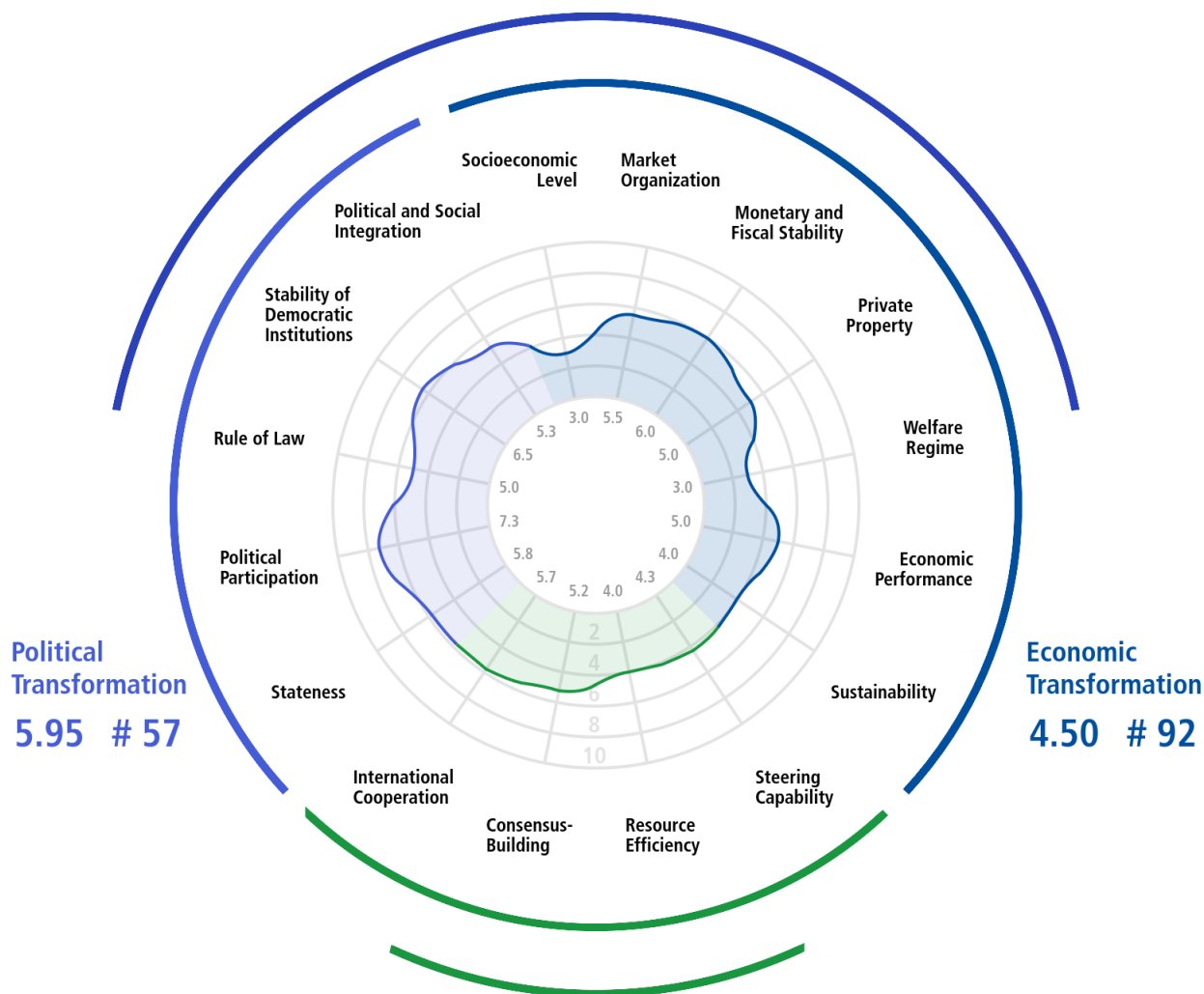


# Nepal

## Status Index

**5.23 # 67**

on 1-10 scale out of 137



## Governance Index

**4.46 # 81**

on 1-10 scale out of 137

This report is part of the **Bertelsmann Stiftung's Transformation Index (BTI) 2022**. It covers the period from February 1, 2019 to January 31, 2021. 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	<b>29.1</b>	HDI	<b>0.602</b>	GDP p.c., PPP \$	<b>4009</b>
Pop. growth <sup>1</sup>	% p.a.	<b>1.8</b>	HDI rank of 189	<b>142</b>	Gini Index	<b>32.8</b>
Life expectancy	years	<b>70.8</b>	UN Education Index	<b>0.521</b>	Poverty <sup>3</sup>	% <b>50.8</b>
Urban population	%	<b>20.6</b>	Gender inequality <sup>2</sup>	<b>0.452</b>	Aid per capita \$	<b>47.6</b>

Sources (as of December 2021): The World Bank, World Development Indicators 2021 | UNDP, Human Development Report 2020. 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 years 2019 and 2020 have been a period of continued improvement in Nepal, despite and sometimes because of significant obstacles. After the 2015 earthquakes and successful national-level elections, Nepal has steadily implemented federalism and achieved economic progress. The COVID-19 pandemic has helped build state capacity and governance, and the country may emerge from the pandemic better than it started. That said, the ruling Nepal Communist Party (NPC), which formed following a merger between two previous communist parties in Nepal, appears on the brink of fracturing, and surprise 2021 elections will be a test of recent progress.

While Madhesi political protests regarding their rights vis-à-vis the majority dominated the previous two years, this agitation gave way to the implementation of federalism. The ruling NPC appeared capable of governing, though law and governance remain weak in Nepal. In early 2020, Nepal held successful national-level elections to replace legislators who were retiring (as a matter of course). All appeared to be stable until December 2020, when Prime Minister Khadga Prasad Oli dissolved parliament and announced surprise elections in April 2021. However, this announcement was subject to a legal challenge, and the NPC now appears on the verge of splitting along factional lines. While this is perhaps not ideal for the short-term stability of Nepali politics, there is real hope in the reaction to Oli's announcement, as all major players appear eager to hold elections, respect the outcome and move forward with democratic governance. Few have suggested a return to violence or demonstrated a lack of respect for Nepal's chosen institutions.

On the economic front, Nepal has largely moved past the 2015 earthquakes and the Madhesi-politics-induced Indian trade blockade (2015 – 2016), which led to shortages of fuel, medicines, produce and other necessities. At its peak during this previous period, inflation exceeded 12% (though only 8.8% annually) and growth was nearly flat at 0.6%. In comparison, GDP growth was 7.0% in 2019 and inflation was brought back in check at 5.6%. Unemployment was down slightly, and export growth and tax revenue were up. Aiding this healthy economic recovery was the reduction in chronic electricity outages and, while final figures are not yet available, estimates for

2019 indicate that this recent positive trend is likely to continue. Though rebuilding after the 2015 earthquakes continues and COVID-19 has severely dampened remittances, steady economic progress has gone a long way toward ameliorating conditions for ordinary Nepalis. Women and minority groups continue to be over-represented among the poor. Nepal has a long way to go economically, particularly in terms of trade liberalization, funding education, and research and development, and fostering industrial or service sector-based economic growth.

On the governance front, many challenges remain and Nepal faces an incredibly challenging structural environment. Nepal is a landlocked country with few natural resources and difficult terrain; it also has considerable ethnolinguistic diversity and staggering poverty. Few governments fare well under such conditions. In Nepal's case, poor governance has long contributed to poverty and economic stagnation, but the recent past has provided some hope for Nepal's future. Governance was given a true test during the COVID-19 pandemic. While its steering capability and resource efficiency remain relatively poor, it has proven remarkably effective given the constraints and the experience of handling the pandemic has increased state capacity. Still, governance challenges remain. Despite Nepal's efforts to normalize relations with India and improve them with China, both have deteriorated during 2020, with little sign of reprieve in sight.

## History and Characteristics of Transformation

Nepal's contemporary political history has been shaped by recurring episodes of mass mobilization and anti-regime contention. Prior to 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 of local governance 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. In the late 1990s, a Maoist rebellion erupted that affected almost all 75 districts across the country. It found support, especially among the impoverished and largely disadvantaged rural population, who often felt neglected by the state. Internal armed conflict contributed to a further decline in democracy and human rights. 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 2004/5, claiming full sovereignty and assuming executive authority. This led to the emergence of a broad opposition movement consisting of the Seven Party Alliance (SPA) and the Maoist insurgents. 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. Maoists were included in the interim parliament and, later, government. It took another year before

popular elections to the Constituent Assembly occurred, in April 2008, with the Communist Party of Nepal (CPN)-Maoist party winning the most seats. In May 2008, at the Constituent Assembly'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 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 Constituent Assembly started its work on the new constitution. Even though the 2007 interim constitution declared Nepal to be 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 Constituent Assembly's ability to reach consensus on key constitutional articles.

After four extensions of its initial two-year tenure, the Constituent Assembly was dissolved without promulgating a new constitution in May 2012. Both the coalition government under Prime Minister Baburam Bhattarai (August 2011 – March 2013) of the Unified Communist Party of Nepal (Maoist), and the nonpartisan government of Acting Prime Minister Khil Raj Regmi (the chief justice of Nepal), which governed the country from March 2013 to February 2014, proved unable to break the constitutional deadlock.

In November 2013, however, the caretaker government succeeded in holding new elections for the Constituent Assembly. These elections saw an impressive comeback for the Nepali Congress (the main opposition party at the time and the ruling party for most of the 1990 to 2006 period). After the Constituent Assembly assembled in January 2014, a multiparty coalition was formed under the leadership of Prime Minister Sushil Koirala (Nepali Congress) in February 2014.

Delays plagued the new Constituent Assembly. In April and May 2015, two devastating earthquakes hit Nepal, which resulted in a great loss of human life and widespread economic destruction. The natural disasters did, however, act as catalysts for constitution making and Nepal's political leaders fast-tracked the conclusion of the process. Amidst much controversy, violent protests in the Madheshi-dominated southern plains of Nepal and an unofficial Indian blockade, the controversial new constitution was eventually promulgated on September 20, 2015. The document backtracked from several of the achievements of the interim constitution with regard to social inclusion. In October 2015, Oli became the new prime minister. However, 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 position of prime minister (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 the local elections. In June 2017, he voluntarily handed over power to Sher Bahadur Deuba, of the Nepali Congress, to oversee 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 since 2006, albeit slow and fragile, has helped to strengthen the state's monopoly on the use of force in many parts of Nepal. Through the promulgation of the new constitution in 2015, successful local and legislative elections in 2017, and successful partial national elections in 2020 (which replaced retiring national-level lawmakers), a process of institutional strengthening, and of the decentralization of power both geographically and culturally is under way.

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 postwar period. 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 remain a threat to the state's monopoly on the use of force.

Past concerns about Indian border security forces acting beyond their jurisdiction have resurfaced recently, and Nepal's western border with India and Nepal's northern border with China have been contested. The Nepali opposition has alleged that Chinese border troops entered Nepali territory and constructed buildings, though this has been denied by the governments of China and Nepal.

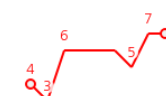
The promulgation of the new 2015 constitution fell short of the more inclusive aspirations of the 2007 interim constitutional settlement and, to some degree, returned to more exclusionary ethno-cultural nationalist narratives. The new constitution includes a version of secularism that has been explained as “special protection for sanatana (Hinduism)”; reiterates the long-standing ban on religious conversion; features discriminatory citizenship provisions on the basis of gender; introduces a new category, Khas-Arya (which encompasses hill-dwelling upper-caste groups),

Question  
Score

Monopoly on the  
use of force

7

'06 '22 10



1

State identity

6

'06 '22 10



1

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, (commonly known as 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 referred to as “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.

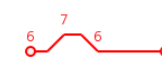
Many public officials continue to maintain strongly held beliefs that Nepali citizenship should be defined by competence in the Nepali language and adherence to the Hindu religion. Such attitudes, which date largely from the recent past when Nepal was officially a Hindu kingdom, have been strongly contested for decades by politically active members of the Madhesi (inhabitants of the “Madhesh,” or Terai, region) and Adivasi Janajati (indigenous nationalities) movements. These groups have demanded a reformulation of the nation-state’s symbolic rhetoric and its concomitant 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. The existing citizenship agreement remains unsatisfactory to many groups, but there has been far less contestation about it over the last two years and there is a sense that public opinion on this issue has stabilized, effectively depoliticizing the issue.

The 2015 constitution defines the Nepali state as secular, a significant improvement from Nepal’s previous status as the world’s only Hindu kingdom (despite the presence of religious minorities). However, Hinduism is protected by the state. The phrase “secular means the protection of sanatana” (a Sanskrit expression that denotes Hinduism) suggests the degree to which Hinduism remains dominant. 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. Progressive political forces and activist lawyers are actively trying to reform the legal system, but changes remain incomplete.

No interference of religious dogmas

6

'06 '22 10



1

The administrative system remains riddled with corruption and 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. 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. Communication, transportation, and basic water, education and health care infrastructure remain problematical, though improvements have been made in urban areas. In rural areas, the infrastructure still does not provide a sound basis for political, social and economic development. The situation has improved substantially in urban areas, especially before the COVID-19 pandemic, 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). In addition, the COVID-19 pandemic has dramatically curtailed the state's ability to provide public services.

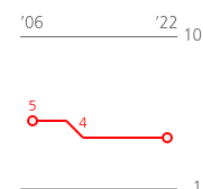
A general restructuring of the civil administration has been under discussion for years. With the promulgation of the new constitution in September 2015, consultations have been under way to adapt Nepal's administration to the country's new federal structure. A new local level structure as decided by the cabinet went into effect in 2017 and some progress has been made. The laws that provide a basis for administrative restructuring have now been drafted and the administrative state largely functions as a working federal democracy.

## 2 | Political Participation

The 2017 local and legislative (provincial and national) elections were the first since the promulgation of the 2015 constitution. Though the period running up to the elections 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. Voter turnout was between 73% and 77% for the three phases of the local elections and close to 69% nationally for the legislative election. After over one hundred attacks involving explosions occurred prior to the elections targeting assemblies and leaders, security forces were deployed to pre-empt election-related violence. Outbreaks of violence during the elections themselves remained localized and small. Several smaller parties threatened to boycott the 2017 elections. In particular, an alliance of several Madhesi parties threatened to boycott all phases of the local elections over concerns of inclusiveness

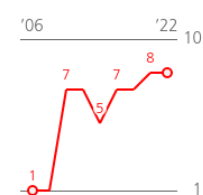
### Basic administration

4



### Free and fair elections

8





and voter participation. Despite this, the elections were largely considered to be free and fair, and Madhesi parties did obtain seats at the local, provincial and national levels.

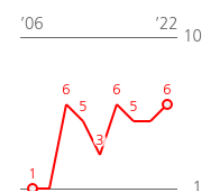
The more recent 2020 legislative elections, which replaced a small number of politicians who were retiring (as a matter of institutional procedure), were carried off smoothly. Universal suffrage was widely respected, multiple parties ran and the secrecy of the ballot was maintained. These elections occurred just prior to the COVID-19 outbreak and, therefore, were not affected by the pandemic.

Since the November 2013 elections to the second Constituent Assembly and the promulgation of the new constitution in 2015, democratically elected political representatives have had the power to govern. Their power remains somewhat constrained, however, in that various political parties, including those that boycotted the 2017 elections, can veto policies by agitating against them. The fact that they have largely not done so suggests that effective power to govern has improved. The merger of the former CPN-M with the CPN-UML to form the Nepal Communist Party in 2018 marked a major milestone in terms of the CPN-M's move away from veto player status. While the Nepal Army was previously seen as a veto player, this is no longer the case. Over 1,400 former combatants from the armed wing of the CPN-M have been integrated into the army, making Nepal one of the few successful instances of post-conflict army integration worldwide. Concerns about a military coup have receded from public consciousness. Other potential veto groups, such as large landowners and business elites, enjoy sufficient access to political parties and, hence, can try to influence policymaking through institutionalized politics. They therefore do not count as "veto groups" as defined in the BTI Codebook. 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 a veto over local democratic decision-making. They have not done so on a large scale to date.

Freedom of association and assembly is guaranteed under Article 17 of the new 2015 constitution. Individuals in Nepal are free to join political and civil society groups, and many people possess multiple affiliations. That said, the constitution allows for "reasonable restrictions" to be imposed by ordinary laws in an extensive range of circumstances. During the protests in the Terai, from August 2015 to February 2016, and again in 2017, the government imposed several curfews and established several "prohibited zones." There have been no similar crackdowns since that time, however. In general, groups operate freely, and mass rallies and activities are common, both in urban centers and far-flung district headquarters. Unsurprisingly, activity of this variety has been tempered by COVID-19-related restrictions. These restrictions were non-discriminatory, remained in place temporarily for several months in 2020 and were enforced by police as part of a large-scale lockdown.

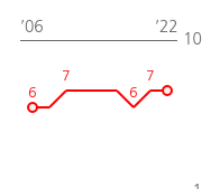
Effective power to govern

6



Association / assembly rights

7



An exception to these generalizations is found in public events involving the Tibetan community. While they lead relatively peaceful lives in Nepal, free of most restrictions, members of this community have sometimes been detained and arrested for staging protests and holding cultural festivals that mention the Dalai Lama. This differential treatment is largely due to Chinese pressure on Nepal, a result of which is that the state, in violation of international law, often does not view the rights of Tibetan refugees as equivalent to those of its own citizens.

Freedom of opinion and expression is guaranteed under Article 17 of the new constitution. Still, the constitution allows for “reasonable restrictions” to be imposed under ordinary laws for an extensive range of circumstances. While under Prime Minister Oli’s tenure there have been a few high-profile incidents in which freedom of expression has been curbed, there have been markedly few incidents of this nature during the evaluation period. As demonstrated by the protests that occurred in late 2020 and early 2021, free expression is regularly enjoyed by most in Nepal.

Nepal has a vibrant media, with many newspapers in the national language, Nepali, as well as English, and several ethnic and regional languages. Community radio has also expanded rapidly and become an important source of news and information for people around the country, especially in rural areas. More recently, growing electricity grids (including micro-grids), complemented by satellite and mobile technology, have facilitated access to social media for many Nepalis, where many different voices are increasingly heard at both local and national levels. The Reporters Without Borders’ 2020 Press Freedom Index ranked Nepal 112 out of 180 countries, a slightly lower ranking than in 2019, when Nepal ranked 106 out of 180.

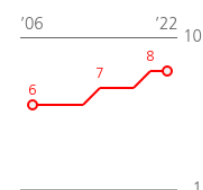
There has been no noticeable change in freedom of expression due to the COVID-19 pandemic. Though protests have been somewhat more limited, this does not seem to be driven by a government desire to stifle expression.

### 3 | Rule of Law

Nepal’s 2015 constitution expressly provides, in Article 56, for the separation of powers. The principle is embedded at the level of institutional design, from the creation of three separate branches of government to the extensive mechanisms intended to ensure that it is complied with. The constitution does weaken the judiciary slightly, especially in comparison to the previous interim constitutions. Impeachment proceedings of Supreme Court justices can be initiated and there is now a separate constitutional bench within the Supreme Court that reviews legislation. In practice, however, the institutional capital associated with Nepal’s judiciary, especially vis-à-vis the other branches, has allowed it to withstand these relatively minor changes. Executive compliance with judicial orders has occasionally been problematical, however. This was the case during the COVID-19 pandemic when Supreme Court restrictions on government action were not complied with by the administrative state.

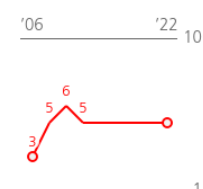
Freedom of expression

8



Separation of powers

5



Otherwise, existing measures were mostly followed during the pandemic. There was, however, a reliance on older centralized legislation (e.g., the Infectious Diseases Act 1963) and ad hoc mechanisms established by executive decision, rather than the utilization of new federal institutions under the Disaster Risk Reduction and Management Act 2017. The parliament was adjourned and unable to meet, as meetings were required to take place in person rather than virtually. Hence, there was little parliamentary oversight (although some committees did meet). Restrictions have since been lifted in alignment with public health guidance rather than political prerogatives.

The institutional design of Nepal's judiciary is similar to that of other federal democracies and particularly to that of India. There is now an independent three-tier judicial system, consisting of the Supreme Court, a High Court for each federal province and a District Court for each district. The Supreme Court is the highest court in the country 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 that can review legislation. This bench now exists and has begun its work but has thus far been ineffective owing to political and logistical problems. This has, of course, added to the court's backlog. The highest court in Nepal has also been weakened by the new impeachment procedure, which has a lower threshold than that provided for in previous constitutions. The nascent Judicial Council, which handles important issues relating to the judiciary, appears to be adding a layer of protection to the courts.

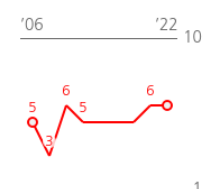
The Supreme Court has historically not shied away from displaying its independence and power. For example, the Supreme Court recently impeached several political leaders on corruption charges, and also issued several courageous decisions on transitional justice, citizenship rights, and quotas for women and minority groups. The recurring problem that the court faces, however, is compliance with its judgments. The executive sometimes flouts them completely. At other times, it reluctantly complies but drags its feet in the process. Civil society has been instrumental in forcing executive compliance in a number of instances.

Civil society in Nepal has long described the climate in the country as being one of impunity. Weak state and judicial capacity mean that ensuring the rule of law and protecting human rights remain 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 adequately prosecute well-documented conflict-related crimes committed during the civil war.

Corruption is often part of doing politics and business in Nepal. Funds, including aid money, continue to be misappropriated at all levels of government, and corruption scandals frequently make the news. Most political parties do dispense patronage to members and supporters, both in terms of material resources and, more commonly, administrative favors. Many would now say that corruption is bad and should be halted, but few have taken steps to stop the practice.

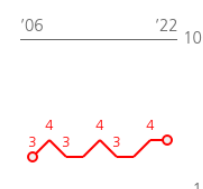
Independent  
judiciary

6



Prosecution of  
office abuse

4



Vested interests among the parties continue to undermine democratic effectiveness. Patronage and clientelism remain relatively common, undermining the equitable provision of public goods and fair appointments to offices. The Bayesian Corruption Index (BCI) scored Nepal 54.3 out of 100 (where 100 = totally corrupt) in 2017 (the last year BCI was calculated). In comparison, the United States scored 28.2, the United Kingdom 15.8 and India 41.4. It should be noted that Nepal's current BCI score is lower than its score between 2005 and 2011, which ranged between 60.0 and 60.5. This change in score indicates that Nepal is becoming less corrupt and adopting a more institutionalized system of governance.

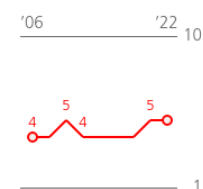
Nepal's anti-corruption body, the Commission for the Investigation of Abuse of Authority (CIAA), has arrested and jailed high-level government officials and politicians on corruption charges in recent years. Overall, however, many corrupt officeholders or authorities who abuse their office can do so without fearing legal consequences. The standing of the commission was severely weakened by the impeachment of its chairman, Lokman Singh Karki, although subsequent CIAA leaders have stayed clear of trouble, and the institution appears to be gaining momentum and gradually rebuilding public trust. In 2020, it has started to come into its own, conducting numerous sting operations and instilling a degree of fear into those who continue to practice corrupt activities.

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 have gone largely unsupported by various branches of government. Amnesty International and others reported discrimination in the manner in which aid was distributed after the 2015 earthquakes. More generally, levels of protection continue to 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 sometimes use disproportionate force to quell political protests. However, law and order has improved of late, and many are hopeful that grievances will now largely be dealt with through the formal system. This was put to the test in late 2020 and early 2021 during protests against Oli's dismissal of parliament. Thus far, the government response has protected civil rights better than during protests in 2015 and 2017.

Still, the court system in Nepal remains inaccessible to many Nepalis due to limited geographical dispersal and scarce resources, both within the system and among those seeking protection for their rights. This has improved considerably, as the entire political system has decentralized in line with the new constitution. Unfortunately, however, the functional capacity of Nepali judges remains somewhat limited due to a lack of experience and training. Public awareness of the judicial process is low and there are delays in the system. Furthermore, although these factors are improving, this improvement has actually exacerbated public frustration with the courts and their

#### Civil rights

5



inability to provide justice. Corruption is also a problem. The large number of pending cases, delays in the implementation of court decisions and controversial judicial appointments have contributed to an overall impression that the judiciary has much work to do before it can be considered fully independent.

Fundamental rights have largely been protected under COVID-19 emergency measures. A nationwide lockdown was imposed, including restrictions on freedom of movement. However, these were time-bound, legal and proportional, and have since been lifted.

#### 4 | Stability of Democratic Institutions

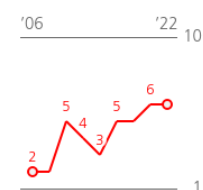
Democratic institutions exist at the national, provincial and local levels, and are stabilizing after a period of contestation. From the second Constituent Assembly election in November 2013 through to the first successful post-election transfer of power following the 2017 legislative elections, Nepal has had numerous prime ministers. These leaders headed unstable coalitions, leading to largely incoherent and ineffective policymaking. After the legislative elections of 2017, which saw the success of a left alliance comprising the Communist Party of Nepal (Unified Marxist–Leninist) and the Communist Party of Nepal (Maoist Center), Oli became prime minister for a second time. The two parties later merged. Despite having a majority in both houses of parliament, Oli’s term has been criticized for its inaction. More recently, the government’s response to COVID-19 has received mixed reviews. But, importantly, many citizens are now expressing their dissatisfaction through existing institutions.

In 2017, Nepal saw the first democratically elected representative bodies at the local level since the disbanding of the elected village councils in 2002. In early 2020, Nepal held successful national-level elections to replace legislators who were retiring as their term limits had been reached. Despite these successes, political parties continue to suffer from weak democratic structures and norms in many respects. In December 2020, Prime Minister Oli dissolved parliament, despite commanding a large majority, due to a factional split in his own party.

The vast majority of political actors support the 2007 agreement on democratic transition and support has since increased secularly. This was confirmed by the elections to the Constituent Assembly in April 2008 and November 2013, in the local and legislative elections of 2017 as well as the 2020 legislative elections. Even the then CPN-M, which decided to boycott the 2013 poll, confirmed its commitment to the constitutional process, contested the elections and later merged with the CPN-UML to form the NCP. An alliance of several smaller Madhesi parties, which had threatened to boycott the 2017 local elections, eventually won several seats during the legislative elections. The executive’s response to COVID-19 has not threatened democratic institutions, although the executive has sidelined the legislature, and subordinate provinces and local governments through the establishment of executive control mechanisms during the COVID-19 pandemic.

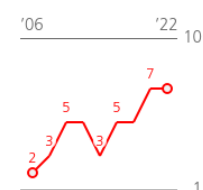
Performance of democratic institutions

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Commitment to democratic institutions

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## 5 | Political and Social Integration

The political party system remains fairly factionalized, polarized and dominated by elites. Disadvantaged groups are increasingly represented in the legislature due to the fact that 40% of the legislature's seats were elected under a proportional system with quotas for marginalized groups (including women). However, unequal access and representation still affect key parts of the government, political parties, the administration, the judiciary, the media, the education system and in business.

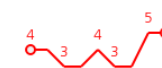
The traditional parties – the Nepali Congress and CPN – have strong social roots but face difficulties recruiting and maintaining the allegiance of cadres from Dalit and Janajati backgrounds, and lack adequate democratic and participatory mechanisms. Most political parties remain personality-oriented organizations with internally authoritarian power structures. A large proportion of power is typically concentrated in the party headquarters in the Kathmandu Valley; any participation at the local level or in rural areas is very limited, though this is starting to shift as federalism transforms the political landscape. The established parties make little effort to achieve balanced popular participation in their own party leadership structures or in the country's political institutions. The upper caste, Bahun and Chhetri, groups dominate in all areas. Despite promises of revolutionary social transformation, Maoist parties have fared only slightly better at democratizing their ranks. Popular support for and trust in Nepal's political parties varies widely from year to year, as indicated by the Himalmedia Public Opinion Poll.

Recent years have seen several new parties arise, largely organized around regional or ethnic affiliations, or around ideology. Some civil society organizations are accepted as more legitimate than others and some maintain explicit political allegiances (others have alliances, but these are less public). 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 believe that Nepal's political parties (and, therefore, the structures of governance that they control and operate) seek to keep power in the hands of upper-caste Hindus and, therefore, are not representative of the country's population. By the same token, many regional and ethnic parties are viewed by the country's elites as exclusionary and a potential threat to national unity. The new constitutional settlement is less fragile than it used to be, but polarization will likely be present for years to come.

Party system

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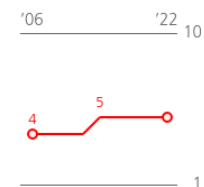
Since Nepal's transition to democracy in the 1990s, civil society organizations and interest groups have established themselves. These include labor unions, community-based groups, local NGOs and organizations for women's rights. They now play a role in representing social interests and interest mediation. 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 phase 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, sometimes working cooperatively with each other. However, the effectiveness of these INGOs and NGOs is questionable, and to some degree they may be undermining state capacity. In addition, better funded groups tend to dominate and funding is often dependent upon alignment with donors, many of whom are not Nepali.

The Asia Foundation's most recent Survey of the Nepali People, which was conducted in 2018, collected data on public perceptions of contemporary political, economic and social development in Nepal. This survey was based on a nationally representative sample of 7,056 people from 588 wards selected from all seven provinces. The Asia Foundation reports that survey responses reflect "a sense of cautious, post-election optimism that the country is finally on the path to stability." Interestingly, more than half (61.3%) of respondents said their local level representative cares about them "somewhat," as compared to 53.0% for provincial parliamentarians and 54.1% for federal representatives. This suggests that federalism and local-level governance may be helping the state reach more people. Trust in the media and in local-level organizations is relatively high, while trust in national-level institutions, save for the army and the courts, is generally quite low. In addition, only 9.4% of female survey respondents stated that their gender was a disadvantage.

While this might indicate improvement compared to previous opinion data, the overall implications for lasting trust in Nepal's nascent democracy are not yet clear. The 2013 Citizen Survey: Nepal in Transition, which was conducted after the dissolution of the first Constituent Assembly in May 2012, suggested that support for democracy in Nepal had waned during the immediate post-conflict period. An often-cited survey (Himalmedia Public Opinion Poll 2013) suggests that the long-standing inability of high-level political actors to ensure the continuity of democratic institutions contributes to relatively low levels of public trust during this time. 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." While the 2018 iteration of the survey suggested continued disillusionment (especially with political parties), 43% of respondents reported that government service delivery had already

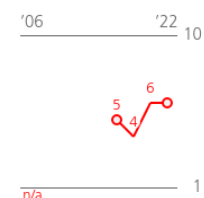
#### Interest groups

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#### Approval of democracy

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improved in the seven months after elected municipal and village councils took over local governments. Even so, the majority of respondents reported confusion on the exact meaning and implications of a federal system. In short, trust in public institutions in Nepal remains volatile.

Despite this, the high levels of participation in the 2017 and 2020 elections suggest that Nepali citizens largely understand and value democratic processes. While the promulgation of a controversial constitution (which was pushed through the Constituent Assembly in an exclusionary fashion), protracted protests in Terai, and the slow progress made on post-earthquake reconstruction and transitional justice weakened support for democracy in Nepal between 2015 and 2017, the recent successful elections and transfer of power have led to cautious optimism, especially at the local level.

COVID-19 does not appear to have impacted the public's perception of democratic institutions.

Country-level studies of trust, strength and forms of social capital in Nepal are hard to come by. The Asia Foundation's 2018 Survey of the Nepali People found that a majority (61.9%) said that social relations between different religious, caste and ethnic groups are improving, a higher percentage than in the previous survey in 2017. While there are anthropological, ethnographic and subnational studies of social capital in Nepal, it remains uncertain if these insights can be viewed as representative or aggregated to the whole society.

Nonetheless, associational activities have improved dramatically in 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, such organizations fill the spaces that might otherwise be filled by effectively decentralized state agencies. Interestingly, as decentralization has occurred, the local state is starting to collaborate more with local associations and even reassume some traditional state activities. Many associations in Nepal continue to further the interests of a specific group, whether defined in ethnic or regional terms. Therefore, it could be argued that these networks might reproduce bonding social capital instead of bridging social capital and, therefore, do not support the formation of civil society self-organization. However, initiatives such as the UNDP's Social Cohesion and Democratic Participation Program (SCDP) are actively working to promote social cohesion and trust across community lines. According to the SCDP's 2017 Annual Progress Report, nearly 4,000 youths, women, marginalized groups, civil society members, government officials, political leaders and journalists have been involved in promoting social cohesion through 81 community-level initiatives.

The COVID-19 pandemic does not appear to have impacted solidarity and trust within civil society, though it has changed it. There is more distrust of perceived outsiders, but also more reliance on and trust in insiders.

Social capital

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## II. Economic Transformation

### 6 | Level of Socioeconomic Development

Socioeconomic exclusion remains a problem in Nepal. It remains one of the poorest countries in the world, with a per capita GNI (PPP) of about \$3,600 (2019), according to World Bank statistics, and a per capita GDP (PPP) of \$3,064 (2018). Remittances have long represented, and continue to represent, a significant part of Nepal's revenue, estimated at 26.9% of GDP in 2019. According to the UNDP's Nepal Human Development Report 2017, the country ranked 147 out of 189 countries, with an HDI score of 0.579 (2018). It is ascending in the rankings after a drop from 2014 to 2015, likely due, at least in part, to the impact of the 2015 earthquakes. The World Bank Post Disaster Needs Assessment (PDNA) priced the damage at \$7 billion, with total reconstruction needs at \$6.7 billion. The largest single need identified by the PDNA was housing and human settlements, estimated at about \$3.27 billion. Reconstruction is ongoing. Nepal's current HDI ranking places it far behind Sri Lanka (71), but ahead of Afghanistan (170).

More finely grained data shed additional light on Nepal's socioeconomic development. As of 2018, according to Nepal's National Planning Commission (Multidimensional Poverty Index), 18.7% of Nepal's population lives below the national poverty line. Several years ago, the World Bank suggested that an additional 3% of the population had been pushed into poverty as a direct result of the earthquakes. This translates into as many as a million more poor people. Recent data suggests that the Nepali economy has functioned sufficiently well that a significant proportion of individuals have escaped poverty over the last two years.

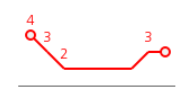
The UNDP Human Development Report, which uses World Bank data, continues to identify a Gini coefficient of 32.8 for Nepal, ranking it 145 out of 189 countries. This is 2010 data, however, so it should be understood as such. The UNDP Gender Inequality Index for Nepal is 0.476, ranking it 115 out of the 162 countries in the 2018 index. Socioeconomic inequalities in Nepal on the basis of gender, caste, ethnicity, language, region and sexual orientation remain structurally ingrained and pervasive, though gender dynamics have changed dramatically over the last decade. These long-standing social hierarchies continue to restrict access to political influence and economic opportunities of the many marginalized groups. For instance, despite gender equality improvements, Nepal ranks 133 out of 153 countries in the Global Gender Gap 2020. This places Nepal below Sri Lanka (88), but above Pakistan (143). The COVID-19 pandemic has impacted everyone in Nepal, but, unsurprisingly, access to adequate care tracks socioeconomic inclusion. Women, in particular, who on average suffer less from the direct health impacts of COVID-19, have suffered more from pandemic-related disturbances.

Question  
Score

Socioeconomic  
barriers

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<b>Economic indicators</b>		2017	2018	2019	<b>2020</b>
<b>GDP</b>	\$ M	28971.6	33111.5	34186.2	<b>33657.2</b>
<b>GDP growth</b>	%	9.0	7.6	6.7	<b>-2.1</b>
<b>Inflation (CPI)</b>	%	3.6	4.1	5.6	<b>5.1</b>
<b>Unemployment</b>	%	3.0	2.9	2.9	<b>4.4</b>
<b>Foreign direct investment</b>	% of GDP	0.7	0.2	0.5	<b>-</b>
<b>Export growth</b>	%	8.9	7.7	5.5	<b>-15.9</b>
<b>Import growth</b>	%	28.2	19.0	5.8	<b>-15.2</b>
<b>Current account balance</b>	\$ M	-1032.6	-2774.7	-1713.6	<b>-50.0</b>
<b>Public debt</b>	% of GDP	25.0	30.1	33.1	<b>42.2</b>
<b>External debt</b>	\$ M	4963.4	5510.9	6513.5	<b>7904.9</b>
<b>Total debt service</b>	\$ M	253.7	244.3	282.9	<b>275.2</b>
<b>Net lending/borrowing</b>	% of GDP	-3.0	-4.8	-4.8	<b>-</b>
<b>Tax revenue</b>	% of GDP	17.4	19.1	19.8	<b>-</b>
<b>Government consumption</b>	% of GDP	8.5	8.1	8.1	<b>9.0</b>
<b>Public education spending</b>	% of GDP	4.8	4.4	-	<b>-</b>
<b>Public health spending</b>	% of GDP	1.2	1.5	-	<b>-</b>
<b>R&amp;D expenditure</b>	% of GDP	-	-	-	<b>-</b>
<b>Military expenditure</b>	% of GDP	1.7	1.5	1.4	<b>1.4</b>

Sources (as of December 2021): 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 to inconsistencies in market forces in Nepal. For instance, it takes 22.5 days and eight procedures to start a business, at a cost of 20.2% of per capita income. 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 and other countries may undercut the latter of these factors, Nepal remains weakly positioned to create market stability. The informal sector in Nepal remains significant, with 94% of workers employed informally.

Nepal ranks 94th on the World Bank's Doing Business 2020 report compared to 110 in 2018. The main reasons behind the rise are improved access to credit information and the opening of the integrated Baxaul Bazaar/Birgunj crossing. Nepal ranks third highest in South Asia after India (63) and Bhutan (89), and ahead of Sri Lanka (99).

Nepal has been making some progress in terms of improving its investor-image. Nepal has already eliminated its previous \$200,000 minimum investment requirement. Furthermore, Nepal has started to implement several laws – the Industrial Enterprise Act and the Special Economic Zone Act – as well as the intellectual property rights policy, which are improving the investment climate. Still, the current investment climate involves slow and arbitrary approval processes, dual registration procedures, delays in trademark registration, and difficulties in remitting royalties and technical fees.

Though foreign direct investment (FDI) inflows into Nepal have increased recently, they remain very low. At 6% of GDP, Nepal's 2019 FDI inflows are even low compared to regional and other comparators. According to the World Bank, while this is partially explained by firms' perception of the risks of operating in the country, the investment regime in Nepal is more restrictive than in other countries at a similar level of development. Restrictive FDI policies continue to compound the challenges the country faces in attracting foreign investment, though the 2019 Foreign Investment and Technology Transfer Act represents a substantial step forward. Despite this improvement, Nepal continues to retain foreign ownership limits in several sectors, including tourism, agriculture, real estate and media.

In practice, the operation of foreign banks, repatriation of profits and currency exchange facilities continue to constrain FDI. India remains the largest single source of foreign investment in Nepal, accounting for 26.9% of FDI capital inflows in 2018. India is also Nepal's most significant trading partner, accounting for 56.72% of Nepal's exports and 64.95% of Nepal's imports in 2017. India's unofficial blockade of Nepal in 2015 and 2016 undermined both trade and bilateral relations between the two countries, although trade and bilateral relations have since largely recovered from this low. Nepal has also increased its trade with China, in part to reduce its structural dependence upon its southern neighbor. FDI from China accounted for 17.5% of paid-up capital inflows in 2016.

Market  
organization

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To fulfill its WTO obligations, Nepal passed the 2007 Competition Promotion and Market Protection Act, which aims to prevent monopolies and cartels. 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 and ensure the independence of the relevant regulatory agencies. Tentative efforts to dissolve syndicates have largely failed. As reported by the Kathmandu post in April 2018: “Two recent 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 suggests that the Competition Promotion and Market Promotion Board is still not fulfilling its assigned task.

Nepal acceded to the WTO in April 2004 as the first least developed country to do so. It’s commitments under the WTO framework 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 effective applied average tariff rate was 12.35% in 2016, which was on the high side for South Asia, where the same statistic was 6.35% in India, 10.09% in Pakistan, 10.72% in Bangladesh and 11.16% in the Maldives. 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, 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. Nevertheless, the institutional and legal structures to implement the WTO agreement remain underdeveloped. Red tape, delays and strikes have significantly discouraged investment in the country. Structural difficulties of trade-related services and infrastructure prevented the realization of potential comparative advantages.

Apart from the WTO, Nepal is also a member of two regional trade frameworks: the South Asia Free Trade Area (SAFTA), and the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC).

The 2016 World Bank *From Evidence to Policy: Supporting Nepal’s Trade Integration Strategy* report states that Nepal remains poorly integrated and has more to gain from integration into regional and global value chains. This remains true, though Nepal’s experience of the 2015/16 informal blockade by India has gone a long way toward openness to regional integration.

Good governance, stable institutions and physical infrastructure are essential to facilitate foreign trade and investment. With these prerequisites largely not in place, Nepal has not seen large-scale benefits from its trade liberalization attempts. In addition, difficult geography, in which the construction of industrial infrastructure is challenging under the best of circumstances, and a difficult industrial relations environment, which makes the hiring and firing employees extremely difficult have also discouraged the growth of large industry.

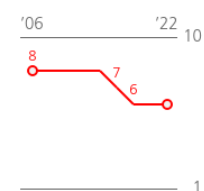
#### Competition policy

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#### Liberalization of foreign trade

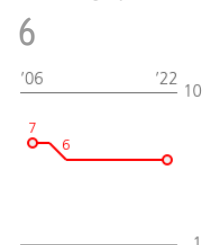
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In *Trade Logistics in Landlocked and Resource Cursed Asian Countries*, editors Charles Harvie, Odbayar Erdenetsogt, Kankesu Jayanthakumaran and Nagesh Shukla report that traders in Nepal not only face distance-related challenges but also challenges related to transit due to Nepal's landlocked position. These challenges include frequent checks by border security officers and police, time-consuming customs formalities, shortages of containers at the borders, differential tariff rates for the Nepalese consignment, and long delays at the Kolkata port, which add to the cost of international trade. Transit costs associated with overseas imports are as high as 20% of the value of goods. This is attributed to the high costs of transport, damage and pilferage (while goods are in transit), time-consuming customs formalities, and numerous fees (both official and unofficial).

Generally, there is little publicly available information on Nepal's banking system. According to the World Bank, Nepal's bank capital to assets ratio stood at 11.93% in 2018. The U.S. Department of State's 2020 Investment Climate Statement indicates that Nepal's banking sector is "relatively healthy though fragmented" and that system assets totaled approximately \$29.7 billion in 2018. As of the same year, 1.49% of the total asset base was estimated as non-performing, which represents a reduction compared to previous years. Still, a number of long-standing issues persist, including banking sector fragmentation, the central bank of Nepal's (Nepal Rastra Bank, NRB) weak supervision of the banking sector, under-banking of the rural population and conflicts of interest arising from the ownership of several banks by prominent businesses. Progress has been made, however, as there are currently 27 commercial banks in Nepal, a reduction from 78 less than a decade ago.

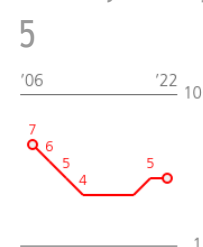
Banking system



## 8 | Monetary and fiscal stability

The Nepali rupee is pegged to the Indian rupee at a rate of NPR 1.6 to INR 1.0, which Nepali policymakers and international organizations such as the IMF insist is important for overall macroeconomic stability. Accordingly, the value of the Nepali rupee fluctuates with the Indian rupee and has weakened against the U.S. dollar considerably, with the exchange rate of the Nepali rupee to the U.S. dollar weakening to NPR 117 to \$1. COVID-19 does not appear to have affected this exchange rate dramatically and the currency has not been devalued. Foreign exchange is not freely available. Under the 1962 Foreign Exchange (Regulation) Act, commercial transactions payable in convertible currency need approval from Nepal's central bank, the NRB.

Monetary stability

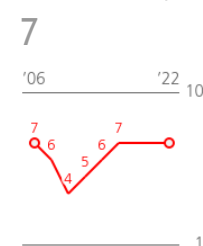


According to World Bank data, reflecting both the earthquake and trade-related disruptions, inflation spiked to over 12% (year-over-year) by mid-January 2016 rising five percentage points in just four months from mid-September 2015. Since then, it has reduced dramatically and stood at 5.6% in 2019. COVID-19 has not dramatically affected inflation in Nepal. The IMF's country report for Nepal in 2010

stated that the NRB lacked independence, which negatively affected supervision and enforcement. The IMF's 2017 report states that 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 enforcing authority have remained weak. The ADB's 2017 macroeconomic update indicates, however, that the NRB has done a decent job of maintaining liquidity, while keeping interest rates in check and supporting capital markets.

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 high concessionality of new debt. At the government level, after the earthquakes Nepal suffered short-run revenue losses (especially in agriculture and tourism) followed by a gradual recovery over the medium term that looked fairly robust until COVID-19 caused further disruptions, increasing expenditures and decreasing revenues. Nepal applied for and received COVID-19-related assistance of \$214 million in May 2020. Despite these added challenges, fiscal policy is expected to remain responsible. A 2019 joint IMF-World Bank report forecasts that the ratio of public debt-to-GDP will increase over time, reaching as high as 42%, but that this ratio is sustainable at present. Nepal's current account balance was -\$5.592 million, as of 2019, while its public debt was \$9.227 million; it had total reserves of \$11.3 billion as of January 2021. However, given Nepal's continued (although decreasing) reliance on remittances, debt dynamics remain susceptible to volatility in remittance flows. The government's challenge is to continue its prudent fiscal policy, while continuing reconstruction, increasing spending on infrastructure to encourage domestic growth and handling the pandemic-related fallout.

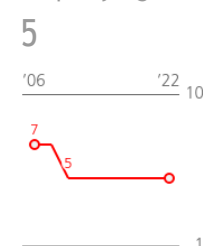
Fiscal stability



## 9 | Private Property

Despite the fact that property rights and the regulation of property are defined by the 2015 constitution, in the absence of good governance, they are regularly violated. Although the Maoists committed to the new constitution, they have not yet restored all property – mostly land – confiscated during the conflict. As part of the peace process that began in 2006, the Maoists agreed, in principle, to return all of it and have done so in the majority of cases. However, some land still needs to be restored, even if there is no official data on contested titles.

Property rights



Insecure property rights are a particular problem for the poor, who often lack proper documentation for land titles, and are ill-equipped to maneuver through local courts and administration. This has been made even more challenging by Nepal's switch from unitary to federal administration. Though land-title offices should theoretically be easier to access under federalism, the poor and uneducated continue to face barriers. Among the poor, women find themselves at a particular disadvantage.

In addition, many who have built additional structures on their land without proper documentation – typically as the land is split between male heirs and individual dwellings are built for nuclear families – are now in the unfortunate position of being unable to sell their land legally. There are also numerous cases of developers who, having taken deposits for plots of land, are unable to produce pre-sold plots due to oversubscription; it is difficult for depositors to get their money back.

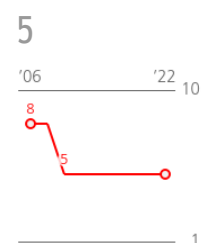
Even though legal provisions regarding property and inheritance declare gender equality, women are often unable to make rightful claims in the face of continuing social discrimination. A sweeping bill that came into force in August of 2018 is making some progress toward ameliorating remaining concerns.

Private companies are constitutionally permitted and protected. Some restrictions apply to foreign ownership. Bureaucratic and legal hurdles an entrepreneur must overcome to incorporate and register a new firm are among the lowest in South Asia. Yet, the real problem for setting up a private commercial or industrial enterprise is not registration, but political and bureaucratic interference in day-to-day business once a firm has begun to operate. These have improved in some ways and worsened in others of late. According to the World Bank Doing Business 2020 report, improvements have been made in dealing with construction permits and securing credit, but conditions have deteriorated with respect to paying taxes and registering a property.

Many of the more than 80 public enterprises, which operated across a diverse range of sectors, were privatized in the 1990s. The process came under some criticism, as many newly privatized companies soon found themselves in choppy waters. There were also allegations that privatization processes were not transparent and that state assets were widely undervalued. Privatization of state-owned enterprises (SOEs) has been on hold since 2008. In 2020, there were 43 public enterprises in Nepal, such as the Nepal Airlines Corporation and the Hetauda Cement Industry Limited. While 26 are profitable, 13 have faced high cumulative losses and unfunded liabilities for years due to operational inefficiencies and other problems. Overall, most observers think public enterprises will increase the burden on taxpayers and consumers because of their poor performance. However, further privatizations are blocked by opposition from interest groups, bureaucratic inefficiencies, the lack of political stability and political consensus, and a weak domestic financial market. According to the U.S. Department of State, despite the Constituent Assembly elections in 2008 and 2013, the government has been reluctant to restart privatizations that had stalled. With the local and national-level elections that occurred in 2017, and the subsequent 2020 national elections, we may see some movement on privatization in the years to come, but there has been little movement to date.

According to the U.S. Department of State's Investment Climate Statements 2020, private enterprises do not have the same access to finance as SOEs and mostly rely on commercial banks. Given their proximity to government officials, SOEs receive non-market-based advantages. The government has not taken large equity stakes in domestic firms to prevent bankruptcy during the COVID-19 pandemic.

Private enterprise



## 10 | Welfare Regime

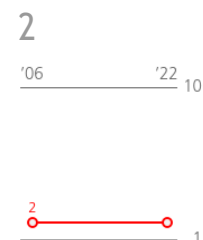
Nepal’s welfare regime remains largely limited to social networks based on familial structures. In some cases, NGOs attempt to fill this gap, but most only provide locally specific piecemeal services, and in some cases actually undercut the state’s efforts to increase its own capacity and deliver services. This means that social welfare options vary greatly, depending on the area of residence, access to international donors and personal networks.

Family support structures are strong but increasingly weakened the widespread and long-term emigration of young people, especially men. Indeed, in rural areas, villages are often populated by women, children and the elderly, so great is the emigration of working-age men to both the Kathmandu Valley and abroad. Although both domestic transfers of wealth from the capital region to rural areas and financial remittances from workers abroad help compensate for social risks, the physical absence of family members strains social ties.

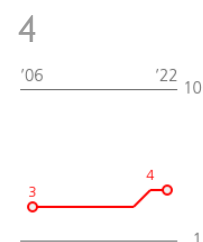
Nepal’s public expenditure on health care (as a percentage of GDP and total government expenditure) are relatively high by South Asian standards but are still insufficient (as in almost all South Asian countries). The inefficient use of finances due to poor state capacity remains a significant problem. Private initiatives to improve social services are limited, and public social services are underdeveloped and insufficient to meet demand. That said, 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. However, public health care institutions are concentrated mainly in urban centers and especially the Kathmandu Valley. As a result, many rural residents continue to lack meaningful access to health care. This has been particularly true during the COVID-19 pandemic. On the plus side, the state’s efforts to manage public health outcomes during the pandemic are building state capacity, which will continue to have an impact long after the crisis is over. The Nepali government did administer a meager food and soap distribution program for the poorest households to alleviate the effects of the pandemic.

Since the end of the civil war 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 Constituent Assembly elections, which, although controversial, established a mechanism for ensuring significant diversity in elected office. A 2007 second amendment to the Civil Service Act 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, Madhesis, 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%

Social safety nets



Equal opportunity





and introduced the new controversial category of Khas-Arya (i.e., high-caste Pahari Hindus, Bahun and Chhetri) for affirmative action purposes. The controversy refers to the protection of a dominant group, akin to affirmative action for “whites” in the United States. 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 across both first-past-the-post and closed-list proportional races. Current representation stands at approximately 33% at the national level and 40% at the local level.

Gender continues to be a barrier to equal opportunity in Nepal. While literacy stands at approximately 60% in Nepal as a whole, female literacy was only 48%, as of the latest data, in 2018. This not all that surprising, given that female enrollment in secondary schools in Nepal stood at approximately 63%, according to World Bank data. The female-to-male enrollment ratio in Nepal was 1.07, as of 2017, according to the most recent World Bank data. Yet, women make up almost 50% of the workforce, with female labor force participation 97% of male participation in 2019, according to ILO data.

Male members of the Nepali-speaking, hill-dwelling Brahmin caste (Bahun), who comprise only 12.2% of the country’s population, continue to acquire an outsized proportion of new civil service posts, though overall the proportion of positions they hold has decreased slightly. Brahmins from the Terai, Kayastha and Rajput communities are also over-represented, though they make up a much smaller percentage 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.

Labor market opportunities in Nepal are highly unequally distributed. A recent ILO publication on the impact of COVID-19 suggests that approximately 80% of the workforce in Nepal continues to be employed in the informal sector, facing multiple challenges and constraints, and left unprotected by basic social safety nets. Workers are subject to exploitation and deprived of many fundamental rights at work. The government has largely turned a blind eye to abuses, though the implementation of a recent labor law is slowly shifting the labor market landscape.

According to Nepal’s Ministry of Labor and Employment, the Department of Foreign Employment issued 215,630 permits allowing Nepalis to work abroad in 2018/19. This number has been declining since 2013/14. For 2018/19, the main destinations through the permit system were Qatar (31.8%), Saudi Arabia (19.5%) and the United Arab Emirates (26.5%). Men accounted for 91.3% of registered labor migrants for this timeframe, a slight decrease from the previous report.

A large percentage of international migrants from Nepal also head to India, for which no visa or foreign labor permit is needed. In 2018, the World Bank estimated that approximately 27% of migrants from Nepal followed this path. More recent data is

not available, but expat Nepalis returned en masse to Nepal during the COVID-19 pandemic. Those Nepali migrants still in India work in the private sector, mostly in manual labor jobs, including in industry, construction work and agriculture, or in the service sector, especially in security. Their wages tend to be low, and the work is often dirty, dangerous and 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 to stop this flow have met with some success, 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

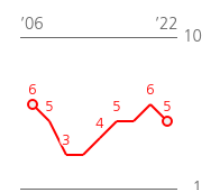
Nepal remains one of the poorest countries in the world. The World Bank estimates that per capita GDP growth in Nepal was 5.0% in 2019, while per capita GNI (PPP) was approximately \$3,600 and per capita GDP (PPP) was \$3,558. The Asian Development Bank (ADB) estimates that the GDP grew by a strong 7.6% in 2018 and by 6.7% in 2019. Nepal's economy contracted by -1.9% in 2020 due to the impact of COVID-19 on the domestic and global economies. GDP growth is projected to rebound by 3.1% in 2021. Inflation stood at 4.2% in 2018 and 4.6% in 2019, reaching 6.2% in 2020. Strong domestic consumption remains reliant on inflows of remittances, however, which surged from just under 11.21% of GDP in 2002 to a high of 31.43% in 2015, before decreasing to 26.92% in 2019. These numbers are likely to change due to the return of expat workers to Nepal due to the pandemic.

Nepal's external debt stood at 17.0% of GDP in 2019 (\$5.4 billion), of which 89% was concessional borrowing from the World Bank and the ADB. Domestic public debt increased from 9.3% of GDP in 2015 to 13.1% by 2019. Nepal's reliance on remittances remains critical. Moreover, according to Nepal's National Planning Commission, Nepal faces a high trade deficit. Over the years, exports have stagnated and imports have skyrocketed. Nepal's export to import ratio hit 1:14.6 in 2019. Officially, Nepal aims to maintain a trade deficit of 20% of GDP, but the estimates for 2017 indicate that there is a deficit of around 37.6% of GDP. India commands the largest share of Nepal's foreign trade, at approximately 65% in 2018, while China accounted for 12%.

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 such a situation is compounded by the lack of social protection schemes, as well as by the COVID-19 pandemic, which has decimated Nepal's important tourism sector.

Output strength

5



## 12 | Sustainability

Economic growth in recent years has been achieved at a high environmental cost and has led to additional environmental degradation, especially because of increasing air pollution, and persistent problems with water sanitation and water resource management. While still not out of the woods, incremental progress is starting to yield gains, with more anticipated in the near term. The Melamchi Water Supply Project, which continues to be “nearly completed” will go a long way toward mitigating severe water shortages in the overpopulated Kathmandu Valley during the dry season. Its promises remain unfulfilled to date, despite 20 years of work, but recent reports suggest the project is on the cusp of completion. In addition, air pollution continues to be a problem, though less so during the COVID-19 pandemic, and water sanitation issues persist. 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.

Nepal’s current Environmental Performance Index (EPI) score is 32.7. This ranks Nepal (145 out of 180 countries) above India (168), Bangladesh (162) and Afghanistan (178), but below Pakistan (142), indicating that environmental performance in the region is very poor. Ambient air pollution remains a major problem in Kathmandu. Particulate pollution is mainly emitted by vehicle traffic (both in terms of combustion emissions and dust re-suspension), other forms of combustion and industrial sources (e.g., brick kilns) within Kathmandu Valley. The 2020 EPI ranked Nepal quite poorly for air quality (i.e., unsafe levels of fine particulate matter), with drinking water and sanitation being only slightly better. Nepal continues to perform better on ecosystem vitality, however.

Nepal has a comprehensive set of environmental policies that date back to the 1970s when the royal family’s private hunting reserve was turned into what is now Chitwan National Park, which was in turn followed by 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 through Community Forest User Groups, groups of locals who come forward with a plan to sustainably manage government-owned forest land. Forest cover has been shown to increase in some of these areas, while others struggle to prevent further deforestation.

The expansion of sustainable energy is slow, but has gained momentum of late, at least in part due to the unreliability of centrally distributed electricity and gas. The main energy source at the household level, outside of urban centers, is biomass (firewood). Nepal also has a number of operational micro-hydro projects distributed throughout the country; hydropower continues to supply 90% of Nepal’s generating

Environmental  
policy

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capacity. The government, with support from donor agencies and bilateral aid, continues to make investments in the renewable energy sector and many of these are already changing the lives of ordinary Nepalis. Progress has been slow but steady. Several donor agencies also assist with incipient plans to incentivize companies to invest in energy efficiency and sustainable energy sources.

The UN Education Index for Nepal was 0.521 in 2019. This relatively low value is driven by persistently low access to education, which is particularly problematical in rural areas, where the majority of Nepalis still live. Nepal's last national census (2011) identified the country's literacy rate to be 65.9%. Among men the literacy rate is 75.1%, while among women the literacy rate is 57.4%. This data is somewhat misleading, however, particularly because the literacy rate among 15- to 24-year-olds in Nepal is 84.8%, with that rate being 89.9% among men and 80.2% among women.

To combat low literacy rates and poor educational attainment more generally, the government has been engaged in reforms designed to make both public and private education more flexible and responsive to citizen needs. 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 significantly improved between 2013 and 2015. In light of this, the literacy rate, particularly among 15- to 24-year-olds, should be higher for the 2021 census, which remains on track to be published despite the COVID-19 pandemic.

As part of Nepal's education reform efforts, the country has 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 (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 previous years, overall exam pass rates were often below 50%. In 2020, the exam was canceled due to the COVID-19 pandemic and students were instead graded on their in-class performance. Thus, it is still too early to tell whether this reform has been successful.

There are other reforms in higher education that are underway, but implementation has been slow. In addition, underfunding remains a problem: 10.19% of overall public spending was allocated to education in 2018, representing 5.1% of GDP. 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 remains insignificant, 0.3% of GDP as of 2010, and it will be some time before Nepal has a thriving R&D sector.

Education policy /  
R&D

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## Governance

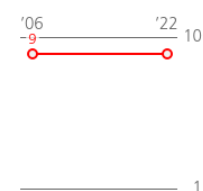
### I. Level of Difficulty

Political leaders in Nepal continue to face significant structural constraints to achieving good governance goals. Highly unfavorable conditions for economic and political transformation include a low level of economic and social development; a population with relatively low, though improving, educational attainment; the geographical disadvantages of a landlocked and relatively resource-poor state; and a strengthening, but still fairly weak state. Nepal's environment is prone to the effects of natural disasters, as evidenced by the devastating 2015 earthquakes, the landslides that destroy the country's infrastructure every monsoon season and man-made ecological degradation. The country's terrain is challenging to navigate, but the state is starting to meaningfully move away from its historical centralization in Kathmandu. With federalism, policymakers are learning to assess citizen aspirations and needs more effectively, and to start to meet them. Still, poverty remains rampant and educational resources scarce in many parts of the country. Meanwhile, rapid urbanization and the ongoing brain drain (nearly a quarter of the country's workforce is employed outside of Nepal) also present unique policy challenges, though the COVID-19 pandemic has reversed the latter trend and brought many expat Nepalis home. The political leadership has been instrumental in Nepal's governance problems. For example, their focus on ensuring their political and material success has contributed to the current governance challenges by drawing attention and resources away from much-needed improvements to infrastructure.

Nepal has long been a major recipient of official development assistance and governance is supported, sometimes to the long-term detriment of state strength, by a host of international and national NGOs. Spaces for civic participation are relatively open in Nepal and this has contributed to the emergence of a variety of indigenous civil society movements. Many forms of engagement center around very specific 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 this 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

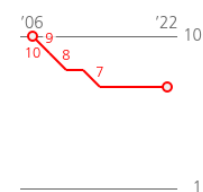
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Civil society traditions

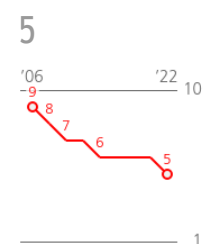
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Political elites have instrumentally used polarization techniques to create cleavages along ethnic and regional lines. While scaremongering among national media outlets often fans the flames, politics has been relatively sedate since the Terai protests in 2015, and the free and fair national and local level elections in 2017. Other problems exist, however. For example, minority ethnolinguistic groups remain dissatisfied and, while outright violence is rare these days, confrontations between cadres of different political parties, as well as between members of different social groups mobilized around identity-based platforms, sometimes threaten stable, peaceful governance, as was evidenced at the end of 2020 by the spillover of tensions within the NCP into the public sphere. Nepal's new institutional framework, and federalism in particular, is managing these risks better than previous institutional frameworks, but tensions remain. The state is also developing its own capacity during the COVID-19 pandemic and Nepal should emerge on the other side of the pandemic in a better position, which is not true for many other countries.

#### Conflict intensity



## II. Governance Performance

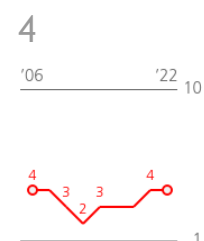
### 14 | Steering Capability

Though the structural constraints on governance in Nepal are high, the political leadership's low steering capability underlie the difficulty Nepal has had pursuing a development agenda. Programmatic politics play a relatively minor role in Nepal's policymaking process. The heterogeneous character of multiparty coalition governments before 2004, between 2006 and 2012, and again since January 2014 make it extremely difficult, even for determined policymakers, to set strategic, long-term priorities. Although majority government has been in place since the merger of the major communist parties following the 2017 election, important policy decisions are frequently subject to fierce distributional battles between different ministries, at both political and administrative levels. Once 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. The urgency and gravity of the COVID-19 pandemic has, however, brought focus to Nepal's political leadership and, in so doing, the Nepali state appears to be strengthening capacity as it deals with the present adversity.

The 2016 coalition government of Prime Minister Dahal (CPN-M) 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 Deuba (Nepali Congress), as agreed upon in advance, the government continued to execute on these priorities. The same was true of the Oli government that came to power after

#### Question Score

#### Prioritization

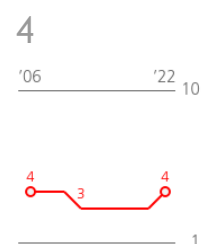


the 2017 elections. But with so many significant tasks on the national-level agenda, policy was often neglected. The segmentation of the cabinet along party lines caused coordination problems between different ministries; weak prime ministerial leadership was also associated with limited control over ministries. In addition, there were few internal regulatory impact assessments (though NGOs regularly provide guidance) and no strategic planning unit, which contributed to a very low strategic capacity of the government to prioritize and organize its policy measures. On the positive side, with the political struggle over the character of the Nepali state settled, at least in the medium term, the political cover for lack of attention to administrative reforms and long-deferred governance tasks disappeared. The COVID-19 pandemic, which has provided the impetus for increased state capacity in Nepal, has also distracted attention away from basic state responsibilities, such as infrastructure repairs, education and policing.

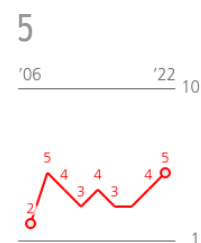
With regard to the steering capabilities of Nepal's governments, the crucial bottleneck lies less in the drafting of good policies than in the government's struggle to implement them. Successive governments have, over the last decades, instituted countless industrial growth, investment and trade promotion 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 implementation of the National Reconstruction Authority and the continued struggle to bring relief to millions of earthquake victims across the country. More recently, the government has demonstrated slightly greater capacity in its response to the COVID-19 pandemic, in that it has distributed some aid (e.g., food stuffs and soap), even in remote rural areas. While a government that gains ground in implementing disaster relief will not necessarily have steering capacity on other issues, Nepal's progress on this one issue is important.

The government in power during the review period has not been particularly effective in terms of implementing policies, although some learning has occurred. Federalism is taking root and its implementation in Nepal is forcing parties to innovate beyond the electoral arena. The distribution of resources closer to the ground is encouraging governing parties and those who seek to govern to tailor policy to local needs. To date, many of these policies have been colored by ethnic politics, but the experimental aspects of federalism may eventually drive innovation at the national level and lead to improvements in steering capacity. District coordination institutions have been established to improve policy coordination across levels of government. The COVID-19 pandemic, if anything, is accelerating the learning process.

#### Implementation



#### Policy learning



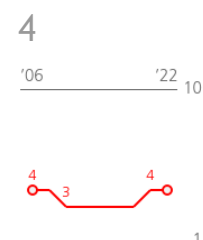
## 15 | Resource Efficiency

Though many recent governments, including the Congress-led government from 2014 to 2015 and the UML-led government (2015 – 2016) failed to efficiently use available economic and human resources for their economic and social policies, the current government has done slightly better, particularly during the COVID-19 pandemic. One significant positive step, which started under the Maoist-Congress coalition government, was the reduction in electricity outages. While Nepal often faced 16-hour per day electricity outages earlier in the decade, load-shedding had been dramatically reduced by 2020. In contrast, however, government management of the Melamchi pipeline, a project that has been ongoing for 20 years and cost far more than anticipated, has not been as efficient or effective. During the COVID-19 crisis, however, the Nepali government has effectively marshaled the resources it has, acquired additional resources and provided a reasonably effective response to the pandemic.

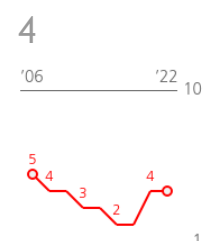
Development aid from India, China and the West, alongside earthquake reconstruction funds and now COVID-19 relief funds, play an important role in Nepal's budget. While the monitoring of these funds is insufficient, it has improved to some degree, with civil society acting as watchdog. While Nepal's administrative and civil service remain underfunded and understaffed, other major administrative problems include fragmented decision-making processes, and the opaque and politicized system of appointments and promotions. Problems in timely spending also contribute to serious delays and waste resources on infrastructure projects and beyond, though the government has moved relatively quickly during the COVID-19 pandemic.

The current NCP 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 type of candidates they recruit and voters they aim to attract. A single political party may be associated with conflicting interests and policy objectives; 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. Policy coordination under such circumstances is challenging. COVID-19 has added to these challenges, but it is also providing opportunities for long-term growth.

Efficient use of assets



Policy coordination





Corruption and poor use of public resources are the norm in Nepal, but investigating allegations is also becoming normal. Though regulations and bodies that exist to ensure transparency have largely proven to be ineffective to date, this is starting to change. The CIAA, which had been plagued by understaffing and controversy, has made progress over the last two years in that it is now actively conducting investigations. While it is too early to evaluate the CIAA's performance in depth, especially as little data exists regarding its functioning, public reporting on its activities suggests that it may become a formidable institution in time. To make meaningful progress, however, it will require far more resources and the widespread support of the Nepali people.

In addition, the auditing of state spending, the public procurement system, conflict of interest rules, asset declarations and campaign financing remains weak. The Office of the Auditor-General does occasionally report on errant state spending, as it did in 2020 with respect to non-competitive bidding processes, but corruption often takes a different character in Nepal and auditing fails to catch a large proportion of it.

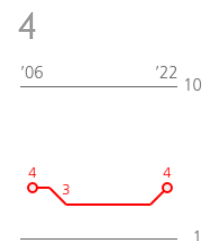
Corruption among government officials concerning the distribution of permits and approvals, the procurement of goods and services, and the award of contracts continues to be a problem. Even the response to COVID-19 was hampered by corruption allegations regarding the supply of medical equipment and the awarding of a contract to the military. For those who lack high-level connections, bribes remain a common way to access public services or accomplish even ordinary activities, such as 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. Federalism is starting to drive resources into rural areas, but progress has been slow.

## 16 | Consensus-Building

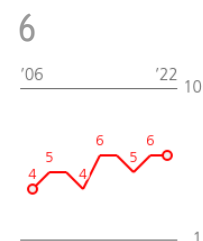
Nepal's 125 ethnic groups, 127 spoken languages, myriad caste and jati groups, and varied ecosystems present a distinct challenge to political consensus. Fortunately, Nepal's political parties have a long history of support for democracy that extends back well before the democratization process started 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 Maoist-Congress coalition government, which was at the helm at time of the 2017 elections, was a coalition of parties that were previously on opposite sides of an armed conflict, suggesting that support for peace and for democracy are strong in Nepal.

Further, the NPC has surprised critics with the degree to which it is willing to operate within a market economy. Though Maoist ideology demands socialist revolution, many cadres and party supporters alike continue to understand this to mean better and more equal provision of public goods such as education and health care.

### Anti-corruption policy



### Consensus on goals



Despite its long history of protest movements, there is a pro-democratic consensus among almost all major political actors. Federalism, as it has been implemented, has lessened the abilities of single actors to concentrate power. Even those aspects of the state that are not subject to democratic processes, such as the Nepal Armed Forces, do not present a major threat to the pro-democratic consensus.

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. Parties that advocate for a revival of the constitutional monarchy are, at this point, to be considered as being on the fringe. 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. While Nepal does have a long history of politics being played out in the streets rather than through institutional mechanisms, the frequency and tenor of protests has changed 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.

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 engage in identity politics. Once ignored because of presumed cultural homogeneity during the monarchy, identity-based political mobilization 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.

However, identity politics in Nepal has succeeded in bringing a more inclusive range of voices into politics and decreasing discrimination on the basis of caste and ethnicity. Its new federal structures offer the opportunity for the more equitable sharing of resources, and the increasingly multiethnic nature of the major political parties bodes well for the future management of caste and ethnic cleavages.

The political leadership has become less repressive, and NGO and civil society activities have increased over the last decade, though the government is rarely systematic in its support for civil society. Put differently, in the absence of systematic attempts by political leadership to hamper civil society, it is, for the most part, flourishing. Advocacy on behalf of women's rights, and cultural and religious minorities has been particularly pronounced and occasionally successful.

For example, following the 2017 local elections, women hold 41% of elected positions in local councils and ward committees; many of them were first-time candidates. 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. Shiva Maya Tumbahamphe, a female candidate, was elected as deputy speaker of the House of Representatives in 2018; she vacated her position in January 2020.

Anti-democratic actors

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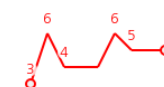


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Cleavage / conflict management

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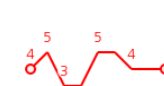


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Civil society participation

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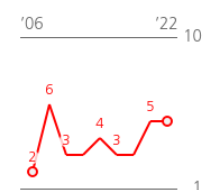
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However, as a result of this identity-based activism, many citizens see civil society as being dominated by the same identity cleavages they see in the political arena. This is in part because organizations often attract members along party lines. 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, civil society associations and non-governmental organizations are sometimes 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. Federalism and political party rules that require inclusive candidate lists are starting to change these dynamics. When public goods are distributed at the local level, the relevant political actors and identity-based groups are different, and there is more knowledge about them. Attempts to involve civil society actors in the COVID-19 response have been limited, but also relatively effective. These efforts represent one of a small but growing number of attempts in recent years by the country's political leadership to systematically include civil society in governance.

In addition to identity-based tensions, the class-based tensions that drove rural support for the Maoists during the conflict persist. Nepal has experienced an extreme form of rural-urban divide over the last 20 to 30 years, with few working-age men remaining in rural areas due to urbanization and emigration. 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 more aware of their relative deprivation, particularly in comparison to their urban counterparts. Federalism is starting to improve the provision of public goods in rural areas, but this has not been achieved equally across all states. While some of the grievances that led to the conflict have been addressed, others raised during the conflict have not. There has been almost no progress on truth and reconciliation. Perpetrators of abuses during the conflict remain at large and victims' concerns remain unaddressed.

#### Reconciliation

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## 17 | International Cooperation

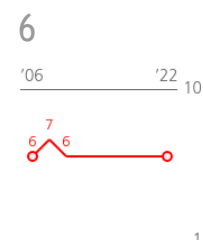
Nepal has a long history of working with international partners. Although this partnership has yielded some results, especially in the areas of education, health, drinking water, telecommunications, road construction, power generation, and environmental conservation, the levels of aid Nepal has accepted in the past, both in terms of funds and know-how, are significant enough that they may be undermining state capacity. While the Nepali state struggled with post-earthquake reconstruction, its response to the COVID-19 pandemic suggests increased state capacity and a more productive relationship with the international community.

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. After the civil war, funding has focused on good governance, peace-building, and technical support to the Electoral Commission and the 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. While withholding aid entirely is not the answer, 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 are clearly problematic.

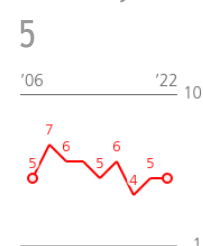
Historically, Nepali governments have cooperated relatively well with international donors and agencies. However, this has been part of the problem. Donors and international financial institutions – and, implicitly, their backers – continue to exert significant policy influence in Nepal. Both during and after the conflict, international assistance has rarely been driven by conditions on the ground in Nepal and by the demands of ordinary Nepalis. The Nepali state, for its part, has almost never turned down assistance. While, in the past, this dependence has skewed domestic politics and likely resulted in the persistent weakness of state capacity, with little or no evidence of economic impact, the governmental response to the COVID-19 pandemic suggests that changes are occurring. Recent Nepali governments, with the legitimacy that comes with democratic elections, have proven better at ensuring aid responds to domestically articulated demands.

In terms of bilateral cooperation, Western governments (the United States, United Kingdom and European Union) have become disillusioned by the Nepali government's inability to use funds and implement agreed upon programs. The

Effective use of support



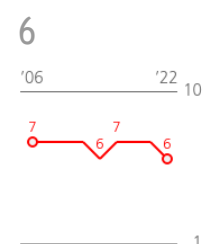
Credibility



Nepali government's delay in administering earthquake relief funds is just one high-profile example of this, though it is seemingly doing better with COVID-19 relief funds. Still, some local and international critics have suggested that donors should withhold aid in order to compel Nepali political actors to perform better. While doing so will hurt ordinary Nepalis more than the government in the short term, it might cause Nepalis to demand better performance. But few are willing to proceed with such a high-risk strategy.

In terms of regional cooperation, Nepal's relationship with China is improving, while its relationship with India continues to gradually recover from its all-time low in 2015. The monarchy and Congress-led governments relied on financial and other support from India, while Maoist-led governments have put more emphasis on improving cooperation with China and increasing economic support from Beijing. With its pivoting back and forth between India and China, Nepal has seemingly adopted a policy of playing these two regional powers off against one another. This policy has recently come under strain following border disputes with both China and India. Nepal remains caught between these two major regional powers and is largely unable to defend itself. After a decline in economic cooperation with India, which resulted in greater economic cooperation with China, Nepal is once again cooperating with India.

Regional cooperation



## Strategic Outlook

Having sustained progress during 2019 and 2020, even in the midst of the COVID-19 pandemic, Nepal appears to have turned a corner and moved away from an especially troubled period in its history. In January 2020, Nepal held national-level elections to replace legislators who were retiring as their term limits had been reached. The fact that these elections were conducted without a hitch is telling.

In December 2020, the House of Representatives was dissolved. After the Supreme Court had reinstated the chamber, it was dissolved again in May 2021. Elections are scheduled for November 2021, which most believe will go ahead as planned – which would be a remarkable achievement given Nepal’s history. Nepal must be careful, however, to consolidate recent political gains. Few Nepalis, regardless of political affiliation, would like to return to open political conflict. Yet, governing political parties have struggled to articulate and then implement clear policy agendas. Identity-based political agendas often dominate. When politically relevant groups do not see the gains they were hoping for, they renew their political demands. Political parties, both inside and outside of government must be vigilant about funneling discontent into institutionalized channels rather than questioning those institutions. Federalism, which was widely debated before Nepal’s move away from its unitary-state status, is still being implemented. It will take time to see the associated gains. If political actors mobilize against federalism, recent progress may be lost. If, however, they focus on further implementation, and improving policy and governance processes, Nepal may finally exit its long period of instability.

Out of necessity, Nepal must also deal with the fallout from and aftermath of the pandemic. While the COVID-19 pandemic has certainly presented Nepal with a panoply of problems, it has also presented a whole host of opportunities. Nepal, with its young population, has been spared the worst of the pandemic, despite its weak public health care infrastructure. Nepal’s government has handled the pandemic better than many would have anticipated, rising to the occasion and building state capacity in the process, including the capacity of provincial and local governments. Going forward, Nepal should build on these successes by continuing to strengthen its federal setup, and decentralize power and resources, while taking advantage of another unexpected boon of the pandemic era: the return of many young, skilled and talented Nepalis from abroad. As economies shut down, Nepal’s expatriate workers returned. At present, the return of Nepal’s expat population, which previously supported Nepal’s remittance-based economy, is widely viewed as a problem and significant focus has been directed toward encouraging these workers to once again emigrate as quickly as possible. This would be a waste, however. Many of these Nepalis have the desire and necessary skills to give back to Nepal, if their talents can be properly marshaled. Nepal would do well to capitalize on this reverse brain drain and facilitate their inclusion into the Nepali economy. The state could take a more active role in this by providing opportunities to those who want to work, and getting out of the way of entrepreneurs, and those with their own ideas about what to do and how to do it. If the state can achieve this, many may look back on the pandemic as a turning point in Nepali history.

As the report makes clear, governance in Nepal remains problematic, even though the pandemic has provided some impetus for improvement. Political and economic gains remain, but progress is fragile. If Nepal is able to continue to strengthen its federal system, complete the next round of elections and take advantage of the opportunities presented by the pandemic, it will be in a very different position in five years' time.