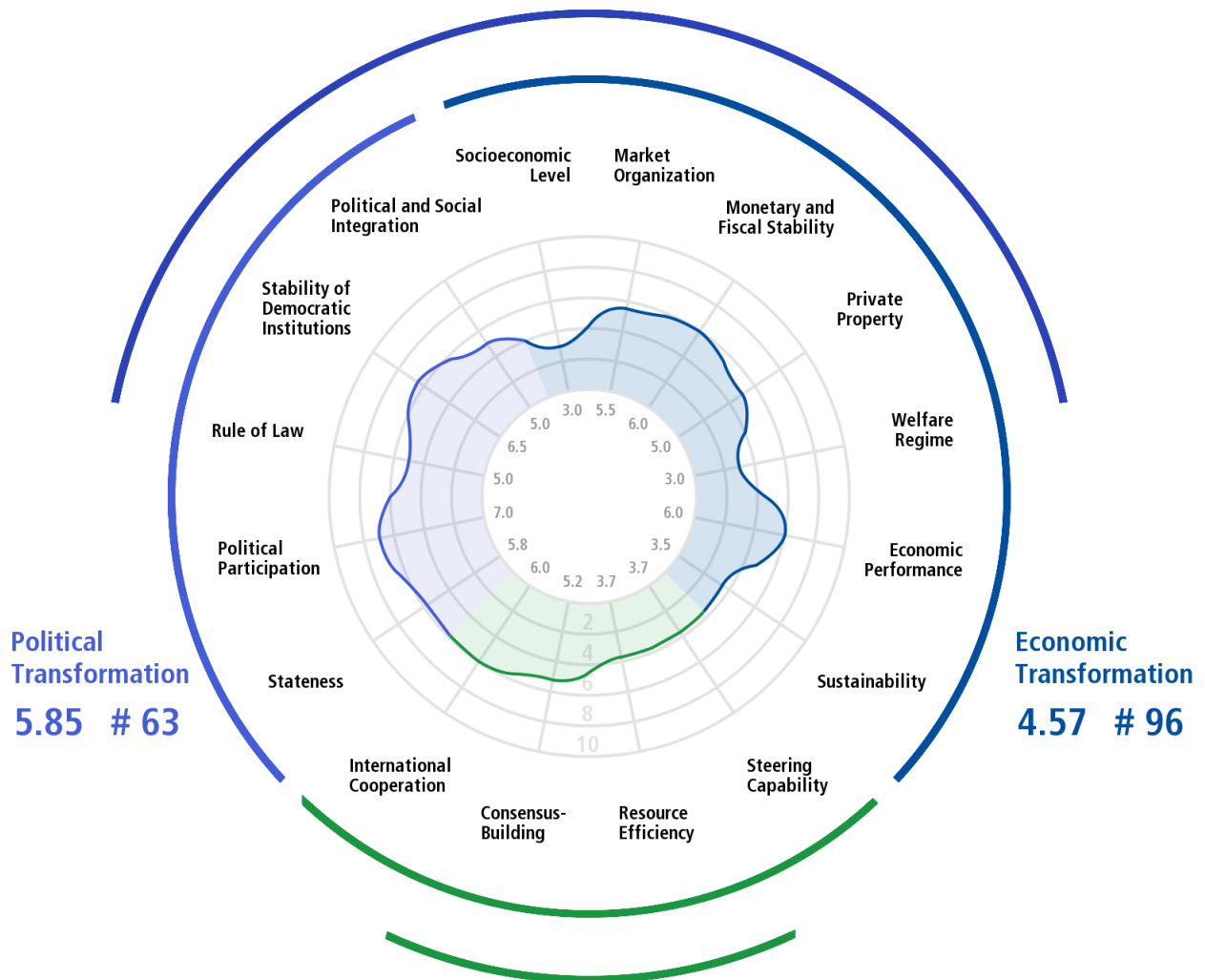


Nepal

Status Index

5.21 # 75

on 1-10 scale out of 137



Governance Index

4.34 # 90

on 1-10 scale out of 137

This report is part of the **Bertelsmann Stiftung's Transformation Index (BTI) 2020**. It covers the period from February 1, 2017 to January 31, 2019. The BTI assesses the transformation toward democracy and a market economy as well as the quality of governance in 137 countries. More on the BTI at <https://www.bti-project.org>.

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Key Indicators

Population	M	28.1	HDI	0.579	GDP p.c., PPP \$	3064
Pop. growth ¹	% p.a.	1.7	HDI rank of 189	147	Gini Index	32.8
Life expectancy	years	70.2	UN Education Index	0.501	Poverty ³	% 50.8
Urban population	%	19.7	Gender inequality ²	0.476	Aid per capita \$	45.5

Sources (as of December 2019): The World Bank, World Development Indicators 2019 | UNDP, Human Development Report 2019. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$3.20 a day at 2011 international prices.

Executive Summary

The last two years have been a period of rebound and cautious optimism in Nepal. After having been hit by two large earthquakes in 2015 that killed over 9,000 people and rendered many more homeless, and having suffered through a long, tortuous constituent assembly process that finally resulted in a new constitution, the country has seen progress on political and economic fronts in the recent past. Governance, however, remains an issue.

During the period under review, Nepal successfully held the first local level elections conducted in the country in 20 years, as well as elections for both the national and provincial legislatures. These elections were the first under the new 2015 constitution, which provides for a mixed electoral system, with federal provinces. Their successful conduct was in some doubt, as veto players, including a coalition of Madhesi parties in the south of Nepal, threatened to boycott the elections. The ruling Congress-Maoist coalition, led by Pushpa Kamal Dahal and Sher Bahadur Deuba in succession, forged ahead anyway. While there were isolated incidents of pre-electoral violence, security forces largely managed to ensure the safety of both the vote and the electorate. At all levels, the elections have been widely hailed as free and fair. While the rule of law and governance remain weak in Nepal, this crucial first step after a period of turbulence should not be discounted, and lawmakers should be given some time and space to make good on their promises of a new era in Nepali politics. Even if governance remains slow and ineffective in the short term, as it may well be, this particular cohort of politicians is far more diverse than any other in Nepal's past. The fact that so many women and so many people from diverse backgrounds are sitting in government together is progress on its own and may quell some of the representation concerns that have long dominated political dialog in Nepal.

Economically, Nepal appears to be moving past the 2015 earthquakes and the Indian trade blockade of 2015 to 2016 that caused shortages of fuel, medicines, produce and other necessities. At its peak, during this previous period, the inflation rate was above 12% (though was only 8.8% annually) and growth was nearly flat at 0.6%. In comparison, GDP growth was 7.5% in 2017, and

inflation was back in check at a rate of 3.2%. Aiding this economic recovery was an end to Nepal's chronic electricity shortages, and while final 2018 numbers are not yet available, they are not likely to depart from this recent positive trend. The percentage of the GDP contributed by remittances continues to decline, which appears to have reduced domestic consumption, assisting in the control of inflation. Though rebuilding after the 2015 earthquakes continues and full recovery remains some distance away, economic progress has done much to ameliorate conditions for average Nepalis. That said, Nepal remains reliant on remittances, and a significant percentage of Nepalis remain below the poverty line. In addition, minorities and women continue to be overrepresented among the poor. Nepal has a long way to go economically, particularly in terms of trade liberalization, education funding, research and development, and the development of industrial or service-sector-based economic growth.

Many governance challenges remain as well. To be sure, Nepal faces an incredibly challenging structural environment. Nepal is a landlocked country with few natural resources and difficult terrain; it also is home to incredible ethnolinguistic diversity and staggering poverty. Few governments fare well under such conditions, but in Nepal's case, poor governance, particularly as evidenced after the 2015 earthquakes, can itself contribute to poverty and economic stagnation. While the government has been given few true tests over the last two years, its steering capability and resource efficiency remain poor. This is at least partially because of its struggle to build consensus within a government and political system that remain fairly fractionalized. Still, the consolidation of the Communist Party of Nepal-Maoist (CPN-M) and the Communist Party of Nepal-Unified Marxist-Leninist (CPN-UML) into the Communist Party of Nepal is a positive step that may contribute to consensus-building in the future. Another recent positive step is Nepal's efforts to normalize relations with India while continuing to improve them with China. But the real work will have to be done at home, under the fairly watchful eye of a demanding and increasingly politically sophisticated citizenry and non-governmental sector. With institutional fights relatively settled and a new class of legislators comfortably seated, it is now time to get down to the real work.

History and Characteristics of Transformation

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

However, this transition did not establish a stable, well-functioning and consolidated liberal democracy. Rather, Nepal experienced a series of weak governments with ineffective governance, and the emerging democratic regime left much to be desired. As a consequence, in the late 1990s, a Maoist rebellion erupted that affected almost all 75 districts of the country. The insurgent movement found support especially among the impoverished and largely disadvantaged rural population, who often felt neglected by the state. Unfortunately, internal armed conflict contributed to a further decline of democracy and human rights in the country. Moreover, in 2001, King Birendra and nearly the entire royal family were murdered under mysterious circumstances. The dead king's brother, Gyanendra, was crowned king on June 4, 2001. Support for the monarchy waned even among royalists after this event, as Birendra was well-respected and Gyanendra was not.

Gyanendra did not help the case for continued constitutional monarchy in Nepal. Disappointed by the government's lack of success in combating the Maoist insurgents, Gyanendra staged a royal coup in 2004/05, claiming full sovereignty and assuming executive authority. The restoration of royal authoritarianism led to the emergence of a broad opposition movement consisting of the Seven Party Alliance (SPA) and the Maoist insurgents. Finally, broad-based anti-regime contention orchestrated by the main opposition parties and civil society groups in April 2006 forced King Gyanendra to reinstate the dissolved parliament.

The newly formed multiparty government concluded a comprehensive peace agreement with the Maoists that opened the way for an interim constitution, which came into force in January 2007. On the same day, an interim parliament, which included Maoist representatives, was formed. In April of that year, Maoists also joined the government. It took another year before popular elections to a constituent assembly (CA) occurred, in April 2008, with the CPN-Maoists finishing as the strongest party. In May 2008, at the CA's first meeting, the monarchy was abolished, and the interim constitution was amended to institutionalize Nepal as a federal democratic republic.

The years that followed these elections were disappointing in many respects, for Nepalis and outside observers alike, as the old power struggles between political leaders started once again. It was only in early 2009 that the CA started its work on the new constitution. Even though the 2007 interim constitution established a secular, federal and republican state, deeply entrenched

differences about the ideal form of the future state impeded agreement between party leaders, which in turn inhibited the CA's ability to reach consensus on key constitutional articles.

After four extensions of its initial two-year tenure, the CA was dissolved without promulgating a new constitution in May 2012. Succeeding interim governments proved unable to break the constitutional deadlock until new elections for the CA were successfully held in November 2013. These elections saw an impressive comeback on the part of the Nepali Congress (the main opposition party at the time, and the ruling party for most of the 1990–2006 period). After the CA assembled in January 2014, a multiparty coalition was formed under the leadership of Prime Minister Sushil Koirala (Nepali Congress) in February 2014.

In April and May 2015, two devastating earthquakes hit Nepal, causing great loss of human life and economic destruction. However, the natural disasters did act as catalysts for the constitution-drafting process, and Nepal's political leaders fast-tracked the drafting work. Amidst much controversy, violent protests in the Terai, and an unofficial Indian blockade, the new controversial constitution was eventually promulgated on September 20, 2015. The document backtracked from many of the achievements of the interim constitution with regard to social inclusion. In October 2015, UML leader K.P. Oli became the new prime minister and his ultra-nationalist stance further polarized Nepali society along identity lines.

In August 2016, an unusual Congress-Maoist coalition took power. The coalition agreed to run the government and share the prime minister's position in tandem (one after the other) as it oversaw local, provincial and national elections. Maoist leader Pushpa Kamal Dahal took the helm first, overseeing the first phase of local elections. In June 2017, he voluntarily handed over power to Sher Bahadur Deuba of the Nepali Congress, who oversaw the latter two local-election phases, as well as the provincial- and national-level elections later that year. Though some pre-electoral violence did take place, elections for all levels of government were hailed as free and fair, and newly elected representatives have now taken their seats, marking a potential watershed moment in Nepal's political transformation.

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

Transformation Status

I. Political Transformation

1 | Stateness

After several years of multidimensional stateness crisis, driven by a Maoist rebellion and a royal putsch, the peace process ongoing since 2006, albeit slow and fragile, has helped to strengthen the state's monopoly on the use of force in many parts of the country. The 2006 Comprehensive Peace Agreement and subsequent tenures of the constituent assembly (CA), from 2008 to 2012 and again from 2014 to 2017, provided a platform for wide-ranging public debate over both the real and ideal nature of Nepali stateness. In 2015, a new constitution replaced the Interim Constitution of 2007. After free and fair elections in 2017, the first successful government transfer since the 2015 constitution occurred in 2018.

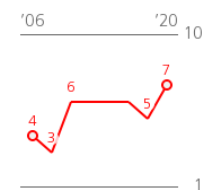
Although the legitimacy of the state's overall sovereignty and territorial claims within its international borders are uncontested in principle, the very nature of the state's internal power structures – both geographical and political – has been up for debate in the post-conflict period. These problems have been complicated by the close relationship between Nepal's civilian government and its armed forces, which has only increased with the Maoist political party (CPN-M and now NCP) in power and with a significant number of Maoist ex-combatants integrated into the Nepal Army (NA) from 2012 to 2014. Rather than enabling legitimate democratic control over the country as a whole, the politics of impunity and militant ethnic and regional movements that have followed the conflict have actually become the main threat to the state's monopoly on force. This was especially true during the intensification of protests over the new 2015 constitution and the unofficial Indian blockade, which was resolved in early 2016.

While in the past there have been concerns over the activities of Indian border security forces acting beyond their jurisdiction, these isolated incidents have not intensified, and by many accounts have subsided. Additionally, along the northern border with China's Tibetan Autonomous Region, Chinese border troops have allegedly overstepped their jurisdiction by occasionally entering Nepali territory.

Question
Score

Monopoly on the
use of force

7



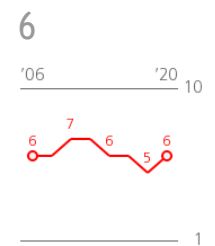
These incidents too appear to be isolated and largely unintentional, and the relationship between China and Nepal has strengthened in recent years. A joint project between China and Nepal currently proposes to build a railway connecting the western region of Tibet with Nepal. This project was one of several bilateral deals signed during Nepali Prime Minister Khadga Prasad Sharma Oli's visit to Beijing in June 2018.

Ever since the creation of modern Nepal 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, the civil service and all other spheres of public life. This changed little after the downfall of the Panchayat system in 1990. The promulgation of the new 2015 constitution fell short of the more inclusive aspirations of the 2007 interim constitutional settlement, and to some degree returned to more exclusionary ethno-cultural nationalist narratives. The new constitution includes a version of secularism that has been explained as “special protection for sanatana (Hinduism)”; reiterates the long-standing ban on religious conversion; features gender-discriminatory citizenship provisions; introduces a new category, Khas-Arya, into the quota system; and reduces the quota of parliamentary seats elected under proportional representation (though quotas still exist for marginalized groups and women). The constitution also establishes “all the mother tongues spoken in Nepal” as the official language(s) of the nation, with Nepali as the language of official transaction. Provinces are allowed to select one or more local languages in which to conduct official business in addition to Nepali. In practice, thus far, Nepali has remained the dominant language of most official proceedings.

People of Indian ancestry living in the Terai (Madhesis), members of numerous ethnic groups (Janajatis), women, and the so-called untouchable castes (Dalits) continue to face substantial legal, economic and social discrimination from high-caste Hindus (often called “hill elites” because they live in the central hill region) who still hold dominant positions in the bureaucracy and political institutions, as well as in Nepal's complex socioeconomic system.

Many public officials continue to maintain strongly held beliefs that Nepali citizenship should be defined by competence in the Nepali language and adherence to Hindu social norms. Such attitudes, dating largely from Nepal's recent past as a Hindu kingdom, have been strongly contested for decades by politically active members of the Madhesi and Adivasi Janajati (indigenous nationalities) movements. These groups have demanded a reformulation of the nation-state's symbolic rhetoric and citizenship policies. Since 2007, identity-based movements have made significant gains in broadening notions of the nation-state and the basis for citizenship. However, since 2010, they have faced increasing resistance from counter-movements that deploy similar identity-based rhetoric to “protect” the privileged citizenship status of erstwhile dominant groups. This second view ended

State identity



up prevailing and was enshrined in the controversial 2015 constitution. The standoff between these competing nationalisms contributed significantly to constituent-assembly delays. The existing citizenship agreement remains embattled and unstable, though a temporary settlement appears to have been reached.

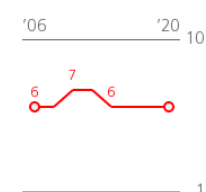
In terms of the legal system, the 2015 constitution defines the Nepali state as secular, but includes an explanation that “secular means the protection of sanatana” (a Sanskrit expression that denotes Hinduism). The document also reiterates a ban on religious conversion, which has been in place since 1959. The Country Code (Muluki Ain), which represents the backbone of Nepali civil and criminal law, still retains numerous provisions more or less directly influenced by a certain reading of Hindu scriptures. While more progressive political forces and activist lawyers have sought to reform the legal system, the changes remain piecemeal and incomplete.

The administrative system is riddled with corruption and urgently in need of reform. As in most South Asian countries, various indicators, such as the ability of the state to tax the economy, indicate weak state capacity in Nepal. Indeed, many Nepalis, even those who can afford to do so, seek to avoid paying taxes because they believe their funds will be misused. While the administrative structure of the state extends beyond maintaining law and order, the country’s administration is also weak and largely unable to provide equitable access for all citizens to administrative services. Especially in rural areas, the infrastructure is limited and still does not provide a sound administrative basis for political, social and economic development. The situation has improved substantially in urban areas, though those living in informal settlements rarely benefit from this change. Citizens seeking to avail themselves of basic state services such as birth and death registration, health care and education – let alone legal redress – encounter complex procedures over which individual political and administrative actors often have discretionary influence. Decision-making is often highly centralized, both geographically (i.e., petitioners from all over the country often must come to Kathmandu to attain their objective) and individually (lower-level functionaries are often unwilling to take responsibility for decisions, so power is concentrated at the top levels). However, steps have been made to address corruption in recent years. The practice of rationing electricity was phased out following a change in leadership in the Nepal Electricity Authority in 2016. A report by the Centre for Investigative Journalism uncovered corruption as a key factor, and in 2018, the energy minister pledged to investigate.

A general restructuring of the civil administration has been under discussion for years. With the promulgation of the new constitution in September 2015, consultations have been under way to adapt Nepal’s administration to the country’s new federal structure. A new local-level structure as decided by the cabinet went into effect in 2017, and some progress has been made. However, the laws that would provide a basis for administrative restructuring were still being drafted as of the time of writing.

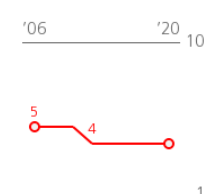
No interference of religious dogmas

6



Basic administration

4



2 | Political Participation

The successful executions of local and legislative elections made 2017 a watershed year for Nepal. Though the lead-up to the election was not without conflict, both the local and legislative elections took place without major setbacks. The legislative election was held in two phases to mitigate logistical, geographic and climatic concerns. The voter-turnout rates were between 73% and 77% for the three phases of the local elections, and close to 69% for the legislative election. After over one hundred attacks involving explosions occurred prior to the elections, largely targeting assemblies and leaders, security forces were deployed to preempt election-related violence. Outbreaks of violence during the elections themselves were isolated and minor.

As was the case during the November 2013 general CA elections, several smaller parties threatened to boycott and protest against the 2017 elections. The 2013 election was boycotted by an alliance of more than 30 fringe parties and the much larger Communist Party of Nepal-Maoist (CPN-M). In 2017, an alliance of several Madhesi parties threatened to boycott all phases of the local elections over concerns of inclusiveness and voter participation. Despite this, elections were largely considered to be free and fair, and Madhesi parties did obtain seats at both the local and national levels.

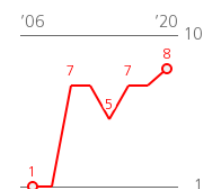
The 2015 constitution reduced the percentage of seats selected under proportional representation in the directly elected lower house (60% of the seats elected under a first-past-the-post (FPTP) system, and 40% under proportional representation) from the arrangements under the previous 2007 interim constitution (42% of the seats elected under FPTP and 58% under proportional representation), thus making the lower house less inclusive. This has been a major grievance of Janajati, Madhesi and other marginalized groups. In addition, one-third of seats have been reserved for women at all three levels of government.

Since the first CA elections in 2008, democratically elected representatives have had the power to govern. Their power remains somewhat constrained, however. Various political parties, including those that boycotted the 2017 elections, can exercise veto power by way of agitation. The CPN-M, however, which has struggled to replace its militant outlook with adherence to democratic norms, has recently made strides. Its successful power-sharing government with the Nepali Congress party marked a milestone in its progress. While each of these actors can be seen as a “veto group,” integrating them into the political process is important for achieving sustainable peace.

On a positive note, the Nepal Army (NA) is no longer a significant veto player. Over 1,400 former People’s Liberation Army (PLA) combatants have been integrated into the NA, making Nepal one of the few successful instances of post-conflict army integration worldwide. Furthermore, despite allusions to the possibility of a military

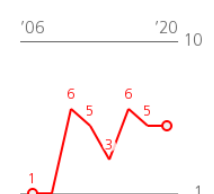
Free and fair elections

8



Effective power to govern

5



coups in recent years, especially before the 2015 constitution, the army top brass has been restrained and has maintained a low public profile.

Other potential veto groups, such as large landowners and business elites, enjoy extensive access to political parties, and can hence try to influence policy-making through institutionalized politics. They therefore do not count as “veto groups” in the context of this report, given their work through institutionalized channels.

Finally, there are veto actors at the local levels (landowners, traditional elites, groups or individuals with control over means of violence and coercion). With the decentralization of the political system, these actors may start to exercise more control. They have not done so on a large scale to date.

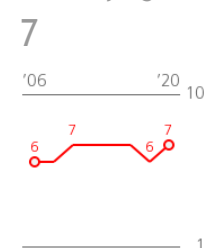
The freedoms of association and assembly are guaranteed under Article 17 of the new 2015 constitution. The constitution allows for “reasonable restrictions” to be imposed by ordinary laws in a variety of circumstances. During the protests in the 2015 to 2016 period and the 2017 protests in the Terai, the government issued curfew orders and established “prohibited zones.” Nevertheless, individuals in Nepal are free to join political and civic groups, and many people possess multiple affiliations. For the most part, such groups operate freely, and mass rallies and programs are common, both in urban centers and rural areas.

The exception to this general rule is public events involving the Tibetan community. While Tibetans lead relatively full lives in Nepal, free of most restrictions, they have sometimes been detained and arrested for staging protests and holding cultural festivals that invoke the Dalai Lama. This differential treatment is largely due to Chinese pressure on Nepal. The state, in violation of international law, often does not view the rights of Tibetan refugees as equivalent to those of its own citizens.

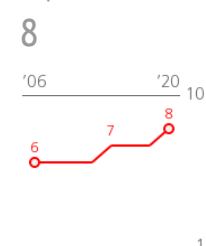
The freedoms of opinion and expression are guaranteed under Article 17 of the 2015 constitution; however, the same provision allows for “reasonable restrictions” on these freedoms. Under Prime Minister Oli’s tenure, there have been a few high-profile incidents in which freedom of expression has been curbed: the arrest on sedition charges of Madhesi activist C.K. Raut and the deportation of Canadian citizen Robert Penner, both on the grounds that their speeches were disturbing Nepal’s social harmony and threatening national unity. These high-profile incidents notwithstanding, the right of free expression is regularly enjoyed by most in Nepal.

Indeed, Nepal has a vibrant media, with scores of print dailies, weeklies and monthlies in the national language of Nepali, as well as English and several ethnic and regional languages. Community radio has also expanded rapidly, especially in rural areas. Growing electric grids, complemented by satellite and mobile technology, have also fostered a diverse and contentious public sphere in which many different voices are increasingly heard at both local and national levels. The 2018 Reporters Without Borders Press Freedom Index ranked Nepal at 106 out of 180 countries, a marked improvement from 2014, when Nepal was at 120th place.

Association /
assembly rights



Freedom of
expression



3 | Rule of Law

Article 56 of Nepal's 2015 constitution expressly provides for the separation of powers. The principle is embedded at the institutional-design level, from the creation of three separate branches of government to the extensive mechanisms intended to ensure that the separation is complied with. However, in practice, the separation of powers is weakened by the tradition of executive dominance, the legislature's subordination to the executive branch of government and strong factionalism within the political parties. Moreover, the constitution does weaken the judiciary slightly, especially as compared to previous interim constitutions. Impeachment proceedings targeting Supreme Court justices are possible, and a separate constitutional bench of the Supreme Court can review legislation. In addition, the executive has occasionally overreached in the past and failed to comply with court rulings. However, the institutional capital associated with Nepal's judiciary, especially vis-à-vis other branches, will likely allow it to withstand these relatively minor changes.

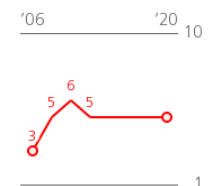
Nepal has an independent three-tier judicial system, consisting of a Supreme Court, a high court for each federal province and a district court for each district. The Supreme Court is the highest court, and generally speaking hears appeals from high courts, while high courts hear appeals from lower courts. The 2015 constitution also provides for a Constitutional Bench within the Supreme Court tasked with reviewing legislation. This bench has now been created and has begun its work, but has thus far been ineffective owing to political and logistical problems, adding to the judicial backlog. The apex court is also weakened by new impeachment procedures, which have lower thresholds than those in previous constitutions. The new Judicial Council provides an added layer of protection for the courts.

The Supreme Court has not historically shied away from displaying its independence and power. It did so recently by impeaching several political leaders on corruption charges and making courageous decisions on transitional justice, citizenship and quotas. However, the court faces a recurring problem of compliance. The executive sometimes flouts rulings completely, and reluctantly complies at others. Civil society has been instrumental in promoting executive compliance.

The court system remains inaccessible to most Nepalis due to insufficient geographical dispersal and scarce resources, both within the system and among those seeking protection. This should change as the entire political system decentralizes in line with the new constitution. Unfortunately, however, the judicial system suffers from a number of other problems. The functional capacity of Nepali judges is somewhat limited due to lack of experience and training. Citizen awareness and understanding of the judicial process generally and of delays in the system specifically are somewhat low, contributing to widespread frustration with the courts and their inability to provide justice. Corruption is also a problem; according to the

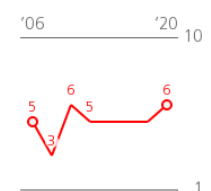
Separation of powers

5



Independent judiciary

6



Nepal Bar Association, it is deeply rooted and particularly problematic in courts of first instance. A large number of pending cases, delays in implementing court decisions, and controversial appointments contribute to an overall impression of a judiciary that is not yet fully independent.

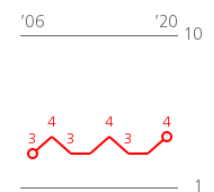
A weak state and low levels of judicial capacity ensure that rule of law and human rights protection remain unfulfilled goals. Certain aspects of the 2015 constitution contribute to this problem. For instance, the president has unrestricted authority to grant pardons. As a result, the political elite rarely face consequences for illegal actions. Nepal has also failed to prosecute well-documented conflict-related crimes. While over 60,000 individuals have come forward to file reports with Nepal's transitional justice bodies, few have been investigated at all and none fully. According to many observers, including the U.N. High Commissioner for Human Rights, this is because Nepal's transitional justice system still allows for full amnesty. Nepal's Supreme Court has ruled that courts must provide justice for conflict violations, invalidating the amnesty provision, but the government has largely ignored this ruling. Given this fact, some have resorted to pursuing perpetrators in foreign courts. Colonel Kumar Lama was prosecuted for torture in the United Kingdom, but was cleared in 2016. Others continue to go about their lives in Nepal or elsewhere without much fear of prosecution.

Corruption remains a part of doing politics and business in Nepal. Funds, including aid money, are routinely misappropriated at all levels of government, and corruption scandals frequently make the news. Most political parties dispense patronage. Companies long ago learned to function in such a system; during the conflict, many complained not about the corruption itself, but about the fact that they had to pay off both sides in order to do business. Many would now say that corruption is bad and should be halted, but few have stopped asking reliable partners in government about "expediting fees."

Still, some changes are afoot. Nepal's anti-corruption body, the Commission for the Investigation of Abuse of Authority (CIAA), has arrested and jailed high-level government officials and politicians on corruption charges in recent years. Overall, however, corrupt officeholders and authorities who abuse their offices can do so with little fear of consequence. This is more so at the local than at the national level, where media and outside attention occasionally result in prosecutions. The CIAA was severely weakened by the impeachment of its Chairman Lokman Singh Karki, but subsequent leaders of the body have stayed clear of trouble, and the institution does appear to be gaining cautious public trust.

Prosecution of
office abuse

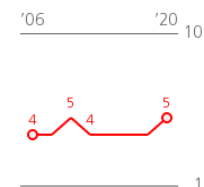
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Nepal's 2015 constitution provides full protection for civil and political rights and an impressive array of economic, social and cultural rights. Constitutional implementation has been slow, however, and many of these rights remain aspirational. Amnesty International and others reported discrimination in aid distribution after the 2015 earthquakes. More generally, levels of legal protection depend on class and caste status, with caste-based discrimination and sexual violence often going unpunished, though this is changing, particularly for sexual violence, after a series of high-profile rape cases in Nepal and neighboring India. The police frequently use disproportionate force to quell political protests and have struggled to enforce order during violently enforced shutdowns (bandhs). While protests in the Terai focusing on the new constitution as well as subsequent protests related to the 2017 elections resulted in violence, the quality of the rule of law has improved of late, and many are hopeful that grievances will now be dealt with largely through the formal system.

Civil rights

5

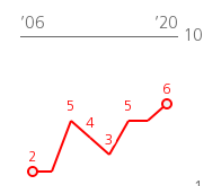


4 | Stability of Democratic Institutions

Democratic institutions exist at the national and local levels, though they remain somewhat contested. From the constituent assembly election in November 2013 through the first successful post-election transfer of power following the 2017 legislative elections, Nepal has had numerous prime ministers. These leaders headed unstable coalitions, leading to largely incoherent and ineffective policy-making. After the legislative elections of 2017, which saw the success of a left alliance comprising the Communist Party of Nepal (UML) and the Communist Party of Nepal (Maoist Center), Khadga Prasad Oli became prime minister for a second time. Despite having a majority in both houses of parliament, Oli was criticized for inaction.

Performance of democratic institutions

6



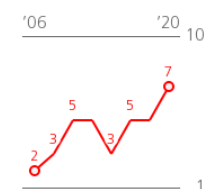
Vested interests among the parties have undermined democratic effectiveness. Patronage and clientelism remain relatively common, undermining the equitable provision of public goods and the fairness of appointments to offices.

In 2017, Nepal saw the first democratic elections for representative bodies at the local level since the disbanding of the elected village councils in 2002, the last elections for which had occurred in 1997. Successful local elections are creating new balance in the democratic system between strong national-level institutions and nascent local-level ones.

Most political actors support the 2007 agreement on democratic transition and institutions. This was confirmed by the elections to the Constituent Assembly in April 2008, in November 2013, and again in the local and legislative elections of 2017. Even the Communist Party of Nepal-Maoist, which decided to boycott the 2013 poll, has now confirmed its commitment to the constitutional process. An alliance of several smaller Madhesi parties that threatened to boycott the 2017 local elections ultimately won several seats during the legislative elections.

Commitment to democratic institutions

7

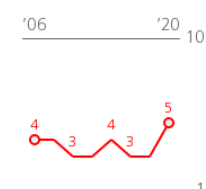


5 | Political and Social Integration

Nepal's party system remains fairly fractionalized and elite-dominated, though the consolidation of the CPN-M and CPN-UML into the Communist Party of Nepal marks a step in the right direction. Recent years have also seen several new parties arise, largely organized around regional or ethnic affiliations, but also around ideological principles. The traditional parties – the Nepali Congress and CPN-UML – have strong social roots but face difficulties recruiting and maintaining the cadre allegiance among Dalits and Janajatis. Most political parties remain personality-oriented organizations with internally authoritarian power structures. Power is typically concentrated in a Kathmandu-Valley-based party head office; local level and rural participation is limited. Established parties make little effort to achieve balanced popular participation either with regard to their own leadership posts or the country's political institutions more generally. The upper caste groups, the Bahun and Chhetri, dominate in all areas. Despite promises of revolutionary social transformation, Maoist parties have fared only slightly better at democratizing their ranks. The Maoists have often enjoyed greater support at the local level due to their protracted mobilization in rural areas during the conflict, but their legitimacy waned during the constitution-drafting process. Popular support for and trust in parties varies widely from year to year, as indicated by the Himalmedia Public Opinion Poll.

Party system

5



Political parties continue to suffer from weak democratic structures and norms in many respects. Disadvantaged segments of society have won a voice in the process thanks to the proportional election system quotas, but still play a minor role within most parties' upper ranks.

Supported by socioeconomic changes and the presence of many INGOs, several civic organizations and interest groups have established themselves since the first transition to democracy, in the early 1990s. These include labor unions, community-based groups, local NGOs and organizations for women's rights. They now play a role in representing social interests and interest mediation. For comparative perspective, Nepal's V-Dem Core Civil Society Index score was a high 0.9 in 2017, while the United States scored 0.95, the United Kingdom came in at 0.93, and India was 0.45.

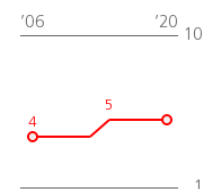
Organizations such as the Nepal Federation of Indigenous Nationalities, the Nepal Bar Association, and the Federation of Nepali Journalists have exercised significant influence by fostering public debate and pressing for political commitments during the most recent phases of Nepal's political transformation. Some of these interest groups are funded by international development agencies, while others derive their support exclusively from local, national or regional actors. Some donors and NGOs act in a parastatal fashion, in many cases delivering services and/or exerting strong influence in policy arenas. Such organizations also serve an important liaison role between citizens and policymakers at the center. However, INGO and NGO effectiveness remains questionable.

This is in part because some civil society organizations are accepted as more legitimate than others, while some maintain explicit political allegiances. In the past, organizations struggled to attract membership across party lines, and as a result, few organizations were accepted as equally legitimate by all relevant actors. This is slowly changing. In addition, many ethnic and regional identity-based groups perceive the political parties (and therefore the structures of governance that they control and operate) as seeking to keep power in the hands of the long-dominant upper-caste Hindus, and therefore as not fully representative. By the same token, many regional and ethnic parties are viewed by the elites as exclusionary and as potential threats to national unity.

The Asia Foundation's 2017 Survey of the Nepali People collected data on public perceptions regarding contemporary political, economic, social and developmental issues in Nepal. The survey was based on a nationally representative sample of 7,202 people from 599 wards selected from all seven provinces. Survey responses reflect "a sense of cautious, post-election optimism that the country is finally on the path to stability." While less than half (43.8%) of the respondents said they had been better represented since the reintroduction of local elections, 89.7% said they were satisfied with the election results. Forty-four percent of respondents believe that federal reform will lead to improvements in their lives, and 45.6% said that the new constitution was a step forward. Among the others, 17% said it was too early to tell whether the constitution was a step forward; 24.6% said it was too soon to tell if federalism would lead to improvements; and 26.7% felt the same about local-level restructuring as they did previously. A majority (58.7%) said that social relations among the different

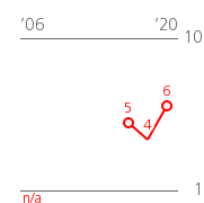
Interest groups

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Approval of democracy

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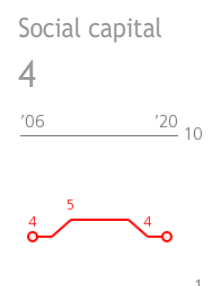
religious, caste, and ethnic groups were improving. In addition, over 80% of respondents supported gender equality.

While these data indicate an upward trend compared to previous opinion data, the overall implications for long-term trust in Nepal's nascent democracy remain to be seen. The 2013 Citizen Survey: Nepal in Transition, suggested waning support for democracy in Nepal during the immediate post-conflict period. According to this survey, support for democracy dropped to 53% of respondents in 2013, from 67% in 2007. Thirty-six percent of respondents said it “does not make a difference” when asked to choose between democracy and authoritarianism, and 11% favored a non-democratic government under certain circumstances. An often-cited survey (Himalmedia Public Opinion Poll 2013) suggests that the long-standing inability of high-level political actors to ensure continuity of democratic institutions contributes to relatively low levels of public trust. According to the survey, 61.1% of respondents thought democracy was under threat, and 39.4% said the reason for this was “wrangling political parties.” This same survey was conducted in 2015, before the creation of the new constitution, with more than half of the respondents reporting Nepal's democracy to be still in danger, and 46.8% of respondents feeling that the condition of the country had worsened compared to previous years. While the 2018 iteration of the survey suggested continued disillusionment (especially with political parties), 43% of respondents reported that government service delivery had already improved in the seven months after elected municipal and village councils took over local governments. Even so, the majority of respondents reported confusion regarding the exact meaning and implications of a federal system. Trust in political parties thus remains volatile.

Despite these concerns, the high levels of participation in the 2017 elections seem to have demonstrated that there is a broad understanding of the importance of democratic procedures. While the CA process, protracted protests in the Terai, slow progress on post-earthquake reconstruction and the lack of advancement on the transitional-justice front may have weakened support for democracy in Nepal between 2015 and 2017, the successful 2017 elections and transfer of power among governments has led to cautious optimism, especially at the local level.

No country-level studies of the strength and forms of social capital in Nepal are available. While anthropological, ethnographic and subnational studies exist, it remains unclear whether these insights can be viewed as representative of the whole society. A study of civil war and social cohesion in Nepal found social cohesion to be strongest in communities that were exposed to high levels of conflict.

That said, associational activities have improved over the last 25 years. Networks of cooperation and mutual support are well developed along not only political party, business and alumni lines, but also along ethnic, caste and regional lines. In many localities, organizations fill spaces that might otherwise be filled by effectively decentralized state agencies. However, they often act to further the interests of a



specific group, reproducing bonding social capital instead of bridging social capital. Nevertheless, initiatives such as the UNDP's Social Cohesion and Democratic Participation Program's (SCDP) are actively working to promote social cohesion and trust. According to the SCDP's 2017 Annual Report, nearly 4,000 youths, women, marginalized groups, civil society members, government officials, political leaders and journalists have been involved in their program through 81 community-level initiatives.

II. Economic Transformation

6 | Level of Socioeconomic Development

Nepal remains one of the poorest countries in the world, with per capita GNI of about \$730 (2016) and per capita GDP of \$835.08 (2017). Remittances continue to represent a significant share of the country's revenue, estimated at 31.3% of the GDP in 2016. In the UNDP's Human Development Report 2017, Nepal was ranked 149 out of 189 countries, with an HDI score of 0.574 (2017). This was a decrease from its 2014 to 2015 ranking, likely due at least in part to the impact of the 2015 earthquakes. The World Bank put an estimated price tag on the earthquake damage of \$7 billion, with total reconstruction needs at \$6.7 billion. To date, only limited reconstruction has occurred.

Nepal's current ranking places it far behind Sri Lanka (76) and ahead of Afghanistan (168). It is important to note that the tables in the UNDP's Nepal Human Development Report 2017 use data available as of July 15, 2018.

More finely grained data shed additional light on Nepal's socioeconomic development. As of 2017, according to Nepal's Finance Ministry, 21.6% of Nepal's population was living below the national poverty line. Several years ago, the World Bank suggested that an additional 3% of the population was pushed into poverty as a direct result of the earthquakes. This translates into as many as a million more poor people. The recent data suggest that either these individuals have recovered and rebounded, or the Nepali economy is functioning well enough that a significant number of different individuals have escaped poverty over the last two years.

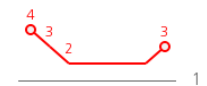
The UNDP Human Development Report continues to identify a Gini coefficient of 32.8 for Nepal, ranking it at 145 out of 189 countries. This is 2010 data, however, so it should be understood as dated. The UNDP Gender Inequality Index score for Nepal was 0.480 as of 2017, giving it a rank of 118 out of 189 countries. Socioeconomic inequalities in Nepal on the basis of gender, caste, ethnicity, language, region and sexual orientation remain structurally ingrained and pervasive, though gender

Question
Score

Socioeconomic
barriers

3

'06 _____ '20 10



dynamics have changed dramatically over the last decade. These long-standing social hierarchies continue to restrict access to political influence and economic opportunities for the many marginalized groups. For instance, despite gender equality improvements, Nepal ranks 111 out of 144 countries in the Global Gender Gap Report 2017. This places Nepal slightly below Sri Lanka (109), but well above Pakistan (143).

Economic indicators		2015	2016	2017	2018
GDP	\$ M	21410.8	21185.9	24880.3	28812.5
GDP growth	%	3.3	0.6	7.9	6.3
Inflation (CPI)	%	7.9	8.8	3.6	4.1
Unemployment	%	1.4	1.4	1.3	1.3
Foreign direct investment	% of GDP	0.2	0.5	0.8	0.6
Export growth	%	6.8	-13.7	13.7	4.4
Import growth	%	9.6	2.8	30.3	14.8
Current account balance	\$ M	2446.6	-167.8	-815.3	-
Public debt	% of GDP	25.6	27.9	26.1	30.2
External debt	\$ M	4150.7	4304.2	4963.3	5478.1
Total debt service	\$ M	226.6	239.7	254.1	243.5
Net lending/borrowing	% of GDP	1.1	1.4	-3.1	-
Tax revenue	% of GDP	16.7	18.7	21.0	-
Government consumption	% of GDP	10.9	11.5	11.3	11.7
Public education spending	% of GDP	3.7	4.4	5.1	5.2
Public health spending	% of GDP	1	1.2	-	-
R&D expenditure	% of GDP	-	-	-	-
Military expenditure	% of GDP	1.6	1.7	1.6	1.4

Sources (as of December 2019): The World Bank, World Development Indicators | International Monetary Fund (IMF), World Economic Outlook | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database.

7 | Organization of the Market and Competition

Poor governance and largely ineffective institutions have led market forces to operate inconsistently in Nepal. Price hikes and artificial shortages related to basic necessities are common and often tied to Nepal's limited arable land, growing population and historical dependence upon imports from India. While growing trade with China may undercut the latter of these factors, Nepal remains weakly positioned to create market stability.

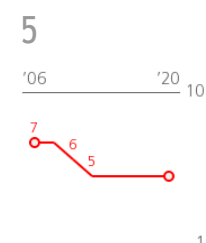
In the last two years, Nepal's economy has made some progress thanks to a reduction in market-entry barriers and improvements in the business environment. For instance, Nepal strengthened access to credit by operationalizing the existing law on secured transactions that implements a functional secured-transactions system and establishes a centralized, notice-based, modern collateral registry. Moreover, the protection for minority investors was strengthened by requiring greater corporate transparency. According to the Doing Business Report 2019, starting a business takes 16.5 days and seven procedures with a cost of 22.2 % of the GNI per capita. The country's score for the "starting a business" category is 84.38 out of a possible 100 (rank 107 out of 190 economies).

While Nepal is not an inhospitable environment for FDI in terms of its regulatory framework, the operations of foreign banks, profit repatriations and currency-exchange facilities in practice continue to constrain foreign investment. India remains the largest single source of foreign investment in Nepal, accounting for 27% of paid-up FDI capital inflows in 2016. India is also Nepal's most significant trading partner, accounting for 63.48% of Nepal's exports and 60.62% of Nepal's imports in 2015. The unofficial Indian blockade of Nepal in 2015 to 2016 undermined both trade and broader bilateral relations between the two countries. However, relations have largely recovered from this low, and Nepal has increased its trade with China, in part to reduce its structural dependence upon its southern neighbor. FDI from China accounted for 14% of paid-up capital inflows in 2016.

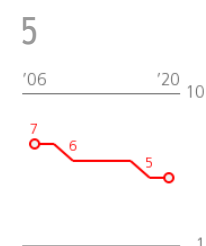
To fulfill its WTO obligations, Nepal passed a Competition Promotion and Market Protection Act, which came into force on January 14, 2007. This is the main legal instrument governing competition policy in Nepal. The act prohibits anti-competitive agreements, abuse of dominant positions, and mergers or other amalgamations made with the intent to control competition. The Competition Promotion and Market Protection Board is responsible for investigating cases and prosecuting alleged infringement in the courts. Therefore, Nepal has a bifurcated adversarial model.

This regulatory framework has not been fully implemented, however. As with so many regulations in Nepal, the weakness of the state and its institutions have limited efforts to reign in powerful private actors. Tentative efforts to dissolve syndicates have largely failed. As reported by the Kathmandu Post in April 2018: "Two recent

Market organization



Competition policy



instances of cartels have been blamed on the weak implementation of government laws. In the first case, the Nepal Bankers Association forced NIC Asia Bank to revise interest rates on deposits. In the second case, bus services operating on Araniko Highway staged a protest against the government for providing a route permit to a new company Mayur Yatayat and breaking up their monopoly.” This recent evidence suggests how difficult it is to enforce the competition law. Moreover, it is an indication of the low level to which competition has taken root in Nepal’s economy.

Nepal acceded to the WTO in April 2004, the first least developed country (LDC) to do so. Nevertheless, the institutional and legal structures to implement the WTO agreement have not been properly developed. Red tape, delays and strikes have significantly discouraged investment in the country. Structural difficulties associated with trade-related services and infrastructure prevent the realization of potential comparative advantages.

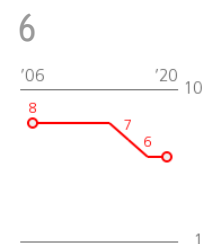
Nepal’s WTO commitments are extensive, with most tariff lines bound at an average final bound rate of 26.3% in 2016; all trading partners hold at least most-favored nation (MFN) status. The simple average MFN applied tariff was 12.1% in 2016, which was on the high side in South Asia. This includes strategic sectors such as agriculture and manufacturing, in which simple average MFN tariff rates continue to fall significantly below final bound lines. Non-tariff measures, largely in the form of import license requirements, affect only a small number of products, which is notable given the developing nature of Nepal’s economy.

Apart from the WTO, Nepal is also a member of two regional trade frameworks: the South Asia Free Trade Area (SAFTA: Afghanistan, Bangladesh, Bhutan, India, the Maldives, Pakistan, and Sri Lanka) and the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC). However, Nepal remains poorly integrated into regional and global value chains, though Nepal’s experience of the 2015 to 2016 informal blockade by India has furthered openness to regional integration.

Traders in Nepal face both distance and transit challenges, due to Nepal’s landlocked position. There are frequent checks by border security officers and police, time-consuming customs formalities, a shortage of containers at the borders, differential tariff rates for Nepalese consignments at the Kolkata port, and long port delays that add to the cost of trade. According to a rough estimate, transit costs associated with overseas imports are as high as 20% of the value of goods.

Nepal’s customs system is not connected to India’s customs system through computer networks, causing delays at customs points. Customs clearance remains highly document-intensive and time-consuming. Customs officials remain capricious and interested in their own financial gain.

Liberalization of
foreign trade



Though FDI inflows into Nepal have increased recently, they remain relatively low. At less than 1% of the GDP, Nepal's FDI inflows are low even compared to regional and other comparators. According to the World Bank, while this is partially explained by the perceived risks of operating in Nepal, the investment regime is also more restrictive than that of similar countries. According to the World Bank, restrictive and unclear FDI policies, complex procedures, inadequate investments and an insufficient infrastructure compound Nepal's trade challenges. Indeed, despite criticism, Nepal continues to retain a foreign ownership limit of 51% in some selected sectors such as legal, accounting and engineering services.

The U.S. State Department's 2018 Investment Climate Statement indicates that Nepal's banking sector is relatively healthy, and that system assets totaled approximately \$26.22 billion as of January 2017, with deposits at \$20.79 billion. A total of 1.64% of the asset base was estimated as non-performing, representing a reduction of almost 50% from 2015. In addition, the ratio of bank capital to assets stands at 11.73%, having increased slightly from 9.99%. This suggests an improved banking environment.

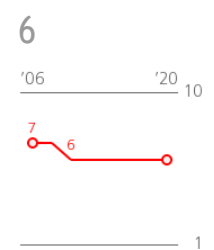
Nevertheless, a number of long-standing issues persist, among them banking-sector fragmentation, weak supervision from Nepal Rastra Bank (Nepal's central bank), insufficient access to banking services among the rural population, and ownership of some banks by prominent businesses (potentially creating conflicts of interest). Progress has been made, however, as there are currently 30 commercial banks in Nepal, down from 78 five years ago.

8 | Monetary and fiscal stability

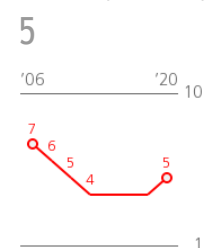
The IMF 2010 Nepal country report states that Nepal Rastra Bank (NRB) has limited independence, negatively affecting supervision and enforcement; the IMF's 2017 report states that some limited progress has been made. A 2014 Asian Development Bank (ADB) report concludes that while the NRB's supervisory capacity has generally improved, its independence and enforcement authority have remained weak. However, the ADB's 2017 macroeconomic update indicates that NRB has done a decent job of maintaining liquidity, while keeping interest rates in check and supporting capital markets.

The Nepali rupee (NPR) is pegged to the Indian rupee (INR) at a rate of 1.6 to 1.0, which Nepali policymakers and international organizations such as the IMF insist is important for overall macroeconomic stability. Accordingly, the value of NPR fluctuates with that of INR. The Nepali rupee has weakened considerably relative to the dollar, with a 2018 low of 117 to the dollar. Foreign exchange is not freely available. Under the 1962 Foreign Exchange Act, commercial transactions payable in convertible currency need approval from the Nepal Rastra Bank.

Banking system



Monetary stability



According to World Bank data reflecting both the earthquake and trade-related disruptions, inflation spiked to more than 12% (year over year) by mid-January 2016, rising five percentage points in the four months after mid-September 2015, but has since fallen drastically to 3.2% in 2017, following the end of trade disruptions. By way of comparison, India's inflation rate was 5.95% in 2016 and 3.33% in 2017.

The 2015 earthquakes represented a major shock to Nepal's economy, but debt distress remained low, according to the IMF, because of low baseline external debt and the large proportion of concessional loans among the new debt. At the government level, Nepal suffered a post-earthquake short-run revenue decline (especially in agriculture and tourism) followed by a gradual recovery over the medium term that now looks fairly robust three years later. Fiscal policy is expected to remain responsible. The IMF forecasts that the ratio of public debt-to-GDP will continue to decrease gradually from 23.0% in 2015/16 to 15.7 % in 2016/17. Meanwhile, the net lending/borrowing ratio stands at -3.09%, a significant decrease from 1.36% in 2016 (and other recent budgets), suggesting that Nepal's recent financial gains have been financed, at least in part, by debt.

However, given Nepal's reliance on remittances and the recent decrease in such flows, debt dynamics remain susceptible to volatility. The government's challenge is to continue its prudent fiscal policy, while also continuing reconstruction and increasing spending on infrastructure to encourage domestic growth.

9 | Private Property

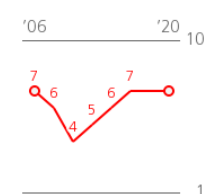
Although property rights are protected by the 2015 constitution, the absence of good governance means they are regularly violated. Though the Maoists have committed themselves to the new constitution, they have not yet restored all property – mostly land – confiscated during the conflict. As part of the 2006 peace process, the Maoists agreed to return all confiscated property and have done so in most cases, even though some land remains to be restored.

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

In addition, many in the Kathmandu Valley who have built additional structures on their land without proper documentation now struggle to sell their land legally. There are also numerous cases of developers who have taken deposits for plots of land in

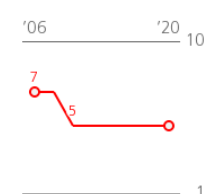
Fiscal stability

7



Property rights

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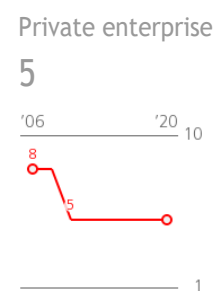
developments and are then unable to produce the plots due to oversubscription; it is difficult for those who paid deposits to get them back.

Even though legal provisions regarding property and inheritance do not entail gender-discrimination, women are often unable to make rightful claims in the face of continuing discrimination through prevailing social practice. A sweeping bill that came into force in August of 2018 should go a long way toward ameliorating these continuing concerns.

Private companies are constitutionally permitted and protected. Some restrictions apply to foreign ownership, but the bureaucratic and legal hurdles an entrepreneur must overcome to register a new firm are among the lowest in South Asia. The real problem is not registration, however, but political and bureaucratic interference in day-to-day business once a firm is operational. This has worsened of late, according to the World Bank Doing Business 2018 report.

According to the U.S. State Department, “the first privatization of a state-owned corporation was conducted in October 1992 through a cabinet decision (executive order). The Privatization Act was passed fourteen months later in January 1994. A total of 23 state-owned corporations have been privatized, liquidated or dissolved so far. The process, however, has been static since 2003 [...] Former public monopolies in banking, insurance, airline services, telecommunications and trade have been eliminated.”

Many of the more than 80 public enterprises in diverse sectors were privatized in the 1990s. The process was criticized, as many newly privatized companies soon found themselves in choppy waters. There were also allegations that the process was not transparent, and that state assets were undervalued. Privatization of state-owned enterprises has been on hold since 2008. In 2016, there were 37 public enterprises in Nepal. Many have faced high cumulative losses and unfunded liabilities for years due to operational inefficiencies and other problems. Overall, most observers think public enterprises will be an increasing burden on taxpayers and consumers because of their poor performance. However, further privatizations are blocked by opposition from interest groups, bureaucratic inefficiencies, lack of political consensus and a weak domestic financial market. With the completion of the local and national level elections in 2017, we may see some movement on privatization in the years to come, but such efforts have been limited to date.



10 | Welfare Regime

Nepal's welfare regime is largely limited to social networks based on familial structures. In some cases, NGOs act as a supplement, but they provide only locally specific, piecemeal services, and in some cases actually undercut the state's efforts to increase its own service delivery capacity.

Family support structures are strong, but are being progressively weakened by the widespread, long-term out-migration of young people, especially men. Indeed, in rural areas, villages are often populated largely by women, children and the elderly. Although domestic transfers of wealth from the capital region to rural areas and financial remittances from workers abroad certainly help compensate for social risks, the physical absence of certain family members sometimes strains social ties.

Private social-service-improvement initiatives are limited, and public social services are underdeveloped, although access to health care in particular has improved in recent years. Nepal has made significant investments in medical education that are just now starting to pay off. Public health institutions are concentrated mainly in urban centers and especially the Kathmandu Valley. As a result, many rural residents continue to lack meaningful health care access. This was exacerbated in the aftermath of the 2015 earthquakes, which destroyed many rural clinics and rendered needed supplies scarce.

Public expenditure on health (as a percentage of the GDP and government expenditure) is relatively high by South Asian standards, but still insufficient. Inefficient use of finances, due to poor state capacity, remains a significant problem.

Legally sanctioned inequality on the basis of ethnicity, language, caste and gender was until recently a defining feature of the Nepali state. While discrimination on the basis of caste was in principle outlawed in the 1960s, it is in practice still affecting many. Gender-discriminatory laws have only recently been struck down and some remain. Activist lawyers have succeeded in having the Supreme Court declare a number of these provisions unconstitutional. However, the new 2015 constitution still discriminates between men and women in passing Nepali citizenship to offspring. Children born to a Nepali man are Nepalis, but children born to Nepali woman with a non-Nepali spouse are not Nepali citizens, even if born in Nepal. Inheritance is also an issue for women. Married women can only inherit from their parents under unusual circumstances.

Many of Nepal's recent episodes of political contention, some of them violent, have been driven by social mobilizations that place the rectification of social inequalities at the top of their agenda. People from certain ethnic, caste and regional backgrounds, especially women, routinely experience discrimination in public life and are excluded from accessing resources and positions of power. Economic-, caste- and gender-

Social safety nets



Equal opportunity



based discrimination were important underlying causes for the rise of the Maoist insurgency in the 1990s, as is evident from involvement of a large number of marginalized people, and particularly women, in the Maoists' regime-change efforts.

Since the end of the conflict in 2006, a range of measures designed to lessen social inequality have begun to take effect, although their implementation and impact are still limited. These include the use of proportional representation in CA elections, which, although controversial, established a mechanism for ensuring significant diversity in elected office. A second amendment to the Civil Service Act in 2007 established, for the first time, affirmative action provisions for the civil service, including the police. These provisions aim to increase the representation of women, indigenous nationalities, Madhesi, Dalits, disabled people and people from "backward" regions. Significantly, the new constitution has reduced the percentage of parliamentary seats elected under proportional representation from 60% to 40% and introduced the new controversial category of Khas-Arya (i.e., high-caste Pahari Hindus, Bahun and Chhetri) for affirmative action purposes. The new constitution also places the burden of ensuring women are elected to political office on political parties themselves, who must field a certain percentage of female candidates in both first-past-the-post and closed-list proportional races. About 60% of the Constitutional Assembly's seats were elected under a proportional system with quotas for marginalized groups (including women), and as a result, disadvantaged groups have been increasingly represented in the legislature. After the 2017 local elections, women held 41% of elected positions in local councils and ward committees. Among the ward committees, 48% of elected women belong to the traditionally disadvantaged Dalit community. Similarly, women make up 34% of the provincial assemblies and 33.5% of the federal parliament. CPN-UML leader Shiva Maya Tumbahamfe, a female candidate, was elected as deputy speaker of the House of Representatives in 2018. However, unequal access and representation persist in key parts of the government, political parties, judiciary, media, education system and in the business sector.

Male members of the Nepali-speaking, hill-dwelling Brahmin caste (Bahun), who comprise only 12.2% of the country's population, continue to occupy 39.2% of civil service posts. Brahmins from the Terai, Kayasthas and Rajputs are also overrepresented, though they make up much smaller percentages of the overall Nepali population. Analogously, over 40% of Nepal's armed forces are comprised of soldiers and officers from the Chhetri caste (15.8% of the population). These same groups dominate the judiciary, the education system, the media, labor unions and even NGOs.

Nepal's labor market provides highly unequal chances; approximately 70% of the workforce continues to be employed in the informal sector (ILO). Workers are subject to exploitation and deprived of many fundamental rights at work. The government has largely turned a blind eye to abuses. Recently, however, a labor law was drafted

to address issues crucial to workers in the informal economy. This reform has only been partially implemented to date.

According to World Bank models of ILO data, 86% of men and 83% of women were employed in the formal and (mostly) informal sector in 2017. World Bank models also suggest that the agricultural sector accounts for 72% of employment, while 20% of the labor force is employed in the service sector and 8% in industry.

According to Nepal's Ministry of Labor and Employment, the Department of Foreign Employment issued 3,509,633 labor permits from FY2008/09 through 2016/17. In 2014/15, 499,102 foreign labor permits were issued, a slight decrease from previous years. This decrease has continued, with the 2016/17 total being at 382,871. The main destinations through the permit system for the period 2008/09 through 2016/17 were: Malaysia (29.88%), Qatar (21.57%), Saudi Arabia (20.37%) and the UAE (10.62%). In addition, 44,978 migrant workers were employed in the Republic of Korea. Men account for 95.18% of registered labor migrants for this time frame, showing little change from the previous report.

While Malaysia has consistently received the largest share of the economic migration flow from Nepal, in 2018, the Nepali government took measures to halt labor permits to Malaysia due to concerns over the mistreatment of migrant workers and overcharging for documents there. Later in the year, the governments of Nepal and Malaysia underwent several rounds of discussions and entered into their first labor agreement in October.

A large percentage of international migrants from Nepal also head to India (26.8% in 2018, according to World Bank data), for which no visa or foreign labor permit is needed. Nepali migrants work in India's private sector, mostly in manual-labor jobs in industry, construction, agriculture or the service sector, especially in security. Their wages tend to be low, and the work is often dirty, dangerous and even degrading. While reliable data are missing, some estimates suggest that as many as 200,000 Nepali women may be employed in the sex industry across India. Civil society efforts have reduced this number, but very little is being done to repatriate and rehabilitate those already employed in this capacity in India, particularly because of the social stigma associated with sex work for many in Nepal.

11 | Economic Performance

GDP growth in Nepal was 6.3% in 2017 to 2018 according to both the IMF and World Bank, while GDP per capita in PPP terms increased from \$2,482 to \$2,697. Estimates for 2018 GDP growth range from 5.9% at the ADB to 6.4% at the IMF.

However, Nepal remains one of the poorest countries in the world, with per capita GNI of about \$730 (2017) and per capita GDP of \$835.08 (2017). The World Bank estimates that the earthquakes, coupled with 2015 to 2016 trade disruptions, pushed down tax revenues, keeping overall growth in fiscal year 2016 to just 0.6% (at market prices) – the lowest in 14 years. Reflecting both the earthquake and trade-related disruptions, inflation spiked to over 12% (y/y) by mid-January, rising five percentage points in just four months from mid-September 2015. As the trade disruptions ended, inflation decreased to 3.2%, while growth rebounded. GDP growth, which had fallen from 6% in 2013 to 0.6% in 2015 due to significant economic losses resulting from the earthquake, spiked to 7.9% in 2016.

Nepal's external debt stood at 16.9% of the GDP by the end of the fiscal year 2015 to 2016 (for a total of \$3.6 billion), of which 87% was concessional borrowing from the World Bank and the Asian Development Bank (ADB). Domestic debt increased from 9.3% of the GDP in 2014 to 2015 to 10.4% by the end of the fiscal year 2015 to 2016.

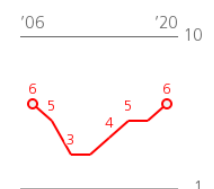
Moreover, according to Nepal's National Planning Commission, Nepal faces a high trade deficit. Over the years, exports have stagnated, and imports have skyrocketed. Between mid-2017 and mid-2018, Nepal's export to import ratio hit 1:14.9. Officially, Nepal aims to maintain a trade deficit of 20% of the GDP, but the estimates for 2017 indicate that there is a deficit of around 32.2% of the GDP. India commands the biggest share of Nepal's foreign trade, at approximately 60%, while China has increased its share to approximately 14%.

Nepal's reliance on remittances remains critical. These surged from just under 11.21% of the GDP in 2002 to a high of 31.43% in 2015, but decreased slightly to 28.31% in 2017.

According to the UNDP Human Development Report, 81.9% of Nepal's population is in employment. However, the ILO highlights that the majority of workers remain in vulnerable employment, and that this situation is compounded by the lack of any social protection schemes.

Output strength

6



12 | Sustainability

After the 2015 earthquakes, many international observers, local media and foreign tourism agencies criticized the lack of preparation and slow government response to weather and geological risks, particularly because the risk of a significant earthquake in Nepal was known to be high and the probable effects catastrophic. On top of earthquake damage, previous patterns of extensive deforestation make the country particularly susceptible to landslides and flooding, especially during the monsoon season. While community forestry practices have improved deforestation in some areas, Nepal, with its unique geographical position and complex ecology, remains quite exposed to the negative effects of climate change.

Economic growth in recent years has been achieved at high environmental cost and has led to additional environmental degradation, especially in the form of air pollution and deepening water-sanitation and resource-management problems. While the nearly completed Melamchi Water Supply Project will go a long way toward mitigating severe water shortages in the overpopulated Kathmandu Valley during the dry season, air pollution continues to spiral out of control, and water sanitation remains problematical. Nepal, more than some other countries in the region, has managed to protect its native flora and fauna, as well as a variety of delicate ecosystems. This is, at least in part, driven by the government's reliance on revenue from eco-tourism.

In 2018, Nepal had an Environmental Performance Index (EPI) score of 31.44 (ranked at 176 out of 180). This rank placed Nepal above India and Bangladesh and slightly below Afghanistan and Pakistan, indicating that Nepal is part of a region that suffers from very poor environmental performance. Ambient air pollution remains a major problem in Kathmandu. Particulate pollution is mainly driven by vehicle traffic, both in terms of combustion emissions and dust re-suspension as well as by other forms of combustion, and industrial sources, such as brick kilns within the valley. During the 2015 to 2016 unofficial blockade, air pollution intensified after Kathmandu residents returned to burning wood for cooking, a practice that had largely been abandoned for gas. Long-term effects on public health have not yet been established, but experts assume they are severe. The 2018 EPI gave Nepal poor air quality ratings (i.e., unsafe levels of fine particulate matter), with drinking water and sanitation only slightly better. Despite these challenges, it's important to note that Nepal does perform better on ecosystem vitality.

Nepal has a comprehensive set of environmental policies that date back to the 1970s, when the royal family turned its own private hunting reserve into what is now Chitwan National Park and followed with other fairly visionary policies. Subsequent efforts have been made in close partnership with the international donor community, and Nepal has made significant progress in the areas of conservation/biodiversity and forestry. Large swaths of Nepal's forests are administered as community forests, managed by groups of locals who come forward with a sustainable management plan.

Environmental
policy

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1

Forest cover has been shown to increase in some of these areas, while others have struggled to prevent further deforestation.

The expansion in sustainable energy use has been slow, but has gained momentum of late, at least in part due to the unreliability of centrally distributed electricity and gas. Outside of urban centers, the main energy source at the household level is biomass (firewood). Nepal also has a number of operational micro-hydro projects distributed throughout the country; hydropower represents 90% of Nepal's generating capacity. The government, with support from donor agencies and bilateral aid, continues to make investments in the hydropower sector. Progress has been slow, however. Several donor agencies also assist with incipient plans to incentivize companies to invest in energy efficiency and sustainable energy sources.

Nepal's score on the U.N.'s Education Index in 2017 was 0.502, which was the same value as 2016 and up from 0.495 in 2015. Its ranking was 149 out of 189.

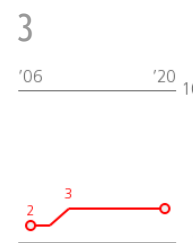
Nepal's last national census in 2011 found an overall literacy rate of 65.9%, with the rate being 75.1% among men and 57.4% among women. These data are somewhat misleading, however, particularly because the literacy rate among those aged 15 to 24 in Nepal is 84.8% (89.9% among men and 80.2% among women). According to the most recent data available, 2015 UNESCO data, Nepal's public expenditure on education amounts to 3.75% of the country's GDP. The Ministry of Education launched a school-sector reform program for 2009 to 2015 with an estimated budget of \$568 million. According to World Bank data, the primary school completion rate improved significantly between 2013 and 2015. In light of this, the official literacy rate, particularly among those aged 15 to 24, should climb in the 2021 census.

Nepal has also recently transitioned from a nationally conducted school-leaving certificate examination (SLC), which acted as an "iron gate" for many students who attended government schools in rural areas, to a "Secondary Education Examination" or SEE. One of the main problems with the SLC was that a student who did very poorly in one or two subjects would fail the exam even if he or she did quite well on other subjects. The SEE, in contrast, essentially takes an average "grade" across all subjects, and if that grade is a passing one, allows the student to move on to secondary education. Pass rates in 2018 were 78%, meaning that most exam takers could move on to 11th grade. In past years, overall exam pass rates were at or below 50%. Whether this reform will be truly successful in the long run remains to be seen, however.

There are other reforms in higher education underway, but implementation has been slow. In addition, underfunding remains a problem: 10.19% of overall public spending was allocated to education in 2018. While this represents a slight increase from previous years, it is well short of Nepal's goal of spending 20% of its budget on education.

Finally, overall national spending on research and development does exist, but remains insignificant at 0.3% of the GDP.

Education policy /
R&D



Governance

I. Level of Difficulty

Political leaders in Nepal continue to face significant structural constraints with regard to the achievement of good-governance goals. Highly unfavorable conditions for economic and political transformation include low socioeconomic development; limited but improving educational attainment; a landlocked location; relative natural-resource scarcity; and a strengthening but still fairly weak state. Nepal's environment is prone to natural disasters, including earthquakes and landslides, as well as man-made ecological degradation. The country's terrain is challenging to navigate, and the state continues to struggle with historical centralization in Kathmandu, around the monarchy. It remains difficult for policymakers at the center to assess citizen aspirations and needs effectively, though this should improve under federalism. In addition, poverty remains rampant and educational resources scarce in many parts of the country; rapid urbanization and ongoing brain drain, as nearly a quarter of the country's workforce is employed outside of Nepal, also present unique policy challenges. The political leadership is not blameless in Nepal's governance problems, however; their focus on identity politics and efforts to ensure their political and material success have contributed to current governance challenges by drawing attention and resources away from much-needed infrastructure improvement.

Nepal has long been a recipient of official development assistance, and governance is supported, sometimes to the long-term detriment of state strength, by a host of INGOs and domestic NGOs. Spaces for civic participation are relatively open in Nepal, particularly after the end of the monarchy, and this has contributed to the emergence of indigenous civil society movements. Many forms of engagement center around local, as opposed to national, affiliations and identities. The number and range of civil society organizations operating even in the most remote and impoverished areas of the country are astounding. Over time, some of these local affiliations may grow into national-level organizations and/or movements, but others may remain local, reflecting the historical and continued diversity of political, social and economic life in Nepal, a place where mutually unintelligible dialects are sometimes spoken on opposite sides of a valley simply because of the limited interaction Nepalis living in these distinct locales have had with one another.

Structural constraints

9



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Civil society traditions

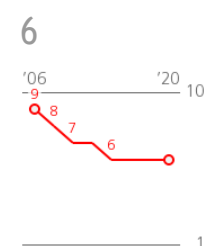
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Political elites have instrumentally used polarization techniques to create cleavages along ethnic and regional lines. Scaremongering among national media outlets often fans the flames. Though the government's handling of protests in the Terai over the new constitution did deepen the Pahari-Madhese cleavage and brought further instability to the country, the fact that free and fair national- and local-level elections have been held seems to have resulted in a temporary political settlement of these particular issues. Others exist, however, and minority ethnolinguistic groups remain dissatisfied. Though outright violence is rare these days, particularly as compared to the period between 1990 and 2010, confrontations between cadres of different political parties as well as between members of different social groups mobilized around identity-based platforms continue to present risks to stable, peaceful governance. Nepal's new institutional framework, and federalism in particular, should manage these risks better than its old institutions, but only time will tell if it is truly up to the task.

Conflict intensity



II. Governance Performance

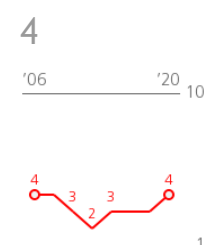
14 | Steering Capability

Though the structural constraints on governance in Nepal are high, the political leadership's low steering capability underlies the difficulty Nepal has had in recovering from the 2015 earthquakes and in pursuing a development agenda more generally. Programmatic politics play a relatively minor role in Nepal's policy-making process. The heterogeneous character of multiparty coalition governments before 2004, between 2006 and 2012, and again since January 2014 have made it extremely difficult, even for determined policymakers, to set strategic, long-term priorities. Important policy decisions are frequently subject to fierce distributional battles between different ministries, at both the political and administrative levels. Once a policy is in place, distributional battles continue at the local level, with identity politics often determining what is done where and who benefits from it.

Prime Minister Dahal's (CPN-M) 2016 coalition government largely focused on implementing the new 2015 constitution, carrying out post-earthquake reconstruction, managing constitutional politics (amendments), and carrying out federal restructuring and elections. After Dahal voluntarily gave up power to Sher Bahadur Deuba (NC), as agreed upon in advance, the Congress-led government continued to execute on these priorities. But with so many significant tasks on the national-level agenda, policy has often been neglected. The continued segmentation of the cabinet along party lines causes coordination problems between different ministries; weak prime ministerial leadership continues to be associated with limited

Question
Score

Prioritization



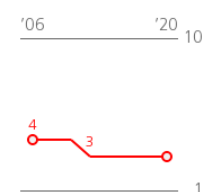
control over line ministries. In addition, there are few internal regulatory impact assessments (though NGOs regularly provide guidance), nor is there a strategic planning unit, which contributes to the government's very low strategic capacity to prioritize and organize its policy measures. With the political struggle over the future character of the Nepali state settled, at least in the medium term, the political cover for lack of attention to administrative reforms and other long-deferred governance tasks is quickly disappearing.

With regard to the steering capabilities of Nepal's governments, the crucial bottleneck lies less in the drafting of good policies than in weak state capacity and the government's struggle to implement such policies. In recent decades, successive governments have instituted countless industrial growth, investment and trade promotion policies, often with substantial and systematic donor input, but there has been very little effect on the ground. This is not completely a function of poor governance at the top; a pervasive lack of expertise and capacity throughout the bureaucracy is also to blame. One example of this inefficiency was the delayed constitution of the National Reconstruction Authority and the continued struggle to bring relief to millions of earthquake victims across the country.

The two different governments in power during the review period were not particularly innovative in their policy-making or in their implementation of drafted policies; opposition parties have not done much better. Learning from past experiences happens on an individual rather than organizational level, though the CPN-M and CPN-UML have been somewhat flexible in their approaching to recruiting voters and to governing, occasionally entering surprising coalitions and luring voters with promises that are locally specific. But, as others have noted, innovation in acquiring power is not always associated with innovation in policy-making after that initial goal has been achieved. Though it has not clearly done so to date, the implementation of federalism in Nepal may force parties to innovate beyond the electoral arena. When the operations of power and the distribution of resources are located closer to the ground, governing parties and those that seek to govern must tailor policy to local needs and demands. If past experience is any guide, these policies may be colored by ethnic politics, but if some demands manage to be articulated in a programmatic way and parties meet them, the experimental aspects of federalism may eventually drive innovation at the national level.

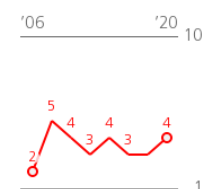
Implementation

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Policy learning

4



15 | Resource Efficiency

Though many recent governments, including the Congress-led government (2014–2015) and the UML-led government (2015–2016), have made inefficient use of available economic and human resources to support their chosen policies, largely due to corruption and mismanagement, subsequent governments have managed to make better progress in achieving policy goals with very similar resources.

State provision of services is often limited even when staff is ostensibly in place, and superficially competitive recruiting procedures often mask politically motivated hiring practices. The management of budget resources is less problematical, if often unrealistic. Nepal's debt load is manageable, though large, and its budget planning is relatively transparent, but expenditures still often outstrip allocations, despite the fact that the government has been chronically under-spending in rural areas. This is perhaps due to the fact that Nepal's administrative organization is in a state of flux as it shifts from a unitary to federal structure.

Development aid from India, China and the West, as well as earthquake reconstruction funds, play an important role in Nepal's budget. Monitoring of these funds is insufficient, but has improved to some degree, with civil society acting as watchdog. While Nepal's administrative and civil services remain underfunded and understaffed, Nepal's administration continues to struggle with fragmented decision-making processes and an opaque and politicized system of transfers and promotions. Different aspects of the bureaucracy are sometimes at odds with each other and undercut progress that might be made with coherent policy coordination. There are few formal coordinating mechanisms. Problems of timely spending also contribute to serious delays and a waste of resources on infrastructure projects and elsewhere.

The current Nepal Communist Party-led coalition government is the 10th government to be formed over the last 10 years. This level of turnover is not surprising. Political parties in Nepal are plentiful and in order to win elections they have had to be increasingly flexible about the politicians they recruit and the voters they try to sway. A single political party may be associated with conflicting interests and policy objectives associated; this is compounded when smaller parties negotiate to be in coalition with larger ones while remaining deeply divided over policy. Few political parties have had time to implement their policy agendas before losing office and this has certainly hampered the efficient use of resources.

Corruption and poor use of public resources are the norm in Nepal. Regulations and bodies that exist to ensure transparency have largely been ineffective to date. That said, the Commission for the Investigation of Abuse of Authority (CIAA), which had been plagued by understaffing and controversy, has, of late, made some progress. The two most recent chief commissioners, Deep Basnyat and Nabin Kumar Ghimire, have performed reasonably well, though the Commission was without a chief

Efficient use of assets

4

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Policy coordination

4

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Anti-corruption policy

3

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commissioner for two months after Basnyat retired in February 2018. It is too early to take a true reading on the CIAA's performance under Ghimire, but the absence of immediate problems is suggestive of an improvement, particularly in relation to the tenure of Chief Commissioner Karki, who was ultimately forced to leave his office by the Supreme Court of Nepal.

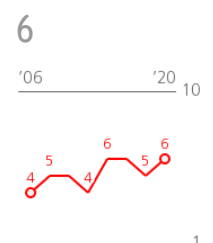
Corruption among government officials concerning the distribution of permits and approvals, the procurement of goods and services, and the award of contracts continues to be a problem. For those who lack connections in high places, bribes are often the only way to win access to public services or accomplish even ordinary activities like securing a driver's license or birth certificate. This situation is compounded by the fact that government services are in scarce supply outside the capital. In theory, federalism should drive resources into rural areas. However, in the fall of 2018 media outlets were reporting that rural provinces had successfully spent only a fraction of their allotted budgets. This suggests that allocating money to rural areas may only be half of the battle.

There has been some additional regulatory progress over the last years. For example, a Right to Information Act was passed in 2009. Ultimately, however, even excellent regulations often fail to turn into social, economic or political change, in part because the bureaucracy tasked with enforcing such provisions typically lacks both the skills and the manpower to do so. One example of this is Nepal's failure to enforce the campaign spending limits enshrined in its election law. A May 2018 report from Samuhik Abhiyan states that over half of monitored candidates failed to keep their spending within the limits prescribed by law. Still Nepal has managed some regulatory successes, often by capitalizing on existing social institutions. Its Community Forestry Program has dramatically reduced forest loss by delegating responsibilities to citizen groups, for example.

16 | Consensus-Building

Nepal's 125 ethnic groups, 127 spoken languages, myriad caste and jati groups and varied ecosystems present a distinct challenge to political consensus. However, Nepal's political parties have a long history of support for democracy that extends back well before the democratization process started in the 1990s. The CPN-M, when they committed to peace, agreed to conduct politics within constitutional democratic boundaries, and despite some early problems with party discipline, they have largely done so. The recent Maoist-Congress coalition government, a coalition of parties that were previously on opposite sides of an armed conflict, suggests that support for peace and for democracy are strong in Nepal. This unlikely coalition involved a commitment by the leaders of both parties to share the prime ministership. The CPN-M leader, Pushpa Kamal Dahal, took the position first, and agreed to turn over power voluntarily midway through his term. Many thought this unlikely, but Dahal surprised

Consensus on goals



his detractors in May 2017 by handing the reins to Sher Bahadur Deuba of the Nepali Congress.

Dahal and the CPN-M, which has now unified with the CPN-UML to form the Nepal Communist Party (NPC), may also surprise critics regarding the degree to which the new entity is willing to operate within a market economy. Though Maoist ideology demands socialist revolution, cadres and party supporters alike generally understand this to mean better and more equal provision of public goods like education and health care.

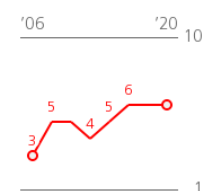
Despite its long history of protest movements, there is a pro-democratic consensus among almost all major political actors. Widespread protests in 2015 and again in the Terai in 2017 should be seen as supportive of the democratic process rather than the opposite. While in government, neither the Maoists nor the Nepali Congress has been able to control all actors or agents with de facto veto power at the local level. This inability to concentrate power should only increase as federalism is implemented and local-level actors are empowered.

The Nepal Armed Forces (NAF) do not present a major threat to the pro-democratic consensus. Though the NAF was instrumental in forcing the royal family from power and there were concerns about a possible military coup d'état in 2012/13, the Nepal Army has not recently engaged in overt political engagement. Its priority during the postwar years was to protect its institutional autonomy – something it accomplished while also incorporating some former Maoist fighters into its ranks.

Other potential sources of dissent from the pro-democratic consensus do not appear to be an imminent threat to it. The former royal family, for its part, has not attempted a return to power. While frustration with democracy ran high during the constituent assembly process, the masses are relatively satisfied with the political settlement that resulted. Conservative parties running on platforms that stress a return to Hindu values and culturally homogenous nationalism do not appear poised to make gains, as similar parties have in India. Parties that advocate for a revival of the constitutional monarchy are at this point considered to be fringe. The conservative-royalist RPP-N, which finished the 2013 elections as the fourth-largest party, won a single seat in the 2017 legislative elections. While there is still a tendency for politics to be played out in the streets in Nepal, rather than through institutional mechanisms, there has been a marked shift toward institutional solutions over the last few years. Social mobilization does still occur, with new groups engaging in civil society sometimes for the first time, but the focus has shifted somewhat toward longer-term strategies and organizations, rather than social movements.

Anti-democratic actors

6



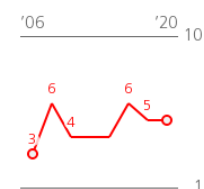
The most significant problem Nepal faces in terms of consensus-building is the tendency of the political elite, particularly over the last few years, to mobilize voters along ethnic lines. Identity-based cleavages, once ignored because of presumed cultural homogeneity during the monarchy period, have become increasingly prominent in the recent past. Political mobilization along identity lines threatens to fragment the political spectrum and prevent political parties from doing little more than identity-based distribution of state resources, something neighboring India has struggled with for decades. This issue was front and center during recent violent protests in the Terai; the unofficial Indian blockade temporarily exacerbated tensions and deepened the Madhesi-Pahari cleavage. However, the political leadership in Nepal deserves some credit for managing to bring the Madhesis back to the table by holding the 2017 elections in stages and, to some degree, forcing Madhesi parties to participate or find themselves out of power.

There have been signs of renewed activity among non-governmental organizations and civil society groups over the last decade. Advocacy on behalf of women's rights and those of cultural and religious minorities has been pronounced and occasionally successful. However, as a result of this identity-based activism, many citizens see civil society as being dominated by the same identity cleavages they see in the political arena. This is in part because organizations often attract members along party lines. In addition, many civil society organizations are highly dependent on donor funding. This funding is vital, but also skews agendas toward donors' funding priorities. It should not be surprising, then, that the legitimacy of social movements, civic associations and non-governmental organizations are often politically determined. Few organizations are accepted as legitimate across the political spectrum. In addition, there is the persistent problem that ethnic and regional identity-based groups perceive mainstream political parties as representatives of the long-dominant upper-caste Hindus. While it is still too early to tell, federalism should ameliorate the last of these concerns.

In addition to identity-based tensions, the class-based tensions that drove rural support for the Maoists during the conflict remain largely in place. Nepal has experienced an extreme form of rural-urban divide over the last 20 to 30 years, with urbanization and outward migration leaving few working-age men in rural areas. To some degree, these geographical population shifts mean that disaffected and unemployed men are less numerous than they were in the 1990s, but rural areas remain poor and are largely supported by subsistence agriculture and remittances. Because of improvements in communications, the rural poor are now more aware of their relative deprivation, particularly as compared to their urban counterparts. Federalism should ultimately result in better rural public goods provision, but this has not yet become a reality. If it fails to materialize, the pro-democratic consensus could lose support.

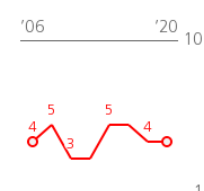
Cleavage /
conflict
management

5



Civil society
participation

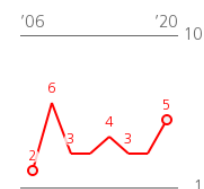
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There continues to be broad support across the political spectrum for delaying the large-scale prosecution of more than 60,000 wartime crime complaints. The parties to the conflict promised transitional justice when they agreed to peace in 2006 and again in the 2007 interim constitution, but no transitional justice body was established until 2014, when both the Commission on Investigation of Disappeared Persons (COIDP) and the Truth and Reconciliation Commission (TRC) were created. The enabling legislation associated with both of these bodies contains amnesty provisions that all but ensure that no high level or widespread prosecutions will occur. Nepal's Supreme Court subsequently ruled that any provisions that grant amnesties and divert such cases from the courts are unconstitutional. However, the government has thus far ignored the Court's ruling and proceeded to establish the two bodies without modification of the enabling legislation. Indeed, the only prosecutions for wartime atrocities that have taken place in Nepal to date have gone through the courts. Nepal's political leaders continue to promise investigation and prosecution of wartime crimes, but these promises appear to be all talk. The efforts that have materialized thus far have rightly been characterized by victims as "token" rather than true reconciliation.

Reconciliation

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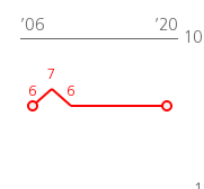


17 | International Cooperation

Nepal has a long history of working with international partners. Although this partnership has yielded some results, especially in the areas of education, health, drinking water, telecommunications, road construction, power generation, and environmental conservation, the levels of aid Nepal has accepted in the past, both in terms of funds and know-how, are significant enough that they may be undermining state capacity. In addition, there is still a need to harmonize earthquake reconstruction funds to increase efficiency and effectiveness.

Effective use of support

6



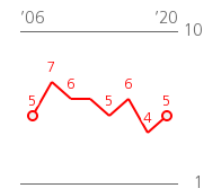
While effective use of support involves relatively capable domestic actors receiving appropriate amounts of aid with the goal of an eventual decrease in external support and increased local capacity, this is not yet the case in Nepal. Donors and international financial institutions – and implicitly, the backers sitting behind them – continue to exert significant policy influence in Nepal. The role of such actors in shaping political and economic outcomes in Nepal has been less than ideal. During the conflict, donor funds were often appropriated by violent actors (both state and Maoist), and subsequent funding has focused on good governance, peace-building, and technical support to the Electoral Commission and Constituent Assembly. Such assistance has rarely been driven by Nepali demand. The Nepali state, for its part, rarely turns down assistance, even if it lacks the capacity to use it effectively. This dependent relationship has skewed domestic politics and has likely resulted in the Nepali state's continued weak state capacity – with little or no evidence of economic impact. At the same time, withholding aid entirely is not the answer, but the sheer quantity of international assistance being offered, the lack of coordination across aid efforts and the degree to which aid rarely responds to domestically articulated demands, suggests that a development assistance reset would be beneficial.

Nepali governments have tried to present the country as a reliable partner over the years. However, since 2006 its reputation as a credible and reliable partner had deteriorated significantly, in part due to political instability. International community attitudes, in particular those of Western donors and large international funding agencies and financial institutions, are ambivalent with respect to Nepal's efforts at market reforms and economic development. While the government is seen as largely on the same page with respect to policy formulation, a long and consistent history of non-implementation has led to widespread skepticism. Yet, in the wake of the 2015 earthquakes and, especially following the completion of the constitution-making process and the 2017 elections, it seems that Nepal's government has been making strides with regard to restoring its reputation.

In terms of recent regional cooperation, the South Asian Association for Regional Cooperation (SAARC) is the official coordinating body. However, SAARC has proved itself to be less than fully functional, in part due to ongoing political tensions between two member states, Pakistan and India. Indeed, SAARC's ineffectiveness has led most countries in the region to rely on bilateral arrangements. In this regard, Nepal's relationship with China is improving, while its relationship with India is slowly recovering from all-time low. After tensions over the Madhesi protests against the new constitution and the unofficial Indian trade blockade caused a severe deterioration in Nepal's relationship with India, Beijing capitalized on the situation and supported the Nepali government during the crisis. Chinese cooperation does not come without costs, however. China continues to pressure the Nepali government to adopt a tough stance toward the Tibetan exile community. For its part, Nepal has pivoted slightly back toward India and has seemingly adopted a policy of playing these two regional powers off of one another. These interdependent relationships could be more fraught than they are, and Nepali officials have arguably managed them reasonably well.

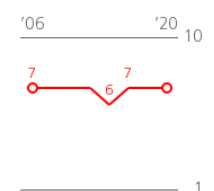
Credibility

5



Regional cooperation

7



Strategic Outlook

Having recently made considerable progress in terms of holding elections for all three levels of government and finally starting to distribute earthquake relief aid, Nepal is potentially poised to turn a corner and move away from a troubled period in its history. Doing so would likely involve “building back better,” as engineers often say: taking the 2015 earthquakes as an opportunity for investment in the infrastructure of the future, not of the past. Another area that Nepal should focus on is education; serious investment here could have the power to propel economic growth and bring a fractionalized country closer together after a divisive period. Turning positive momentum into real change, however, is challenging, and it is not yet clear Nepal’s leaders are up to this task. Their task is complicated by a reliance on aid, aid fragmentation and donor proliferation, all of which have made the development impact of aid marginal.

Perhaps the most challenging aspect of infrastructural investment in Nepal is not the challenging physical terrain, but the fraught socioeconomic landscape. Nepal needs better infrastructure throughout the country. Thus, in an ideal world, Nepal’s government could invest in infrastructure projects that would benefit the greatest number of citizens, economically and otherwise. The problem with such an approach, however, is that it is not likely to ameliorate the urban-rural divide that in many ways fueled Nepal’s civil war. Indeed, Maoists capitalized on the monarchy’s lack of rural spending and state capacity to make inroads in rural areas. Then, at the height of the conflict, many Nepalis, especially if they were not Maoist aligned, migrated to the Kathmandu Valley. As a result, many of the most pressing infrastructure projects lie in the Valley and in connecting the Valley to international trade. Renovation of Tribhuvan International Airport and its runways is one example of such a project. But heavy spending in the Valley would not be politically wise given Nepal’s particular history. Thus, as Nepal’s leaders move forward, they must strike a careful balance between investing in projects that will yield the greatest short-term economic returns and those that will facilitate peace and stability.

Education is another area in which Nepal’s government must invest, but invest wisely. Here too, the legacy of monarchy-era spending habits looms large. As with infrastructure, Nepali leaders have struggled to deliver public services like education in rural areas. If managed well and with an eye toward the economic integration of the country, regardless of its rural or urban location, investment in education today could go a long way toward ameliorating the long-standing grievances held by Nepalis living far from the seat of government. Curriculum innovation will help with this. For instance, schools can be used to educate about rather than paper over the conflict, its causes and consequences. Schools can also embrace Nepal’s diversity by teaching about it, while also providing the skills necessary to integrate far-flung communities into the larger country and world. One way to do so, especially since Nepal has long struggled to staff rural schools, might be to harness the power and skills of some of Nepal’s better educated citizens who tend to go abroad to work. Expansion of programs that tap into the idea of good citizenship, such as “Teach for Nepal,” an initiative that places university graduates and young professionals in two-

year teaching fellowships in public schools, might work in this regard. Of course, education is also a minefield, but it is one that Nepal must navigate sooner rather than later if it hopes to move forward politically, economically and socially.

As this report makes clear, governance in Nepal continues to lag, even while there have been improvements in Nepal's political and economic transformation. If corruption remains as problematical as it has in the past, the likelihood that Nepal's leaders will be able to make strides in infrastructure and education is quite low. However, if decision-makers are able to reign in corruption and dedicate government efforts and funds to both of these tasks, historians will likely look back at the 2015 constitution and the 2017 elections as marking a true turning point in the country's political and economic history.