

BTI 2014 | Nepal Country Report

Status Index	1-10	4.37	# 99 of 129	
Political Transformation	1-10	4.63	# 82 of 129	➔
Economic Transformation	1-10	4.11	# 104 of 129	➔
Management Index	1-10	3.98	# 96 of 129	

scale score rank trend

This report is part of the Bertelsmann Stiftung's Transformation Index (BTI) 2014. It covers the period from 31 January 2011 to 31 January 2013. 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	27.5	HDI	0.463	GDP p.c.	\$	1484.3
Pop. growth ¹	% p.a.	1.2	HDI rank of 187	157	Gini Index		32.8
Life expectancy	years	67.5	UN Education Index	0.358	Poverty ³	%	57.3
Urban population	%	17.3	Gender inequality ²	0.485	Aid per capita	\$	19.3

Sources: The World Bank, World Development Indicators 2013 | UNDP, Human Development Report 2013. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$2 a day.

Executive Summary

The 28th of May 2012 was a watershed moment in Nepal's political transformation. Before that date, aspirations remained (despite mounting doubt) that the Constituent Assembly (CA) elected in April 2008 would deliver the new constitution it had been tasked to write, including the proposed administrative map for federal restructuring. After that date, on which the CA was dissolved without promulgating a constitution, the country entered uncharted, extra-constitutional waters. The interim constitution of 2007 did not provide guidance in the event that the CA failed to complete its constitution-writing task. In the wake of the CA's dissolution, political alliances were reconfigured around an array of proposals for how to move forward, which included constitutional amendments to resurrect the defunct CA, and the appointment of a technocratic caretaker government tasked with holding elections for a new CA. By the end of the reporting period, consensus was forming around the latter option, with the country's chief justice favored to take on the role of transitional prime minister.

Uncertainty about the future in early 2013 should not obscure several achievements made on the long road to post-conflict state restructuring before the CA was dissolved. After several months without a prime minister, due to lack of consensus in the CA, Maoist Central Committee member Baburam Bhattarai finally brokered adequate support and was sworn in as Nepal's 35th prime minister in late August 2011. In October of that year, Bhattarai signed the Bilateral Investment Promotion and Protection Agreement (BIPPA) with India, in an effort to boost the economy by encouraging investor confidence in the country.

In November 2012, the Army Integration Special Committee created vacancies to accommodate 1,462 People's Liberation Army (PLA) combatants. Over the past five years, the initial number of 32,000 individuals who have registered for integration gradually boiled down to a number well below 2000 applicants.

Fewer than 8,000 trained and ideologically left-leaning combatants are now opting for the Voluntary Retirement Scheme that offers between 500,000 and 800,000 Nepalese rupees (NPR). Concerns about their future course of action are frequently articulated, especially since some former cadres have joined the radical Maoist faction led by Mohan Vaidya.

By early February 2012, the “expert” State Restructuring Commission (SRC) had submitted its report proposing an 11-state federal structure. Alongside the concept paper of the CA’s Committee for Restructuring the State, which was submitted several months earlier, the SRC report should have provided, within the extended CA deadline, a solid basis for concluding negotiations over the shape of the new federal state. However, highly contentious debates over whether Nepal should adopt so-called identity-based federalism (often referred to as ethnic federalism, although the latter term is rejected by its proponents) ultimately dissolved the existing political will to bridge differences, and in turn the CA itself.

Despite ongoing political instability, economic and development indicators rose between 2011 and 2013. Nepal was hailed as a “star performer” by the Multidimensional Poverty Index, which showed that the percentage of poor people in Nepal dropped from 64.7% to 44.2% between 2006 and 2011. 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 investment climate – 134/141 on the United Nations Conference on Trade and Development (UNCTAD) World Investment Report 2011. Overall, the financial situation is volatile, and while improvements in human development may be real, they are also fragile.

History and Characteristics of Transformation

The 2006 Comprehensive Peace Agreement is often treated as the beginning of Nepal’s state restructuring process, but in fact this is only the most recent phase in a long-term process of transformation that has been ongoing since at least the early 1950s. At that time, the country’s first democratic movement ended the feudal rule of the Rana oligarchs, opened the country to the outside world, and returned the democratically-minded King Tribhuvan to the throne with India’s support. King Tribhuvan himself initially promised Constituent Assembly elections in 1950 (the work of Ambedkar’s Constituent Assembly across the border in India, from 1948 to 1950, was a compelling exemplar), but this long-promised milestone in democratic governance was only achieved in 2008 after over half a century of stop-and-start political progress.

During the interceding five decades, Nepal experienced several forms of governance and opposition to the state. From 1960 to 1990, the authoritarian King Mahendra ruled the nation as a unitary Hindu kingdom through the “partyless Panchayat democracy” system, which muted political, religious, ethnic, regional and other forms of difference. The People’s Movement of 1990 resulted in the promulgation of the 1990 constitution, which, with King Birendra’s assent, reined in royal powers and led to a series of elected parliaments in the 1990s (led alternately by the Nepali

Congress and United Marxist-Leninist parties). In 1996, the Maoists declared their People's War with a 40-point ultimatum accusing the democratically elected government of being incapable of fulfilling its citizens' aspirations. A decade of civil conflict ensued. The Maoist movement did not appear out of the blue, but rather built upon earlier phases of political mobilization across rural Nepal initiated by the mainstream political parties as early as the 1970s. Such efforts were augmented by development projects that emphasized empowerment and individual rights, which gained traction in the early 1990s. The dismissal of local governing bodies in 2002 and the authoritarian royal coup of King Gyanendra in 2005 (following the 2001 royal massacre in which Birendra and his family were killed) returned the country to a brief period of autocratic rule, during which time democratic rights were suspended. Gyanendra could not maintain popular support, however, and was deposed after the Second People's Movement of April 2006, which drew its power from an alliance between the Maoists and the mainstream political parties (then referred to as the Seven Party Alliance). This collaboration in turn paved the way for the November 2006 Comprehensive Peace Agreement.

It was this agreement, and the ensuing 2007 interim constitution, which established the project of secular, federal and republican state restructuring as the primary agenda for Nepal's political transformation. The demand for federal devolution, however, was not new, and gave voice to a range of interest groups long dissatisfied with the inequitable and heavily centralized nature of the state. Long-awaited Constituent Assembly elections were held in 2008 with a mixed electoral system (half first-past-the-post, half proportional representation), yielding a Maoist plurality, although not a majority. The 601-member Constituent Assembly, with its unprecedented ethnic, caste and gender diversity, was vested with the responsibility of promulgating a new constitution. However, 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 in May 2012. Since then, negotiations have continued to find a way forward towards a new constitution and an inclusive, restructured state that provides equal rights to all citizens.

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 in proportional context 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.

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

The 2006 Comprehensive Peace Agreement and subsequent tenure of the Constituent Assembly (CA) from 2008 to 2012 provided a platform for wide-ranging public debate over both the real and ideal nature of Nepali stateness. Although few contest the legitimacy of the state's overall sovereignty or territorial claims within its international borders, the very nature of the state's internal power structures – both geographical and political – has been up for debate during the post-conflict period. Despite the long, drawn-out nature of the constitutional process, until the first half of 2012 there was a sense of optimism that these issues would be resolved, bringing disparate groups together and enabling the country to consolidate its post-conflict structural transformation in a unifying fashion. However, since the May 2012 dissolution of the CA – which failed to promulgate a new constitution due to deep-seated political and ideological differences over the ideal nature of future Nepali stateness – confidence has decreased in the ability of the government to assert legitimate forms of territorial control across the breadth of the country in a democratic manner.

Monopoly on the
use of force

6

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) in 2012. Rather than enabling legitimate democratic control over the country as a whole, the public perception that the NA has undue influence on government officeholders has aggravated historically pervasive feelings of fear and distrust in the state and its armed forces on the part of many Nepali citizens. Such attitudes contribute to the strength of oppositional political movements that seek to challenge the elite privilege that infuses both political party structures and the NA.

In some cases, these movements have demanded new forms of territorial autonomy, notably in the Limbuwan region along Nepal's eastern border with India. The

country's open southern border with India in the Terai region allows cross-border militant and criminal groups to operate with a significant degree of impunity, and the Nepali state is unable to respond effectively to law and order problems in that border region. Concern over the activities of Indian border security forces in uniform acting beyond their jurisdiction were noted. The northern border with China's Tibetan Autonomous Region is more strictly regulated, primarily from the Chinese side, but in several recent instances Chinese border forces have allegedly overstepped their jurisdiction by entering Nepali territory.

The definition of citizenship, as well as the attributes of national belonging, remain raw and open questions. The interim constitution of 2007 for the first time removed the designation of "Hindu state" from the country's legal definition. In the CA's first session, in 2008, King Gyanendra was deposed, and Nepal declared a secular, democratic, federal republic. "The Nepalese people collectively constitute the nation," states the 2007 constitution, and the citizenry are recognized as having "multiethnic, multilingual, multi-religious [and] multicultural characteristics." However, significant challenges remain before these ideals can be realized. Discriminatory attitudes among high-caste Hindus (often referred to as "hill elites" because they live in the central hill region) towards other communities on the basis of ethnicity, language, religion and region persist strongly. 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.

Women have also suffered from longstanding discrimination in securing citizenship. According to the Nepali Citizenship Act of 2006, a person can apply for citizenship on the basis of either maternal or paternal descent, but the relevant parent must be able to sign the documents. Widespread female illiteracy precludes many children from applying for citizenship, especially if the father is absent or not a Nepali citizen. Even in cases in which the mother is literate, the law is often not adequately implemented and women are often told that they must return with a male relative in order to process citizenship documents for their children.

State identity
6

With the abolition of the “Hindu state” and Hindu kingship as central tenets of self-definition, Nepal moved to increase the religious freedoms that were first significantly introduced by the 1990 constitution’s definition of the nation “irrespective of religion, race, caste or tribe.” However, in practice, a Hindu ideological ethos that encodes hierarchies based on caste difference 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.

No interference of religious dogmas

6

Basic administrative structures have suffered from neglect and abuse during the long, drawn-out process of state restructuring. This is in evidence at all levels. Many positions in high level commissions have been left unfilled for years (notably the Commission for the Investigation of Abuse and Authority and the National Human Rights Commission), and there has been a nearly complete vacuum of elected government officials at the local level since 2002, when the last village councils, elected in 1998, were disbanded as part of the government’s response to the Maoist insurgency. Corruption and nepotism are rampant, and equitable access for all citizens to administrative services is rarely guaranteed. Basic infrastructure is under severe pressure – particularly in urban areas, where 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

In recent years, the promise of federal restructuring has provided a convenient excuse for failure to address such basic administrative shortcomings. Aware that the process of devolution from unitary to federal state structure will necessarily entail a complete overhaul of administrative structures, few officeholders are willing to act now to correct problems since their own futures are not secure. After the May 2012 dissolution of the CA, incentives to reform have dwindled further. On the one hand, the process of restructuring appears likely to take even longer than initially anticipated, and on the other, the backlash against federalism, which has gained traction in the most recent two-year period, has given civil service officeholders new cause to hope that radical restructuring will never take place, and they will therefore never be held to account for their poor conduct.

2 | Political Participation

The last elections were held in 2008 for the CA. These were generally held to be free and fair by international observers, and yielded the largest (601 members) and most diverse governing body Nepal had ever seen (largely due to the provisions for proportional representation in the electoral system embedded in the interim constitution). Following the May 2012 dissolution of the CA, there has been substantial confusion and political maneuvering surrounding the process for holding future elections. The 2007 interim constitution did not anticipate a situation in which the CA failed to produce a statute outlining the electoral procedure, and therefore there are no democratically agreed upon guidelines for future general elections. Maoist Prime Minister Baburam Bhattarai initially called for elections in November 2012 to elect a new CA, but both political as well as logistical obstacles quickly foiled this plan. At the conclusion of the reporting period, elections were under discussion, but details including the date remained unclear. Local governance is also sorely in need of electoral rejuvenation – the last local elections were held in 1998, with those councils disbanded in 2002.

Free and fair
elections

5

From May 2012 onwards, Prime Minister Baburam Bhattarai presided over what the Nepali media called a “caretaker government.” His democratic mandate effectively expired with the CA’s tenure. But, due largely to the lack of other compelling leadership options, Bhattarai managed to maintain his grip on power. At the same time, it is exceedingly difficult for Bhattarai and his officials to pass legislation or achieve progress on any substantive issues due to the political opposition they face from both the Nepali Congress and the Communist Party of Nepal (Unified Marxist-Leninist) (CPN-UML).

Effective power to
govern

3

The Maoist split announced in June 2012 has added complexity to the situation. The breakaway Vaidya faction is forging new alliances with a range of actors across the political spectrum. What remains of former Prime Minister Pushpa Kamal Dahal’s and Bhattarai’s Unified Communist Party of Nepal (Maoist) (UCPN(M)) is vastly stronger by numbers but faces serious problems of factionalism and disaffection.

The various factions of the Madhesi Janadhikar Forum (MJF-Democratic and MJF-Nepal) are popularly portrayed as kingmakers whose small but influential position enables them to determine the government’s course. These dynamics mean that much of the government leadership’s time is spent negotiating political alliances rather than tackling substantive issues.

The interim constitution of 2007 guarantees fundamental rights of association and assembly. 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

Association /
assembly rights

7

headquarters. Most recently, these rights have been tested by the Occupy Baluwatar movement, which, since December 2012, has staged an ongoing mass sit-in outside the prime minister's residence to demand greater governmental attention to violence against women, as well as general law and order concerns. Protestors have been briefly detained and released, but in general citizens can expect their right to assemble to be respected – a strong contrast to the conflict era, when even private gatherings such as weddings were often challenged by security forces attempting to curtail assembly. 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. This approach is especially problematic due to the cultural and linguistic similarity between Tibetans and many Nepali citizens.

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 2011 – 2012 Reporters Without Borders Press Freedom Index ranked Nepal at 106 out of 179 countries, a notable improvement from its 2010 ranking of 119 out of 178. This shift is attributed to the decline in attacks by Maoist groups against journalists in the Terai, as well as the increased efficiency of the justice system. However, January 2013 witnessed a return to the intimidation, familiar from the conflict and immediate post-conflict era, of journalists: In the far-western district of Dailekh, more than 20 journalists were displaced due to a scuffle between Maoist cadres and opposition parties in relation to the prosecution of those charged with the 2004 murder of Dailekh journalist Dekendra Thapa. Such incidents demonstrate that, despite the overall positive trajectory in this domain, freedom of expression may be subject to highly localized conditions.

At a broader structural level, improvements in freedom of expression for the general populace may be linked to the gains of identity-based movements that have sought to widen the purview of acceptable political debate, and encouraged citizens from a range of backgrounds to participate in the public sphere. Nonetheless, studies show that most mainstream media houses are still overwhelmingly dominated by upper caste Hindus. Further improvements in freedom of expression will also require a greater commitment to diversity on the part of key media outlets.

Freedom of
expression

7

3 | Rule of Law

The 2007 interim constitution initially afforded disproportionate powers to the executive – the prime minister and his cabinet. Subject to few checks and balances, they completely or partially controlled emergency powers and appointments to constitutional bodies including the Supreme Court. However, a much healthier division of powers was established with the Constituent Assembly, which doubled as legislative parliament and declared Nepal a republic in its first sitting, in 2008. The new president took over some executive powers, and the legislature was now able to meaningfully check others.

Separation of powers

5

With the dissolution of the CA in May 2012, the situation is close to where it was in 2007, with no legislature in place. A remaining check on the prime minister, however, is President Ram Baran Yadav. In principle, there is a risk that President Yadav may attempt to assume broader executive function, but the highly polarized nature of Nepal's political landscape has so far prevented him from obtaining the broader backing necessary for such a step.

There is intense debate about the precise nature of the separation of powers in the next constitution. Concerned over the power of conservative forces to block reforms, the Maoists have pressed for a strong executive president. Their opponents in the Nepali Congress and the UML favor a parliamentary system. The proposed compromise, a semi-presidential system, risks legislative and executive paralysis given the fragmented nature of Nepal's party landscape. Concern about obstructions to reform has also put the Maoists on a collision course with the judiciary. Their constitutional draft submitted to the CA granted ultimate power to interpret the constitution to the legislature, not to the Supreme Court or a constitutional court.

Formally speaking, the independence of the judiciary is ensured. 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. The impeachment of any Supreme Court justice requires a two-thirds majority in parliament. One significant limitation on the courts' jurisdiction is the executive's ability to grant pardons or suspend sentences for criminal convictions. The judiciary is often seen as conservative, especially with regard to questions of national identity and religion. Nevertheless, many Nepalis appear to perceive the courts above the district level as more reliable than other state institutions. As will be elaborated below, the Supreme Court has also been able to convict several political leaders on corruption charges. The fact that this has been possible, despite considerable political opposition, points to a relatively high degree of autonomy from the political sphere.

Independent judiciary

5

Corruption in Nepal remains entrenched in politics and business. Funds, including aid money, are routinely stolen at all levels of government, and corruption scandals – many minor, some major – frequently make the news. But responsibility does not exclusively or even primarily lie with a venal administration; there is also popular demand. Nepal’s political culture requires political parties to 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.

Thus, unsurprisingly, prosecution is generally extremely weak. That said, 2011 and 2012 have seen several high-profile corruption convictions. Three former ministers and one sitting minister from across the party spectrum were convicted; three are currently serving jail terms, and the fourth died in 2008. Similarly, the courts sentenced three high-ranking police officers and two businessmen, one of them British, over the procurement of defunct armed personnel carriers for Nepali U.N. peacekeepers in Sudan (it did not prosecute the two home ministers under whose tenures the embezzlement occurred in 2007). This represents a welcome trend, but it is too early to note systemic change.

Development aid from India, China and the West plays an important role in Nepal’s budget. Monitoring of these funds is generally insufficient. More rigorous monitoring of the substance of work done, rather than just receipts and workshop attendance numbers, could go some way toward curbing corruption.

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. As long as soldiers, police and civil servants can be confident that the state protects its own from accountability for crimes, including the most egregious ones, little can be expected from perfunctory counter-corruption measures.

In principle, civil and political rights were well protected both under the 1990 constitution and the 2007 interim constitution. The latter also contains an impressive catalogue of economic, social and cultural rights. Nepal is a signatory to most international human rights treaties. This failed to prevent grave and well documented human rights abuses during the ten years of civil war (extrajudicial executions, forced disappearances, rape and torture). There is complete lack of political will for systematic investigation and prosecution, despite commitments on paper. Not a single perpetrator of grave human rights violations during the war has been tried and convicted since 2006.

Prosecution of
office abuse

4

Civil rights

4

In August 2012, the government submitted ordinances for the establishment of a Disappearance Commission and a Truth and Reconciliation Commission to the president, who has not yet signed them. Human Rights activists and the U.N. Office of the High Commissioner of Human Rights (OHCHR) warn that ordinances contradict fundamental human rights principles: They envisage amnesties even for gross human rights violations, empower the commission to initiate reconciliation processes without the request of either victim or perpetrator, and lack a focus on prosecution.

Not only is there no political will to prosecute wartime crimes, but the political leadership goes to great length to prevent it. For example, Prime Minister Bhattarai sharply protested the January 2013 arrest of Nepal Army Colonel Kumar Lama by U.K. authorities over allegations of torture, calling his arrest under universal jurisdiction a threat to national sovereignty and the peace process. On similar grounds, he criticized the arrest of several Maoist cadres accused of murdering journalist Dekendra Thapa in Dailekh during the war, and is accused of trying to scuttle the investigation. Both cases are merely particularly blatant examples of a general dynamic. Throughout the last years, successive governments led by different parties have withdrawn cases, ignored court verdicts and promoted officials accused of grave human rights violations.

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. For example, the case of a returning female migrant worker who was raped and robbed of her earnings by immigration officials, in December 2012, sparked weeks of protests in Kathmandu. The alleged perpetrators were disciplined but not prosecuted.

4 | Stability of Democratic Institutions

Democratic institutions exist in theory, but with the end of the Constituent Assembly as legislature they are very constrained in practice. From 2008 to 2012, the 601-member CA was touted as the most diverse and democratic governing body Nepal had ever possessed. However, during the second half of the Constituent Assembly's tenure, many commentators expressed concerns that CA members themselves were not involved in substantive decision-making processes; instead, it often appeared that decisions were made in small closed-door sessions between the top leaders of major political parties, and brought to the CA for rubberstamp approval. The leadership structures of the major political parties are notoriously top-heavy and often do not

Performance of
democratic
institutions
3

operate their internal affairs transparently. Since the May 2012 dissolution of the CA, there has been no democratically elected governing body at the national level, and there have been no elected democratic bodies at the local level since 2002. The judiciary and civil service are hampered by infrastructural limitations as well as a culture of corruption. District-level agencies are often the most effective actors, playing a mediating role between national and local concerns – but even the most committed district-level civil servants are often hampered by dysfunction elsewhere in the system. Local party structures play a mixed role. Despite the fact that the parties have not been democratically legitimated since the last local elections in 2002, nothing at the local and district level happens without them. This often reinforces a culture of cooperative corruption, but to some extent it also perpetuates local political legitimacy against an otherwise overly powerful bureaucracy.

During the first half of its tenure, the CA was accepted by most not only as legitimate, but as a source of great promise for the future of Nepali democracy. However, conservative political actors and commentators worked to undermine the CA's authority, calling into question the democratic commitment and efficacy of such a large and diverse body with many inexperienced members subject to lobbying by a range of special interests. By late 2011, the body was beginning to lose legitimacy due to its inability to promulgate the constitution that was its primary objective, providing an entree for conservative forces to launch critiques of the constitutional process as a whole. Subtle allusions to the possibility of a military coup have appeared in recent months, suggesting that some elements in the military leadership may not view the current arrangement as legitimate. However, the top brass has not raised explicit challenges, and in fact defied requests by opposition parties to back a dismissal of the Bhattarai government. It is widely assumed that India has strongly discouraged any army involvement in politics at this stage. There are many vocal civil society organizations representing the full scope 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 not fully representative of citizens at large. 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.

Commitment to
democratic
institutions
3

5 | Political and Social Integration

The party system is strongly rooted, but does not always articulate the full range of societal interests. The traditional parties – Nepali Congress and CPN-UML – have had difficulties recruiting and maintaining the allegiance of cadres from dalit and janajati backgrounds. 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. The split of Mohan Vaidya’s hard-line faction reflects not only rifts at the leadership level, but also a significant measure of discontent in the party base. All parties are largely driven by individual charismatic leaders, and ideological consistency is not emphasized. Recent years have seen several new parties arise, largely organized around regional or ethnic affiliations. Since early 2012, two new parties have launched that seek to challenge the traditional parties by mobilizing marginalized communities. One is the Federal Socialist Party, led by janajati defectors from the Congress and UML parties, and the other is led by a group of janajati intellectuals who advocate “pluri-nationalism.” It remains to be seen how effective these new parties will be at attracting voters and broadening political representation.

Party system
4

There is a wide range of active interest groups. Many are incorporated as NGOs, while others maintain religious or professional affiliations. Organizations such as the Nepal Federation of Indigenous Nationalities, the Nepal Bar Association, and the Federation of Nepali Journalists have played significant roles 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.

Interest groups
5

The May 2012 dissolution of the Constituent Assembly, which did not produce a constitution despite a significant investment of time, money and trust by a variety of actors during its four-year tenure, has led to broad questioning of both the normative and pragmatic value of democracy. Political actors across the spectrum continue to draw upon democracy as a key rhetorical trope, yet it is hard to see how they have translated these ideological commitments into practice, either inside individual parties, or in governance at the national level. This state of affairs has encouraged some elements on both the far left (e.g. the Mohan Vaidya-led hard-line Maoist faction) and the far right (e.g. those who advocate a military coup or even a return to

Approval of
democracy
n/a

royal power) to publicly question whether democracy is indeed the best form of government, and to not-so-subtly propose other options. Given the longstanding inability of high-level political actors to ensure the continuity of democratic institutions, levels of public trust are relatively low. According to the Himalmedia Public Opinion Poll 2013, over 50% of people either don't know or won't say who should be prime minister, do not think there is any leader who should be, or want an independent (non-party) candidate. Fully 61.1% of respondents thought democracy was under threat, and 39.4% said the reason for this was "wrangling political parties." Yet citizens are also not easily courted by alternative propositions, since over the past two decades they have experienced democracy, a Maoist war and royal authoritarian rule, leading to a general disaffection with political actors regardless of whether they claim to be democratic or not.

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. But larger solidarities that bridge the interests of identity-based groups (whether defined by regional or ethnic criteria) are relatively rare, and inter-group trust is limited. 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.

Social capital
5

II. Economic Transformation

6 | Level of Socioeconomic Development

Nepal is still one of the poorest countries in the world, and very unequal. Despite the ongoing difficult political situation since the end of the civil war in 2006, however, the living standard of many Nepalis continued to improve in 2011 and 2012. Remittances are the main reason for this development. As of 2010 – 2011, almost 56% of households received remittances, of which 42% were sent back by international migrants (mainly from India, Malaysia, Saudi Arabia and the UAE).

Between 2009 and 2011, Nepal's Human Development Index rose from 0.449 to 0.458. Particularly notable is the reduction of poverty. The percentage of Nepalis living below the poverty line fell further, from over 30% in 2003 – 2004 to 25.4% in 2010 – 2011. Existing poverty also appears to have become less severe, as the poverty gap ratio fell to 50%. A range of other development indicators improved: Literacy,

Question
Score

Socioeconomic
barriers
2

school enrolment and average life expectancy rates rose, and child and maternal mortality rates fell (United Nations Development Action Framework, UNDAF, 2012). The picture on employment is mixed. According to data provided by Nepal's Central Bureau of Statistics, the unemployment rate has decreased further, to 2.2% in 2010 – 2011. However, the high percentage of the labor force working 19 hours or less per week (31.7%, up from 24.4% in 2003 – 2004) may indicate significant underemployment.

Overall inequality appears to have decreased, but the figures are inconsistent. The World Bank records a Gini coefficient of .41 in 2011, while the Nepal Living Standard Survey puts the same indicator at .32. According to the latter, the nominal income of the poorest quintile rose by almost 397% between 2003 – 2004 and 2010 – 2011, that of the richest quintile by 233%. In any case, the aggregate indicators continue to hide considerable inequality along geographical, gender, ethnic and caste lines.

Gender inequality is still significant, but has improved in some fields. For example, 71% of the male population above 15 years of age is literate, but only 44.5% of girls and women (National Living Standards Survey, NLSS, III). Both overall literacy and the female-male ratio, however, have improved significantly since 2003 – 2004. Data also indicates that current enrolment rates are almost gender-equal: 67.2% (male) to 70.2% (female) at primary school level, 26.9% to 26.6% in lower secondary, and 15.7% to 14.2% in secondary school. Similarly, the NLSS 2010 – 2011 indicates labor force participation is similar for men and women, around 80% for both.

Human development opportunities also differ along lines of caste and ethnicity. Worst off are dalits, both in the hills and in the Terai. Brahmins, in contrast, have the overall highest average consumption and lowest poverty rate. In between lie various hill and Terai caste and ethnic groups. Some of them, such as Newars, Gurungs and Limbus, fall closer towards the higher end of the continuum, while others, such as Tamangs or Chepangs, fall at the lower end.

The picture is additionally complicated by significant regional differences. Thus, the far-western hills are by far the poorest region of Nepal, and a Brahmin living there is significantly more likely to be poor than members of many overall more disadvantaged groups from richer regions. However, it is important to note that, within each region, the overall dynamics of caste and ethnic inequality hold: A far-western hill dalit is still likely to suffer much worse deprivation than his Brahmin neighbor.

Most development data in Nepal has to be taken with a rather large grain of salt. While it may be used to gauge broad trends, it often does not lend itself to more fine-grained quantitative analysis.

Economic indicators		2009	2010	2011	2012
GDP	\$ M	12854.8	15955.7	18977.3	19414.7
GDP growth	%	4.5	4.8	3.9	4.6
Inflation (CPI)	%	11.6	10.0	9.5	9.5
Unemployment	%	-	-	-	-
Foreign direct investment	% of GDP	0.3	0.6	0.5	-
Export growth	%	3.9	-10.4	-2.1	14.1
Import growth	%	12.6	28.3	-4.7	1.8
Current account balance	\$ M	18.4	-128.1	288.6	576.9
Public debt	% of GDP	39.3	35.4	33.3	33.1
External debt	\$ M	3778.4	3796.8	3956.1	-
Total debt service	\$ M	176.8	187.3	203.2	-
Cash surplus or deficit	% of GDP	-	-1.4	-1.0	-1.7
Tax revenue	% of GDP	11.8	13.4	13.2	13.6
Government consumption	% of GDP	10.8	10.0	9.6	10.3
Public expnd. on edu.	% of GDP	4.7	4.7	-	-
Public expnd. on health	% of GDP	2.3	1.9	2.1	-
R&D expenditure	% of GDP	-	-	-	-
Military expenditure	% of GDP	1.6	1.6	1.4	-

Sources: The World Bank, World Development Indicators 2013 | International Monetary Fund (IMF), World Economic Outlook 2013 | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database 2013.

7 | Organization of the Market and Competition

The picture of market-based competition in Nepal is mixed, and there is both a formal and an informal dimension to this. There are only two state monopolies, electricity distribution and the trade in petroleum products. But broader restrictions on private sector activity persist, particularly in cross-border financial flows. International investors require central bank permission to withdraw investments or repatriate returns. Selling Nepali currency is difficult, and requires letters for credit. (This may be for good reasons; Nepal has a massive capital flight problem.) Prices are controlled

Market-based
competition
5

for a range of products, most importantly petroleum products and some food products, such as vegetables. In addition, a range of sectors are still closed to foreign ownership, or restrictions apply.

A Bilateral Investment Promotion and Protection Agreement (BIPPA) with India, signed in October 2011, addresses some of these disincentives for foreign direct investment (FDI) for Nepal's largest trading partner. In particular, it guarantees nondiscriminatory compensation in the case of nationalization or expropriation, and the right to repatriate returns. Nepal also has BIPPAs with five other countries.

Businesses in Nepal spent less time on dealing with regulation (permits, licenses, tax administration) than those in comparator countries, but tedious regulation is a particular problem for larger companies, according to the World Bank Group Investment Climate Assessment (2012). For small- and medium-sized enterprises, the 2012 World Bank/IFC "Doing Business" report for Nepal highlights the enforcement of contracts, dealing with construction permits, and trading across borders as the most problematic areas. Nepal's "license raj" constrains entrepreneurship to a large extent, while inadequate implementation of laws and regulations forms an additional obstacle. In the international "Doing Business" comparison, Nepal stands at rank 107 out of 183.

The most pressing regulatory issue appears to be political instability, which 90% of businesses in the Investment Climate Assessment cited as a major problem. Corruption is common, but seen as major problem only by one-fifth of companies, and 63% of companies view courts as fair. In fact, political instability appears to refer in particular to problems with organized labor. Labor unions in Nepal are closely tied to political parties, and constitute an integral component of the latter's patronage machinery. As a result, labor relations are extremely poor. This, again, affects larger companies in particular.

The IFC/World Bank identifies poor labor relations in combination with Nepal's rigid labor regulations as a key culprit in creating the large informal sector (undifferentiated minimum wages, and restrictions on layoffs). Different studies put the proportion of formally registered enterprises as low as one-fifth, and the percentage of workers employed informally as high as 70%. In fact, companies in the informal sector also appear better prepared to navigate the obstacles posed by political instability. While 69.6% of firms surveyed for the Investment Climate Assessment cited political instability as their most important problem, the proportion in the informal sector was 23.7%.

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.

Anti-monopoly
policy

6

Recent examples include capping of deposit interest rates by the Nepal Bankers Association at the height of the 2010 liquidity crisis, right under the eyes of the Central Bank; the openly cartelized transportation sector; and syndicates in a range of retail sectors, including for essential food items. 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.

Nepal acceded to the World Trade Organization in April 2004 as the first Least Developed Country (LDC) to do so. 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. However, Nepal retains much room for maneuver, since average applied tariff rates, at 12.2% in 2011 – 2012, are well under the average bound rate. 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.

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).

Nepal's banking sector has recovered significantly from the 2010 – 2011 liquidity crisis, but it is still structurally at risk. In 2010 and early 2011, the rapid expansion of credit, especially for the real estate sector, in combination with the rolling over of an increasing number of nonperforming real estate loans, and a drop in deposit growth, led to a severe liquidity crisis. Interbank lending rates spiked as high as 15% in 2010, and the credit-to-deposit ratio grew to 81.2%.

Recent measures by the central bank to strengthen the banking sector have alleviated the crisis. Among these measures are a refinancing facility to decrease interbank lending rates and ease the liquidity crunch, a cap on real estate and housing loans, and a cap on real estate lending at 25% of overall portfolio. Interbank lending rates have come down as a result, and the credit-to-deposit ratios, especially of larger commercial banks, have improved.

However, persistent structural problems mean the financial sector remains at significant risk. The key issue is the central bank's limited independence and resulting weak supervision and enforcement. The high number of banks and financial institutions exacerbates these regulatory difficulties, and easily leads to unhealthy

Liberalization of
foreign trade

8

Banking system

6

competition. Capital requirements are only enforced patchily. Several state-owned banks with high proportions of nonperforming loans still need to be restructured.

Nepal's banking sector largely fulfills international standards. The key problem remains noncompliance with international guidelines against money laundering.

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 U.S. dollar considerably during 2011 and 2012.

Anti-inflation /
forex policy
4

Inflation levels over the last years have consistently been above the target of 7% set by the central bank (10% in 2010, 9.5% in 2011). 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; low agricultural production in 2011 (but not 2012); and additional inflationary pressure through civil servant salary increases in the 2011 budget. However, analysts expect inflation to drop in 2013 with decreasing inflation in India, which is Nepal's largest trading partner.

Nepal pursues a prudent fiscal policy, and its debt burden is moderate. For 2012, public debt was 33.3% of GDP. The ratio of debt service to revenue and grants was 14.5% in 2011 and is estimated at 12.3% in 2012. Nepal runs a hefty import deficit, but finances it through remittances. The current accounts balance in FY 2012 was positive at 4.8% of GDP, significantly up from the -1% deficit in FY 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. Official reserves are at 6.8 months of imports of goods and services at current levels, up from 5.8% in 2011.

Macrostability
6

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.

9 | Private Property

Property is generally well protected by a constitutional right to property and other legal provisions. However, 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.

Property rights
5

One particular concern is property, mostly land, seized by the Maoists during the civil war. The Maoists had agreed in principle to return all of it, and have done so in the majority of cases, but some land still remains to be restored.

Private companies are constitutionally permitted and protected. Some restrictions apply to foreign ownership. In the early 1980s, the state ran more than 80 public enterprises in diverse sectors, including manufacturing. Many of them were privatized in the 1990s, beginning under the first Nepali Congress-led government in 1992. 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.

Private enterprise
5

10 | Welfare Regime

Nepal does not have a comprehensive social welfare system. Successive governments have implemented piecemeal schemes targeting individual disadvantaged groups, such as the elderly, widows or the disabled. Many school subsidy programs also exist to encourage school attendance among marginalized groups, particularly dalit girls. Several programs exist to provide subsidies to people recognized as belonging to one of these groups, but the amounts provided are often negligible (e.g., NPR 500/month to senior citizens) and/or do not reach their intended recipients regularly. These problems of access are often encountered at the district level, where eligible citizens may encounter difficulties with registration, or learn that the amounts received for distribution at the district level are incommensurate with the number of eligible recipients in the area. In many cases, NGOs 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. Family

Social safety nets
2

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.

Legally sanctioned social inequality on the basis of ethnicity, caste and gender was a defining feature of the Nepali state from its unification in the 18th century until very recently. Discrimination on the basis of caste was in principle outlawed in the 1960s, but in practice 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. Much of Nepal's recent political upheaval has been driven by social mobilizations that place the rectification of such inequalities at the top of their agenda. Most significant have been the Maoist movement, the Madhesi movement and the indigenous nationalities movement, but other collectivities organized around the same general principles of rectifying social inequality include regionally based groups in far-western Nepal, Dalit activists and a range of gender-based campaigns, of which the Occupy Baluwatar movement is only the most recent and high-profile. Equality of opportunity remains elusive, a fact that provides such movements with their impetus. People from certain ethnic, caste, and regional backgrounds, as well as women – not to mention those from disadvantaged class positions – routinely experience discrimination in the public sphere and difficulty accessing resources and positions of power. The civil service is notoriously unequal, as demonstrated by 2010 data showing that 72% of positions were held by members of the Brahmin caste, who comprise only 12.74% of the country's population. The army, although more diverse, is still highly inequitable, with over 40% of its ranks filled by members of the Chhetri caste, who comprise 15.8% of the population.

However, a range of recent 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 2008 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 (45% of seats are intended to be earmarked as “reserved,” of which 33% go to women, 27% to indigenous nationalities, 22% to Madhesis, 9% to Dalits, 5% to disabled people and 4% to people from “backward regions”). “Social inclusion” has also become one of the watchwords of many donor-driven projects in the NGO world, establishing a popular rhetoric of

Equal opportunity
3

equality in many domains of social work, even if that aspiration is not always fully realized at the programmatic level.

11 | Economic Performance

Nepal experienced healthy growth of 4.6% in 2011 – 2012, up from 3.9% in the previous year. GDP is now at NPR 1,558 billion; per capita GDP grew from \$712 to \$735 over the last year. Reasons are a particularly strong agricultural season, and a strong service sector, driven by a further increase in remittances by labor migrants.

A sector-by-sector breakdown of 2011 GDP reveals a large agricultural sector (35%), dependent on weather; a large and growing service sector (50%), primarily driven by labor migration and remittances; and a relatively small industrial sector (15%), reflecting the adverse climate for long-term investment. Growth trends in 2011 – 2012 reinforced this distribution, with a slight improvement in industrial growth: agriculture 4.9%, service sector 5.1%, and industry 2.7% (IMF 2012).

Reliable unemployment figures are hard to come by. Official unemployment is relatively low, but underemployment is widespread. The lack of employment opportunities continues to drive significant numbers of mostly young Nepalis abroad.

Remittances are instrumental to keeping the economy afloat. Official remittances rose from \$3,545.2 million in 2010 – 2011 to \$4,413.8 million in 2011 – 2012, and now account for 22.7% of GDP (up from 18.7% the previous year). Including remittance flows through unofficial channels, these numbers could be much higher (a World Bank estimate in 2011 put them at 25% – 30% of GDP). The remittance dependency puts Nepal at considerable risk from external shocks, since most migrant laborers are concentrated in India, Malaysia and the Gulf Cooperation Council (GCC) states, working in low-income sectors such as construction.

Remittances have kept the economy afloat in FY 2011 and 2012. They finance Nepal's massive trade deficit and help maintain a balance of payments surplus (see above, Section 8.2).

Inflation declined to 8.3% in FY 2011 – 2012, with non-food inflation at around 9% (IMF 2012). Some analysts doubt the low inflation figures, however, suggesting it may in fact be as high as 11.5%.

Other macro-indicators show significant improvement. Foreign direct investment improved from 0.2% of GDP in 2010 to 0.5% in 2011, with projections for 2012 at 0.6%. Tax revenue increased significantly, from NPR154.7 billion in 2009 – 2010 to NPR171.8 billion in 2010 – 2011 and an estimated NPR 211.7 billion in 2011 – 2012, due to successful reforms in revenue administration (IMF 2012).

Output strength
4

12 | Sustainability

In 2010, Nepal had an Environmental Performance Index score of 68.2, which places it significantly above its income peer group (45.8) and the regional average (57.4). Nepal's good 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.

Environmental
policy
5

Efforts have been particularly successful in the areas of conservation/biodiversity and forestry. Large swathes of Nepal's forests are administered through Community Forestry 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 (up to 12 hours per day during the winter months), 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.

Progress in enrolment rates at the primary through tertiary levels is impressive, but reforms to address quality problems in Nepali schools and universities remain stalled. Public expenditure on education remains at a relatively low 4.7% of GDP. Enrolment rates at Nepali schools have been on the rise for decades, and the last two years have seen the continuation of this trend. The share of Nepali children enrolled in primary (classes 1-5), lower secondary (classes 6-8) and secondary school (classes 9/10) is now at 96%, 78%, and 45% – 50%, respectively. However, the quality of schooling has not necessarily improved.

Education policy /
R&D
3

The government has made a first step towards evidence-based policymaking in this field with the new National Assessment of Student Achievement, which measures student skills in grades one, three, and eight. An important attempt at improving the quality of primary education is a new focus on reading in early grades, which is, however, not yet being implemented. At the higher secondary level, the government

has started supporting community schools (as opposed to private colleges) with additional teachers and scholarships for students from disadvantaged communities.

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: Three central universities administer several hundreds of thousands of students studying in affiliated campuses across the country. Laws establishing six new universities have been passed, but the actual campuses have not been set up, due to competing political pressures. Underfunding is a persistent problem of the higher education sector: Out of overall public spending on education, only about 10% is allocated to universities. Recent data on R&D spending is not available, but experts say it is negligible.

Transformation Management

I. Level of Difficulty

The Nepali political leadership faces significant structural constraints in achieving good-governance goals. 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 contributes to this scenario, as well as uneven educational resources across the country. While urban Kathmandu and other emerging centers like Pokhara and Biratnagar possess highly educated workforces who often compete vigorously for top positions, most rural districts have difficulty attracting and retaining skilled workers in key sectors like health and education. This leads to brain drain, as nearly a quarter of the country's workforce is employed outside of Nepal. This scenario presents significant challenges to governance and administrative capacity-building. 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. With the personal claims to power of most party leaders so deeply embedded in the old structure of the state, the political leadership is, in a manner of speaking, its own structural constraint, which hinders aspects of the state restructuring process that might introduce new avenues to power and therefore undercut their own positions.

Structural
constraints
9

The country is earthquake and landslide prone, and it has been significantly affected by floods over the last several monsoon seasons. It is struggling with HIV prevention, particularly among returning migrant workers.

Spaces for civic participation are manifold in Nepal, and citizen participation in debate is robust and increasing in sophistication. The forms of engagement observed may not match traditional 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

Civil society
traditions
7

between a range of different interest groups were key to the successes of both the 1990 and 2006 democratic movements. It remains to be seen what kinds of alliances may be forged at the grassroots level in the next phase of the state restructuring process to push elite political actors towards a parallel bridging of differences as they seek to determine the shape of the new federal state.

Although public perceptions of polarization and cleavage along ethnic and regional lines have grown over the last several years, exacerbated by scare-mongering in many national media outlets, actual instances of violent conflict have decreased during the reporting period. Certainly in contrast to the decade-long period of outright conflict between 1996 and 2006, and the immediate post-conflict years during which law and order remained significant problems, especially in the Terai area, the intensity of violence has decreased during the last few years. Contrary to expectations, emerging evidence from several locales suggests increasing cooperation between members of different cultural communities, as individuals maximize their strategic options amidst the uncertainty about what role identity-based allegiances will play in constituting the new polity once restructuring advances. Nonetheless, many tensions run only slightly below the surface, and 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

The key strategic question for Nepali politics since the Constituent Assembly elections in 2008 has been the federal restructuring of the state. This agenda was originally advanced by the Maoists and various identity-based movements. The two other major political parties, the UML and the Nepali Congress (NC), reluctantly agreed to writing this agenda into the 12-point agreement, the original road map for the peace process, and the interim constitution in 2007. But vast differences persisted from the beginning about whether borders of new federal states should be drawn along lines of ethnic and regional identity. The Maoists largely supported this agenda, while UML and NC were vehemently opposed to it. Over the following four years, productive debates took place in the state restructuring committee and the constitutional committee of the CA, which produced detailed reports of possible federal models. However, the senior leadership of neither NC nor UML truly owned those efforts, and questions of government leadership and the future of the cantoned

Question
Score

Prioritization
3

Maoist combatants stood in the foreground. While a vigorous public debate about federalism ensued, it did nothing to depolarize positions.

The depth of Nepal's political divide over federalism became clear in the beginning of 2012. With the start of the process of integrating some Maoist combatants into the Nepal Army, and rehabilitating others into society, the last putative obstacle to negotiating the new constitution had been removed. Yet negotiations stalled, ultimately over the question of federalism, and the CA was dissolved in May 2012.

Due to the fundamental nature of the debate about state restructuring, it naturally occupies a prominent place in current politics, and public imagination; other long-term strategic priorities, such as economic development, have been pushed to the background. There were some indicators that the Bhattarai administration started to transcend the immediate objectives of the peace process and formulate more long-term objectives. Among them are policy initiatives such as the Nepal Investment Year and the Nepal Investment Board. Infrastructure development, especially electricity production, is a key constraint to investment in manufacturing, and has long been identified as a strategic sector by governments across party lines, with no result in practice.

Some analysts, however, dismissed the policy initiatives of the Bhattarai government as cheap publicity stunts, undertaken in full knowledge that they would not be implemented. While the lack of tangible changes over the last one and a half years might support this interpretation, this has also been an extraordinarily difficult time politically. 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 their party base.

The efforts of the Bhattarai government to strengthen Nepal's investment climate have met with some limited success, but failed to achieve structural change so far. Among the successes are the BIPPA with India, mentioned above, and the negotiation of several Indian and Chinese investments for large hydropower projects. All of these measures, however, have also sparked strong criticism from opposition parties as well as from within the Maoists; future obstacles to implementation cannot be ruled out.

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.

Indeed, other examples show that Nepal's bureaucracy is fully capable of implementing policies, provided that the major parties demonstrate the political will. For example, after the 2007 Madhesi protests and legal changes to entitle the children

of Nepali mothers and foreign fathers to citizenship by descent, there was a marked improvement in the provision of citizenship certificates in the Terai (it has since flagged).

Of course, the most overwhelming strategic priority – a road map for state restructuring agreed on by almost all parties in principle – has not been achieved due to fundamental differences over what implementation might look like in practice.

Policymaking plays a relatively minor role in Nepal's politics for several reasons. Important policy decisions are frequently subject to fierce distributional battles between different ministries, either at the political or even the upper administrative level. Furthermore, the crucial bottleneck lies less in the making 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.

The most important policy decisions Nepal faces at the moment are inherently political. This concerns first and foremost the debate about federalism. Of course there are technical dimensions to the fundamental administrative changes that will be necessary in the federalization process. But the questions that stand in the foreground, and contributed significantly to the collapse of the constitution writing process in 2012, have to do with the political effects of different forms of federalism: Prominent themes range from economic redistribution to the integrity of the Nepali state and rendering Nepali nationalism more inclusive.

In fact, learning from past experience is a contentious issue. The political force that has shown 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. The NC and UML, in contrast, were punished in the 2008 elections for failing to take into account the mood for change in general, and ethnic and regionalist demands in particular. Apart from small, innovative factions that are desperately trying to bring their parties back in touch with the people, neither the UML nor the NC leadership seems to have rethought its strategic approaches since then.

Flexibility has been a hallmark of political resilience, but does not necessarily lead to innovation. As new political players with change agendas, first the Maoists, then the Madhesi parties, have been incorporated into patronage politics, there were struggles over distribution, but fundamental changes to the rules of the game dropped out of sight.

Policy learning

4

15 | Resource Efficiency

Nepal's civil service is neither overstaffed nor overpaid. To the contrary, civil servant wages are for the most part insufficient to pay for a decent living, and well below what a similarly qualified person could earn in the private sector. Wages in both sectors are far outstripped by income opportunities in donor-funded development organizations. Arguably, this is one of the reasons why corruption is so endemic at all levels of government in Nepal. Two other major problems of Nepal's administration are its fragmented decision making processes, and the opaque and politicized system of transfers and promotions. As the top political leadership in government and opposition frequently fails to establish a working consensus on immediate priorities, and the bureaucracy is subject to numerous contradictory forces, the allocation of resources is inefficient almost by default.

Efficient use of assets

3

As discussed above, Nepal's budget is overall balanced, and the level of state debt rather low. Problems appear on the expenditures side. Since 2008, the annual budget regularly got entangled in broader disputes about government leadership, and hardly a budget was passed on time. This results in tremendous difficulties with budget expenditure. The end of the financial year usually sees a mad spending rush, which is not conducive to transparency.

Nepal's major political parties are deeply divided over fundamental policies such as federal restructuring. If anything, coordination is most effective when aimed at preventing coherent policies from emerging. In addition, important policy decisions are frequently held hostage to demands for changes in government leadership, or other short-term political gains.

Policy coordination

3

Inefficiency results from both formal and informal institutional factors. The judiciary is independent, and frequently works at cross purposes with the political sphere. For example, conservative judges frequently torpedo measures aimed at creating a more inclusive Nepali national identity. Having denied the possibility of a further extension, the Supreme Court bears at least some responsibility for the lapsing of the CA. The party system itself is fragmented not only between, but also within parties. In the constitution drafting process, this frequently pitted CA members who worked hard to achieve progress against upper party echelons more concerned with short-term political gain. In combination with the highly personalized style of authority within parties, the effects are often crippling.

The misappropriation of public resources and other forms of corruption are systemic 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

Anti-corruption policy

3

among them, the Commission for the Investigation of Abuse of Authority (CIAA), has not had a commissioner for six years.

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.

16 | Consensus-Building

With the de facto acceptance of multiparty democracy by the Maoists, there is general consensus on democratic principles. The precise nature of democracy, however, is still contested: The Maoists tend towards centralized authority (presidential system), while the NC and UML favor a parliamentary system. Similarly, there is broad agreement on the need for a market economy. The problem here rather lies with the implementation of policies to strengthen the operation of market principles.

Consensus on goals

6

The Maoists are facing and posing some thorny questions. Baburam Bhattarai (who was prime minister for much of the reporting period) has made clear that their support for multiparty democracy and essentially capitalist economic growth is not a short-term tactical move. To the contrary, he views it as 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. This line still has much traction in the party. Maoist leader Mohan Vaidya, together with a considerable minority of the party apparatus, split off to form the CPN(M) in 2012 precisely because he felt the revolution had been betrayed. The continued ideological commitment to revolutionary politics does not constitute a direct threat to the democratic system; the democratic opposition is too strong, the international environment too adverse, and the Maoists increasingly too invested in mainstream politics, both politically and financially. What it may complicate, however, is the formulation of coherent policies aimed at market economic growth.

The flexibility of Nepal's state is a major obstacle to the full establishment of the rule of law, and rational, transparent forms of governance. However, the same flexibility is at the root of the state's ability to integrate or contain antidemocratic actors. The Maoist transformation into a mainstream political party is a case in point. In 2006, the Maoists emerged from a decade of civil war with a clear revolutionary agenda and a dedicated cadre of followers. Seven years later, they are deeply invested in

Anti-democratic actors

5

Nepal's politics, and their patronage networks have come to depend on the continuation of the status quo just as much as those of other major parties.

The Nepal Army, a real threat to Nepal's democracy not only during the civil war but also on several occasions afterwards, has refrained from overt political engagement over the last 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 NA's autonomy, but otherwise does not wish it to play a larger role in politics.

The former royal family, lastly, 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.

Nepal's political leadership has done little to counteract the growing polarization of the political sphere along ethnic lines, but stepped in to prevent escalation. The polarization along identity lines, particularly over the question of identity-based federalism, is manifest in heated op-ed exchanges in newspapers, the utterances of political leaders, and of course the dissolution of the CA in May 2012. On occasion, national political leaders have resorted to more or less roundabout ethnic slurs, in particular aimed at Madhesi politicians.

It is nevertheless uncertain where this dynamic is headed. Identity-based cleavages increasingly find expression in the party landscape, and this may be a good thing. After the formation of Madhesi parties after the Madhesi movements in 2007 and 2008, a large group of Janajati leaders has left the NC and UML to establish two Janajati parties. When the Madhesi parties established themselves as new political forces in the 2008 CA elections, the major political parties accepted them as such, however grudgingly. Madhesi leaders have since been well represented in coalition governments. This has helped deescalate the mood among Madhesi activists, even as conservative opposition has so far prevented the establishment of federalism. Janajati activism may potentially take a similar course. However, whether this is possible will only become clear with the next elections.

Identity-based tensions may occupy the foreground in the public debate, but 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. The toxic mix of inequality and poverty remains

Cleavage /
conflict
management
4

potent. The remittance economy works as a safety valve, in the sense that it helps Nepal's youth fulfill at least some of their aspirations, and has led to a steady rise of living standards overall. At the same time, social ascent creates new aspirations, which are likely to lead to renewed distributional struggles in the future.

Together with political parties, civil society actors have played an important role in struggles for democracy since the end of the party-free Panchayat system in 1990. Since then, a large number of civil society organizations and a vibrant media sphere have emerged.

Civil society
participation
5

Civil society in Nepal in many ways does not constitute an independent sphere of deliberation and action. Instead, many civil society organizations including human rights organizations 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.

Parts of civil society have also aligned themselves along emerging identity-based fault lines. Much of the media world and the human rights community is dominated by members of hill Hindu upper castes, and favors dominant discourses. Many of the organizations that drive regionalist and ethnic movements themselves take civil society forms.

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. A recent example of civil society-driven agenda-setting is the Occupy Baluwatar movement, which demands measures to prevent violence against women. This movement may have a fairly narrow urban class base, and it is too early to say to what extent it might be successful, but it does prove that autonomous civil society action is possible in some spheres.

There is consensus across the political board to prevent the prosecution of wartime crimes in any systematic manner. Many among the leadership are implicated themselves. Some Maoist leaders could be prosecuted for chain of command responsibility (as is the case for many Nepal Army generals). Some of the worst atrocities by state security forces 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.

Reconciliation
4

Progress on the legacy of centuries of discrimination along lines of caste, ethnic and regional identity is even harder to assess. As discussed elsewhere in this report, Nepal

has come far in moving away from formerly dominant conceptions of the nation. These subsumed the entire population under upper caste cultural values in a manner that was officially egalitarian, but left much leeway for informally discriminating against all whose language and culture diverted from the ideal. The demands of identity-based activism may appear radical, but they are in fact relatively modest and workable. There are no demands for compensation for historical wrongs, which could have led to thorny questions about, for example, land redistribution. Instead, what is called for are largely measures aimed at creating a more level playing field. These include some redistributive policies, such as quotas and reservations in the administration, but mostly they aim at removing the implicit bases for ongoing discrimination by recognizing Nepal's many languages and cultures as equally valuable, and their bearers as equally enfranchised political actors.

17 | International Cooperation

Donor agencies exert significant influence on Nepali policymaking, as do their diplomatic counterparts. Notably, the U.N. Mission in Nepal (UNMIN), which monitored the peace process from 2007 to 2012, ended its mandate and left Nepal just before the beginning of the current reporting period, before combatant reintegration was completed or a constitution was promulgated. UNMIN's departure spurred a reconfiguration of international interests on the ground in the early part of the reporting period, and recalibration of Nepali political actors' allegiances.

The World Bank has operated in Nepal for more than five decades, and maintains a substantive engagement in policymaking, alongside the U.N. agencies (notably the United Nations Development Programme, UNDP). Influential bilateral organizations include the British Department for International Development (DFID), the Japanese International Cooperation Agency (JICA), the United States Agency for International Development (USAID), the German Society for International Cooperation (Deutsche Gesellschaft für Internationale Zusammenarbeit, GIZ), the Swiss Agency for Development and Cooperation (SDC) and several Scandinavian organizations. 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

Effective use of
support

6

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.

The international community at large saw the 2008 Constituent Assembly elections as a moment of great hope, and poured resources into supporting the Nepali state in the early years of the CA's tenure. However, certain influential countries, notably India and the U.S., maintained reservations about the credibility of any Maoist-led government. By the beginning of the current reporting period, other international actors also began to doubt the inter-party political will to complete the state restructuring process. The failure to promulgate the constitution by the deadline, and the dissolution of the CA, seriously damaged the state's credibility in the eyes of the international community, since much of the international assistance received since the end of the conflict was contingent on the understanding that this fundamental task would be completed as promised.

Credibility

5

International community attitudes, in particular those of Western donors and large international funding agencies and financial institutions, are ambivalent with respect to Nepal's efforts at market reforms and economic development. While the government is seen as largely on the same page with respect to policy formulation, a long and consistent history of non-implementation has led to widespread skepticism.

Nepal maintains close relations with India and China, both countries with which it shares long, erratically regulated borders. Historically, the relationship with India has been stronger, but the Maoist leadership has made new overtures to China in very recent years. 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, along Nepal's northern Himalayan belt, 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. Nepal endeavors to be a good neighbor, despite facing significant pressures on both sides. Nepal is a member of South Asian Association for Regional Cooperation (SAARC) and has also played a key role in developing a multilateral regional forum on climate change, initiated at the 2011 climate summit held in Bhutan.

Regional
cooperation

6

Strategic Outlook

Nepal now stands at a key juncture in its long process of political transformation. The country must find a way out of its current extra-constitutional impasse, and embark upon the next phase of constitution writing in general, and state restructuring in particular, with a renewed commitment to compromise. Political actors from across the spectrum will need to demonstrate flexibility, the will to forge consensus on a series of thorny issues, and the ability to craft creative yet realistic frameworks to achieve the 2006 promise of a restructured, secular, democratic, federal republic. Before that goal may be reached, elections must be held, a workable federal map drawn, and a new constitution promulgated. These political initiatives must be complemented with attention to pressing economic and infrastructural issues that have been neglected over the past several years.

As a transitional government moves towards the next phase of state restructuring, all political actors should reach out to their constituencies, engaging citizens directly in the continued process of democratic transition to ensure that a wide range of public views are represented in the political process. Party leaders should focus on the long-term agenda of durable state-making, rather than short-term agendas of personal gain. All parties should be aware that further foot-dragging may open up undesirable spaces for nondemocratic actors to gain traction. The NC and UML would gain credibility by working constructively with other parties towards a realistic proposal for a more inclusive, equitable state, while the UCPN(M) must continue compromising on its demands for a centralized form of governance. The UCPN(M) leadership should also be mindful of over-centralization within the party, watching carefully the actions of its cadres across the country in order to maintain control of the party structure.

The UCPN(M) also bears responsibility for leading the way towards an agreement on transitional justice provisions, including the prosecution of grave crimes committed during the conflict era by all sides. The army should be lauded for staying out of the political fray, but should continue to be carefully monitored. In order to keep its international image intact, the army must cooperate with political actors in establishing the transitional justice system, and proactively pursue the prosecution of suspected war criminals in its ranks.

Once a new constitution-drafting body is formed, options for federal demarcation should be considered dispassionately, putting aside the polarizing rhetoric of the debate over identity-based federalism that derailed the last Constituent Assembly. A federal map should recognize the legitimate aspirations of ethnic and regional actors through its naming strategies and draw carefully determined boundaries that allow new electoral constituencies to emerge, while refraining from attaching preferential rights directly to individual identities or residence in specific territories. Instead, inequalities can be addressed through a robust, centralized system of affirmative action that grants equal entitlements to members of designated social or economic groups regardless of their provincial place of residence. Such a compromise solution will be necessary to avoid further alienating citizens mobilized around ethnic and regional identities, while

also assuaging fears of erstwhile dominant group members that they will become second-class citizens in the new system. Political actors as well as citizens from diverse backgrounds must work to foster a climate of trust across existing social boundaries to facilitate the eventual process of federalization.

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.