

# BTI 2010 | Nepal Country Report

<b>Status Index</b>	1-10	<b>4.60</b>	# 90 of 128	
Democracy	1-10	5.35	# 69 of 128	↑
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scale: 1 (lowest) to 10 (highest)    score    rank    trend

This report is part of the Transformation Index (BTI) 2010. The BTI is a global ranking of transition processes in which the state of democracy and market economic systems as well as the quality of political management in 128 transformation and developing countries are evaluated.

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### Key Indicators

Population	mn.	28.1	HDI	0.55	GDP p.c.	\$	1051
Pop. growth	% p.a.	1.7	HDI rank of 182	144	Gini Index		47.3
Life expectancy	years	64	UN Education Index	0.58	Poverty <sup>2</sup>	%	77.6
Urban population	%	16.8	Gender equality <sup>1</sup>	0.82	Aid per capita	\$	21.3

Sources: UNDP, Human Development Report 2009 | The World Bank, World Development Indicators 2009.

Footnotes: (1) Gender Empowerment Measure (GEM). (2) Percentage of population living on less than \$2 a day.

## Executive Summary

After a comprehensive peace agreement between the Seven Party Alliance (SPA) and the Communist Party of Nepal (Maoist) (CPN-Maoist) in November 2006, the parties jointly worked out an interim constitution that was implemented on 15 January 2007. On the same day, a new interim parliament with 330 nominated members, including Maoist representatives, was formed. In April 2007, the Maoists also joined the government. It took another year and three delays before a Constituent Assembly (CA) was elected by the Nepali people on 10 April 2008, to date the most important step towards a new Nepal. The people showed a democratic maturity, by punishing those parties and leaders who bore the most responsibility for the failure of the democratic system inaugurated in 1990. The CPN-Maoist, which stood for necessary fundamental reforms of state and society and also offered the most inclusive list of candidates, won half of the 240 direct mandates and 30% of the seats on the basis of the proportional lists. It is now the strongest party, with 220 out of 601 seats in the CA. The months that followed these elections were disappointing in many respects, as the old power struggles between political leaders started once again, this time with the participation of the Maoists. Monarchy was abolished on 28 May 2008, and Ram Baran Yadav (a member of the Nepali Congress party) was elected as first president of Nepal by the CA. In August 2008, a coalition government was formed with Pushpa Kamal Dahal (CPN-Maoist) as prime minister. It was only in early 2009 that the CA could start its work on the new constitution, which is slated for promulgation on 28 May 2010. Militancy and crimes are widespread despite the end of the Maoist insurgency. Most affected is the Tarai flatland along the southern border with India. The supply situation has deteriorated dramatically in 2008, with extreme power shortages rampant. The country also faces negative effects from the global economic crisis.

## History and Characteristics of Transformation

The modern Nepali state was created between 1743 and 1816, largely by means of conquest. In the post-unification period, Nepali court politics were characterized by weak personal rule and acute political instability. The royals and their upper Hindu caste courtiers engaged in conspiracy, murder and killings, which led to the rise of Jang Bahadur Rana in a bloody massacre in 1846. The subsequent Rana oligarchic rule lasted for 104 years. The law code of 1854 was based on traditional Hindu political thinking, and introduced a hierarchical social setup that made the masses second- or third-class citizens. An armed movement led by the Nepali Congress (NC) terminated the Rana system after a compromise was reached in Delhi (India) between the king and the Ranas, through the mediation of the Indian government. The Delhi compromise guaranteed a multiparty system, fundamental rights and the return of monarchy to its traditional position. The 1950s was a period of democratic experimentation, with numerous governments appointed and dismissed by the king. General parliamentary elections took place in 1959 and were won by the NC. However, this first attempt at parliamentary governance ended with the intervention of the king through a military backed coup in December 1960. The so-called Panchayat system was introduced in the same year, featuring direct rule by the king himself.

A pro-democratic people's movement brought down the Panchayat system in early 1990. The constitution introduced on 9 November 1990 transformed Nepal into a constitutional Hindu monarchy and established a multiparty democracy with a bicameral legislature, an independent judiciary and a catalogue of fundamental human rights. Since then, Nepal has experienced a succession of weak governments, most of which have lasted less than a year. A Maoist rebellion, which erupted in February 1996, caused increasing problems for the government and over the years affected almost all 75 districts of the country. The movement found support among the impoverished and largely disadvantaged masses of the rural population. The fighting between the Royal Nepali Army (RNA), which was first mobilized in November 2001, and the Maoist's People's Liberation Army (PLA), has contributed to the decline of democracy and human rights in the kingdom, causing considerable concerns among Westerners and Nepalis over the country's future.

The entire royal family of King Birendra was murdered on 1 June 2001 under mysterious circumstances, and the dead king's brother, Gyanendra, was crowned king on 4 June 2001. A brief cease-fire and dialogue with the Maoists ended in November 2001 with a renewed escalation of violence. The government declared a state of emergency. In May 2002, Prime Minister Sher Bahadur Deuba (NC) recommended that the king dissolve parliament, set new elections and issue a decree extending the state of emergency for another three months. In addition, he dissolved the elected local bodies when local elections could not take place in July 2002. When parliamentary elections proved similarly impossible to be held as scheduled, the prime minister and the leaders of other parties agreed to ask the king, under the authority of

Article 127 of the constitution, to postpone the elections and form a government with representation from all parties.

Instead of reinstating the dissolved parliament, King Gyanendra seized this opportunity to stage a royal coup, claiming full sovereignty and assuming executive authority. He disbanded the cabinet, postponed elections indefinitely and appointed a new government made up largely of technocrats and dissident members of major parties, rather than party leaders. In June 2004, King Gyanendra re-installed Deuba as prime minister of a multiparty government, in hopes of quelling the growing number of protests and street demonstrations. Disappointed by the lack of success in combating the insurgency, the king again declared a state of emergency, and with the assistance of the RNA, seized power on 1 February 2005 and thus completed his coup d'état. The king dismissed the cabinet, detained opposition leaders and NGO activists, and appointed a crisis cabinet with staunch royalists that reported directly to him. Under great pressure from civil society, a loose political alliance was formed in November 2005 between the Seven Party Alliance (SPA) and the Maoist insurgents. A pro-democracy movement in April 2006 forced King Gyanendra to accept the principles of popular sovereignty and to reinstate the dissolved parliament.

Gyanendra invited the SPA to implement the people's "roadmap to peace," which included the election of a constituent assembly to rewrite the constitution, an inclusive state and society, and the introduction of a federal republican system. Former Prime Minister Girija Prasad Koirala (NC) was appointed new prime minister. A comprehensive peace agreement with the Maoists in November 2006 opened the way for the new interim constitution that came into force on 15 January 2007. A new parliament was formed that included representatives of all parties, including the Maoists. In April 2007, the Maoists also joined the government of Prime Minister Koirala. General elections to a constituent assembly (CA) were delayed twice and finally took place on 6 April 2008. These elections ended with a disaster for NC and the Communist Party of Nepal-Unified Marxist Leninist (CPN-UML). The clear winner was the CPN-Maoist with 37% of the seats (220 out of 601). On 28 May 2008, the CA abolished the institution of monarchy and declared Nepal a federal republic. Ram Baran Yadav (NC) was elected to be the first president of Nepal in July 2008. One month later, a new coalition government was formed under Prime Minister Pushpa Kamal Dahal (CPN-Maoist). The CPN-UML joined this government, while the NC remained in the opposition. However, the peace process still remains fragile with the incomplete integration of the former People's Liberation Army into the Nepalese Army (NA) and with the army disobeying orders from the government. After almost one year, the CA has just started its work of writing a new constitution, scheduled to come into force on 28 May 2010.

## Transformation Status

### I. Democracy

#### 1 | Stateness

After several years of a multidimensional crisis of stateness, driven by a Maoist rebellion and a royal putsch, Nepal has initiated a process of peace and constitutional renewal in 2006. A state monopoly on force has been reinstated in most parts of the country, but remains weak in the southern flatland area (Tarai) along the Indian border. Ever since the unification of the country in the late 18th century, stateness has been linked with the religion, language and culture of the so-called upper Hindu castes (Tagadhari), especially the Brahmans (Bahun), who dominate politics, the judiciary, the media and all other spheres of public life. This changed little after 2006. For years, public life and law and order had been eroded by the Maoist insurgency as well as the counterinsurgency efforts of the Royal Nepali Army. This situation has improved only somewhat after the end of the conflict. The politics of impunity and militant ethnic and regional movements have now become the main threat to the state's monopoly on force.

Monopoly on the use of force

The interim constitution of January 2007 introduced fundamental changes to the state identity. Nepal is no longer called a Hindu state, but is rather a "secular, inclusive and fully democratic" state. Thus, one precondition for the abolition of traditional state and society hierarchies has been established. But the current transitional period has so far seen little in the way of practical changes. The traditional hierarchical Hindu thinking still exists in the minds of many so-called leaders. This means that women still lack the same rights and opportunities as men. People of Indian ancestry living in the Tarai (Madhesi), members of numerous ethnic groups (Janajati) and the so-called untouchable castes (Dalit) continue to face manifold discrimination. Thanks to the proportional aspect of the elections to the Constituent Assembly (CA), disadvantaged groups are at least adequately represented in the assembly, but the same cannot be said for the government, political parties, administration, judiciary, media, education system or business.

State identity

With the abolition of the Hindu state, the situation of other religions has improved. The official recognition of non-Hindu festivals further supports this development.

No interference of religious dogmas

The Maoists demand a totally secularized political system, though they have tried to intervene in Hindu traditional practices. All other political parties and actors remain deeply influenced by the legacies of the Hindu caste system.

The administrative system is moribund, riddled with corruption and urgently in need of reform. Especially in rural areas, the infrastructure is too weak to provide a sound administrative basis for political, social and economic development. This is most of all true in the Tarai region, where the administration's activity is threatened by numerous militant groups. A general restructuring of the civil administration has been under discussion for years, and these debates have intensified in recent months. Due to the ongoing discussion over the future federal state system, administrative restructuring can not take place before the promulgation of the new constitution in May 2010.

Basic  
administration

## 2 | Political Participation

A new election system was introduced for CA elections, beginning on 10 April 2008. Of the seats, 240 fell to the winning candidates in each of the country's 240 constituencies, according to a first past the post (FPTP) electoral system. Another 335 were elected through a system of proportional representation (PR). Each voter had two votes, one for a FPTP candidate, and one for the PR lists of the parties. The composition of the PR party lists is required to be strictly regulated, in order to guarantee that different population groups will be represented in the CA according to their respective share in the country's total population. However, parties are not bound to the same rules in nominating FPTP candidates. In addition to these 575 elected members of the CA, the government nominates another 26 members from among persons of good reputation who have rendered significant contributions to national life. Numerous national and international observation teams reported that the 2008 elections were free and fair compared to other South Asian countries, although cases of intimidation and booth capture were reported.

Free and fair  
elections

Democratic rule remains fragile despite the formation of a Maoist-led coalition government following the election results of April 2008. On the one hand, the CPN-Maoist has had problems in replacing its militant outlook for adherence to democratic rules. On the other, the losers of the elections, and particularly the NC, have been unable to implement necessary internal democratic reforms. Instead of practicing constructive oppositional politics, the NC has sought to boycott every initiative of the government within the CA or in the various commissions. One urgent task is the integration of the core of the former People's Liberation Army (PLA) into the Nepalese Army (NA). The peace process is in danger as long as this problem is not solved. The integration of the two armies is opposed both by the NC and the NA leadership. The army chief has even gone so far as to disobey orders from the defense minister, thus calling the army's loyalty into question. On 22

Effective power to  
govern

February 2009, the Supreme Court issued an interim order to the Defense Ministry and the NA halting of the induction of new personnel in the army.

Freedom of association and assembly is guaranteed by the interim constitution of January 2007. Before the elections to the Constituent Assembly, incidents were reported in which pro-monarchy party meetings were attacked, especially by Maoist groups. With the total defeat of royalist forces in the elections, such cases are no longer evident. Occasionally, there are reports of clashes between different party groups in rural areas, most of all in the Tarai. In summer 2008, the government brutally suppressed mainly peaceful demonstrations and protests against China by Tibetan exiles. This obviously happened as a result of pressure from the Chinese government.

Association /  
assembly rights

With respect to press freedom, Reporters Without Borders ranked Nepal at 160 out of 167 countries in 2005, and at 159 out of 168 countries in 2006. In 2007, the country rose to position 137 out of 169 countries and stagnated at position 138 out of 173 countries in 2008. There has been a great improvement compared to the times of the royal putsch, but journalists still face threats on the part of government, parties, party sub-organizations and militant groups. Three journalists were murdered in 2007, one of which had been working for a pro-Maoist paper. Two more journalists were murdered in 2008, and in January 2009 the young female journalist Uma Singh was brutally killed in the Eastern Tarai town of Janakpur. Generally, there has been a sharp rise in incidents of attacks against or intimidation of journalists in the Tarai region since 2007. This has gone hand in hand with the growing militancy of Madhesi groups in the area. In late 2008, the Maoist-led government promised to respect press freedom, but it too has exerted pressure on journalists. For example, in December 2008 Maoist unionists attacked Himal Media, one of the leading media houses in Kathmandu, and injured a number of journalists and other staff. The reaction of the government was less than halfhearted.

Freedom of  
expression

### 3 | Rule of Law

In the absence of a parliament between October 2002 and April 2006, Nepal was governed at all levels by executive fiat. In early 2009, this was still true on the local level, though discussions were underway to fill the positions with political party nominees. However, this plan was opposed by the NC. On the national level, the situation has slowly improved since 2007. The interim constitution of 15 January 2007 grants the prime minister and cabinet sweeping authority, subject to minimal checks and balances. The compromised independence of institutions such as the judiciary has weakened the principle of separation of powers. The parliamentary elections of April 2008 replaced the parliament of January 2007 by legislative members selected by popular ballot. The elections also brought the single-party

Separation of  
powers

majority of the NC to an end, and made the coalition government of Prime Minister Pushpa Kamal Dahal more responsible to the parliament.

After the end of the royal regime in April 2006, the Supreme Court issued a number of decisions strengthening the rights of disadvantaged societal groups. However, on several occasions, the government ignored judicial orders. A special problem has been the political decision of the Maoist-led government to turn a blind eye to crimes committed in the context of the Maoist insurgency. In late 2008, a conflict rose between Law Minister Dev Gurung and Justice Moti Kaji Sthapit, when Gurung demanded the latter's resignation from the Judicial Council responsible for appointments within the judicial service. The interim constitution had created the Judicial Council as an exclusive authority for dealing with some of the most important issues relating to an independent judiciary. In particular, the framers of the constitution hoped that the process of judicial nomination would bolster the independent and impartial image of the judiciary, rather than undermining it.

Independent  
judiciary

A lack of effective legal consequences has been and still is a serious obstacle in ensuring the rule of law and protection of human rights. The inclusion of provisions in the interim constitution such as the unrestricted authority of the government to grant pardons enabled the political elite to sweep past misdeeds under the carpet. Neither the crimes of the Maoists or the security forces, nor the political responsibility for these crimes by the different governments have to date been the subject of investigation. A report on the crimes of the royal government during the April 2006 movement was presented to the government then led by Girija Prasad Koirala (NC) in November 2006, but as of this writing had not yet been published. However, the Commission for the Investigation of Abuse of Authority (CIAA) has intensified its work in recent months. In early February 2009, it announced it would take legal action against powerful leaders, top bureaucrats and even ministers who have been accused of involvement in irregularities.

Prosecution of  
office abuse

Violations of human rights in Nepal take many forms. The main such incidents perpetrated by the numerous militant groups or party-affiliated organizations, but also by the state, include widespread disappearances, torture, extra-judicial killings, rapes, and severe restrictions on freedom of assembly, speech and movement. The elections to the Constituent Assembly in April 2008 have marked the absolute height in the peace process so far. Neither the pre- nor post-election governments have demonstrated a high degree of honesty or political will to implement their commitments. Violent and unruly forces have continued their activities, taking advantage of the government's weakness. Even the government formed after garnering a majority in August 2008 has had difficulty in taking hold of the situation. The youth wing of the Maoists, recently renamed as Young Democratic Communist League (YDCL), became more anarchical after the party won the

Civil rights



elections. The other parties followed suit, forming similar organizations and adhering to the same unruly line. It has become clear that the continued existence of such groups has been one of the primary reasons for the persistent lack of law and order.

#### 4 | Stability of Democratic Institutions

Political institutions such as parliament, parties and the bureaucracy have matured and stabilized somewhat with the ongoing peace process. The most important step was the election of the Constituent Assembly in April 2008, which will also function as a parliament for the remainder of the interim period. A coalition government under Prime Minister Pushpa Kamal Dahal (CPN-Maoist) was formed in August 2008, on the basis of the election results. Thus, government and parliament once again enjoyed popular legitimacy, but the performance of both institutions remains quite weak due to ongoing power struggles between the various parties and leaders. All parties suffer from a lack of democratic structures and norms in many respects. Disadvantaged sections of society have won a voice in the process, thanks to the proportional election system, but play only a minor role in the higher reaches of the parties.

Performance of democratic institutions

The interim constitution of January 2007 established a commitment by party leaders to democratic transition and institutions. This path was confirmed by the people by means of the elections to the Constituent Assembly in April 2008. However, the following months were less promising. The decisive alteration of traditional power structures necessary to complete the democratic transition has encountered resistance from conservative institutions such as party elites and elements of the army and the bureaucracy. The ongoing unrest in the Tarai illustrates the dangers of ignoring popular discontent. Many of the traditional party elites still fail to understand this. In addition to the Tarai unrest, Nepal faced growing militancy from ethnic organizations in the hill area in early 2009. This is sign that the inclusive state promised by traditional elites is still little more than lip service.

Commitment to democratic institutions

#### 5 | Political and Social Integration

Nepal's political parties still lack adequate democratic and participatory mechanisms. Most are personality-oriented organizations with an authoritarian power structure. All power is concentrated in the party headquarters in the Kathmandu valley; any participation at the local level or in rural areas is very limited. None of the established parties makes any effort to achieve balanced popular participation in its own leadership posts or in the country's political institutions. The upper Bahun and Chetri castes (especially the former) dominate in all areas. This was nowhere better illustrated than by the first-past-the-post

Party system

candidate lists for the April 2008 elections, in which – with the exception of the CPN-Maoist – no major party included candidates from disadvantaged social groups.

The 1990 constitution prohibited political parties from representing the interests of minority ethnic groups or Dalit castes. However, its well formulated catalogue of basic rights contributed to the establishment of numerous civic organizations. Civic organizations, functional interest groups and, especially, NGOs supported by foreign donors, exist and play a certain role in representing social interests and interest mediation. There have been signs of increasing political activism among non-governmental organizations and civil society groups ever since the early 1990s. A broad political participation by various sectors of society and various social organizations – professionals, civil society leaders and activists, the media, human rights workers, students, political activists, and even government bureaucrats – was the defining feature of the anti-royalist/pro-democracy movement of April 2006. This has further intensified with the return to legitimate democratic institutions in 2008. However, facing a continued disregard on the part of party political elites, interest groups are turning towards militancy, especially in the Tarai region.

Interest groups

The widespread participation of the masses in the elections to the Constituent Authority proved that there is a broad pro-democracy attitude among Nepali citizens. However, consent to democratic norms among elites seems to be fragile, and there is still a strong tendency for politics to be played out in the streets rather than through institutional mechanisms. The CA has hardly been able to start work, due to boycotts by party leaders seeking to push the government into decisions that should be rightfully be decided by the CA in the process of writing a new constitution.

Consent to democratic norms

The associative life of Nepali society has been improving. However, the insurgency in the 1990s and 2000s proved an intermittent impediment to the civic self-organization of various social groups. Ethnic groups were the first to demand equal rights and inclusion in the 1990s. Organizations representing women, Dalits and the Madhesi (Tarai) population have done the same in recent years. These were closely followed by interest organizations representing workers, disabled persons and homosexuals. Nevertheless, the society remains marked by traditional thinking and deep cleavages based on social class, religious caste and ethnicity.

Associational activities

## II. Market Economy

### 6 | Level of Socioeconomic Development

Nepal is one of the poorest countries in the world, with a per capita GDP of about \$1,078. The protracted insurgency has adversely affected development efforts. The peace process initiated in 2006 has threatened to stagnate. The country's infrastructure is insufficient to meet steadily growing demand. Nepal ranked 145th of 179 countries in the UNDP's 2008 Human Development Index, its score of 0.530 placing it in the lower-medium category of development. In 2006, the country was still grouped in the lowest category, however. At least 55.1% of the population is estimated to live on less than \$1.25 per day, and as much as 77.6% on less than \$2 per day. The Gini coefficient of 47.2 indicates a rather high level of income inequality. Pervasive social exclusion results from poverty, unequal access to education, and deeply rooted ethno-religious and gender discrimination. For instance, with a GDI value of 0.520, Nepal ranked 128th out of 177 nations included in the UNDP's Human Development 2007/2008 report. Throughout the period under consideration, Nepal was unable to improve social disparities, significantly lower poverty levels or reduce income inequality.

Socioeconomic  
barriers

Economic indicators		2004	2005	2006	2007
GDP	\$ mn.	7273.9	8130.3	9074.4	<b>10282.6</b>
Growth of GDP	%	4.7	3.1	3.7	<b>3.3</b>
Inflation (CPI)	%	2.8	6.8	7.6	<b>6.1</b>
Unemployment	%	-	-	-	-
Foreign direct investment	% of GDP	0.0	0.0	-0.1	<b>0.1</b>
Export growth	%	-	-	-	-
Import growth	%	-	-	-	-
Current account balance	\$ mn.	100.0	153.1	150.1	<b>5.7</b>
Public debt	\$ mn.	3299.9	3130.1	3285.2	<b>3484.8</b>
External debt	\$ mn.	3358.1	3197.5	3409.1	<b>3644.6</b>

		2004	2005	2006	2007
Total debt service	% of GNI	1.6	1.5	1.5	1.4
Cash surplus or deficit	% of GDP	-1.4	-1.0	-	-
Tax Revenue	% of GDP	9.0	9.2	8.8	9.8
Government consumption	% of GDP	8.6	8.9	8.7	9.2
Public expnd. on edu.	% of GDP	-	-	-	-
Public expnd. on health	% of GDP	1.4	1.5	1.6	-
R&D expenditure	% of GDP	-	-	-	-
Military expenditure	% of GDP	1.8	1.9	1.7	1.6

Sources: The World Bank, World Development Indicators 2009 | UNESCO Institute for Statistics | International Labour Organization, Key Indicators of the Labour Market Database | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security.

## 7 | Organization of the Market and Competition

Nepal's interim constitution of 2007 guarantees a market-based economic system. Although the foundations of a competitive market economy exist pro forma, practical implementation remains uneven. Despite efforts at privatization and deregulation in the past two decades, market competition still suffers from a weak institutional framework. As in every South Asian economy, the informal sector is significant. In a labor force of more than 11 million, 76% work in the agricultural sector, 6% in industry and 18% in services. According to a new report by the Central Bureau of Statistics, slated for publication in March 2009, the employment rate has risen from 42% in 2004 to 85.8% (90.2% for men and 81.9% for women). These figures include many young people who have gone for jobs to foreign countries, especially to India, the Gulf region, Malaysia and Korea.

Market-based competition

Article 35(12) of the 2007 interim constitution declares that the state shall adopt policies to attract foreign capital and technology, while at the same time promoting indigenous investment for the purpose of national development. The Maoist-led government has started efforts to attract foreign investment, though results have been slow due to the political background of the leading party. Indigenous investment is slowly starting, such as in the power generation sector, but is hampered by the lack of supply of essential goods.

Anti-monopoly policy

In general, foreign trade is liberalized. The country's trade with India is an exception, being subject to special regulations and somewhat restrictive requirements. Trade with India makes up 63.9% of Nepal's total trade. Over the

Liberalization of foreign trade

long run, Nepal is part of the agreement to establish a South Asian Free Trade Area (SAFTA) by the end of 2016. In 2008, talks with China to aimed at improving bilateral trade relations intensified. In March 2009, the Nepalese government submitted a list of 497 products for which it sought duty-free entry into China, in a bid to promote exports and reduce the growing trade deficit with its northern neighbor. Nepal's total foreign trade grew by 20.4% during the first six months of the fiscal year 2008 –2009. However, higher growth in imports, as compared to exports, expanded the country's trade imbalance, with the trade deficit widening by 27.3% during this period.

Financial sector reforms in recent years affecting both the central bank (Nepal Rastra Bank) and the largest commercial banks in the country have contributed to the development of a better functioning banking sector and capital market. The implementation of financial sector reforms included the enactment in 2002 of legislation to increase central bank autonomy and strengthen its supervisory and regulatory functions. The capital market is efficiently overseen by a securities board. There are further efforts under way for improvements in corporate governance, accountability and transparency in order to tackle a number of problems such as strong government ownership and rather high ratios of non-performing assets (NPA). The NPA volume has been on the decline in recent years, at the same time that total loans have been continually increasing, thus resulting in a more favorable proportion. However, the NPA ratio is still a long way from being satisfactory. Insufficient regulation and supervision, inadequately developed financial markets, low-quality corporate governance in the banking sector, the lack of a competitive environment resulting from fragmentation of the banking system, a poor banking culture, and ineffective banking services for the rural sector have all been in the focus of financial politics in recent months. As part of stern action against willful defaulters on bank loans of more than 10 million Nepalese rupees, the government decided in early 2009 to impose a ban on property transactions for these individuals, bar them from operating businesses and seize their passports.

Banking system

## 8 | Currency and Price Stability

The value of the Nepalese rupee decreased between early 2008 and early 2009 from about 63 rupees to the dollar to 79 rupees per dollar (or from 92 rupees to the euro to 100 rupees per euro). In fiscal years 2005 and 2006, consumer prices respectively rose 4.5% and 8%. There was a small decrease to 6.4% in 2007 and 5.8% in January 2008 before the inflation rate began to increase exorbitantly, up to 14.4% in January 2009. As in most countries in South Asia, Nepal has felt inflationary pressures in recent years due to high oil prices. However, inflation this year was also driven by the food and beverage category, which posted an 18.3% rise, and the non-food and service category which saw a 10.3% rise in prices. These rates can respectively be compared to 7.3% and 4.2% category price increases in 2007.

Anti-inflation /  
forex policy

Nepal's economy remains in a fragile state. The insurgency may have ended, but political instability has remained or even increased, especially in the Tarai region. The high oil price on the world market has led to insufficient supply and substantial losses for the Nepal Oil Corporation (NOC) in 2008. The increasing frequency of power outages, with load shedding of up to 16 hours per day in early 2009, has damaged the economy severely. The current government has successfully tried to increase revenue by putting pressure on tax defaulters. Government income rose 25.5% in the first six months of the 2008 – 2009 fiscal year as compared to the same period of the previous year, due to increases in income tax collection, VAT revenue, excise, vehicle taxes and registration fees, as well as to the high growth in non-tax revenue.

Macrostability

## 9 | Private Property

Property rights and the regulation of property are defined by the interim constitution. Though the Maoists have committed themselves to this constitution, and even lead the government as of this writing, they have nevertheless hesitated in restoring all the property they had confiscated during the times of insurgency to the rightful owners. Equal property rights for women still only exist on the paper.

Property rights

The privatization and sale of public enterprises and state companies has advanced in recent years. Acquisition of private property by foreigners, as well as the right to purchase property and to invest funds, is restricted, except in the case of native Nepalis living abroad. Special regulations for such non-resident Nepalis (NRN) have been under discussion for years.

Private enterprise

## 10 | Welfare Regime

Nepal has virtually no welfare regime outside of social networks based on familial structures. Private initiatives are isolated, and public social services are underdeveloped and insufficient, although access has been improved in recent years. Over the last decade, Nepal has seen tremendous growth in medical colleges and the annual production of new doctors will soon cross 1,000. The country now has over 40 nursing campuses. Each year, the 125 separate medical institutes under auspices of the Council for Technical Education and Vocational Training (CTEVT) produce over 4,000 new health assistants, nurse midwives, and community medical assistants. But they concentrate mainly on urban centers, especially the Kathmandu valley, while most rural Nepalis are still without health care.

Social safety nets

The proportional representation regulations for CA elections have guaranteed that most societal groups are represented in the assembly. But this has meant little so far, since they remain representatives of their parties, while decisions within the parties

Equal opportunity

are taken by leaders who are primarily male Tagadharis, or drawn from the so-called higher Hindu castes. This is true for all parties, though the Maoists have tried to provide some greater participation for women and other disadvantaged groups. The problem is particularly true for the other two big parties, the NC and the CPN-UML, which are still totally dominated by the traditional elite. For the most part, party leaders were not elected to the Constituent Assembly. The same traditional groups dominate all spheres of life, including the judiciary, the education system, the media, security forces, unions, and NGOs. Social and economic caste-based discrimination is widespread, and was an important underlying cause for the rise of the Maoist insurgency in the 1990s, as is evident from the participation of a large number of marginalized people in the upheaval. But the politically responsible persons have learnt nothing.

## 11 | Economic Performance

The political stalemate and escalating conflict since 2000 have had a negative impact on Nepal's economy, which grew on average by around 2% over the past few years. Finance Minister Baburam Bhattarai has said that the 2008 – 2009 budget would push the overall economic growth rate to 7% from 5.6%. The growth rate in the agricultural sector was expected to be 4.5%, with 8.3% growth in the non-agricultural sector. But the Asian Development Bank (ADB) predicted an economic growth rate of only 3.5% in early 2009. The inflation rate was estimated by the government to be around 7.5%, but the real figures lay at more than 14% in late 2008 and early 2009. It is expected that the global economic crisis will also hit Nepal hard. Remittances from expatriate labor are already on the decline. The power shortage that cannot be reduced in near future will have further negative impacts.

Output strength

## 12 | Sustainability

After years of conflict and instability, there is a need for strong environmental management to support growth, sustainable livelihoods and poverty reduction, states a 2009 World Bank Country Environmental Analysis report. The country has achieved modest economic growth in recent years, but at high environmental cost, and rapid economic growth will lead to even greater environmental degradation. There are three basic challenges faced by the environmental sector in the present context. These are urban environment management, managing the impacts of growth, and development activities and environmental governance. In recent months, there have been a number of calls from environmental experts for the implementation of measures protecting the wetlands, flora and fauna of the country. Corresponding government policies are still pending.

Environmental policy

Nepal's public infrastructure and education system is underdeveloped, especially in the areas of higher education and research and development (R&D). The most recent budget as of this writing, with a total of 236 billion rupees, provides 38 billion rupees (44% more than in 2007 – 2008) for education. In support of this, the government expects foreign aid of 10.5 billion rupees. In the longer run, the Ministry of Education is planning to launch a school sector reform program for 2009 – 2015 with an estimated budget of \$5680 million. According to this program, there will be two educational structures: elementary level from grades one to eight, and secondary level from grades nine to 12. Students will also be given the option of technical and vocational streams beginning from grade nine, and the same national examination board will oversee exams to certify students. Vocational education will start from 2009/10 and will continue through 2012/13 and beyond. The restructuring of secondary education, including integration of grades nine through 12, and the introduction of vocational streams, will be phased in across the country beginning in the 2012 academic year. Gender equality, inclusiveness, capacity development, and new institutional arrangements are other aspects of the reform program.

Education policy /  
R&D



## Transformation Management

### I. Level of Difficulty

A number of highly unfavorable conditions for economic and political transformation persisted throughout the review period, creating massive structural constraints on governance. These included a low level of economic and social development, a population of relatively low, through improving educational level, the geographical disadvantages of a landlocked state, resource scarcity, and still-weak stateness. The stagnating renewal process is responsible for the fact that these conditions have not changed appreciably as compared to the previous report.

Structural  
constraints

Although Nepal is one of the major recipients of official development assistance (ODA), it has a fairly large sector of international and national NGOs. Indigenous civil society traditions have improved in recent years, but once again stagnated after April 2006.

Civil society  
traditions

The massive structural constraints on governance have been further aggravated by widespread political violence and ethnic and religious discord, as well as the highly polarized conflict over income distribution that erupted into open civil war in 1996. The peace process that was initiated in 2006 is still weak, despite the elections to a new Constituent Assembly in April 2008. Ethnic and regional conflicts, especially in the Tarai region, have intensified with the ongoing discussions over the future state system.

Conflict intensity

### II. Management Performance

#### 14 | Steering Capability

Though the structural constraints on governance are high, the political leadership's low steering capability is another important cause for Nepal's current crisis. The first step of the current peace process was a comprehensive peace agreement

Prioritization

between the state and the former CPN-Maoist insurgents in November 2006. As the basis for current state reconstruction, the interim constitution of January 2007 contains a number of compromises that may ultimately prevent necessary fundamental changes in politics, society and economy. The elections to the Constituent Assembly in April 2008 were more or less free and fair and underlined the people's desire for fundamental changes. Prior agreements on future institutional arrangements and on issues of economic and social transformation have been called into question as a result of power struggles between the different parties and their leaders.

The government's capability to implement reform policies effectively has been hampered by weak political leadership, confrontational tactics and a lack of clear strategic priorities. The extreme partisanship of Nepalese officials exacerbated these shortcomings. Nepal's reform goals achieved a measure of consistency in 2007, but this ended after the elections to the CA in 2008 when the CPN-Maoist won more than a third of the seats, more than the two leading parties of the 1990 system, the NC and the CPN-UML, put together. Though these parties could not prevent the formation of a Maoist-led government in August 2008, they have done everything possible to derail Maoist enthusiasm for reform politics, with the CPN-UML acting from inside the government, and the NC as the main opposition party. The Maoist-led government presented an inflated budget that aimed at raising expenditure by 45% in a single year. It lacked concrete plans for improving development projects' poor implementation capacity. A voluntary declaration income scheme (VDIS) in early 2009 sought to raise the revenue growth rate to 32% from 21% in 2008. This scheme was extended until March 2009 after tax collection exceeded expectations. The scheme met much protest on the part of business circles, but it seems to be a step towards an improvement in the general attitude toward paying tax. Further reform will depend on the stability of the peace process. At the time of writing, this has been called into question by difficulties in integrating members of the People's Liberation Army into the Nepalese Army (NA). The United Nations Mission in Nepal (UNMIN) is serving as an observer of this process, and had its tenure extended for half a year in January 2009. Opposition to the integration of the two armies comes from the NC as well as from the NA leadership. The recruitment of new soldiers by the NA, against the stay order of the government, has called the loyalty of the army to state and government into question and once again endangers the peace process.

Implementation

Between 2005 and early 2008, the mainstream political parties have shown some degree of learning, not least by brokering a peace deal with the Maoist insurgents, writing an interim constitution, and forming an interim parliament and common government together with the CPN-Maoist. Despite growing differences and clashing individual ambitions for power, the parties were able to hold elections for the Constituent Assembly in April 2008. The first-past-the-post election results

Policy learning

proved that the Maoists had best understood the need for social and political inclusion, winning half of the 240 direct mandates. Both the CPN-UML and NC were deeply shocked by these results, but had difficulty understanding that their own failures and non-inclusive politics were the main reasons for these developments. While the CPN-UML is gradually starting a process of internal reforms, and also participates in the government, the NC remains a conservative-minded clique of Bahuns centered on the extended Koirala family, which contributed one-eighth of the party's FPTP candidates. Beyond the "high politics" of peace negotiations and constitutional reform, the bureaucracy and the political leadership have shown little willingness (or ability) to learn from past errors. In daily politics, the routines of policy-making have failed to enable innovative approaches the manifold problems of social and economic development in this country. This gives reason to doubt that the elected Constituent Assembly will be able to write a new constitution by May 2010 able to provide the basis for a democratic, inclusive and development-oriented Nepal.

## 15 | Resource Efficiency

The government does not make efficient use of available economic and human resources for its economic and social policies. During the period under study, resources intended for development were misappropriated to finance two armies, or simply vanished due to corruption. Greater problems are related to of the lack of electrical power, against a background of steadily growing demand. Power cuts and load shedding have long been a regular feature of life, but the problem escalated in December 2008 and January 2009 with blackouts of up to 16 hours a day. This has affected the economy and all spheres of public life. Nepal has among the world's highest proportions of water-generated power, and the current shortage is the result of failed policies, mostly on the part of NC-led governments in the 1990s, as well as of 10 years of Maoist insurgency that prevented the development of new water resources. It is difficult to see how even today's levels of demand can be met in the near future. Another pressing problem is the ongoing job shortage, which has forced hundreds of thousands of young Nepalis to migrate to India, the Gulf region, Malaysia and Eastern Asia in search of employment. Job-creating policies remain nonexistent. What cultural resources are available tend to be used to block reforms, rather than in pursuit of the country's advantage.

Nepal's institutional framework and political environment do not provide for a high degree of coordination among conflicting political objectives, or allow the formation of coherent policies. Under the new interim government of 2007, coordination did not increase, partly because of the heterogeneous nature of the current party government, and partly because of the main political actors' need to "deliver" on promises to their competing constituencies and supporters. The

Efficient use of assets

Policy coordination

Maoist-led government in power as of this writing has often implemented Maoist policies without consulting its coalition partners. The NC, as the main opposition party, prefers to boycott the work of the Constituent Assembly if this is likely to prevent the government's reforms. Both government and opposition lack the will to compromise that made the peace process and elections possible.

Corruption is a fundamental problem in Nepal, both in the public and private sectors. In all key public sectors, petty corruption is endemic and officials are known to demand bribes even for routine services. Corruption in the political system, with political parties functioning as tools of the high-caste Kathmandu-based elite, is institutionalized. The Corruption Control Act has established sanctions for corrupt practices, but the laws are weakly enforced and high-profile government officials widely act with impunity. In practice, the existing anti-corruption system serves to target only low-level bureaucrats, with minimal impact on the political elite. In early 2009, discussions were opened with the aim of giving the Commission for the Investigation of Abuse of Authority (CIAA) greater legal ability to indict the politically powerful. Corruption is seen as an obstacle to maintaining and expanding investment in Nepal. Corruption among government officials with regard to the distribution of permits and approvals, the procurement of goods and services, and the award of contracts presents significant obstacles to doing business. The situation is further complicated by the fact that government services are in scarce supply outside the capital. Most of the countryside lacks basic public services or local offices. Bribes are often the only way to get access to public services, or to accomplish even ordinary activities. Poor Nepalis lack access to the courts and have no means to seek redress for corruption or abuses of power. Judges and staffers in lower-level courts are known to accept bribes. Court employees and public prosecutors are even perceived as the main facilitators of corruption.

Anti-corruption  
policy

## 16 | Consensus-Building

With the abolition of monarchy and the total defeat of pro-royal political forces in the elections to the Constituent Assembly, one of the traditional players in domestic politics has vanished. Monarchy is an institution of the past, and is little missed. Among the political parties, the cards were newly mixed by the results of the elections of April 2008. The CPN-Maoist has only a relative majority, and will thus have to compromise on its revolutionary politics. These compromises made possible the merger of the CPN-Maoist with another extremist left group under the new name Unified CPN-Maoist in January 2009. However, the more mainstream politics of the Maoists caused a hardliner faction under the leadership of Matrika Yadav to splinter off just one month later, retaining the CPN-Maoist name. There was only minimal consensus among other mainstream political elites before the elections. These elites failed to implement social reforms capable of addressing the

Consensus on goals

insurgency's socioeconomic roots. Indeed, economic development had almost no place in the country's political discourse. Following the elections, the political parties once again found it difficult to bridge differences that have proved previously irreconcilable. Despite the assembly's inclusive composition, little has been done to eliminate social disadvantages. This gives reason to fear that social and regional conflicts will continue to dominate Nepal's political future.

The institution of monarchy was formally abolished during the first session of the elected Constituent Assembly on 28 May 2008. This decision was respected by the deposed king, Gyanendra, who elected to stay in the country. However, his son proved more resistant, leaving Nepal along with his family. Some conservative forces, who saw the monarchy as their leading symbol, still hope for a return of monarchy, but the pro-republican vote of the people was overwhelming. The army remained loyal to the king until the very end, and there have been no substantial personnel changes at the top of the military command. On several occasions, the army has failed to bow to the order of the elected government, especially when it began recruiting new soldiers in early 2009. Neither do the Maoists appear steadfast in their commitment to democracy, though this is less true of the Maoist government than of the sub-organizations that still tend towards militant and aggressive behavior. Other political parties, especially the opposition Nepali Congress, have been responsible for the slow progress in integrating the two armies. In addition, the NC has prevented the daily work of the assembly, in hopes of bargaining with the government in this way. Tarai organizations and parties, even those in the government, have time and again threatened the democratic process by means of boycotts, strikes, blockades and other violent behavior. In early February 2009, Matrika Yadav and his supporters split off from the CPN (Maoist) and threatened the launch of a new Madhes movement. A number of ethnic resistance movements in the hill region turned to violence at about the same time.

Most of the parties and their leaders have been unable to address traditional problems of socioeconomic and ethno-religious cleavages, social exclusion, and regional inequalities. This fact has undermined the historic achievements of the democratic transition in 1990, as a sustainable depolarization of Nepali society has not yet been achieved. The constitutional and legal regulations responsible for the proportional election lists have, for the first time, made the substantive political participation of different population groups possible. But the composition of the directly elected candidate lists, especially those submitted by the NC and the CPN-UML, has shown that the traditional party leaders still fail to grasp the nation's core problem. Political leaders in Kathmandu have made only desultory attempts to address the various Tarai issues, and have not been able to satisfy the main demands of the Tarai population. The same is true for the diverse ethnic population groups of the hill area. Nepal is seeking to develop a federal political system, but

Anti-democratic  
veto actors

Cleavage /  
conflict  
management

there is danger the country may break apart over different population groups' diverse aspirations and demands if political leaders are not able to establish unity in diversity.

Civil society was mainly responsible for the pressure leading to the royal regime's breakdown, as well as for the initiation of the peace process between the mainstream political parties and the CPN-Maoist. The engagement of NGOs seeking to influence political reforms or economic and social policies has been more effective since the monarchy gave up its power in April 2006. In the realms of women's rights, and rights for ethnic, language and cultural minority groups, civil organizations have intensified efforts to advocate reforms. But the struggle to improve the representation of women's interests and those of ethnic and religious minorities is still an uphill battle, as the dominant upper-caste elite refuses to allow the equal participation of all social groups. Madhesi and ethnic organizations forced a number of concessions from the dominant state elite in 2007 and 2008, but for the most part these have not yet been implemented. In particular, this affects the Dalits, whose lack of representation has only recently received greater public attention. The nomination of a Dalit as Minister for Land Reform in March 2009 can be seen as a major success for Dalit struggles. Except when resorting to strikes and demonstrations that severely affect public life, civil society groups' impact on public policies remains limited. In general, the political parties remain reluctant to acknowledge the role of civil society or to allow meaningful participation in the political process, even when – or perhaps particularly when – popular opinion differs from their positions.

Civil society  
participation

Although the Maoist insurgents won more than one-third of the seats in the Constituent Assembly, subsequently heading a coalition government with their chairman Pushpa Kamal Dahal as prime minister, national reconciliation and the discussion of past injustices remain major unaccomplished tasks. In the 10 years of the Maoist rebellion, especially after the state of emergency was declared in November 2001, both the Maoists and the state security forces committed gross violations of human rights. At least two-thirds of the capital crimes and most of the cases of disappearance were attributable to the security forces, acting on the order of King Gyanendra and an NC-led government. To date, the state has made virtually no effort to investigate these offenses. This makes it harder to achieve any reconciliation between victims and perpetrators. Thus far, the security forces, the CPN-Maoist and the other political parties, as well as the former king, show little willingness to engage in a reconciliation process that could point uncomfortable fingers at them all. Analyzing the years 2007 and 2008, it seems that the political parties understand transitional justice to mean compensation for victims and amnesties to human rights violators, as the Informal Sector Service Center (INSEC) writes in its Human Rights Yearbook 2009.

Reconciliation

## 17 | International Cooperation

Nepal has a long history of working with international partners. Although this partnership has yielded good results, especially in the areas of education, health, drinking water, telecommunications, road construction and power generation, there is still a need to improve coordination and harmonize aid and debt relief so as to increase efficiency and effectiveness. Development assistance should also be channeled toward traditionally neglected regions and groups. Relations between donor groups and the government were strained during the times of the royal putsch (2002 – 2006). However, since the April 2006 transition, relations between the new government, donors and Western governments have relaxed considerably. This development was bolstered further by the successful CA elections in April 2008. Aside from the previously mentioned traditional areas of aid, donor countries have invested substantial amounts of money to help Nepal reach a state of peace and democratic governance. However, recent months have seen growing disillusionment over the continued selfish politics pursued by all parties and their leaders. In February 2009, the new U.S. government refused to remove its terrorist designation from the governing CPN-Maoist, an action that may prove symbolic.

Effective use of support

The elections to the Constituent Assembly in April 2008, and the formation of a Maoist-led coalition government in August 2008, brought Nepali politics back to the rules of legitimacy. The government has since tried to act as a reliable partner. However, major international actors (especially the United States) and international organizations doubt the reliability of the current government. This has both to do with the repeatedly undemocratic behavior of Maoist cadres and the confusing statements of their leaders, and with the politics of defamation and boycott practiced by other parties, especially by the NC.

Credibility

The Kingdom of Nepal has only two neighboring states: India and the People's Republic of China. Nepal has improved its bilateral relations with both since the democratic transition. Not even the fact that Nepal now has a government led by Maoists seems to have had any negative influence on the country's relations with India. In addition, Nepal is a member of the South Asian Association for Regional Cooperation (SAARC), which has its headquarters in Kathmandu.

Regional cooperation

## Strategic Outlook

The elections to the Constituent Assembly on 10 April 2008 have so far been Nepal's most important step toward a durable peace and a new, inclusive political system. At first view, it appeared that the conservative camp, with the monarchy as its outstanding symbol, was washed away by these elections. In this sense, the formal abolition of monarchy in May 2008 was a natural consequence. But conservatism and traditionalism in Nepal are not restricted to the monarchy as a symbol, or to the circles that supported the king's direct rule. They are an integral part of the thinking and behavior of the country's ruling elite, which dominates not only the political parties, including the so-called communist ones, but also all spheres and institutions of public life. The Maoist insurgency has come to an end, and the former rebels are now in the government, but many of their sub-organizations and cadres still follow militant ways of behavior. The CPN-Maoist is still far from being a democratic party. A number of Maoist leaders are dissatisfied with recent developments and compromises. Matrika Yadav from the Tarai, who recently formed a splinter CPN-Maoist party, is only one example. The two other big parties, the CPN-UML and particularly the NC, still have a number of extreme conservative elements. Both parties have resisted fundamental reforms, as well as the implementation of internal democratic structures and procedures. That is why the NC, as the second strongest party in the CA, has become the greatest obstacle to necessary fundamental reforms of state and society. The new Nepal must be a nation of full and equal opportunity for all its citizens, including those traditionally excluded on the basis of caste, ethnicity, gender and political conviction. Ethnic and regional tensions have already replaced the Maoist insurgency. These issues have been most intense in the Tarai flatlands along the border with India, but are also increasing in the hill area populated by numerous ethnic groups and Hindu castes. One of the CA's key tasks will be the formation of a federal system that can both satisfy the demands of the numerous disadvantaged sections of society, and prevent separatist tendencies such as those already being felt in the Tarai region. Political leaders must concentrate on these concerns immediately. Issues such as the integration of the Maoists' PLA into the Nepalese Army should be solved as soon as possible, and not used as an excuse to delay the reform processes. Reforms that can be initiated independently of the new constitution, including a reform of the education system and the implementation of fundamental rights such as the equality of all citizens, should be begun without further wait, and should not be boycotted by any party. Most of all, the ability of leaders to act with impunity has to be curtailed. Against the background of the global economic crisis and the nation's growing supply problems, Nepal needs more help and diplomatic guidance than ever before from her foreign partners if the current path to a new Nepal is to be successful.