

BTI 2012 | Nepal Country Report

Status Index	1-10	4.45	# 98 of 128	
Political Transformation	1-10	5.00	# 74 of 128	➔
Economic Transformation	1-10	3.89	# 112 of 128	➔
Management Index	1-10	3.75	# 101 of 128	

scale: 1 (lowest) to 10 (highest) score rank trend

This report is part of the Bertelsmann Stiftung's Transformation Index (BTI) 2012. The BTI is a global assessment of transition processes in which the state of democracy and market economy as well as the quality of political management in 128 transformation and developing countries are evaluated.

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Please cite as follows: Bertelsmann Stiftung, BTI 2012 – Nepal Country Report. Gütersloh: Bertelsmann Stiftung, 2012.

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Key Indicators

Population	mn.	30.0	HDI	0.458	GDP p.c.	\$	1199
Pop. growth ¹	% p.a.	1.8	HDI rank of 187	157	Gini Index		47.3
Life expectancy	years	68	UN Education Index	0.356	Poverty ³	%	77.6
Urban population	%	18.2	Gender inequality ²	0.558	Aid per capita	\$	29.1

Sources: The World Bank, World Development Indicators 2011 | UNDP, Human Development Report 2011. 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 high expectations for a new Nepalese political future which followed the 2008 election of a constituent assembly have been cut down by the political reality of power struggle and a policy of blockade. Nepalese politics have since been marked by political turmoil and deadlock.

In 2010, the deadline set for promulgation of the new constitution was extended until 28 May 2011, leading to another year of stalemate regarding the urgent political, social and administrative reforms that are necessary to prevent a backslide into the pre-conflict era. In the likely case that the constituent assembly proves unable to pass the new constitution by the deadline, the government either has to rely on other parties to further extend the constituent assembly's term or it might seek to transfer decisions about Nepal's federal structure to another body. In any case, the government has consumed a good share of the available public support, risking unrest and minimizing its chances of passing necessary significant reforms.

The current government, which includes the Maoists as the largest party, is jeopardized by the second largest party and a significant bloc of Madhesi parties in opposition, who are threatening to jam an extension of the constituent assembly. The critical elements of the peace process, integration of the Maoist combatants and dismantling of the People's Liberation Army along with the adoption of a new constitution, have all been exploited in struggles over power sharing.

The United Nations Mission in Nepal (UNMIN), which has been supporting the peace process since January 2007, closed its operations on 15 January 2011. The Security Council decided to end the mission despite the ongoing peace process due to differences between the Maoists and other major political parties on the further extension of UNMIN's tenure. The vacuum left by UNMIN's departure will be filled by a special committee.

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 oligarchy lasted for 104 years. The 1854 law code 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 between the king and the Ranas was reached through the mediation of the Indian government in Delhi. The Delhi compromise guaranteed a multiparty system, fundamental rights and the return of monarchy to its traditional position. The 1950s were 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 Panchayat system was introduced in the same year, and featured 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 that erupted in February 1996 caused increasing problems for the government and over the years has 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 unexplained 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 the 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 launched 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 once more appointed prime minister.

November 2006 marked a turning point in Nepalese politics; a comprehensive peace agreement between the Seven Party Alliance (SPA) and the Communist Party of Nepal (Maoist) (CPN-M) put an end to the civil war that the Maoist party launched against the royal regime of King Gyanendra Shah and the mainstream political parties in 1996. An interim constitution came into force on 15 January 2007. On the same day, an interim parliament with 330 nominated members was formed; the Maoists rejoined the government in April 2007. In the aftermath, the election of a constituent assembly was delayed three times within the following year until the Nepali people could cast their votes on the country's political future. The elections brought the CPN-M a landslide victory and led to the political downfall of the conservative parties who were held responsible for the collapse of the democratic system established after the Jana Andolan movement in 1990. The CPN-M election campaign focused on fundamental political and social reforms. On the other hand, the use of intimidation and coercion by Maoists has also been reported in the run-up to the elections. Though falling short of an absolute majority, the CPN-M achieved half of the 240 direct mandates and 30% of the seats on the basis of the proportional list. Holding 220 out of 601 seats, the Maoists form the strongest faction in the constituent assembly. Ram Baran Yadav (NC) was elected first president of the Federal Democratic Republic of Nepal in July 2008. One month later, a new coalition government was formed under Prime Minister Pushpa Kamal Dahal (CPN-M). The CPN-UML joined this government, while the NC remained in the opposition. In May 2009, the Maoists stepped out of the government, making way for a minority government lead by the CPN-UML under Prime Minister Mahdava Kumar Nepal. Due to political pressure exerted by the Maoist party, Prime Minister Nepal resigned in 2010. After 16 failed attempts to elect a new prime minister, Jhala Nath Khanal (CPN-UML) became Nepal's 34th Prime Minister with the help of the Maoist party in February 2004.

With political instability being on the rise again, a peace process that is persistently fragile, and an incomplete integration of the former PLA into the NA, Nepal remains in a critical state of transition.

The constituent assembly has still not accomplished the urgent process of writing a new constitution, the deadline has been again rescheduled until 28 May 2011, while it remains doubtful that the deadline will be met this time.

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

Transformation Status

I. Political Transformation

1 | Stateness

After several years of a multidimensional crisis of stateness, driven by the Maoist anti-regime conflict and a royal coup d'état, a process of peace and constitutional renewal started in 2006. After ten years of Maoist insurgency, a state monopoly on force has been reinstalled in most parts of the country, although it remains weak in the south in Terai, along the Indian border, where ruling Madhesi landowners struggle for political representation. The Terai movement is dominated by the Yadav caste, which suggests that the conflict is a struggle for political positions rather than for socioeconomic or political change. The feudal system in the eastern Terai results in the socioeconomic deprivation of the Nepalese Dalit and has strong potential for violent conflict escalation in the near future.

The erosion of public life and law and order during the Maoist insurgency and the RNA counterinsurgency still represent a severe obstacle to the stabilization of state authority. In the wake of the conflict, a politics of impunity and a growing number of militant ethnic and regional movements pose the main challenge to the state's monopoly on force.

The founding of the multiethnic and multilingual Nepalese Hindu kingdom in the late eighteenth century was based on the language, religion, and culture of the upper Hindu castes and led to an almost exclusive domination by Brahmins (Bahun) and Kshatriyas (Chhetri) in all public and political spheres. As all other groups have been excluded from political and socioeconomic participation, even most of the Maoist leaders belong to the upper castes. There was little change in this situation after 2006. The interim constitution fundamentally redefined the Nepalese state's identity. After eliminating the definition "Hindu state", Nepal is now by definition an "inclusive and fully democratic state". While this precondition for the abolition of traditional state and social hierarchies has been established, the current transitional period has so far seen little in the way of practical changes. The

Question
Score

Monopoly on the
use of force

6

State identity

7

traditional hierarchical Hindu thinking persists in the minds of many leaders, leading to the ongoing deprivation of women, Dalit, various ethnic groups (Janajati) and people of Indian ancestry (Madhesi). Although a proportional modus has been adopted during the elections and disadvantaged groups are now adequately represented in the constituent assembly, underrepresentation remains tenacious within the government, political parties, administration, judiciary, media, education system and business.

Where the Nepalese constitution of 1990 defined the nation “irrespective of religion, race, caste or tribe,” (Part one, Article two), the interim constitutional abolition of the Hindu state principle goes a step further and leads de jure to an improvement for those Nepalese citizens who follow non-Hindu religions. Officially, the recognition of non-Hindu festivals supports this development, but the legacies of the highly exclusive Hindu caste system remain intact. Persistent socio-religious traditions still have a strong impact within the political system. Consequently, the Maoists demand a fully secularized political system, stripped of all the legacies of the Hindu caste order.

No interference of religious dogmas

7

The reform of the Nepalese state has not reached the basic administration level yet. The administrative system remains highly ineffective, corrupt and authoritarian rather than participatory, and it is therefore imperative that it is reformed. So far, long standing administrative norms which include a slow and non-transparent decision-making processes, ritualized official work, and a great emphasis on process rather than results, have not been overcome.

Basic administration

4

Nepal’s civil servants seldom obey prescribed rules. The term “afno manchhe” describes administrative decisions influenced by informal sources (political influence, bribery, personal connections) rather than formal rules. The weak to nonexistent infrastructure (especially in rural areas) does not provide a sound administrative basis for political, social and economic development. During the conflict period, these circumstances led to the installment of parallel administrative systems by the Maoists. Today, highly centralized and non-participatory decision-making form a major obstacle to the necessary development of an administration system that matches the requirements of the desired federal democratic system. The administration’s activity in the Terai remains threatened by numerous militant groups. A general restructuring of the civil administration has been under discussion for years. Due to the ongoing discussion over the future federal state system, administrative restructuring can’t be expected until the new constitution is finalized.

2 | Political Participation

A new election system for constituent assembly elections was introduced on 10 April 2008. Of the 575 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 an FPTP candidate, and one for the PR lists of the parties. The composition of the PR party lists is strictly regulated in order to guarantee that different population groups will be represented in the constituent assembly according to their respective share of 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 constituent assembly, the government nominates another 26 members from among persons of good reputation who have made 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

7

Democratic rule in Nepal is affected by chronic fragility. Since the elections of 2008, three prime ministers have been confirmed in office. Mahdav Kumar Nepal (CPN-UML), who followed Pushpa Kamal Dahal (CPN-M) in 2009, resigned in June 2010. After more than seven months under caretaker government, Jananath Khanal (CPN-UML) took his oath in early 2011, and a new cabinet has yet to be formed. Dahal and Kumar both failed to either oversee the writing of a new constitution or reach a compromise on the integration of the former PLA. With the CPN-M and the NC forming the two largest parties in parliament, Khanal's chances to have the constitution and state policies passed by parliament are poor, since a two-thirds majority is required. The demands of the CPN-M, who supported Khanal, includes key ministries and major concessions regarding the controversial main points of an agreement to form a new security force for the PLA and to have the government led by the CPN-M and CPN-UML in turns. The dispute disrupted parliament, and sessions have been adjourned due to the absence of the cabinet and the constitutional committee.

Effective power to
govern

5

The interim constitution of 2007 guarantees fundamental rights of association and assembly. Nepal has ratified the International Covenant on Civil and Political Rights (ICCPR). Since 2008, the Nepalese government has repeatedly conducted preventive arrests and posed restrictions on demonstrations during anniversaries and festivals of the Tibetan community. The Nepalese government continued to endorse the "One China Policy" and claimed these measures were justified by Nepal's Public Security Act (3.1.), while the Supreme Court of Nepal has condemned these violations of international prohibitions on arbitrary arrest and detention on more

Association /
assembly rights

7

than one occasion, stating that the use of preventive detention orders fails to fulfill the requirements laid out in Article 25 of the Interim Constitution.

In 2010, the Reporters Without Borders Press Freedom Index ranked Nepal at position 119 out of 178; in comparison with its 2008 position (138 of 173), this climb indicates some improvement. Nevertheless, Reporters Without Borders condemns the failure of the Nepalese government to protect journalists from a growing number of attacks on the freedom of the press. In February 2010, Jamim Shah, a media owner of Kashmiri origin and head of satellite TV station Channel Nepal and cable television company Space Time Network, was gunned down in the center of Kathmandu. In March, Arun Singhaniya, a regional media owner in the troubled Terai, was murdered in Janakpur. Several armed groups in the region claimed to be responsible for the killing, stressing a lack of tolerance for independent media. The sharp rise in incidents of attacks against or intimidation of journalists in the Terai region since 2007 could not be stopped, and government action has been deficient. In 2011, another 12 attacks have been reported, located in Kathmandu, Eastern Nepal, and the Terai.

Freedom of
expression
6

3 | Rule of Law

At the national level, the interim constitution of 2007 currently grants the prime minister and cabinet extensive authority, subject to limited checks and balances, and the compromised independence of the judiciary is undermining the separation of powers. Since 2008, Nepal's government has negotiated the future horizontal and vertical separation of state power – a fruitless effort, illustrated by the repeated postponement of a new constitution. When the committee on state restructuring and distribution of state power presented their first draft in February 2010, insurmountable controversies among the political parties became obvious. While the NC and CPN-UML refuse the division of provinces on base of caste and ethnicity, maintaining that such a step might foster disintegration, Madhesi parties cling to their demand for a single Madhesi province in the Terai. The major political parties are unable to overcome their divergence on the future shape of the presidential system, the electoral mode to be adopted, and the modalities of constituting federal units, and risk political instability and a collapse of the transformation process.

Separation of
powers
5

Nepal's judiciary lacks functional autonomy regarding the determination of jurisdiction, selection of staff, and financial independence. Nepal's three-tier court system suffers from major delays, due to procedural mismanagement, including the inefficient allocation of judges and staff. The widespread disregard for judicial orders and decisions, of which a good share is not enforced, is another major obstacle.

Independent
judiciary
5

The maintenance of impunity regarding crimes committed during the Maoist insurgency runs the risk of a breakdown in law and order. Limited access to justice for marginalized and vulnerable groups remains a challenge. The exclusion of many from representation in justice institutions on grounds of gender, ethnicity and caste has not been resolved.

Although recent programs of international cooperation in the justice sector have addressed a wide range of issues, the overall impact of assistance fell short. The frequent leadership changes and limited capacities of institutions in an highly unstable political environment curtailed the success of international assistance.

The lack of coercive measures and legal consequences exercises a destabilizing effect on the rule of law and the protection of human rights. The unresolved issue of impunity and the resulting failure to investigate the past crimes of the Maoists and the security impairs the state's credibility to a large extent.

Prosecution of
office abuse
3

In 2004, the Commission for the Investigation of Abuse of Authority (CIAA) filed a case against Chiranjivi Wagle, who became the most senior politician convicted on corruption charges in 2011.

The legal actions against politicians and bureaucrats announced by the CIAA in 2009 did not lead to reported impeachments or convictions in the following year. Given the regular delays within the judicial system, the final results remain to be seen.

Human rights in Nepal are violated in many ways, the lion's share of incidents being linked to the numerous militant group or party-affiliated organizations throughout the country. Mushrooming party-affiliated youth organizations, like the Young Democratic Communist League of the Maoist party, impose a persistent threat to law and order in the state.

Civil rights
4

In his 2010 report, the UN secretary-general stated that the widespread practice of extortion of officials, teachers, and business people by armed groups and ethnic groups is on the rise despite increased police patrols. In the Terai, several armed groups have been accused of recruiting children as messengers for ransom collection and for enforcing bandhs (strikes).

The state itself is accused of human rights violations. According to human rights groups, the government's special security police – employed to address the deteriorating security situation – have become involved.

The Office of the High Commissioner for Human Rights documented 57 cases of deaths as a result of the unlawful use of force by security forces between January 2008 and June 2010.

4 | Stability of Democratic Institutions

The visible growing stabilization and maturity of Nepali political institutions during the ongoing peace process seems to have reached a peak in the successful election of the constituent assembly in April 2008. Afterwards, political institutions were once again weakened by power struggles between various parties and leaders, with parliament and the parties both being affected.

Performance of
democratic
institutions
4

The fights over access to power within the government lasted over 21 months, including 16 unsuccessful votes to select a new prime minister – the third in office since 2008 – and many incidents indicated a backslide into the pre-conflict era of political instability.

Deficient internal democratic structures and norms remain a persistent problem for Nepalese parties. Furthermore, recent reports indicate that, due to controversies between Baburam Bhattarai and Pushpa Kamal Dahal, a split of the CPN-M is imminent.

The interim constitution of January 2007 established a commitment by party leaders to democratic transition and institutions. This path was democratically confirmed by the April 2008 constituent assembly elections. However, the following months were less promising. Conservative institutions such as party elites and elements of the army and the bureaucracy have resisted the decisive changes required to make traditional Nepali power structures fit for a democratic transition. The ongoing unrest in the Terai illustrates the dangers of ignoring popular discontent. Many of the traditional party elites still fail to understand this. In addition to the Terai unrest, Nepal faced growing militancy from ethnic organizations in the hill area in early 2009. The commitment made by traditional elites to an inclusive state is little more than lip service.

Commitment to
democratic
institutions
5

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 political headquarters in the Kathmandu valley; any participation at the local level or in rural areas is very limited. None of the established parties make any effort to achieve balanced popular participation in their own leadership posts or in the country's political institutions. The upper Bahun and Chetri castes (especially the former) dominate in all areas. This was convincingly illustrated by the FPTP candidate lists for the April 2008 elections, in which – with the exception of the CPN-Maoist – no major party

Party system
3

included candidates from disadvantaged social groups or a significant number of female candidates.

The outlawing of political parties who represent the interests of ethnic and religious groups or Dalit under the 1990 constitution led to the formation of various CSOs. A large share of them got involved during the 1990 Jana Andolan and the protests that led to the downfall of the Hindu monarchy. Since 1990, the number of development NGOs funded by bilateral or multilateral resources increased from 193 to approximately 33,000. The density and networks of NGOs were valuable assets during the mobilization for regime change. During the political upheaval of 2006, civil society in Nepal acquired a new quality. The mobilization of diffuse and dispersed elements of civil society through the media, NGOs, professional organizations, and civil society forums has played a critical role. To what extent civil society activities will shape the future public discourse and exert influence on the process of policy-making will crucially depend on their ability to sustain and extend successful networking between local political elites and external actors.

Interest groups
4

The widespread mass participation in the constituent assembly elections emphasized a broad pro-democracy consensus among Nepali citizens. This indication is amplified by a growing involvement in civil society groups. The media plays an active role in promoting democratic principles and adamantly comments on the malfunctioning of the government. However, the public consent to democratic norms outweighs that among the political elites, where acceptance of democratic rules and norms still seems to be fragmentary. The incapability of the government to adopt a new constitution within the given time frame underlines the fact that political elites rather prefer to circumvent democratic rules and norms in order to retain power, and so risk political instability and creating space for further destabilizing development.

Approval of
democracy
n/a

The associative life of Nepali society has improved in the last two decades.. Ethnic groups were the first to demand equal rights and inclusion in the 1990s, while organizations representing women, Dalit and the Madhesi (Terai) population gained importance in recent years. These were closely followed by interest organizations representing workers, disabled persons and homosexuals. Nevertheless, Nepali society remains marked by traditional thinking and deep cleavages based on social class, religious caste and ethnicity.

Social capital
5

II. Economic Transformation

6 | Level of Socioeconomic Development

Question
Score

In 2010, the Nepalese government made little progress in realizing people's economic, social, and cultural rights through economic development.

Socioeconomic
barriers

2

The 2010 UNDP Human Development Report ranks Nepal at position 138 out of 169 countries. Despite climbing up eight positions, Nepal's poor development score of 0.428 places the country in the low human-development category. The average annual GDP growth rate between 2005 and 2009 came to 4% (World Bank, 2011), generating an estimated GDP per capita (PPP) of \$1,200 in 2010. With a total labor force of 11.8 million, the employment rate accounted to 61.8% (World Bank, ADB, 2008). Remittance has contributed significantly to the reduction of poverty in the past 15 years, and the World Bank (2011) places Nepal among the top five countries in terms of the contribution of remittance to GDP (approximately 23%).

A Gini index of 47.3 proves a comparably high level of income equality, although this follows a trend of growing inequality in recent decades according to the Gini coefficient. According to UNDP's evaluation, the variation in poverty incidence geographically and socially equates to the 2005 reporting period. The 2009 assessment indicates that 95.5% of poor people live in rural areas and the incidence of poverty in rural areas (28.5%) is almost four times higher than that in urban areas (7.6%). The rural poverty reduction rate – at 18% – limps behind that in urban areas (20%). Widespread social exclusion based on ethno-religious and gender-related discrimination is a main obstacle for socioeconomic development. Based on data from 2004 and 2006, the 2009 UN Human Development Report Nepal calculates disaggregated human development indicators for different ethnic groups and castes, revealing a wide gap between the upper-caste Hill Bahuns, Madhesi Bahuns and Chhetri, and Newar at top of the development curve (maximum HDI index 0.625) and Terai/Madhesi Dalit at the bottom (maximum 0.383).

Nepal's government has failed to create a significant reduction of poverty and to generate higher levels of employment through enforced investment. It pays little respect to the development of the private sector, which could act as a main driver of growth.

Economic indicators		2007	2008	2009	2010
GDP	\$ mn.	10277.6	12572.6	12897.2	-
GDP growth	%	3.4	6.1	4.4	4.6
Inflation (CPI)	%	6.1	10.9	11.6	10.0
Unemployment	%	-	-	-	-
Foreign direct investment	% of GDP	0.1	0.0	0.3	-
Export growth	%	-0.9	0.7	3.9	-13.7
Import growth	%	2.9	8.2	12.6	26.7
Current account balance	\$ mn.	5.7	733.3	18.4	-128.1
Public debt	% of GDP	42.8	40.4	39.4	35.5
External debt	\$ mn.	3602.3	3685.2	3683.0	3702.3
Total debt service	\$ mn.	147.3	161.9	176.6	186.9
Cash surplus or deficit	% of GDP	-	-	-	-
Tax revenue	% of GDP	9.8	10.4	11.8	13.3
Government consumption	% of GDP	9.2	9.9	10.8	10.6
Public expnd. on edu.	% of GDP	-	3.8	4.6	-
Public expnd. on health	% of GDP	6.0	6.0	5.8	-
R&D expenditure	% of GDP	-	-	-	-
Military expenditure	% of GDP	1.9	1.8	2.0	-

Sources: The World Bank, World Development Indicators 2011 | International Monetary Fund (IMF), World Economic Outlook 2011 | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database 2011.

7 | Organization of the Market and Competition

Nepal's 2007 interim constitution provides for a market-based economic system. Pro-forma guarantees of a competitive market economy are effectively thwarted by a profound lack of implementation. A weak institutional framework affected deregulation and privatization efforts throughout the last two decades and put restrictions on the freedom to launch and withdraw investments. The annual joint World Bank/IFC "Doing Business" report ranked Nepal at 116 out of 183 countries in 2011 compared to 112 in the previous year, indicating that conditions for

Market-based
competition

5

investment deteriorated during the period under review. For decades, Nepal has maintained a currency peg of NPR 1.6 to INR 1. Though the Nepalese government aims to align its policy liberalization with India, Nepal's structural disadvantage in terms of technology, power resources, transport and overall political instability is severely hampering this endeavor. The Competition Promotion and Market Protection Act announced by the government in 2007 reinforces the legal framework to keep anti-competition practices at bay, but it barely enforced. The sector-wise structure of GDP shows a steady growth of the tertiary sector in the recent years – its contribution to the GDP in 2009/2010 is estimated at 51.5% while the primary sector is expected to account for 34.1%. In the same period, the share of the secondary sector is expected to be 14.4% (Nepal Economic Survey 2009). An extensive share of the labor force is absorbed in the informal sector, which is basically labor-intensive. The 2008 National Labor Force Survey estimates that 96.2% of the economically active population earn their livelihoods from revenues of the informal sector. Of these, 76% are occupied in the agricultural sector, and about 24% generate an income from the non-agricultural sector.

The government of Nepal is slowly adopting an open competition policy in most sectors of the economy. Former public monopolies in banking, insurance, airline services, telecommunications and trade have already been eliminated, and the remaining restrictions on private and foreign operations in other areas will follow. In some sectors, 100% foreign ownership remains illicit. As per its accession commitments to the WTO, Nepal opened the domestic banking sector to foreign investment on 1 January 2010, allowing engagement in wholesale but excluding retail and banking. Foreign bank investment is limited to major infrastructure projects. The hydropower sector holds the largest potential for development, as only a small fraction of an estimated power generation potential of 83,000 mw has been realized so far. Policies regarding hydropower generation have shifted towards private development. In 2001, a policy to simplify the licensing process and break the monopoly of the Nepal Electric Authority (NEA) was announced. Due to weak implementation, the expected effects of boosted foreign investment failed to appear – the most prominent exception being the end of the NEA's monopoly on power generation. Despite existing legal provisions, Nepal's policy of preventing monopolistic structures is falling short on account of deficient enforcement.

Nepal has been a member of the WTO since April 2004. In general, the government is following a liberalized trade policy with the exception of trade with India, which is subject to special regulations and requirements. Trade with India accounts for over 60% of the total trade, leading to a trade imbalance with India of 50.3% in 2009. In the medium term, Nepal agreed upon the establishment of a South Asian Free Trade Area (SAFTA) by the end of 2016.

In 2009/2010, Nepal's merchandise exports declined by 9.8% and reversed the trend of the same period of last year when exports had increased by 15.8%. On the

Anti-monopoly
policy
6

Liberalization of
foreign trade
8

other hand, merchandise imports grew by 35.2% during the period under review, aggravating the trend of the previous year (26.4%) and consequently adding to the country's trade imbalance. Decreasing exports and accelerated import growth led to a falling ratio of export to import of 16.1% in 2009/10 versus 24.2% in the previous year.

As the largest institutions in the Nepalese banking system, Nepal Bank Limited (NBL) and Rastriya Banijya Bank Limited (RBB) are subject to a process of restructuring under the Financial Sector Reform Program. Though some improvements have been achieved, both are still featuring a negative capital base and adequate capitalization of these two banks remains a big challenge. The establishment of a credit rating agency remains overdue. The national Nepal Rastra Bank (NRB) is also being re-engineered. Currently, the NRB is carrying out programs of human resource development and management, installing a more effective regulatory and supervisory framework, standardizing the internal audit system and creating accessible, easy, and more efficient banking services.

The implementation of financial sector reforms included the 2002 enactment of legislation to increase central bank autonomy and strengthen supervisory and regulatory functions. Efforts to improve corporate governance, accountability, and transparency in order to tackle unresolved issues of strong government ownership and rather high ratios of non-performing assets still have to prove effective.

8 | Currency and Price Stability

Since 2004, Nepal has been subject to gradually ascending inflation, with an annual percentage of change increasing from 2.8% to 10.9% in 2009.

During 2009/2010, the government's monetary policy failed to create microeconomic stability and curtail the price increase that showed double-digit growth despite the government containment target of 7%. In 2010, high oil prices continuously exerted some inflationary pressure, but high food prices added substantially to the already severe burden. The index of the food and beverages group increased by 11.3% in the review period whereas the index of non-food and services climbed only by 7.3%. Nepal has been following a two-fold exchange rate policy – one for the Indian rupee and another for convertible currencies. The Nepalese Rupee is pegged to its Indian counterpart at a fixed rate of 1.6. While India's growth rate has strengthened the Indian Rupee, the Nepalese Rupee faces devaluation. Consequently, currency adjustment is a major concern for Nepal's economic policymakers. The pegged exchange rate helps to control inflation within the country to some extent, but this comes at a price because if Nepal's government gives up its monetary autonomy it cannot use its own domestic monetary policy to achieve macroeconomic stability. The Nepal Economic Survey 2009/2010 shows a

Banking system

6

Anti-inflation /
forex policy

4

positive trend for the Nepalese Rupee vis-à-vis major international currencies. Nepal's currency appreciated by 7.8% against the dollar between July 2009 and March 2010 and stood at NPR 72.40.

Nepal's economy remains in a fragile state. The insurgency may have ended, but political instability is persisting or even increasing, especially in the Terai region. The increasing frequency of power outages could not be checked in 2010 and continued to damage the economy severely. In January 2010, Nepal's minister for energy, Prakash Sharan Mahat, announced that the government is working to limit power outage to 12 hours per day. Simultaneously, the state-run electricity provider NEA imposed daily power cuts of 11 hours. During 2009/2010, revenue mobilization of the government grew by 26.1%, due to the mobilization of tax volunteers, growth in imports and a tax administration reform, including enforced control of revenue leakages. VAT grew by 36.2%, a growth attributed to increased consumption and reforms in the VAT administration. Reforms in custom administration and increased imports of high-tax-yielding vehicles and spare parts contributed to a high growth of customs revenue, rising by 32.1%. Over the past few years, Nepal's total public debt has been declining. Nevertheless, the government recognizes the depletion of foreign exchange reserves since July 2009 and the emerging vulnerabilities of the financial sector as possible threats to stability.

Macrostability
5

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 time of writing, they have nevertheless hesitated to restore ownership of all the property they confiscated during the times of insurgency. Women's equal property rights still only exist on the paper.

Property rights
5

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
5

10 | Welfare Regime

Nepal's welfare regime is underdeveloped and fails to cushion the effects of the economic crisis. Current adjustment mechanisms leave little financial space for programs of social protection and exercise a long-term effect on the already critical living standard of Nepal's vulnerable groups. The government does provide a

Social safety nets
2

number of social programs, including a civil service pension, food-for-work programs, social pensions, microcredit programs, and abecedarian programs for micro-insurance. Given the low number of beneficiaries and the narrow budget, the overall reach of social programs can only be minimal.

Social inclusion and targeted programs were announced in the Tenth Plan, aiming at bringing positive changes in the overall HDI. After the 2006 peace accord, poverty alleviation programs became a centerpiece in political parties' agendas, but the responsible authorities stopped short of the necessary strong commitment to implement and monitor these programs. Considering the poor results from targeted programs and recently non-performing projects, it must be stated that social policy failed to increase economic opportunities for Nepal's poor. The social investment policy neglects the development of human resources by passing up the chance to create opportunities for future social development. The key issue of low government spending on social protection has been addressed recently, as the government has significantly expanded the coverage of social programs and their planned expenditure, for example, featuring a food distribution program and expanding school meals. Another central issue is the expansion of employment programs, including the re-integration of combatants and conflict-affected populations into economic and social life.

A symbolic step towards equal opportunity was made in the adoption of a proportional representation system during the constituent assembly elections. While most of the societal groups are represented in the political system today, little changed regarding the predominance of high-caste Hindus in a political elite that is nearly unchallenged in deciding all critical political issues. Commitment to democratic norms and equal opportunities is rare – nowhere more so than within the parties. These findings are notably true for the NC and the CPN-UML, who both feature an unbroken predominance of the traditional elite. Only the Maoist party showed some effort to provide greater participation for women and marginalized groups.

Outside the political system, the picture is identical. The entire public sphere is controlled by high-caste Hindus, including the education system, the media, security forces, unions, professional organizations, the judiciary, and – last but not least – bi- and multi-laterally funded NGOs. This profound social and economic discrimination was a main cause for the outbreak of the Maoist insurgency in 1996 and has not been eradicated. An important reason for the persistence of the high-caste Hindu predominance is the lack of political commitment of those leaders who fear losing power if they open up space for other groups. But the lack of social development and deprivation that has affected a great share of the population for centuries seems to be an even bigger obstacle to breaking the dominance of the traditional elite.

Equal opportunity
3

11 | Economic Performance

Although Nepal's GDP per capita (PPP) showed some slight improvement, standing at \$1,156 (PPP) in 2009, the state remains among the poorest in the world. Though Nepal has managed to maintain a steady medium-growth rate since 2006, standing at 4.7 in 2009, economic development is slowed by high inflation (10.5% in 2009) and an opaque rate of unemployment and working poor.

Output strength
3

In 2009, Nepal showed a current account deficit (-10.1), while the moderate increase of the level of public debt was kept at bay. The ability of the government to increase the level of tax revenues (12.9% in 2009 versus 10.4% in 2008) was a positive sign.

In general, political stalemate and new emerging conflicts add more pressure to Nepal's economic development. The effects of the global economic crisis struck Nepal by slowing the growth of remittances. However, the level of remittances remained high compared to other sources of foreign exchange and were above their 2007 level. Nepal's deficient energy policy has created an inveterate power shortage that can't be brought under control and will inevitably put economic development at risk.

12 | Sustainability

In recent years, Nepal achieved a modest economic growth that came at a relatively high environmental cost. A decade of conflict and political mismanagement has put additional pressure on Nepal's fragile environment. Political instability leading to poverty and overpopulation has created various social and ecological problems, for example, deforestation and subsequent soil erosion due to a lack of other available fuels and construction material. Nepal's main challenges concern the installation of effective instruments of urban environment management, the strict control of impacts of growth, and a sustainable management of natural resources through enforced environmental governance.

Environmental
policy
5

The 2010 Environmental Performance Index (EPI) assigns a value of 68.2/100 for Nepal. Despite achieving a high score regarding the vitality of the ecosystem, Nepal is scoring comparably low in terms of the health outcomes which result from the environmental burden of disease (EBD) and risk factors such as poor water and sanitation and indoor and outdoor air pollution. In 2010, Nepal scored 41.4 against the regional average of 58.5, indicating that Nepal's population is severely affected by problems due to environmental mismanagement.

Subsequently, Nepal's previous prime minister, Madhav Kumar Nepal, announced plans for a new environmental policy in June 2010, highlighting the importance of

efforts at local level to save ecological and natural resources, and stressing the roles of local administration, NGOs, civil society and other stakeholders in good environmental management. No steps to adopt and implement a coherent environmental policy have been undertaken so far.

Nepal's education system is poorly developed and there is scarcely any R&D policy in place.

Consequently, the country has a low overall literacy rate of 57.9%, the male vs. female rate amounting to 71.1:45.4. In 2008, 3.8% of the GDP was allocated for education. Access to education is a major issue for children belonging to the various deprived social groups, and especially girls. In 2009, the ratio of female to male enrollment stood at 86.2% (primary), 88.6% (secondary), and 40.3% (tertiary). According to the World Bank, only 51% of children from the lowest-income quintile attend primary education while 87% of the richest do. The quality of schooling in the public schools is low, as high repetition and low completion rates indicate. The government has developed a three-fold strategy in recent years to address the structural problems of the deficient education system. The Community School Support Project, launched in 2003, has helped to significantly improve primary school access for children from disadvantaged communities. The objective of the long-term Education for All Project (EFA) is to improve primary school access, with a special focus on girls and children from disadvantaged groups. At this program's core lies a commitment to the construction of classrooms, grants of scholarships to girls and disadvantaged groups to cover household costs of education, teacher training and certification, and expansion of adult literacy programs to poor and disadvantaged adults. According to the 2011 Global Monitoring Report on EFA prepared by UNESCO, the number of children enrolled in primary education increased by 1.2 million between 1999 and 2008. And – last but not least – the Second Higher Education Project aims to improve the quality and relevance of higher education and research, and increase access for academically qualified underprivileged students by working to strengthen the system capacity and providing reform grants and student financial assistance. The creation of vocational training capacities is another issue that must urgently be addressed in the near future.

Education policy /
R&D

3

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 education level, a deeply fragmented society due to pervasive discrimination in ethno-religious cleavages, the geographical disadvantages of a landlocked state, resource scarcity, and stateness that was weakly developed. Evidence of significant rural epidemics in parts of Nepal is growing, and HIV prevalence is severe as transmission occurs largely through sex work and intravenous drug use. The majority of Nepal's long-standing developmental deficits of extreme poverty, the lack of an educated labor force as well as the severe infrastructural problems are a legacy of the previous decades if not centuries.

Structural
constraints
9

However, the political elite has to be held responsible for more than two years of stagnation in the reform process. Their failure to come to terms, cease their power struggle games and establish and enforce rules and norms of good governance puts Nepal's future development at risk.

Nepal's social capital is poorly developed, and centuries of structural discrimination against the low-caste and non-Hindu populations have left deep social cleavages. Civil society has been weakly institutionalized by the political oppression of minorities who were banned from forming political parties that represented the interests of ethnic and religious groups or Dalit. Multi- and bi-laterally funded NGOs started to fill the gap after 1990, addressing problems faced by the deprived societal groups. However, international organizations are no adequate substitute for a vivid local civil society rooted in indigenous traditions. The democratic movements of 1990 and 2006 brought about some change, putting various civil society groups on the stage. It remains to be seen if the newly formed civil society groups will be able to sustain their involvement and act as a mature controlling body vis-à-vis the political actors.

Civil society
traditions
8

The long-standing massive structural constraints on governance that Nepal has faced over centuries have been further aggravated by widespread political violence and ethno-religious discord. In 1996, the highly polarized conflict over income distribution and social participation finally erupted into a decade of open civil war. The peace process that followed in 2006 is still fragile, despite the new constituent assembly elections in April 2008. Unresolved ethnic and socioeconomic conflicts, especially in the Terai region, have intensified with the ongoing discussions over the future state system and the government's disinclination to formulate and implement effective measures to reduce the widespread socioeconomic deprivation of a vast number of groups in Nepal.

Conflict intensity
7

II. Management Performance

14 | Steering Capability

Question
Score

Despite the severe structural constraints on governance, the political leadership's poor steering capability is a major cause for Nepal's current crisis. The lack of a potential counter elite adds to the problem. The momentum that was gained by signing the comprehensive peace agreement between the state and the former CPN-Maoist insurgents in November 2006 and the successful conduct of the constituent assembly elections in April 2008, has been wasted. Although the people of Nepal have emphatically demanded fundamental changes at the ballots, the political authorities fell back into the habit of power struggles between the different parties and their leaders or within the parties themselves, that already has exercised an enormously destabilizing effect on Nepal's earlier political systems, and finally culminated in a decade of anti-regime conflict in 1996. Today, prior agreements on future institutional arrangements and on issues of economic and social transformation are at stake due to the absorption of political parties and their leaders in power games.

Prioritization
2

The government's ability to effectively implement reform policies has been hampered by weak political leadership, confrontational tactics and a lack of clear strategic priorities. Nepal's reform goals achieved a measure of consistency in 2007, but this ended after the elections to the constituent assembly in 2008 when the CPN-Maoist won more than a third of the seats, outweighing the two leading parties of the 1990 system, the NC and the CPN-UML, put together. Both parties followed a strategy to derail the reforms initiated by the Maoist-led government in 2008, with the CPN-UML acting from inside the government, and the NC as the main opposition party. The switch to a minority government under the CPN-UML in 2009 did not redraw the picture. The Maoists who left the government in May

Implementation
3

2009 have now started to take the veto player's part. In November 2010, the obstruction of the passage of the annual budget by the Maoists – now the strongest opposition party – has put the caretaker government led by the CPN-UML under pressure. Meanwhile (April 2011), the Maoist party is set to return to power with Pushpa Kamal Dahal showing clear ambitions to become prime minister again. However, throughout a multitude of power games and climate of self-induced political instability, Nepal's government still fails to implement the policies that it managed to formulate. The 2009 implementation of the Voluntary Tax Income Scheme to raise government revenues has been the commendable exemption. Reforms of the education system have been substantially assisted and co-funded by multilateral partners and therefore do not exemplify the government's distinct implementation capacity.

The integration of the former PLA combatants remains a crucial open question. Although clear strategies had been cut out earlier, power shifts within the government led to new emerging debates about the future strategy and consequently to a delay of implementation.

Further reform will depend on the government's discipline to achieve the necessary stability to start good governance and sustain the peace process.

Nepal is involved with numerous international organizations and subject to a variety of reporting processes due to its status as recipient of multi- and bi-laterally funded development assistance. There are plenty of opportunities to install a continuous, coherent and effective monitoring system to optimize future policy planning and implementation, but Nepal's government did not show much enthusiasm for setting up an integrated monitoring system.

Towards the end of the anti-regime conflict and before the 2008 the constituent assembly elections, Nepal's mainstream political parties demonstrated some degree of learning by negotiating 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. At this point, Nepal's political elite seemed to have reached the climax of its learning curve and the short history of successful learning was interrupted. While the FPTP election results emphasized that the Maoists, winning half of the 240 direct mandates, had best understood the need for social and political inclusion, both CPN-UML and NC failed to realize that their own democratic failures and non-inclusive politics were the main reason for these developments. While the CPN-UML is gradually initiating 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 peace negotiations

and constitutional reform, the bureaucracy and the political leadership have shown little willingness (or ability) to learn from previous failures. In daily politics, the routines of policy-making have failed to enable innovative approaches the manifold problems of social and economic development in Nepal. This gives reason to doubt that the elected constituent assembly will be able to meet the extended May 2011 deadline to propose a new constitution that could provide for a democratic, inclusive and development-oriented Nepal.

15 | Resource Efficiency

The government does not make efficient use of available economic and human resources to promote potent economic and social policies. Since 2006, resources intended for development were misappropriated to finance two armies, or consumed by corruption. A lack of electrical power and a background of steadily growing demand are constantly jamming Nepal's development potential. Power cuts and load shedding have long been a regular incidence that is still not adequately addressed, continually affecting the economy and all spheres of public life. Nepal has among the world's highest proportion 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 ten 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 severe issue is the lack of employment opportunities caused by the dearth of human resource development strategy. Job-creation policies remain nonexistent.

Efficient use of assets

3

Given the transitional status of the state marked by a delayed process of constitution writing and an ongoing debate about the structure of the federal system, the government's capacity to coordinate conflictive objectives effectively into a coherent policy is difficult to judge. The decision to trade the previous highly centralized system for a more decentralized structure to address different needs according to socioeconomic and geographical differences has not been transformed into a working system yet. Despite obverse announcements, often made by the Maoists, Nepal's political leaders cling to a highly personalized coordination style, featuring strong hierarchic and bureaucratic elements. Subsequently, Nepal's current institutional framework and political environment do not provide for a high degree of coordination among conflicting political objectives.

Policy coordination

3

Corruption in Nepal is endemic, both in the public and private sectors. It prevails in all public sectors and the demand for and payment of bribes is widely accepted even for routine services. Within the political system, with political parties functioning as proxies of the high-caste Kathmandu-based elite, corruption is institutionalized. The Corruption Control Act has established sanctions for corrupt practices, but the laws are weakly enforced and high-profile government officials can act with impunity. In

Anti-corruption policy

3

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. The 2011 conviction of Chiranjivi Wagle on corruption charges has set a first benchmark, though the full force of the legal actions announced by the CIAA against politicians and bureaucrats in 2009 still remain to be seen.

Corruption is seen as an obstacle to maintaining and expanding investment and doing business 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. 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.

16 | Consensus-Building

With the abolition of monarchy and the total defeat of pro-royal political forces in the constituent assembly elections, one of the traditional players in domestic politics has vanished. Monarchy is an institution of the past. The major parties are committed to democracy and market economy, if only on paper. Nevertheless, economic development has scarcely been addressed in the country's recent political discourse. In the aftermath of the elections, the political parties once again found it difficult to bridge differences through democratic rules and norms.

Consensus on goals
4

The institution of monarchy was formally abolished during the first session of the elected constituent assembly on 28 May 2008. Some persistent 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 refused to bow to the authority of the elected government, especially when it started recruiting new soldiers in early 2009 despite a political order against this. The Maoists do not appear steadfast in their commitment to democracy either, though this is less true of the Maoist government than of the suborganizations that still tend towards militant and aggressive behavior. Terai organizations and parties, even those in the government, repeatedly threaten the democratic process by means of boycotts, blockades and other violent behavior during the period under review.

Anti-democratic actors
4

Some increase of violent ethnic movements in the hill region has been prevalent recently. The lack of democracy within the ruling parties and a deficient acceptance of democratic norms and rules among the political authorities remain a major issue.

The majority of political parties and their leaders refused to address the deeply rooted problems of socioeconomic and ethno-religious cleavages, social exclusion, and regional inequalities. This fact undermined the historic achievements of the democratic transition in 1990, as a sustainable depolarization of Nepali society has not yet been achieved. For the first time, the constitutional and legal regulations of the constituent assembly elections provided for substantial political participation for different population groups. Nevertheless, 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, and retain traditional mechanisms of recruitment. So far, the government has halfheartedly addressed the various Terai issues, while to a large extent ignoring the main demands of the Terai population. The same is true for the situation of diverse ethnic population groups living in the hill area. While Nepal is seeking to develop a federal political system, its political leaders fail to establish the binding framework as a precondition to negotiate the diverse aspirations and demands of different groups.

Cleavage /
conflict
management
4

Civil society played a major role in the process that led to the downfall of the royal regime and exerted some influence on 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 high-caste elite opposes 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. This affects the Dalit population in particular, and their 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. In general, civil society groups' impact on public policies remains limited. Political parties barely accept 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 own positions.

Civil society
participation
3

National reconciliation and the discussion of past injustices remain major unaccomplished tasks. During the decade of 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

Reconciliation
3

the capital crimes and most of the cases of disappearance were attributable to the security forces, acting on the order of the king and an NC-led government. To date, the state has made virtually no effort to investigate these offenses. A sustained policy of impunity prevents the necessary process of coming to terms with the past. 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 get involved in a process of reconciliation that might lead to uncomfortable questions and answers.

Currently, the government is not undertaking steps to foster a process of 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 towards deprived regions and groups. Relations between donor groups and the government were strained during the times of the royal takeover (2002 – 2006). However, since the April 2006 period of transition, relations between the new government, donors and Western governments have relaxed considerably. This development was bolstered further by the successful constituent assembly 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. Nevertheless, the last two years have seen growing disappointment over the selfish politics still pursued by all parties and their leaders. Nepal's government is accepting help from international partners but fails to provide its own substantial contributions through formulation and implementation of coherent policies in order to tackle Nepal's major issues.

Effective use of
support
6

The April 2008 constituent assembly elections brought Nepali politics back to the rules of legitimacy. The changing governments have since tried to act as a reliable partner within the international community. However, major international actors (especially the United States) and international organizations doubt the reliability of the current government. India in particular shows a critical attitude towards the Maoist government of 2008/2009 and seems to be concerned by the foreseeable return of the Maoists to power in 2011. This judgment is based on the repeatedly undemocratic behavior of Maoist cadres as well as of a number of confusing statements by their leaders. The politics of defamation and boycott practiced by all

Credibility
6

political parties – and especially the NC – might have added to the critical international judgment.

Nepal has two neighboring states: India and China. Both have been long-standing development partners, though the relationship with India is more profound due to common linguistic, cultural, and religious identities that overlap in both countries. During the process of democratic transition, Nepal has tried to improve its bilateral relations with both. Throughout the conflict period, relations with India have been somewhat affected by the anti-Indian propaganda brought forward by Maoist cadres. Today, the revision of the asymmetric 1950 Indo-Nepal Treaty of Peace and Friendship is a core point of the Maoists political agenda. Nepal is also a member of the South Asian Association for Regional Cooperation (SAARC).

Regional
cooperation
7

Strategic Outlook

The April 2008 constituent assembly elections have so far been Nepal's most important step towards a sustainable peace and a new, inclusive political system. However, the resistance of Nepal's political elite to full compliance with democratic rules and norms is compromising Nepal's intermediate transformational success.

Although at first sight, the 2006 democratic movement and the subsequent constituent assembly elections in 2008 seemed to have swept away Nepal's conservative camp, conservatism and traditionalism in Nepal are not limited to the worship of monarchy or to those circles that supported the king's direct rule. They are an integral part of the thinking and behavior of the country's ruling elite, not only dominating the political parties – including the communist ones – but also all spheres and institutions of public life. The end of the Maoist insurgency has led to a re-integration of the former rebels into the political mainstream, but many of their suborganizations and cadres still follow militant ways of behavior. Despite the adoption of almost social-democratic propaganda, the CPN-M is still far from being a democratic party. A number of Maoist leaders are dissatisfied with recent developments and compromises. Matrika Yadav, who formed a splinter CPN-Maoist party in 2009, is only one example. Baburam Bhattarai has recently threatened to break away, due to internal disputes with Pushpa Kamal Dahal. The two other major parties, CPN-UML and NC in particular are still harboring a number of extreme conservative elements. Both parties have resisted fundamental reforms, as well as the implementation of internal democratic structures and procedures. This makes the NC, as the second strongest party in the CA, a major obstacle to necessary fundamental reforms of state and society. Nepal's future political system has to provide equal opportunity for all citizens, including those traditionally excluded on the basis of caste, ethnicity, gender, and birth. Meanwhile, ethnic and regional tensions have replaced the Maoist insurgency. These issues have been most intense in the Terai along the Indian border, but are also increasing in the hill area populated by numerous ethnic groups and Hindu castes. One of the constituent assembly's key

tasks will be laying out the foundations 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 witnessed in the Terai. Political leaders have to address these concerns immediately. Likewise, issues linked to the integration of the Maoist PLA into the Nepalese Army should be approached soon. Nepal's government needs to pursue those reform efforts separately from the adoption of a new constitution: the ongoing improvement of educational and environmental programs is essential. Furthermore, the issue of impunity has to be addressed adequately, paving a way for a sustainable process of reconciliation to prevent future contention due to unresolved conflicts of the past. Multi- and bi-lateral international assistance and consultancy remain important. Without the major political stakeholders clear commitment to sustain the peace- and state-building process at any cost, abandoning personal power ambitions, and giving up deeply rooted traditional concepts of rule in favor of a political process that is guided by democratic norms, international assistance will largely fail to make an impact.