

# Nepal

<b>Status Index</b> (Democracy: 3.70 / Market economy: 5.39)		<b>4.55</b>	<b>Management Index</b>		<b>4.16</b>
<b>HDI</b>	0.526		<b>Population</b>	26.1 Mio.	
<b>GDP p. c. (\$, PPP)</b>	1,420		<b>Population growth<sup>1</sup></b>	2.3%	
<b>Unemployment rate</b>	n/a		<b>Women in Parliament</b>	6.4%	
<b>UN-Education Index</b>	0.53		<b>Poverty<sup>2</sup></b>	37.7%	
			<b>Gini-Index</b>	36.7	
Source: UNDP: Human Development Report 2005. Figures for 2003 – if not indicated otherwise. <sup>1</sup> Annual growth between 1975 and 2003. <sup>2</sup> Population living below \$ 1 (1990-2003).					

## A. Executive summary

This report will show the Kingdom of Nepal has suffered from setbacks in political and economic transformation in the time span studied. The roots of political crisis in Nepal reach back to the 1990s. The current crisis began in June 2001, when King Birendra and most of the royal family were massacred. Nepalese democracy, which had existed since 1990, fell into complete disarray. King Gyanendra ended the country's 15-year experiment with democracy and took power in a royal coup d'état on October 4, 2002, and, again on February 1, 2005.

In the aftermath, Nepal's economic system declined. Tourism, the backbone of the economy, has suffered most from the ongoing political and security crisis. This has deepened the problems of market economic and social development in the land-locked Himalaya Kingdom.

The negative consequences of the political crisis, such as the suspension of basic democratic institutions and rights and the worsening security situation, have worsened in the past five years. The institutional structures of a market economy remain in tact only those areas still under government control. Economic growth is unstable and government policies are under constant threat from the protracted insurgency. The education and research system is insufficient. Property rights are threatened by Maoist insurgents and the general lack of law and order. Levels of political violence and extremism are extremely high. Other deficits of democratic transformation include: a weak rule of law, corruption, an unconsolidated system of political parties, ineffective government, and, insufficient degree of consensus-building. Problems of economic and democratic transformation are rooted in massive structural constraints on governance. However, management failures of the political elite have contributed to the crisis as well. Accordingly, this report on the status of

transformation to democracy and a market economy in Nepal during the past five years (2001-2005) concludes that Nepal has definitely lost ground on the path toward these goals. The Kingdom clearly stands out as an example of failed political and economic transformation in Asia and Oceania.

## **B. History and characteristics of transformation**

The modern Nepali state was created in 1768 by conquest. In the post-unification period, Nepali court politics was characterized by weak personal rule and acute political instability. The queens and kings and their courtiers engaged in conspiracy, murder and killings, which led to the rise of Jang Bahadur Rana in a bloody massacre known as Kot Parba in 1846. The rise of Jang established the family oligarchy for 104 years until it was challenged by the anti-Rana armed movement led by the Nepali Congress Party. The movement was also supported by King Tribhuvan, who was pushed into the background by the Rana rulers.

This movement was terminated after a compromise was reached in Delhi (India) between the Congress, the king and the Ranas with the mediation of the Government of India. The Delhi compromise guaranteed a multiparty system, fundamental rights and a democratic constitution. However, the compromise spirit did not last long as the Ranas, political leaders and the king following divergent paths. The king started asserting his power at the cost of democracy. The Constitution of 1950 became a royal gift that reserved sovereign power for the king. The first attempt at parliamentary governance ended with the intervention of the king through a military-backed coup on December 15, 1960. The so-called panchayat system was introduced the same year. That council-oriented system was intended to give the king's absolute rule an air of democracy. However, at its core, it meant royal rule by the king himself. After three decades of royal autocracy, the democratic transformation began in early 1990 with a people's movement that brought down the panchayat system within just two months. The constitution introduced on November 9, 1990, converted Nepal to a constitutional monarchy and established a multiparty democracy with a bicameral legislature, an independent judiciary and a catalog of fundamental human rights.

The Nepali Congress won the first free parliamentary elections in May 1991, taking an absolute majority of the seats in parliament. The Communist Party of Nepal (Unified Marxist-Leninist), or CPN (UML), founded when two communist splinter groups joined forces in early 1991, established itself as the second force. The third strongest party was a loose alliance of extreme leftist, Maoist-oriented parties known as the Samyukta Jana Morcha Nepal (SJMN) or United People's Front Nepal. The conservative forces of the former panchayat system formed two parties with the same

name, Rastriya Prajatantra Party (RPP) or National Democratic Party. The parties differed only in their respective leaders, Lokendra Bahadur Chand and Surya Bahadur Thapa.

The NC government under Prime Minister Girija Prasad Koirala collapsed in mid-1994 due to dissent within the party. In the next elections, held ahead of schedule in November 1994, no party won an absolute majority. This led to chaotic conditions in the following years, with frequent changes of government. The elections of May 1999 once again gave the NC an absolute majority in parliament, but longstanding rifts within the NC made the pursuit of stable and constructive policies impossible. Three NC governments under different prime ministers failed within as many years.

The Maoist rebellion, which erupted in February 1996 in a few mountainous districts of west-central Nepal, caused more and more problems for the Nepalese government. Its instigators were radical forces that had been active in Parliament as part of the SJMN in the early 1990s, but went underground in 1995 to establish the CPN (Maoist). When the government did not respond to the insurgents' demands, the Maoists began a "people's war", targeting security forces, government facilities and those they saw as "enemies of the people". The movement increasingly found support among the impoverished and largely disadvantaged masses of the rural population. For them, the country's formal conversion to democracy had brought mounting frustration with the unbridled power politics, nepotism and corruption of the established party leaders. Within a few years, the Maoist movement spread throughout the country. At the same time, the violent encounters between Maoists and security forces grew more and more brutal on both sides.

A brief cease fire and dialog after the massacre of the royal family on June 1, 2001, ended in November 2001 with a renewed escalation of violence. The Deuba government declared a state of emergency. This, however, did not suffice to quell the insurgency. In May 2002, when it became evident that the conflict could not be solved militarily, members of Parliament from all parties showed reluctance to prolong the state of emergency. Therefore, on the recommendation of Prime Minister Deuba, King Gyanendra dissolved Parliament, set new elections for November 13 and issued a decree extending the state of emergency for three months. When it became clear that parliamentary elections could not be held as scheduled due to the continuing Maoist rebellion and the resulting lack of security, Deuba and the leaders of other parties agreed to ask the king, under Article 127 of the constitution, to postpone the elections and form a government with representation from all parties. King Gyanendra seized this opportunity to stage a coup. Accusing Prime Minister Deuba of failure to carry out his duties, the king claimed sovereignty and assumed executive authority. He disbanded the Deuba cabinet, postponed parliamentary

elections indefinitely and appointed a new government made up largely of technocrats and dissident members of major parties, but not the party leaders.

In May 2004, King Gyanendra re-installed Sher Bahadur Deuba as Prime Minister. Disappointed by the lack of success in fighting the Maoist insurgents, the king again declared a state of emergency and with the assistance of the Royal Nepal Army (RNA), seized power on February 1, 2005. The king dismissed government, detained opposition leaders and leading non-governmental organization (NGO) activists, and appointed a crisis cabinet that reports directly to him.

## **C. Assessment**

### **1. Democracy**

Democratic transformation in Nepal has suffered serious setbacks during the review period. Politically, Nepal is now at a deadlock, and has no road map for the future. The three political forces – the parliamentary parties, the monarchy and the Maoists – have failed to reach a consensus that would set any peace agenda for the country. Governance in Nepal suffers a great deal due to the pervasive influence of traditional political culture and orientation of major forces. Feudalist and authoritarian trends haunt the leaders of political parties, making them weak and submissive before the traditional monarchy. Both the agenda of the constitutional monarchy and the demands of popular sovereignty are rendered ineffective by the infighting between the country's three major political forces.

The king, who seems to be quite uneasy with the prospect of democracy, has further stymied prospects for reform by imposing a state of emergency. As of March 2005, all political parties – including the underground Maoists – are opposed to the king's direct rule. While parliamentary parties are demanding either the restoration of parliament or the holding elections so that the reform agendas may progress, the Maoists want a constituent assembly and an end to the monarchy.

#### **1.1. Stateness**

Nepal has been experiencing a multidimensional crisis of stateness for several years. The nature of its stateness is contested because the state is linked with the religion, language and culture of the upper Hindu castes, especially the Brahmans (Bahun), who dominate the government elite. The constitution is in part contradictory: Article

11 stresses the fundamental equality of all citizens, regardless of religion, race, gender or other characteristics, but citizenship depends solely on the nationality of a person's father. Women have only limited rights. People of Indian birth or ancestry living in the Tarai region, bordering India, are often denied citizenship even after generations of living in Nepal. Members of the numerous ethnic groups and the so-called untouchable Hindu castes experience manifold discrimination.

The political process is only formally secularized. The administrative system is weak, riddled with corruption and urgently in need of reform. Due to of the many years of Maoist rebellion, there is no state monopoly on the use of force. Civil war has eroded public safety and law and order, and even the increasing involvement of the Royal Nepalese Army (RNA) in the counterinsurgency has been unable to restore them. Working administrative structures exist only in those parts of the country still under control of the government. Even there, the state infrastructure is too weak to provide a sound administrative fundament for political, social and economic development.

## **1.2. Political participation**

Until 1999, universal suffrage, the right to campaign for public office and properly conducted elections were the rule. Since 1991, however, obstructions and minor irregularities have increased progressively. Whichever government was in office often attempted to gain advantages from its position; this became especially evident in the local elections of 1992 and 1997. Since the king has overtaken political power in 2002, no democratic elections have been held at the national level and the political rulers are not determined in democratic elections.

The RNA, always loyal to the king, has become an increasingly important source of power as the Maoist uprising has escalated, and especially since the king directly seized power on October 4, 2002 and again on February 1, 2005. The state media is subject to government influence, while some of the private media is partisan in nature. Since 1990, political and civil society organizations have been able to assemble freely, but this was restricted by the state of emergency declared in November 2001 and February 2005. Currently, freedoms of association and of assembly are not assured. Civil society organizations can act only under the double constraint of fearing government repression if they are too outspokenly critical of state and Maoist political violence if they are determined to be "enemies of the people".

### **1.3. Rule of law**

The 1990 constitution prescribes the separation of powers. Under the constitution, the king has only formal status as part of the executive and legislative branches, and lacks any direct decision-making authority in either area. At present, the constitution is no longer in force and constitutional checks and balances exist only on paper.

The judiciary is independent in principle, but the Supreme Court has occasionally issued politically influenced decisions. Most recently, the government and the security forces have repeatedly disregarded judicial directives. Even before the king's seizure of power, the rule of law in Nepal was tenuous due to pervasive authoritarian characteristics of monarchy and other political actors. Judges seem to be guided by the intent of the king, not by the rules and regulations made for administering justice.

Rampant political and bureaucratic corruption counts as one of the main reasons for the difficult political situation. The first serious attempts to combat corruption came in the middle of 2002, when even former cabinet ministers and their family members were called to account. However, no final court decisions have yet been made in these cases. Taking into consideration the increasing political influence of the armed forces, the king and the royal entourage, it seems highly unlikely that the rule of law will be strengthened in the near future.

Civil liberties are compromised and human rights violations are frequent. In fact, Human Rights Watch groups warn that Nepal is "plunging deeper into a massive human rights crisis" with "arbitrary arrests, censorship, and general repression" with suspended fundamental constitutional rights including the freedom of assembly. As of February 9, 2005, more than 150 opposition politicians, human rights activists, student leaders and trade unionists had been arrested in the wake of King Gyanendra's takeover. A February 2005 report by the International Crisis Group stated that the country's record on "disappearances and extra-judicial killings is one of the world's worst".

### **1.4. Stability of democratic institutions**

In the post-1990 multiparty politics, a number of institutions came into existence. Yet, parliamentary government and bicameral legislature – consisting of the House of Representatives and the National Assembly – could not be strong due to shortsightedness of political parties, which did not try to make parliament strong and active enough to withstand the government's invariable efforts to bypass it. Opportunistic alliances were created within the parliament to secure power and

leadership within it. Most governments faced crises of instability due to intra- and inter-party conflicts.

During the country's decade-long experience of a multiparty system, decline of political institutions such as parliament, parties, bureaucracy were noticeable. The decline of institutions created a crisis of governance. Eventually the ambitious king intervened on the pretext of the failure of the elected government to hold elections in time. The institution of prime minister could not be effectively established despite the provisions and spirit of the constitution.

Other institutions also suffered considerably due to partisan bias and politicization of businesses, educational institutions and other organizations. Along with the violent Maoist insurgency, it was these factors that precipitated the political crisis that – with the help of army and police – the king took advantage of. Today, all political institutions are moribund. One of the reasons for this outcome has been the failure of political parties to permanently end the monarchy's dominant position.

Finally, since 2002, Nepal's democratic institutions were gradually rendered ineffective. Even before that, their institutional efficiency had been hampered when the legislative and executive branches of government were presided over by competing political parties. Indeed, since the start of democratization in 1990-1991, this was almost always the situation. The wrangling between the executive government and the stubborn majority opposition in parliament often led one side or the other to initiate political blockades. To make matters worse, all the parties were prone to fissures within their ranks, caused less by ideological dissension than by the party leaders' jockeying for power. Nepal's political actors often abused the country's democratic institutions. In general, political disputes tend to spill into the streets, where they were waged with an excessive number of demonstrations and strikes.

### **1.5. Political and social integration**

Problems with institutional stability and efficiency are associated with the lack of sufficient organizations and mechanisms of socio-political integration. All of Nepal's political parties lack adequate democratic and participatory mechanisms. Most are personality-oriented organizations with a authoritarian power structure. 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 make any effort to achieve balanced popular participation in their own leadership posts or in the country's political institutions. The upper Brahman and Chhetri castes (especially the former) dominate in all areas.

The constitution prohibits political parties from representing the interests of minority ethnic groups and the untouchable Hindu castes. However, its well-formulated catalog of basic rights has contributed to the establishment of numerous civic organizations. Civic organizations, functional interest groups and, especially, NGOs supported by foreign donors exist and play a certain role in representing social interests and interest mediation. However, the ongoing civil unrest, the anti-democratic measures taken by the king, repression by the security forces and the continuing economic downturn have had a negative impact on the topography of civil society organizations and organized interest groups. Even without taking these trends into consideration, the associative life of Nepalese society is anemic. The ongoing civil unrest has impeded a stronger civic self-organization of various social groups. Overall, it is unsurprising that social trust is weak. Even though no reliable data on social capital is available, it is plausible to assume that political violence and economic decay in recent years have contributed to a decline of social capital in a society already marked by deep cleavages based on social class, religious caste and ethnicity.

Ethnic minorities, the Tarai population and women are significantly underrepresented, while the Dalit groups, regarded as “untouchable”, are not represented at all. Although every party’s platform proclaims commitments to end political, social and economic discrimination against and exclusion of major segments of the population, the statements are nothing but empty promises, forgotten as soon as the polls close.

Both voter turnout - always relatively high - and voting habits demonstrate that the people of Nepal have understood democratic norms and procedures better than the candidates who seek to represent them. Dissatisfaction with established party politicians runs high. This also explains the relatively strong support for the Maoist demands and indications of approval for the antidemocratic steps taken by King Gyanendra.

## **2. Market economy**

### **2.1. Level of socioeconomic development**

Nepal is one of the poorest countries in the world, with a per capita GDP of about \$1,370 (PPP). The protracted insurgency is adversely affecting development efforts. Nepal ranked 140 of 174 in the United Nations Development Program’s 2004 Human Development Index (HDI) and falls within one of the lowest categories of



development with a score of 0.504. At least 37% of the population is estimated to be living on less than \$1 per day, and as much as 82.5% on less than \$2 per day. Pervasive social exclusion results from poverty, unequal access to education and deeply rooted ethno-religious and gender discrimination. Throughout the period under consideration, the country was able to improve social disparities, lower poverty levels significantly or reduce income inequality.

## **2.2. Organization of the market and competition**

Nepal's constitution guarantees a market economic system. While the foundations of a competitive market economy exist pro forma, however, practical implementation remains uneven. Despite efforts of privatization and deregulation in past years, market competition still operates under a weak institutional framework. The formation of monopolies and oligopolies is regulated inconsistently. As a rule, foreign trade is liberalized. The country's trade with India is an exception, as this trade is subject to special regulations and sometimes-restrictive requirements.

Financial sector reforms in recent years affecting both the central bank and the largest commercial banks in the country have contributed to the development of a well-functioning banking sector and capital market. The implementation of financial sector reform included the enactment in 2002 of legislation to increase central bank autonomy and strengthen its supervisory and regulatory functions. The capital market is efficiently overseen by a securities board. However, further improvements must be made in corporate governance, accountability and transparency.

## **2.3. Currency and price stability**

While Nepal maintained stable macroeconomic politics during the 1990s, its fiscal position deteriorated, partly as a result of higher security spending and a rise in domestic borrowing in recent years. Between financial years 2000 and 2003, consumer prices rose from 3.5% and 5%. Motivating factors of this cost-push inflation included increasing wholesale prices, upward adjustments in educational fees and petroleum prices and supply shortfalls – particularly of agricultural products whose transport was affected by the manifold disturbance of domestic transports by the Maoist insurgency. Particularly the prices for food and beverages went up in recent years. Inflation was estimated at a moderate to 3.8% in financial year 2004.

At present, Nepal has been following the de facto pegged exchange rate regime with Indian currency, which has subordinated monetary policy to the exchange rate

objective. As result of the peg to the Indian rupee, the nominal and real effective exchange rates for the Nepalese rupee depreciated, respectively, by 12.5% and 6% between 2002 and 2003. Due to the country's accession to WTO, the current exchange rate peg is subject to international review of the potential impact on competitiveness.

#### **2.4. Private property**

Property rights and the regulation of property are adequately defined. The privatization and sale of public enterprises and state companies has advanced in recent years. The acquisition of private property by foreigners – the right to purchase property and to invest funds – is restricted, except in the case of native Nepalese living abroad. Of course, property rights are only guaranteed in those regions of the country still under the control of the central government's security forces, while the Maoist insurgents in the "liberated" areas are attempting implement their vision of a socialist economy based on the confiscation of private property, especially land.

#### **2.5. Welfare regime**

Nepal has no welfare regime except the social networks based on familial structures. Private initiatives are limited to isolated cases at best and public social services are underdeveloped and insufficient, although access has been improved in recent years. Public health expenditure is at about the same level as in the Philippines and Vietnam (in 2001, 1.5% of the GDP), which puts Nepal at average position among the countries in Asia and Oceania. Again, the protracted insurgency has adversely affected the already-marginal social safety net, because it weakens community- and family-based structures and the insufficient public health system. Equality of opportunity is not realized. Life chances, job opportunities, access to the health system, education and income are highly dependent on social background.

#### **2.6. Economic performance**

Per capita GDP in terms of PPP is low: around \$1,370 in 2002. Throughout the period under review, per-capita GDP grew at rates - 0.3% and 2.3%—significantly lower than in the late 1990s. Between 2001 and 2004, Nepal's GDP growth dropped from 4.7% to 3.5%. In FY2002 Nepal's economy reportedly contracted first time in nearly 20 years, shrinking by 0.3% as a result of the insurgency's impact on trade (including tourism) and manufacturing as well as an irregular monsoon and weak

external demand. The economy recovered in 2003, expanding by 2.7%. An IMF team has forecasted 3.5% growth for 2004 and 2005. In the wake of the king's takeover in February 2005, growth is expected to drop. Future economic prospects will likely be influenced by the outcome of the peace negotiations underway with the Maoists and the king's ability to come to terms with democracy and its advocates. Broad-based growth and poverty reduction also require strong agricultural growth, projected for 3.5 % between financial years 2004 and 2006.

Private consumption and business revenue shortfalls and decreased levels of external finance contributed to downward revisions of Nepal's budgetary targets in 2003-2004. The budget deficit dropped from 5.9% to 5.5% of the GDP between 2001 and 2003, while the current account deficit moved from 2.7% to 4.6% of GDP in the period under review.

## **2.7. Sustainability**

Because of definite regional differences and pronounced income inequality between social groups, Nepal's economic growth cannot be described as sustainable. The results of programs designed to combat poverty are mixed at best. Ecological concerns are taken into account in economic development planning, not the least because of their relevance for tourism, one of the country's major income sources. However, because of weak stateness, and the insurgency, institutional support for environmental protection is weak.

Nepal's public infrastructure and education system is underdeveloped, especially in the area of higher education and research and development (R&D). Nepal's government spends an annual 3.4% of the GDP on education, which amounts to approximately 14% of total government expenditure. Investments in R&D are insignificant, as is the number of researchers and scientists employed in that field.

## **3. Management**

### **3.1. Level of difficulty**

A number of highly unfavorable conditions for economic and political transformation persisted throughout the review period. These included a low level of economic and social development, the underdevelopment of fundamental market-economic structures, a poorly-educated population, geographical disadvantages, resource scarcity, ethnic and religious discord, protracted insurgency, highly polarized conflict

over income distribution, the lack of political majorities and weak stateness. The massive structural constraints on governance, the weak traditions of civil society and widespread political violence that climaxed into open civil war in recent years only increase the difficulty of transformation in Nepal.

### Profile of the Political System

Regime type:	<i>Autocracy</i>	Constraints to executive authority:	<i>1</i>
System of government:	<i>Parliamentary</i>	Latest parliamentary election:	<i>1999</i>
Head of State:	<i>King Gyanendra Bir Bikram Sah Dev</i>		
1. Head of Government:	<i>Thapa</i>	Cabinet duration:	<i>06/03- 06/04</i>
2. Head of Government:	<i>Deuba</i>	Cabinet duration:	<i>06/04- 02/05</i>
3. Head of Government	<i>King Gyanendra Bir Bikram Sah Dev</i>	Cabinet duration:	<i>02/05- present</i>
Source: BTI team, based upon information by country analysts, situation in July 2005. Constraints to executive authority (1-6 max.) measures the institutional constraints posed by a federal or decentralized state, a second parliamentary chamber, referenda, constitutional and judicial review and the rigidity of the constitution.			

### 3.2. Steering capability

Though the structural constraints on governance are high, the political leadership's low steering capability is another important cause for Nepal's current crisis.

The government lacks either a clear strategy for affecting economic and political reform or for a viable solution to the insurgency problem. The government's capability to implement reform policies effectively was hampered by weak political leadership, the choice of confrontational tactics and the lack of clear strategic priorities. The extreme partisanship of Nepalese officials exacerbated these shortcomings. Nepal's reform goals achieved a measure of consistency only under pressure from international organizations and financial donors, whose contributions account for some 60% of Nepal's total budget. The government continues to give priority to combating poverty. As politics during the period under study focused exclusively on retaining power, however, the expectations of those advocating social and economic reform were not fulfilled.

The reform policies of one government after another failed due to the inability to implement these plans successfully. As a rule, the goals set in the five-year plans were far too ambitious. In recent years, hardly any lessons were learned from past mistakes. Political instability and frequent changes of government fostered this negative tendency.

After a state of emergency was declared in November 2001, the government focused entirely on domestic security, diverting resources away from development and

reforms. Domestic policy has not followed any coherent course since mid-2002. Although the royal coup d'état and the installation of the Chand government in October 2002 took place with the professed goal of reviving the process of democratization and reform, this failed when all the major parties refused to cooperate. The Chand government has taken positive steps toward reform in certain areas, such as education and health, but its lack of legitimacy detracts from the significance of these initiatives. The opposition's almost unremitting refusal to cooperate with the government added to the difficulty. As a result, innovative political approaches were doomed to failure. The Maoist rebellion has made it almost impossible to pursue purposeful reforms in rural areas.

### **3.3. Resource efficiency**

The government does not make efficient use of available economic and human resources for its economic and social policies. During the period under study, resources intended for development were continually and increasingly misappropriated to finance military expenditures. Some public services had to be discontinued, especially in western regions. Available cultural resources are not used to the country's advantage; rather, they are more often misused to block reforms.

The institutional framework of governance in Nepal does not provide for a high degree of coordination among conflicting political objectives to form coherent policies. Political instability and frequent changes of government – as well as the increasing involvement of the armed forces in domestic politics and government administration – only fosters this negative tendency.

Curbing corruption remains an important issue. No institutional framework for combating corruption has been elaborated and the rules in place are neither consistently nor impartially applied. Indeed, the country's corruption rate is above average, even in comparison with other countries in the region. According to Transparency International's 2002 Corruption in South Asia Report, the most corrupt sectors include the police and the judiciary.

### **3.4. Consensus-building**

Two of the three core players in domestic politics – the royalists and the Maoist insurgents – vacillate between ambivalence to democracy and socially responsible market economy as ultimate goals of transformation and open denial of these goals. Even though all other major political and social actors favor a constitutional monarchy, parliamentary democracy, a multiparty system, the political elite has not

implemented social reforms that could address the socioeconomic roots of the insurgency. Indeed, economic development has almost no place in the country's political discourse.

So far, the monarchy, the government, the political parties and the insurgents have failed to find a way to bridge differences that so far have proved irreconcilable. As yet, the government's initiatives to promote the representation of interests of women and ethnic minorities have done little to eliminate social disadvantages. More effective, by contrast, has been the engagement of numerous NGOs that try to influence economic and social policy. Both in the realm of women's legal status and that of ethnicity, language and cultures, these civil organizations have managed to implement small reforms in recent years.

The struggle to improve the representation of women's interests and those of ethnic and religious minorities are still an uphill battle, the dominant upper-caste party elite refuses to allow the appropriate participation of all societal groups. In particular, this greatly affects the Dalits, whose lack of representation has only recently received greater public attention. Creating another source of unrest, conservative civil society organizations became more outspoken after King Gyanendra's seizure of power. Yet another problem area is the task of addressing past injustices. In the nine years of the Maoist rebellion, especially after the state of emergency was declared, both the Maoists and the state security forces have committed gross violations of human rights. To date, the state has made hardly any effort to investigate these offenses. This makes it harder to achieve any reconciliation of victims and perpetrators.

On the Maoist issue, each political party and camp advances its own agenda, and has failed to reach a consensus. The Nepali Congress wanted to restore the dissolved parliament and then tackle the Maoist problem; the CPN (UML) was ambivalent on either forming an interim government or for restoration of parliament or constituent assembly; the other parties less had similar vague approach to it. Obviously the "democratic" political parties were not able to tame semi-democratic veto actors such as the royalist camp or to co-opt the anti-parliamentary opposition of the extreme left.

### **3.5. International cooperation**

In the recent years, the government actively supported the U.S. "war on terror." In fact, the government has much benefited from the anti-terrorist campaign launched by the United States after the 9/11 attacks: it's effort to tackle the Maoist insurgency got a boost in the form of military supplies from the United States, United Kingdom and India, putting the Maoists under active international pressure. The internal effort for a

negotiated settlement failed, however, forcing the government to pursue military means.

Even though the elected governments were to receive international support, aid only continued to flow until king's intervention in 2002. After the first royal coup d'état, the major donors became assertive in putting pressure on the government to formulate and implementing policies regarding developmental projects and administrative streamlining. International financial institutions and bilateral donor agencies openly voiced their dissatisfaction with the country's problems, including its rampant corruption and lack of effective decision-making.

After King Gyanendra's seizure of power in February 2005, the major donors not only stopped foreign assistance but also discontinued their supply of military equipment and arms for fighting Maoist "terrorism." It will remain stopped until the restoration of democracy. India, the United Kingdom and the United States have come together to put pressure on the king to restore democracy, to release detainees and to work together with the parliamentary parties. Japan, a major donor, has agreed to extend grant assistance of over \$17 million for two projects. However, Japan has strongly urged Nepal's government to release political detainees, and promptly restore the freedoms guaranteed by the constitution. One of the Nepalese cabinet ministers said openly that, due to the failure of foreign policy, a misunderstanding has arisen between the king and the major countries.

#### **4. Trend of development**

##### **4.1. Democratic development**

Even before the review period of this report, Nepal suffered from faltering democratization and political instability, weak stateness and inefficient public administration, a weak judicial system, low-quality public services and erosion of the rule of law. These unfavorable conditions have worsened during the review period. Rule of law, democratic procedures, political rights, civil liberties, freedom of speech and the press experienced setbacks between January 2001 and March 2005. The coup d'états staged in 2002 and 2005 put a decisive end to the democratic system introduced in 1990. Sovereignty passed from the people back into the hands of the king, who has cast off his constitutional obligations.

## 4.2. Market economy development

Protracted political crisis and civil unrest adversely affected socioeconomic development in Nepal. Although the kingdom commenced its transformation toward a market economy many years ago, a long road still lies ahead. The main reason for this slow progress is that the economic transformation is primarily driven by a few interest groups and economic organizations as well as by the country's few large companies.

Basic indicators of social and economic development show slight progress in most criteria, including human development, gender equality, education levels and per capita income. Though mildly improved, however, all of these indicators remain on a very low level.

**Table 1: Development of socioeconomic indicators of modernization**

	HDI	GDI	GDP index	UN Education index	Political representation of women	GDP per capita (\$, PPP)
2000	0.490	0.470	0.43	0.48	6.0 (1990)	1,327
2002	0.504	0.484	0.44	0.50	5.9 (2004)	1,370

Sources: UNDP, Human Development Report, 2002, 2004.

Measured in terms of macroeconomic data, economic development in the later part of the review period even lost momentum compared with the first part of the period. In view of the current crisis conditions, it is unclear when the state's development policy will again show a positive trend.

**Table 2: Development of macroeconomic fundamentals (2000-2004)**

	2000	2001	2002	2003	2004
Growth of GDP in %	6.1	4.7	-0.3	2.7	3.5
Export growth in %	39.6	11.7	-15.6	6.4	5
Import growth in %	23.9	6.6	-7.2	15.8	10
Inflation in % (CPI)	2.4	2.9	4.8	-1.15	5.1
Investment in % of GDP	24.3	24.1	24.1	25.8	26.7
Tax Revenue in % of GDP	8.7	9.5	9.3	9.4	N.A.
Unemployment in %	N.A.	N.A.	N.A.	17.4	N.A.
Budget Deficit in % of GDP	-4.7	-5.9	-5.4	-3.6	N/A
Current Balance in billion \$	0.24	0.28	0.25	0.16	0.19

Source: Economic Survey-2004 and Tenth Plan-His Majesty's Government of Nepal



Furthermore, economic development in Nepal is not supported by a solid social and economic infrastructure, which could provide sustainability. Rather, the institutional environment for market-economy action has worsened despite some positive developments in the organization of the economy and competition.

#### **D. Strategic perspective**

During the Cold War Nepal enjoyed a strategic importance for the foreign policy of numerous countries. The United States, the United Kingdom and others sent aid for building an infrastructure. The priorities of donor countries have changed since the end of the Cold War, but aid continues to flow. Japan is Nepal's biggest donor. Attention from abroad has died down with the declining efficiency of political parties to govern the country. The authoritarian move of the king to usurp power has derailed the constitutional process and drawn criticism from donor nations. The spurt of Maoist violence and the lack of effective response to tackling it have also diverted the attention of donors to security issues. But when King Gyanendra took power into his own hands in the name of ending "terrorism" by imposing a state of emergency, the major donors reacted by censoring the King's action. Military and developmental aid to Nepal stopped. India, the US and the UK are engaged in formulating a common strategy for putting pressure on the King of Nepal so that democracy can be restored soon.

Yet, all these donor countries are now in a dilemma. If they continue to withhold military support, the Maoists, who have already become a formidable force, may overrun the country. If they support the status quo, democracy is in peril. All agree that they need to defeat Maoist "terrorism". But the military option is not the only solution. Political options have to be found for bringing the Maoists into the political mainstream. The strategic challenge in assisting Nepal in its efforts to stop civil war and foster democratic and economic transformation is two-fold. A medium-term counterinsurgency strategy is needed that combines short-term reactive measures with a viable long-term preventive strategy. Any policy must emphasize addressing the root causes of armed confrontation that stimulates political violence and terrorism.