year as their government has floundered.

Due to the breakaway of the CPN-M faction from the CPN-UML in 2012, party system fragmentation increased further and the 2013 election confirmed the regionalized and volatile character of the party system. In their 2013 election manifestos, the major political parties insisted on their differences with each other over constitutional issues of federalism and parliamentary vs. presidential systems. These differences left in place serious uncertainties about the ability of the new CA to achieve a compromise and deliver a constitution. Yet, some indicators point towards at least temporary (and limited) depolarization, such as the willingness of the 33-party anti-election alliance led by CPN-M to join the CA through government nomination. Moreover, in 2014, the party held its national congress and agreed to pursue a non-armed urban-centric "people's revolt" instead of an armed "people's war."

Recent years have seen several new parties arise, largely organized around regional or ethnic affiliations. In addition, there are many vocal civil-society organizations representing the full spectrum of political perspectives. Some are accepted as more legitimate than others, but most civic associations maintain explicit political allegiances. It is rare to find organizations attracting membership across party lines, and therefore few organizations are accepted as equally legitimate by all relevant actors. In addition, many ethnic and regional identity-based groups perceive the political parties (and therefore the structures of governance that they operate) as seeking to keep power in the hands of long-dominant upper caste Hindus, and therefore as not fully representative of the citizenry as a whole. By the same token, many of the regional and ethnically based parties are viewed by those elites as exclusionary and potentially threatening to national unity.

Supported by socio-economic changes and the presence of many international NGOs, several civic organizations and interest groups have established themselves since the first transition to democracy, in the early 1990s. These include labor unions, community-based groups, local NGOs, and organizations for women's rights. They are playing a role in representing social interests and interest mediation. Organizations such as the Nepal Federation of Indigenous Nationalities, the Nepal Bar Association, and the Federation of Nepali Journalists have exercised significant

Interest groups

5

influence in fostering public debate and pressing for political commitments during the most recent phase of transformation. Some of these interest groups are funded by international development agencies, while others derive their support exclusively from local, national or regional actors. Some donors and NGOs act in a para-statal fashion, in many cases delivering services and/or exerting strong influence in policy arenas. Such organizations also serve an important liaison role between citizens and policymakers at the center.

The May 2012 dissolution of the Constituent Assembly, which proved unable to draft a constitution, has led to broad questioning of both the normative and pragmatic value of democracy and has encouraged some elements on both the far left and the far right (e.g., those who advocate a return to monarchy) to publicly question whether democracy is appropriate for Nepal. According to the Citizen Survey: Nepal in Transition in 2013, conducted by the State of Democracy in South Asia/Nepal Chapter (SDSA/N) of the Nepal Center for Contemporary Studies (NCCS) and International IDEA, support for democracy dropped to 53% of respondents from 67% in 2007. Moreover, 36% of respondents said it “does not make a difference” when asked to choose between democracy and authoritarianism, and 11% favored a non-democratic government in certain circumstance. An often-cited survey (Himalmedia Public Opinion Poll 2013) seems to indicate that the longstanding inability of high-level political actors to ensure the continuity of democratic institutions has contributed to relatively low levels of public trust. According to the survey, 61.1% of respondents thought democracy was under threat, and 39.4% said the reason for this was “wrangling political parties.” On the other hand, the widespread participation of voters in the 2013 elections and the success of ideologically moderate parties such as the NC seem to demonstrate that there is a broad understanding of the importance and approval of democratic procedures among Nepali citizens.

Approval of  
democracy  
5

Studies of the level of trust and the strength and forms of social capital in Nepal are not available, except for a few anthropological and ethnographic studies that provide anecdotic evidence. It remains uncertain if these insights can be viewed as representative or aggregated to the whole society.

Social capital  
5

Nonetheless, associational activities have been improving in the last 25 years. Networks of cooperation and mutual support are well developed along not only political party, business and alumni, but also along ethnic, caste and regional lines. In many localities, such organizations fill the spaces that might otherwise be filled by effectively decentralized state agencies. However, they often act to further the interests of a specific group, whether defined in ethnic or regional terms. Therefore, it could be argued that these networks do reproduce bonding social capital instead of bridging social capital, and, therefore, do not support the formation of civic self-organization.

## II. Economic Transformation

### 6 | Level of Socioeconomic Development

Question  
Score

Nepal is one of the poorest countries in the world, with per capita GNI of about \$730 and per capita GDP of less than \$400 (2013). According to the UNDP's Nepal Human Development Report 2014, the country ranked 145th out of 187 countries, with an HDI score of 0.540 (2013), up from 157th in 2013 (note: the two rankings are not directly comparable). That put Nepal one rank above Pakistan (146) and well ahead of Afghanistan (169).

Socioeconomic  
barriers  
2

The insurgency of the 1990s, the authoritarian backlash in the early 2000s and the political standstill since 2008 proved detrimental to long-term development. The country's infrastructure is insufficient to meet steadily growing demand. Even though the poverty situation improved between 2001 and 2011, the 2011 Nepal Living Standards Survey showed a clear association between caste and ethnicity, and income disparities that reflect pervasive social exclusion, unequal access to education, and deeply rooted ethno-religious and gender discrimination. On a positive note, Nepal has improved its ranking in the GDI from 102nd in 2013 to 98th in 2014. Furthermore, according to a 2011 World Bank study, and the Nepal Human Development Report 2014, the percentage of poor people in Nepal dropped from 64.7% to 44.2% between 2006 and 2011, with significant differences between districts, gender, caste and ethnicity. Overall, improvements in human development are real but fragile, and overall improvements in living standards and quality of life for many Nepalese coexist with more or less unchanged horizontal and vertical inequalities.

The decline of the national poverty ratio over the past 15 years has been mainly the result of booming remittances. In fact, the total number of labor permits issued yearly increased between 2008/09 and 2013/14, from approximately 220,000 up to 522,000. Of those, more than 440,000 were arranged through recruitment agencies. While Malaysia (40.9% of all male and female labor migrants), Saudi Arabia (22.9%), Qatar (20.3%), the UAE (11.2%), and Korea are the main destination countries for legal labor migration through recruitment agencies, more than three in four migrants are presumably employed in India. However, due to the open border with India, a more definite assessment of the magnitude of unregistered labor migration is not possible.

Economic indicators		2005	2010	2013	2014
GDP	\$ M	8130.3	16002.7	19244.2	<b>19636.2</b>
GDP growth	%	3.5	4.8	3.8	<b>5.5</b>
Inflation (CPI)	%	6.8	9.3	9.0	<b>8.4</b>
Unemployment	%	2.5	2.7	2.7	-
Foreign direct investment	% of GDP	0.0	0.5	0.4	-
Export growth	%	-3.0	-10.4	10.3	<b>23.7</b>
Import growth	%	6.9	28.3	14.2	<b>18.0</b>
Current account balance	\$ M	153.1	-127.6	1160.2	-
Public debt	% of GDP	51.9	35.4	31.9	<b>27.7</b>
External debt	\$ M	3191.1	3788.7	3832.6	-
Total debt service	\$ M	119.5	189.3	217.8	-
Cash surplus or deficit	% of GDP	-1.0	-1.4	1.5	-
Tax revenue	% of GDP	9.2	13.4	15.3	-
Government consumption	% of GDP	8.9	10.0	9.9	<b>11.2</b>
Public expnd. on education	% of GDP	3.4	4.7	4.1	-
Public expnd. on health	% of GDP	1.6	2.4	2.6	-
R&D expenditure	% of GDP	-	0.30	-	-
Military expenditure	% of GDP	1.9	1.6	1.5	<b>1.5</b>

Sources (as of October 2015): The World Bank, World Development Indicators 2015 | International Monetary Fund (IMF), World Economic Outlook, October 2015 | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database 2015.

## 7 | Organization of the Market and Competition

Article 35(12) of the 2007 interim constitution declares that the state shall adopt policies to attract foreign capital and technology, while at the same time promoting indigenous investment for the purpose of national development. With the Competition Promotion and Market Protection Act (2007), legislation to prevent monopolies and cartels exists, but it is scarcely implemented. In fact, informal access barriers, collusion and price fixing are part and parcel of regular business conduct across a wide range of sectors, and are routinely tolerated by regulators.

Market-based  
competition

5

The Maoist-led government of Prime Minister Baburam Bhattarai (August 2011 - March 2013) started efforts to attract foreign investment, though results have been slow due to the political background of the leading party. Tentative efforts to dissolve syndicates – for instance in the transport sector in early 2012 – often meet with fierce resistance, and have proven unsuccessful so far. Indigenous investment is slowly starting, such as in the power generation sector, but is hampered by shortages of essential goods.

The 2015 Doing Business Report by the World Bank has Nepal at rank 108 out of 189 economies in terms of the ease of doing business. According to the report, Nepal strengthened its legal institutions by, among other things, improving building regulations and improving building inspection procedures, by reducing the administrative processing time at the company registrar and by establishing a data link between agencies involved in the incorporation process.

As mentioned before, with the 2007 Competition Promotion and Market Protection Act, legislation to prevent monopolies and cartels exists, but it is scarcely implemented. Tentative efforts to dissolve syndicates – for instance in the transport sector in early 2012 – often meet with fierce resistance from militant labor unions and private business, and have proven unsuccessful so far. Indigenous investment is slowly starting, such as in the power generation sector, but is hampered by shortages of essential goods.

Anti-monopoly  
policy  
6

Nepal acceded to the World Trade Organization in April 2004 as the first Least Developed Country (LDC) to do so. Nevertheless, the institutional and legal structures to implement the WTO agreement have not been properly developed. Structural difficulties of trade-related services and infrastructures prevented the realization of potential comparative advantages. Apart from the WTO, Nepal is also member of two regional trade frameworks: the South Asia Free Trade Area (SAFTA: Afghanistan, Bangladesh, Bhutan, India, the Maldives, Pakistan, and Sri Lanka) and the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC).

Liberalization of  
foreign trade  
7

Its commitments under the WTO framework are extensive, with most tariff lines bound at an average final bound rate of 26.2%; all trading partners hold at least Most Favored Nation (MFN) status. The effectively applied average tariff rate of 12.5% in 2012, which was significantly higher than the regional average of 7.2%. This includes strategic sectors such as agriculture and manufacturing, in which simple average MFN tariff rates fall significantly below final bound lines. Non-tariff measures, in the form of import license requirements, affect only a small number of products. Negotiation priorities under the WTO framework are improved market access for LDCs in general, and Nepal's own export products in particular, as well as easier movement of LDC semiskilled and unskilled labor.

While in principle, Nepal has a number of investment-friendly laws and regulations in place, the operation of foreign banks, repatriation of profits, and currency exchange facilities remain constrained.

India is the largest single source of foreign investment in Nepal, accounting for 43% of greenfield FDI inflows in 2013. Trade with India made up almost 70% of the country's total trade in 2013, but is subject to special regulations and somewhat restrictive requirements. While Nepal's share in world trade is minimal (0.063% in 2014), its total merchandise exports contracted by 3.0% in 2013, whereas services exports grew by 25.1% (Asia-Pacific total: 2.1% growth in merchandise exports and 4.9% growth in services exports in 2013). Merchandise imports and services imports grew by 8.9% and 9.3%, respectively. Nepal continued to run a trade deficit of \$5.43 billion in FY 2013, which is largely funded through remittance income.

Nepal's banking and financial sectors suffer from persistent structural problems. Key problems include the central bank's limited independence (despite the 2002 enactment of legislation to increase central bank autonomy) and weak supervision and enforcement capabilities; the high number of banks and financial institutions and the lack of a competitive environment resulting from fragmentation of the banking system; ineffective enforcement of capital requirements; an extensive sector of state-owned banks with high proportions of nonperforming loans; and weak incentives for improving corporate governance, accountability and transparency in the banking system. The nonperforming assets (NPA) volume declined in recent years, at the same time that total loans have been continually increasing, thus resulting in a more favorable proportion. However, the NPA ratio is still a long way from being satisfactory.

Banking system  
6

## 8 | Currency and Price Stability

The Nepali rupee (NPR) is pegged to the Indian rupee (INR) at a rate of 1.6 to 1.0, which Nepali policymakers insist is important for overall macroeconomic stability. Accordingly, the value of the NPR fluctuates with the INR, and weakened against the dollar considerably. The exchange rate of dollar to NPR declined from a 2013 peak of 1:1080 to 1:96 in April 2014. Foreign exchange is not freely available. Under the 1962 Foreign Exchange (Regulation) Act, commercial transactions payable in convertible currency need approval from the central bank (Nepal Rastra Bank, NRB). Inflation levels in recent years have consistently been above the target of 7% set by the central bank (9.0% and 9.5% in FYs 2013 and 2014). Several factors are responsible for the high rates: the lagged impact of monetary expansion; "imported inflation" from India, given the porous border and pegging of currencies; and a steep increase in food prices in 2013/14.

Anti-inflation /  
forex policy  
4

At the government level, revenues were strong in 2013 and 2014, increasing from 285 billion NPR in FY 2012 to approximately 408 billion in FY 2014. However, actual government spending has been sluggish, particularly on infrastructure. Therefore, this has not translated into more effective service delivery. Nepal pursues a prudent fiscal policy, and its debt burden is moderate. For 2013, the World Bank notes a public-debt ratio of 31.9%. The ratio of debt service to revenue and grants declined from 10.3% in 2012 to 8.7% in 2013. Nepal runs a hefty import deficit, but finances it through remittances. The current accounts balance in 2013 stood at 6.9% of GDP, significantly up from 2.5 in 2011. Contributing positive factors were increases in remittance inflow and tourist numbers, prevailing against decreasing export growth and the rising price of imports as the NPR devalued. In 2013, official reserves were at 9.8 months of imports of goods and services at current levels, up from 6.8 months in 2012. The IMF/World Bank (2012) debt sustainability analysis therefore identifies Nepal as at only moderate risk of debt distress, but notes elevated risks due to liabilities connected to the losses of two state-owned enterprises (Nepal Oil Corporation and Nepal Electricity Authority losses amounted to 0.8% and 0.4% of GDP respectively in FY 2011 – 2012 alone), and potential need to intervene in the fragile financial sector. The government's challenge is to continue its prudent fiscal policy, while restructuring state-owned enterprises and the financial sector, and at the same time increase spending on infrastructure development to encourage domestic growth.

Macrostability  
7

## 9 | Private Property

Property rights and the regulation of property are defined by the 2007 interim constitution. Though the Maoists committed themselves to this constitution when leading the government from 2011 to 2014, they have nevertheless hesitated in restoring all the property (mostly land, they had confiscated during the insurgency). As part of the peace process begun in 2006, the Maoist agreed in principle to return all of it, and have done so in the majority of cases, but some land remains to be restored.

Property rights  
5

Insecure property rights are a particular problem for the poor, who often lack proper documentation for land titles, and are ill-equipped to maneuver through local courts and administration. Smallholders in the Terai region are often caught in a catch-22, whereby they require citizenship certificates to register their land properly (only Nepali citizens can own land), and land titles are among the most important supporting documents through which the local administration ascertains citizenship status. Among the poor, women find themselves at a particular disadvantage.

Even though legal provisions regarding property and inheritance have been equalized since 2006, women are often unable to make rightful claims in the face of continuing discrimination through prevailing social practice.

Private companies are constitutionally permitted and protected. Some restrictions apply to foreign ownership. Bureaucratic and legal hurdles an entrepreneur must overcome to incorporate and register a new firm are among the lowest in South Asia. Yet, the real problem for setting up a private commercial or industrial enterprise is not registration, but political and bureaucratic interferences in day-to-day business once a firm has begun to operate.

Private enterprise  
5

Many of the more than 80 public enterprises in diverse sectors were privatized in the 1990s. The process came under some critique, as many newly privatized companies soon found themselves in choppy waters. There were also allegations that privatization processes were not transparent, and that state assets were widely undervalued. Privatization of state-owned enterprises has been on hold since 2008. Right now, there are 36 public enterprises in Nepal, such as the Nepal Airlines Corporation (NAC) and the Hetauda Cement Industry Limited (HICL). Many have faced high cumulative losses and unfunded liabilities for years due to operational inefficiencies and other problems. Overall, most observers think public enterprises will be an increasing a burden on taxpayers and consumers because of their poor performance. However, further privatizations are blocked by opposition from interest groups, bureaucratic inefficiencies, the general lack of political stability, lack of political consensus and a weak domestic financial market. Given the current political standstill, it seems unlikely that there can be substantial changes in the near future.

## 10 | Welfare Regime

Nepal has virtually no welfare regime outside of social networks based on familial structures. In some cases, NGOs attempt to fill this gap, but they only provide locally specific, piecemeal services. This means that the social welfare options may vary greatly depending on area of residence and access to international donors.

Social safety nets  
2

Family support structures are strong, but increasingly weakened by widespread, long-term out-migration by young people, especially men. Although their financial remittances certainly help compensate for social risks, their physical absence often means that the elderly and other dependents are left on their own, or are reliant upon more distant relations

Private initiatives are isolated, and public social services are underdeveloped and insufficient, although access has been improved in recent years. Over the last decade, Nepal has seen tremendous growth in medical colleges and other institutions of medical education. However, these institutions concentrate mainly on urban centers,

and especially the Kathmandu Valley, while most rural Nepalese are still without healthcare.

Public expenditure on health (in percentage of GDP and government expenditure) are relatively high by South Asian standards but are still insufficient (as in almost all South Asian countries) and resource waste and inefficient use of finances remain huge problems.

Legally sanctioned social inequality on the basis of ethnicity, caste and gender was a defining feature of the Nepali state until very recently. While discrimination on the basis of caste was in principle outlawed in the 1960s, in practice it remains a defining feature of life for many Nepali citizens.

Laws that discriminate on the basis of gender have remained on the books until much more recently, with laws enabling married women to inherit property and to pass citizenship on to their children coming into force only in 2006. Implementation of these new provisions is still erratic at best. Many of Nepal's recent episodes of political contention have been driven by social mobilizations that place the rectification of such inequalities at the top of their agenda. People from certain ethnic, caste, and regional backgrounds, and especially women, routinely experience discrimination in public life and are excluded from accessing resources and positions of power. Social and economic caste-based discrimination was an important underlying cause for the rise of the Maoist insurgency in the 1990s, as is evident from the participation of a large number of marginalized people in the upheaval.

Since 2006, a range of measures designed to improve this situation have begun to take effect, although their implementation and impact is still limited. These include the establishment of proportional representation guidelines for the Constituent Assembly elections, which, although controversial in their details, established a mechanism for ensuring significant diversity in elected office; and the 2007 second amendment to the Civil Service Act, which established, for the first time, affirmative action provisions for the civil service, including the police, provisions that aim to increase the representation of women, indigenous nationalities, Madhesis, Dalits, disabled people and people from "backward" regions. However, for example, 2010 data show that 72% of positions in the civil service were held by members of the Brahmin caste, who comprise only 12.74% of the country's population. In addition, over 40% of the NAF's ranks filled by soldiers and officers from the Chhetri caste (15.8% of the population). Moreover, the same traditional groups dominate the judiciary, the education system, the media, labor unions, and even NGOs.

Nepal's labor market provides highly unequal chances; approximately 70% of the workforce is employed in the informal sector (ILO), facing multiple challenges and constraints and left unprotected by basic social safety nets. Workers are subject to

Equal opportunity  
3

exploitation and deprived of many fundamental rights at work. In the past, Nepalese governments have turned a blind eye to abuses.

Recently, a labor law was drafted to address issues crucial to workers in the informal economy. Given the climate of political stagnation, there is little expectation this essential reform will be implemented.

According to official data from the Central Bureau of Statistics, 90.2% of men and 81.9% of women were employed in the formal and (mostly) informal sector in 2009. The agricultural sector accounts for 76% of employment, while 18% of the labor force are employed in the service sector and 6% in industry. According to the data on labor permits issued, men account for more than 95.1% of the registered labor migrants. But there are many more men and women working in India's private sector, mostly in manual labor jobs in industry, construction work, agriculture, or the service sector. Their wages tend to be low and the work is often dirty, dangerous and even degrading. While reliable data are missing, some 100,000 to 150,000 Nepali women are estimated to be employed in the sex industry across India.

## 11 | Economic Performance

Nepal's economy is heavily dependent on agriculture and remittances. The latter continued to increase over the review period, contributing 22% to the national GDP in 2013. Overall, Nepal achieved disappointing economic growth of 3.6% in FY 2013, followed by strong growth of 5.2% in FY 2014. While political instability and historically low levels of activity in both the industrial and agricultural sectors, as well as a disappointing harvest in 2013, were the main reasons for the economic slowdown in 2013, a favorable monsoon and robust agricultural production, and growth in worker's remittances by more than 21% (now amounting to 28.2% of GDP), boosted growth in 2014. In contrast to agriculture (4.7%) and services (6.1%), growth in industry was only 2.7% in FY 2014 (ending mid-July 2014). Overall consumer price inflation reached 9.9% in FY 2013, as a consequence of the onset of the NRP's depreciation against the IRP and the dollar, and a surge in food prices and in imports of food items. Reliable unemployment figures are hard to come by. Official unemployment is relatively low, but underemployment is widespread. As mentioned before, the lack of employment opportunities continues to drive significant numbers of mostly young Nepalese abroad. Other macro-indicators show mixed developments. While foreign direct investment decreased slightly, from 0.5% of GDP in 2012 to 0.4% in 2013, tax revenue increased significantly, mainly due to successful reforms in revenue administration (IMF 2012). Nepal's trade balance continued to deteriorate in FY 2013, with adverse developments in both exports and imports, while significant delays in budget approval depressed public spending, which declined in real terms in FY 2013. However, as mentioned before, a strong inflow of remittances financed the country's massive trade deficit and helped to maintain a balance of payments surplus.

Output strength  
5

## 12 | Sustainability

With its unique geographical position and complex ecology, Nepal is one of the main countries to experience significant negative effects of climate change. In 2014 alone, the country suffered from three major weather-related disasters that damaged the tourism industry and national infrastructure. Many international observers, local media and foreign tourism agencies criticized the lack of preparation and rapid responses by the government to weather-related risks.

Economic growth in recent years has been achieved at high environmental cost and will probably lead to even greater environmental degradation, especially because of increasing air pollution and deepening problems of water sanitation and water resource management. In recent years, there have been calls from environmental experts for the implementation of measures protecting the wetlands, flora and fauna of the country. Corresponding government policies are still pending.

In 2014, Nepal had an Environmental Performance Index score of 37 (rank 139 out of 178), which placed it significantly above other South Asian countries (except Sri Lanka). Nepal's relatively better EPI performance in many ways reflects its dismal economic situation: Manufacturing continues to play a minor role in the national economy, and most electricity is generated in hydropower plants. However, for the last several decades, Nepal has also put in place a comprehensive set of environmental policies in close partnership with the international donor community. Efforts have been particularly successful in the areas of conservation/biodiversity and forestry. Large swaths of Nepal's forests are administered through community forest user groups, and the forest cover generally decreases at a very low rate. Large-scale deforestation still occurs, however, especially in the southern Terai belt.

The expansion of sustainable energy use has been less successful. The main energy source at the household level, outside of urban centers, is biomass (firewood). The government has drawn up plans to facilitate investments in the hydropower sector to alleviate the crippling power cuts during the dry season, but so far with little to show for it. Several donor agencies also assist with incipient plans to incentivize companies to invest in energy efficiency and sustainable energy sources.

Ambient air pollution is a major problem in Kathmandu. Particulate pollution is mainly driven by vehicle traffic, both in terms of combustion emissions and dust re-suspension, as well as by other forms of combustion, and industrial sources such as brick kilns within the valley. Long-term effects on public health have not yet been established with certainty, but experts assume they are severe.

Environmental  
policy  
5

While the basic adult literacy rate is estimated to have risen from 64% to 84% between 2011 and 2013, as a result of government campaigns, this is judged on very low standards and many of those considered “literate” are, in fact, functionally illiterate. The Ministry of Education launched a school sector reform program for 2009 – 2015 with an estimated budget of \$568 million. Despite better funding from the government, public schools saw their success rates drop by more than 20% from 2011 to 2013. Vocational education started in 2009/10 and continued through 2013/14. Gender equality, inclusiveness, capacity development, and new institutional arrangements are other aspects of the reform program. The results of the nationally conducted school-leaving certificate examinations in 2012 demonstrated the dismal state of the country’s educational system, as three-fourth of pupils in public schools who took the exams failed. Moreover, teachers and school personnel frequently complain about undue interference by officials in human resources affairs, curriculum development and financial matters.

Reforms in higher education are underway, but implementation has stalled. The central aspect of current reform efforts is to break up the centralized university system. However, underfunding remains a problem of the higher education sector as only about 10% of overall public spending is allocated to university education. Finally, overall national spending on research and development remains insignificant.

Education policy /  
R&D  
3

# Transformation Management

## I. Level of Difficulty

The Nepali political leadership faces significant structural constraints in achieving good-governance goals. Highly unfavorable conditions for economic and political transformation include a low level of economic and social development; a population with relatively low, though improving, educational attainment; the geographical disadvantages of a landlocked state; resource scarcity, and still-weak stateness. Nepal's environment is prone to the effects of natural disasters and man-made ecological devastation. The country's terrain is challenging to navigate, and, coupled with an overly centralized state machinery, it is often difficult for policymakers at the center to effectively assess citizen aspirations and needs. Widespread poverty, as well as uneven educational resources across the country, rapid urbanization and ongoing brain drain, as nearly a quarter of the country's workforce is employed outside of Nepal, deepen problems of "inadequate infrastructure, haphazard planning and poor business environment," according to a 2011 World Bank report.

Structural  
constraints  
9

Militancy and crime are widespread, despite the end of the Maoist insurgency. Most affected is the Tarai flatland along the southern border with India.

Nonetheless, the political leadership is also in large part responsible for the long, drawn-out nature of the political transition, which in itself has contributed to the current challenges by drawing attention away from much-needed infrastructural development agendas.

Nepal is one of the major recipients of official development assistance (ODA), and has a fairly large sector of international and national NGOs. Spaces for civic participation are manifold in Nepal, and have improved in recent decades, contributing to the emergence of indigenous civil-society movements. Many forms of engagement observed may not match conventional definitions of civil society, in the sense that they are often grounded in very specific local or ethnic affiliations, rather than articulated in highly visible forms at the national level. However, the number and range of civil-society organizations operating even in the most remote and impoverished areas of the country are astounding. The challenge for these groups, however, is to articulate their agendas with national organizations and political actors to achieve sustained change in concert with the aspirations of multiple constituencies. Broad-reaching alliances between a range of different interest groups were key to the successes of both the 1990 and 2006 anti-regime mass movements.

Civil society  
traditions  
7

Public perceptions of polarization and cleavage along ethnic and regional lines have grown over the last several years, exacerbated by scaremongering in many national media outlets, whereas actual instances of violent conflict have decreased. Yet, there were still political assassinations and IED attacks by militant groups, as well as violent clashes between ethnic Kirati activists and the police in 2013. Since then, however, at least three groups (JTMM-S, Terai Samyukta Jankranti Party, and Madhes Rastra Janatantrik Party) surrendered their weapons, and several others participated in peace talks.

Nonetheless, many tensions run only slightly below the surface, and the society and the political elite are deeply split into social classes and ethnic or religious communities. Confrontations between cadres of different political parties, as well as between members of different social groups mobilized around identity-based platforms, run the risk of erupting into outright conflict if these groups perceive that their interests are inadequately addressed.

Conflict intensity  
6

## II. Management Performance

### 14 | Steering Capability

Though the structural constraints on governance are high, the political leadership's low steering capability is another important cause of Nepal's current crisis. In general, policymaking plays a relatively minor role in Nepal's politics. The heterogeneous character of multiparty coalition governments before 2004, between 2006 and 2012, and again since January 2014 make it extremely difficult even for determined policymakers to set strategic priorities. Important policy decisions are frequently subject to fierce distributional battles between different ministries, either at the political or even the upper administrative level.

While the main priority of the new coalition government of Prime Minister Koirala (NC, since January 2014) and the newly elected CA is on drafting a new constitution, the focus on constitutional politics overshadows other urgent policy needs. Given the fragmented and factionalized party system, prime ministers (both Maoist and NC-based) are occupied with short-term challenges of political bargaining, which leaves little political space for the prioritization and organization of policy measures. Moreover, the segmentation of the cabinet along party lines contributes to little coordination between different ministries and weak prime ministerial leadership and control over line ministries. In addition, there are no regulatory impact assessments, nor is there a strategic planning unit, which contributes to a very low strategic capacity of the government to prioritize and organize its policy measures. Finally, the

Question  
Score

Prioritization  
3

ongoing political struggle over the future character of the Nepali state contributes to a standstill regarding any administrative reforms. One notable exception is the Koirala government's successful foreign policy prioritization on improving diplomatic and economic ties with both China and India.

With regard to the steering capabilities of Nepal's governments, the crucial bottleneck lies less in the drafting of good policies than in their implementation. Thus, successive governments have, over the last decades, instituted countless industrial growth, investment and trade promotion policies, often with substantial and systematic donor input, and very little effect on the ground.

Different governments' capabilities to implement reform policies effectively have been weak, partly because of confrontational tactics, and the lack of clear strategic priorities. This is most obvious regarding the failure of all three prime ministers who were in office during the review period to successfully conclude the constitution-making process. While the Maoist government of Prime Minister Bhattarai (August 2011 to March 2013) achieved limited success in strengthening Nepal's investment climate, concluding the BIPPA with India, mentioned above, and in negotiating several Indian and Chinese investments for large hydropower projects, the government presented an inflated budget that aimed at raising expenditure by 45% in a single year. Moreover, the government lacked concrete plans for improving development projects' poor implementation capacity.

On the other hand, the interim government of Acting Prime Minister Regmi (March 2013 to February 2014) was at least able to organize and conduct national elections for the CA in November 2013. It remains to be seen if the current coalition government of Prime Minister Koirala will be able to implement some of its (often contradictory) policies. The fact that the NC is back in office may help as the extreme partisanship of Nepalese officials exacerbated problems of implementation, especially during the period of the Maoist-led government. Even though the NC and other opposition parties could not prevent the formation of a Maoist-led government in 2011, they have done everything possible to derail Maoist enthusiasm for reform politics.

Ultimately, Nepal's patronage system militates against the changes in governance necessary to improve the investment climate. For example, the Nepal Investment Board ran into instant trouble with several ministries when it attempted to establish a one-stop shop for hydropower investments.

Regarding innovation in policymaking and implementation of drafted policies, the record of three different governments, as well as that of the opposition parties, was mixed during the review period. Learning from past experiences did not seem to happen: Nepal's political elite by and large supports the perpetuation of traditional social cleavages, ensuring their grip on power. The political force that has shown

Implementation  
3

Policy learning  
3

itself to be the most flexible in the recent past is the Maoists, with mixed results. Notably, the former rebels have adapted to mainstream politics, including the system's dysfunctional patronage-based aspects, while continuing to pursue some, if not all, of their progressive policies. Moreover, in 2014, the Maoists dropped the concept of "people's war" and included the more moderately framed aim of "people's revolt" into their party manifesto. In addition, both NC and Maoist parties have shown some willingness to compromise regarding the contentious issue of integration of former Maoist insurgents into the NAF, dropping maximalist demands and taking a more pragmatic approach.

On the one hand, both the CPN-UML and NC were deeply shocked by the 2008 election results. As a reaction to the formation of a Maoist government in 2011, which relegated the NC to opposition status, the NC especially showed some indication of understanding that its own failures and non-inclusive politics were the main reasons for these developments. While the CPN-UML is gradually starting a process of internal reform, and also participates in the government, the NC remains a conservative-minded clique of Bahuns centered on the extended Koirala family. Beyond the "high politics" of peace negotiations and constitutional reform, the bureaucracy and the political leadership have shown little willingness (or ability) to learn from past errors. In daily politics, the routines of policy-making have failed to enable innovative approaches to the manifold problems of social and economic development in this country. The primary example for the lack of political and policy learning is the blocked constitutional process.

Nepal's political leaders seem to employ the strategy that flexibility guarantees political resilience. But flexibility does not necessarily lead to innovation. As new political players with change agendas were incorporated into patronage politics, new struggles over distribution occurred. Fundamental changes to the rules of the game dropped out of sight.

## 15 | Resource Efficiency

Neither the Maoist-led government from 2011 to 2013, nor the interim government of Prime Minister Regmi (2013 - 2014) or the Koirala government (since 2013) efficiently used available economic and human resources for their economic and social policies. Often, resources intended for development vanished due to corruption. Greater problems are related to shortages of electrical power against a background of steadily growing demand. Another pressing problem is the inveterate job shortage, which has forced hundreds of thousands of young Nepalese to migrate to India, the Gulf region, Malaysia and eastern Asia in search of employment. Job-creating policies are de-facto nonexistent, leading to a drain-off of Nepal's human capital.

Efficient use of  
assets

3

Development aid from India, China and the West plays an important role in Nepal's budget. However, monitoring of these funds remained insufficient. While Nepal's administrative and civil services remained severely underfunded and also understaffed, other major problems of Nepal's administration are fragmented decision-making processes, and the opaque and politicized system of transfers and promotions. While public revenues continued to increase in 2013/14 (as mentioned before), problems of timely spending also increased and contributed to serious delays and waste of resources.

While the heterogeneous nature of the current party government is one important reason for its failure to coordinate between conflicting interests and policy objectives, the need for all major political parties to deliver on promises to their competing constituencies and supporters is another. While the Maoist-led government in power (2011 - 2013) had often implemented Maoist policies without consulting its coalition partners, the NC, as the main opposition party, preferred to boycott the work of the Constituent Assembly if this was likely to prevent the government's reforms. The current multiparty government under Prime Minister Koirala (NC) consists of 10 ministers from the CPN-UML, 11 from the Nepali Congress, one from the CPN (ML), and six from the RPP and other parties or nonpartisan experts. These parties remain deeply divided over fundamental policies, and, hence, there is little political space for effective policy coordination. Rather, policy decisions are frequently held hostage to demands for changes in government leadership, or other short-term political gains.

Policy  
coordination  
2

The misappropriation of public resources and other forms of corruption are endemic in Nepal (see "prosecution of office abuse"). Rules and regulations to ensure transparency exist but are enforced poorly. Anticorruption agencies lack the political or administrative support necessary for working effectively. The most important among them, the Commission for the Investigation of Abuse of Authority (CIAA), has not had a Commissioner for eight years.

Anti-corruption  
policy  
3

There has been some additional regulatory progress over the last years. For example, a Right to Information Act was passed in 2009. Other steps, such as laws to govern political party financing, might help. Ultimately, however, the best regulation will matter little as long as there are no agencies strong enough to enforce them. For example, regulations exist to compel political parties to declare their income, and parliamentarians to declare their sources of income and assets. Both regulations are outright ignored or subverted in the vast majority of cases.

The appointment of a controversial politician and businessman as the head of the Commission for the Investigation of Abuse of Authority (the country's main anti-corruption agency) in 2013 was seen by many NGOs, the media, and international as

well as academic observers as a sign of the lack of enthusiasm and political will for serious attempts in containing corruption among Nepal's political class.

Corruption among government officials with regard to the distribution of permits and approvals, the procurement of goods and services, and the award of contracts presents significant obstacles to doing business. The situation is further complicated by the fact that government services are in scarce supply outside the capital. Most of the countryside lacks basic public services or local offices. Bribes are often the only way to get access to public services, or to accomplish even ordinary activities.

## 16 | Consensus-Building

On the one hand, there is a broad consensus among most political parties, including mainstream Maoist parties, about the transformation towards democracy as a strategic, long-term goal. The two main ruling parties – the Nepali Congress and the Communist Party of Nepal–Unified Marxist–Leninist (CPN–UML) – are pro-democracy. On the other hand, various agreements on future institutional arrangements and on issues of economic and social transformation have been called into question as a result of power struggles between the different parties and their leaders. Moreover, support for democracy is conditional among the CPN (Maoist), Madhese-based parties, and the royalist Rastriya Prajatantra Party–Nepal (RPP–N). Some other fringe parties remain outside the ongoing deliberations inside the CA. Due to the ongoing political crisis, the conservative-royalist RPP–N finished the 2013 elections as the fourth-largest party. The party demands that Nepal be once again declared a Hindu state and is the only party that advocates a return to the pre-2008 monarchy. While not openly anti-democratic, this indicates a split regarding the basic type of state and the character of Nepal as a multi-religious nation and a secular state. Furthermore, all along the political spectrum, there is still a strong tendency for politics to be played out in the streets rather than through institutional mechanisms. Nonetheless, in many areas of the country, the last several years have seen a significant shift in the scope of social mobilization, with new spaces opening up for previously marginalized individuals to participate in associational life.

With the de facto acceptance of multiparty democracy by the Maoists CPN–UML, there is also general consensus that essentially capitalist economic growth is the best way to safeguard the achievements of the 2006 people's movement, and ensure Nepal's sovereignty. At the same time, the Maoists' official ideology still espouses a socialist revolution as their final goal. Still, it is difficult to ignore the argument that the Maoist leadership will be unable to formulate a coherent market economic growth policy as long as it retains the explicit goal of achieving a socialist revolution, and as long as this line has a strong following within the party base. The fact that the CPN–Maoist dropped "people's war" from its charter and toned down its anti-Indian rhetoric is a promising sign but needs to be supplemented by concrete political action.

Consensus on goals

6

However, it is not only the various Maoist parties that have proclaimed consensus on the goal of market economic transformation without corresponding actions. The same is true for other parties, such as the Congress, which seems either unwilling or unable to develop coherent policies of economic transformation that would match its political rhetoric.

Despite the constitutional standstill since 2010, the political confusion in recent years, and ongoing debates about the concretization of institutional reforms (presidential vs. a semi-presidential form of governance; the specific type of federalism), the major political parties share a basic pro-democratic consensus. While in government, neither Maoists nor the Nepali Congress can completely control all powerful semi-democratic actors or agents with de facto veto power at the local level. Nevertheless, they can limit their influence significantly.

Anti-democratic  
actors

6

On the one hand, the 18 months that followed the November 2013 elections were (again) disappointing in many respects, as the old power struggles between political leaders started once again and the constitutional assembly remained unable to draft a constitution. On the other hand, the fact that all relevant political parties are participating in the constitutional process means that potential anti-democratic spoilers remain integrated in the processes of peace-building and democratization. Similarly, several multiparty coalition governments have failed to improve resource efficiency and exhibited a low steering capability. At the same time, the inclusion of various Maoists groups and non-Maoist forces in the coalition government (since 2014) demonstrates a degree of political flexibility among the political elites that is urgently needed to keep the peace process going and to prevent a collapse of (highly) defective democracy. While this form of flexibility remains a major obstacle to the full establishment of the rule of law, and rational, transparent forms of governance, it is at the root of the state's ability to integrate or contain antidemocratic actors.

Finally, despite some worries about a possible military coup d'état in 2012/13, the Nepal Army has refrained from overt political engagement in recent years. Its priority during the postwar years was to protect its institutional autonomy, and it appears content having achieved this goal. In addition, the army is highly dependent on India, which similarly has made clear that it will suffer no infringements on the NAF's autonomy, but otherwise does not wish it to play a larger role in politics.

The former royal family appears far too discredited for a comeback. Popular frustration with multiparty democracy is high, particularly since the lapse of the CA; conservative parties may well see a significant increase in their vote shares on platforms stressing a return to Hindu values, and defending Nepal's old style of culturally homogenous nationalism. However, these parties have either distanced themselves explicitly from a revival of constitutional monarchy, or grown suspiciously quiet about it

In Nepal, there are some 125 ethnic groups, 127 spoken languages, scores of castes and three distinct ecosystems that have long divided its 27 million people into feuding communities, making political consensus and conflict management extremely difficult.

Cleavage /  
conflict  
management  
6

The political leadership's record of conflict-management has been mixed in the last two years. On the one hand, the relevant political parties and elites have done little to counteract the growing polarization of the political sphere along ethnic lines. In addition, identity-based cleavages increasingly find expression in the party landscape, as demonstrated by the results of the 2013 elections. On the other hand, political leaders from various parties and political camps to some extent successfully prevented cleavage-based conflicts from further escalating. The formation of Madhesi parties and Janajati parties since the late 2000s, and their ability to establish themselves as new political forces in the 2008 and 2013 CA elections, forced the established mainstream political parties (including the larger Maoist parties) to accept these parties as a regular and relevant part of the political spectrum. Following both the 2008 and the 2013 elections, Madhesi leaders have been well-represented in coalition governments. This has helped calm the mood among Madhesi activists. In addition, Janajati parties also seem to have become a more or less well-accepted part of the political landscape.

Parts of civil society have also aligned themselves along emerging identity-based fault lines. Some social movements, civic associations and non-governmental organizations are accepted as more legitimate than others, but most maintain explicit political allegiances. It is rare to find organizations attracting membership across party lines, and therefore few organizations are accepted as equally legitimate by all relevant actors. In addition, many ethnic and regional identity-based groups perceive the political parties (and therefore the structures of governance that they operate) as seeking to keep power in the hands of long-dominant upper caste Hindus, and therefore not fully representative of citizens at large.

While identity-based tensions may occupy the foreground in the public debate, it is also important not to forget the class tensions that both drive and crosscut them. Support for the Maoists during the civil war depended on a complicated mix of ethnic sentiments, local political alignments and class consciousness, and the latter played a role at least as central as the others. And despite the successful holding of the 2013 election and the formation of a new government, Nepali politics and society remain deeply divided.

With mass mobilizations in 1960, 1990 and 2006, a tradition of civil resistance and nonviolent mass mobilization has built up, which can rightly be considered civil-society participation. Tellingly, however, this participation took the form of street politics, which is to a large extent a reflection of the insufficient openness of the political system for civil society and popular access to institutionalized politics.

Civil society  
participation  
5

There have been signs of increasing political activism among non-governmental organizations and civil-society groups since the return to legitimate democratic institutions in 2008, which has continued in the last two years.

In the realms of women's rights, and rights for ethnic, language and cultural minority groups, civil organizations have intensified efforts to advocate reforms. But the struggle to improve the representation of women's interests and those of ethnic and religious minorities is still an uphill battle, as the dominant upper-caste elite refuses to allow the equal participation of all social groups. Madhesi and ethnic organizations forced a number of concessions from the dominant state elite in recent years and especially from the Maoist-led government in 2011/12, but for the most part these have not been implemented by the Maoist government or succeeding cabinets since 2013.

Some of Nepal's most pressing policy debates are being held in the broader sphere of civil society. This is particularly true of questions around federalism and measures aimed at identity-based inclusion. Here, civil-society organizations advocating for lower caste, ethnic and regionalist concerns were crucial in pushing these concerns onto the political agenda.

However, except when resorting to strikes and demonstrations that severely affect public life, interest groups and civil-society groups' impact on public policies remains limited. Moreover, many civil-society organizations, including human-rights organizations and labor unions, are informally but closely associated with political parties. In addition, many civil-society organizations are highly dependent on donor funding. While this funding can provide much-needed support for progressive projects, it also skews agendas as civil-society activists work to realign their work with donors' funding priorities.

There is consensus across the political board to prevent the prosecution of wartime crimes in any systematic manner. For example, some Maoist leaders could be prosecuted for chain of command responsibility (as is the case for many Nepal Army generals). However, the Maoist-led government, in 2013, passed legislation that sought to grant amnesty to those responsible for major human-rights violations. While the Supreme Court rejected the provisions in a January 2014 ruling and issued arrest warrants over several cases of rights abuses during the war, there have been no prosecutions so far and it seems extremely unlikely that the Koirala government will start to change this policy. Rather, some of the worst atrocities by state security forces

Reconciliation  
3

took place under Nepali Congress and UML government leadership. Instead, Nepal's political leaders press for token reconciliation efforts and blanket amnesties for perpetrators; there is no discussion of investigations into command and administrative responsibilities.

In 2014, the Koirala government set up a Truth and Reconciliation Commission and a Commission on the Disappeared to look into possible war crimes during the conflict between Maoist guerrillas and the state that had cost more than 16,000 lives. However, under the proposed (and controversial) Truth and Reconciliation Bill, persons found during hearings by the commissions to be guilty of war crimes and serious human-rights violations could receive a pardon (except rapists).

## 17 | International Cooperation

Nepal has a long history of working with international partners. Although this partnership has yielded good results, especially in the areas of education, health, drinking water, telecommunications, road construction and power generation, there is still a need to improve coordination and harmonize aid and debt relief to increase efficiency and effectiveness.

Donor agencies and international financial institutions exert significant influence on Nepali policymaking, as do their diplomatic counterparts. The role of such actors in shaping Nepal's peace process and political transition has been controversial. During the conflict years, many donors were unable to efficiently retask funds to avoid appropriation by violent actors (both state and insurgent), and in the post-conflict years they have refigured much of their engagement in terms of good governance, peace-building support, and technical support to the Electoral Commission and Constituent Assembly. Such assistance has often been proffered in an ad-hoc manner, driven by strategic priorities emerging from these organizations' home offices, rather than by conditions on the ground in Nepal – but the Nepali state has been happy to accept whatever is on offer, rather than seeking to align development support with well-articulated priorities of its own. Some critics have suggested that donors should withhold aid in order to compel better performance from Nepali political actors, but a more accurate reading of the scenario would locate the international community itself as complicit in creating the conditions that have led to the current state of affairs.

Both before and after the 2006 revolt, Nepali governments would cooperate with international donors and agencies. The same is true for periods of Maoist, NC-led or interim governments. However, the Maoist government (2011 - 2013) may have put more emphasis on improving cooperation with China and increasing economic support from Beijing (the PRC continued to increase its support and, for example, increased budgetary assistance to Nepal), partly because of the latent anti-Indian

Effective use of support

6

sentiments and skepticism regarding Indian policies vis-à-vis Nepal. However, the interim government of Chief Justice-cum-Prime Minister Regmi and the NC-led government of Prime Minister Koirala applied a more balanced foreign policy approach, which aimed to use bilateral assistance from both Beijing and New Delhi.

In general, several Nepali governments have tried to present the country as a reliable partner. Recent bilateral agreements with India (some negotiated during the term of the Maoist government from 2011 to 2013) and China, as well as the holding of the 2014 SAARC summit in Kathmandu (organized by the caretaker government and hosted by the NC government of Prime Minister Koirala) demonstrate that this has been relatively successful.

Governments in New Delhi and Beijing both supported the 2013 election. However, the government in Beijing may see its interests threatened by the growing demand for ethnicity-based federalism in Nepal and continues to pressure the Nepali government to adopt a tough stance toward the Tibetan exile community. On the other hand, Nepal remains a hub of anti-Indian activities of various sorts, creating latent friction in Nepali-Indian relations.

In recent years, Western governments (U.S., UK, EU) have become increasingly disillusioned by continued selfish politics pursued by all parties and their leaders. The constitutional assembly's failure to produce a constitution dismayed many of the country's most important foreign partners and donors, including India, the U.S. and European Union. Accordingly, some local and international critics have suggested that donors should withhold aid in order to compel better performance from Nepali political actors.

The Kingdom of Nepal has only two neighboring states: India and the People's Republic of China. Historically, the relationship with India has been stronger, but the Maoist leadership has made new overtures to China in very recent years. Nepal has improved its relations with both in recent years. Nepal hosted the 2014 SAARC summit, the first such meeting since 2011. The summit itself, however, produced little by way of substantial results, except for the conclusion of a joint agreement on electricity. In 2014, newly elected Indian Prime Minister Modi visited Nepal, the first Indian prime minister in 17 years to make a state visit there.

Hydropower resources comprise the most significant axis of trans-regional cooperation, as well as contestation. China has increasingly funded hydropower projects, along with associated road construction, while India seeks to access hydropower produced by Nepal for purchase. Nepal contributes migrant labor to both countries, especially India, which remains the most popular site for Nepali workers even as new routes to the Middle East and beyond open up. The 1950 Indo-Nepal Friendship Treaty enables such mobility since it mandates an open border, but it also engenders disputes between the two countries over citizenship and security. The Sino-Nepali border is more rigorously policed by both sides, and China carefully watches Nepal's response to Tibetan activities within its borders.

Credibility

6

Regional  
cooperation

7

## Strategic Outlook

As in previous years, one of the main priorities for the CA and the government for the near future must be to bring the constitutional process to a successful conclusion. This especially requires a consensus on the basic structure of the state that is a compromise between a federalist state model based on an ethnic administration model, advocated by the two major ruling parties (NC, UML), and the district-based, non-ethnic system. Other major political challenges include the integration of newly emerging minority parties, the strengthening of state capacity, and the development of a sustainable approach to reconciliation and transitional justice. Moreover, the ability to manage conflict and cleavages needs to be improved, especially with regard to the newly emerging transnational proletariat that is spread across Nepal, India, the Gulf and Malaysia and has concerns distinct from the traditionally poor—and whose interests remain ignored by all major political forces. In addition, organized labor unions feel their interests have been sacrificed to appease business, not only by non-Maoist governments, but also by the Maoist themselves. In addition, the rapidly expanding middle classes have not found an outlet for political articulation of their interests except social media and sporadic street protests. The marginalized groups feel that, despite investing so much energy in social movements, and faith in the CA, the traditionally dominant groups consolidated and conspired to deprive them of their rights. The traditionally dominant can see their powers and privileges slipping away, and feel unfairly victimized. There has not even been a token decision on land reform and agriculture modernization, leaving the landless and marginal farmers dissatisfied. Labor militancy and infrastructure gaps have left the business community in a more dismal state than five years ago. Reconciliation law left those who have borne the brunt of atrocities aggrieved about the lack of justice. However, given the questionable ability of the political leadership and the fragile and polarized party system, it remains uncertain if that can be accomplished in the near-to-midterm future.

As the political process moves forward, politicians and policymakers should work with the public administration and the international development community to attend to the country's fragile economic situation. The business community should work with state regulators to shelter strategic long-term growth sectors, such as hydropower, from political interference, protecting and encouraging investment. New forms of public-private partnership should be considered that support both state and community initiatives, with donors and NGOs working in concert with the state whenever possible. Through this framework, creative mechanisms might be proposed to channel remittance inflow into civic organizations and long-term initiatives for broad-based development at village, district and national levels. In all of these processes, both the state and the international donors that support it should be consistent in their engagement with local actors, improving transparency and monitoring of implementation and impact over time.