THE STATE OF FEDERALISM IN NEPAL

AN ASSESSMENT

AUGUST 2022

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The Center for Governance and Markets is a hub of a global network of researchers and practitioners in the areas of governance and institutional analysis. It creates space for scholars to explore and exchange diverse ideas and produce rigorous research on the impact of governance institutions, markets, and technology on peaceful coexistence, freedom, and well-being around the world. Its mission is to understand, from a perspective of pluralism and intellectual diversity, the institutions and governance arrangements that affect social order and human well-being and to generate knowledge of the ways in which individuals and communities overcome challenges to living free, prosperous, and peaceful lives.

The Center for International Private Enterprise (CIPE) is an NGO working at the intersection of democracy, governance, and economic development. CIPE has nearly 40 years of experience designing, implementing, and evaluating projects worldwide that strengthen democratic governance, combat corruption, empower marginalized populations, and open space in closed political systems. CIPE is a core institute of the U. S. National Endowment for Democracy and a non-profit affiliate of the U.S. Chamber of Commerce and currently has more than 200 projects and grants with local partners in over 80 countries. Learn more about CIPE's work in Nepal and elsewhere at cipe.org.

EXECUTIVE SUMMARY

BACKGROUND

The fragile history of constitutions in Nepal must be taken into consideration when assessing the stability and promise of any constitutional order. Nepal's current federal constitution is an experiment in post conflict reconciliation. Adopted in 2015, it came into being after decades of political violence and instability. It is the seventh constitution adopted in Nepal since 1948. This trend means that the shelf life of constitutions there is very short. Given this history, citizens might not expect this constitution to be in place for a very long time.

Ethno-federalism emerged as a political solution in Nepal after more than 13,000 people were killed during a decade-long civil conflict from 1996-2006. Nepal is a diverse society, with more than 100 languages and dialects spoken. The country also has a long-standing state-enforced caste hierarchy. The Maoist Party, formally the Communist Party of Nepal (Maoist Center), played a significant role in introducing federalism to Nepal, but other major political parties also supported it.

The adoption of a federal constitution in Nepal has not been without geopolitical consequences. India's inhospitable response to the promulgation of the federal constitution in 2015 and the rising dominance of major communist parties in Nepal have revitalized Sino-Nepali relations, including Nepal's signing onto China's Belt and Road Initiative in 2017.

STATE OF FEDERALISM

An increasing proportion of Nepalis are confident that the country is heading toward federalism. According to *A Survey of the Nepali People in 2020 (SoNP)*, 65.6% of Nepalis believe that the country is transitioning toward federalism and greater political stability. In 2017, only 52.9% believed that to be the case. This change appears to be due to rapid development of infrastructure such as roads as well as improved access to electricity, health services, and education. A comparison of survey data from 2018 to 2020 shows that people view all three levels of governments (local, provincial, and federal) as becoming more responsive to their needs.

The coronavirus pandemic may have been a defining challenge to Nepal's nascent federal system. The pandemic posed governance challenges across all three levels of government. The Nepali legislature has yet to draft updated infectious-disease laws compatible with federalism. Thus, the federal government has largely ignored subnational governments' needs in its decision-making. Instead of working with local governments, federal authorities have issued directives that local governments have had to comply with to receive any financial and administrative assistance.

Despite the lack of meaningful assistance by central and provincial authorities, many local governments took innovative approaches to respond to pandemic challenges. Various news reports and academic studies indicate that local governments fared better than both provincial and federal governments in handling the pandemic. Instead of waiting for promised help from federal and provincial authorities, local governments raised funds to purchase their own testing kits, used local resources to produce masks, and printed pamphlets and brochures to raise awareness.

At this early stage in the development of federalism in Nepal, it is not possible to link economic indicators to changes in political systems, including the transition to a federal system. This is so for two reasons. First, it is difficult to empirically identify the causal effect of federalism on any economic outcomes in Nepal. For example, many events in 2015, including the 7.8-magnitude earthquake, had profound economic effects, making it impossible to isolate the effects of federalism. Second, even if we were able to find an empirical strategy that would allow us to tease out the effects, it has only been six years since the institutional change, which is not enough time to assess the country's long-term trajectory.

ACHIEVEMENTS

Inclusivity and pluralism

Nepal has come a long way toward greater inclusivity. The federal constitution of 2015 carved out a clear legislative path to a more egalitarian and pluralistic society and has accelerated the process of equalizing political and economic access for all castes, ethnicities, and genders. Notwithstanding many pending ethnic issues, Nepal has made significant progress in reconciling with its discriminatory past. Data show that political representation of women (32.7%), Madhesis (17.1%), and Dalits (6.9%) has increased dramatically since Nepal's first experiment with democracy in 1991.

Local elections

In May 2017, Nepal held local elections for the first time in two decades and elicited 74% voter turnout. A total of 36,639 representatives were elected in 753 local units. The election marked an end to central-government-appointed officials' formal control of local governments. Of the elected local representatives, 41% (14,352) were women. Despite rampant fears of vote stealing prior to the elections, they turned out to be overwhelmingly free and fair. Nepal held its second local level elections on May 13, 2022. Nepali citizens voted for representatives **in 6 metropolitan cities, 11 sub-metropolitan cities, 276 municipalities, and 460 rural municipalities,** to fill 35,221 local legislative and executive seats. The voter turn-out decreased to about 64% in 2022 from **74%** in the 2017 local elections. **41.21%** women representatives were elected this time, which is only slightly higher than the share of women representatives elected in 2017 (**40.96%).** Minimal incidents of election related violence were reported in the run up to the local elections, but **a relatively higher number of violent incidents** occurred across the country on the election day. Nonetheless the 2022 local level elections were viewed as relatively **free and fair**. Moreover, the timely selection of public officials in a fair manner represents an achievement and an important step closer to consolidating the federal system in Nepal.

Trust in local government

Data from SoNP also reveal that citizens have high trust in their local governments: 82% of the survey respondents noted that they trust their municipal or rural-municipal council. The numbers vary for different types of elected representatives, but only slightly: 73% trust their elected ward chair, 69% trust their mayors and rural-municipal chairs, 69% trust their representatives in ward citizen forums, and 70% trust their local political leaders. These solid-but-not-outstanding numbers indicate that people are cautiously optimistic about their elected representatives.

Devolution of authority

The federal government has passed substantial legislation that enables and empowers local governments. The passage of the Local Government Operation Act of 2017 was a major milestone in the devolution of authority because it provided a federal legal framework to operationalize the constitutional mandate at the local level. The Act outlines functions, powers, roles, and responsibilities of local representatives and enables them to implement programs and policies based on local needs. The federal parliament also passed the Inter-governmental Fiscal Management Act the same year, which provided further clarity regarding the

collection, sharing, and distribution of revenues among different tiers of government. It specifies types of grants to be distributed by the federal government to provincial and local governments, thus providing subnational governments with predictable revenue streams for supporting long-term local development projects.

Local accountability

Local elections and decentralization have produced mixed results for local government accountability. On one hand, devolution of authority to local governments has led to increased accountability. Decentralization has shifted the responsibility of carrying out economic development projects from federal bureaucrats to local elected representatives. As a result, citizens, community-based organizations, and local media are better able to monitor local economic activities. On the other hand, it has also brought issues of corruption far closer to home than they were before because local governments now have far greater authority than they had in the past. Local projects have brought new accountability challenges. Many local governments lack the human resources and technical capacity to publish information on their income and expenditure and lack formal mechanisms to monitor and address public corruption.

Local economic development

The Local Governmental Operation Act of 2017 ceded responsibilities and rights to various sectors of the economy over to local governments. To support local development, the share of the national budget allocated to local governments also increased substantially. In 2017/18, the share was 17.6%, compared to roughly 5% before 2015. Moreover, across all provinces, the share of the national budget allocated to local governments has increased since 2017. This increase has led to rapid infrastructural development at the local level. Optimism regarding private sector investment has also increased (Giri, Pyakurel, & Pandey, 2021).

Business development

Federalism has increased business prospects and opportunities in rural municipalities. Although some regulatory barriers owing to jurisdictional ambiguities persist, there are constitutional provisions in place to encourage the private sector. Over the next several years, legal clarification may help to remove these ambiguities.

CHALLENGES

Bureaucratic challenges

There is a dire need to reform the Nepali bureaucracy to make it compatible with the federal system and more accountable to public needs. While some training and capacity building may be helpful, fundamental transformation must begin by abandoning the traditional unitary bureaucratic structure chiefly accountable to a single ruler. Despite several reform attempts, the Nepali bureaucratic structure retains its hierarchical and rent-seeking character. Implementing any programs and policies, however small, entails incurring prohibitive transaction costs and requires a series of approvals at various levels. From the standpoint of development planning and policy implementation, the Nepali bureaucracy is highly inefficient.

Civil service

The Nepali bureaucracy is struggling to attract and retain qualified employees. Besides the exogeneous pressure posed by labor market competition, the Nepali bureaucracy faces an even bigger problem: it needs fundamental reforms to meet the challenges of the new federal system of governance. This entails transforming its opaque, vertical structure to a more horizontal system with checks and balances at the local level. Clear channels of accountability must be put in place. This may mean shrinking the federal bureaucracy and increasing the bureaucratic capacity of provincial and local governments. This can be achieved in part by transferring federal employees to provincial and local governments.

Centralized nature of political parties

Nepali political parties play an important role in patronage and nepotism. All leading parties—notably the Nepali Congress Party, Communist Party of Nepal (Unified Marxist-Leninist) (CPN-UML), and Communist Party of Nepal (Maoist Centre)—have centralist characteristics. Top party leaders tend to hold onto their positions for life. Since the signing of the 12-point understanding between the seven mainstream political parties and the Maoists in 2005, major political parties have engendered an undemocratic practice of resolving interparty disputes in closed sessions rather than through open political processes and contestation.

Political parties and federalism

The transition to federalism has forced major parties to restructure to become more inclusive. High-caste, hill-origin men continue to control central positions in all parties, but Dalits, Janajatis, Madhesis, and women have been increasingly represented at the subnational levels. Although the political parties, at least in rhetoric, want to decentralize, their central leadership is reluctant to reform party structures. Central leaders fear that party decentralization may mean that they can no longer exercise full control over local and provincial politics.

Jurisdictional ambiguities

In the absence of historical or legal precedents of formal self-governance, both local and provincial governments are facing immense technical difficulties in drafting new laws consistent with the spirit of the federal constitution. In many areas of governance, provinces and local bodies must rely on prevailing federal laws with centralist tendencies. Moreover, bureaucrats and law enforcement officials at all levels still draw their salaries from the federal government and are thus not fully accountable to local and provincial elected bodies. This has led to legal ambiguities and implementation challenges in the areas of resource distribution, public administration, and employee integration.

Ethnic challenges

Ethnic frictions will remain an arduous challenge in transitioning to a federal Nepal because many factors that led to those tensions in the past have not been addressed. Although the federal constitution makes explicit provisions for broader inclusion of different castes and ethnic groups, high-caste, hill-origin elites continue to wield substantial political power and occupy a disproportionate number of positions in bureaucracies, elected government, the police, and the military. Moreover, many Madhesis and Adivasi Janajatis (indigenous nationalities) fear that without complete autonomy, the state will continue to erode their cultures and languages and to usurp their individual and communal property rights.

Accountability challenges

The transition from a unitary system of governance to federalism has generated new accountability challenges. At all levels of government, there is a lack of a clear legal framework to assess the fiscal state of public programs. Lack of adequate formal accountability mechanisms is a major challenge, as is noncompliance with existing mechanisms.

Resource limitations

The creation of new tiers of independent government at the local and provincial levels has generated a need to expand the civil service, which requires hiring essential staff and building new offices. Many provinces have had to establish new departments and offices to fulfill their constitutionally mandated roles. The lack of office space is especially dire at the local governmental level. This has proved to be a major barrier to devolution of power. In many instances, several ward offices are operating from a single room. In others, local governmental activities are being conducted from district headquarters.

Technical capacity

Despite constitutional guarantees and legal provisions to plan and implement programs at the local level, most local governments still lack the technical and fiscal capability to manage their own budgets. According to existing fiscal laws, local governments ought to present their budgets to their local assemblies by the third week of June. However, in the fiscal year 2020/21, 23% of local governments were unable to do so.

Geopolitical challenges

Although Nepal and India share deep ties, their relations have always been contentious. India has intervened frequently in Nepal's politics and has played a prominent role in Nepal's political evolution. India's desire to micromanage Nepali politics was most apparent in 2015, when it imposed an unofficial blockade on Nepal in response to the promulgation of the federal constitution. The blockade severely hurt Nepal–India relations and pushed Nepal closer to China. In response to pleas by CPN-UML and CPN (Maoist Center) leaders, China has committed to financing various infrastructural projects and expanding Sino-Nepali trade volume. Nepali leaders must navigate these geopolitical tensions carefully. Although politicians may find anti-India rhetoric useful to gain local support, Nepal cannot afford to jeopardize trade relations with India. At the same time, China's interests in the region are also evolving, and its territorial ambitions have been expanding.

RECOMMENDATIONS

- Some international organizations are focused on federalism in part because it has the potential to deliver public goods and services more effectively, and most narratives about federalism treat service-delivery outcomes and citizen perceptions of them as the most important metrics. Yet Nepal selected a federal constitution not only to improve in these respects but to ameliorate deep ethnic divides. And while federalism might not be effective in improving service-delivery outcomes in the short term, it has already been successful in addressing ethnic and social tensions. It is important for international organizations to stress both the successes and the challenges in ameliorating social tensions.

- Nepali think tanks at the center and subnational level noted that, in general, donors working on federalism issues have focused on developing national-level frameworks. But it is important to also support local organizations and initiatives, as many local governments and provinces remain institutionally weak. International organizations can support such entities in at least a couple of ways:
  - Generate institutional knowledge and capacity, especially at the provincial and local levels. CIPE's support to provincial policy think tanks is a great example in this line of work
  - Help clarify the roles of authorities at different levels of government to avoid the conflict resulting from overlapping jurisdiction. Conversations and engagements with local organizations based at the subnational level may be beneficial to support this effort.

- Jurisdictional ambiguities and resulting tensions are major impediments to implementing federal ism. Local organizations active in this field should document these impediments on electronic platforms. They can take inspiration from the Samriddhi Foundation's Legislative Repository.

- Provinces often do not prepare their budgets on time, and they face budget-execution problems. CIPE programming can help provinces meet these challenges and in turn allow them to better plead with the national government to address their needs.

- Caste and ethnic tensions underlie all major political issues in Nepal, but donor organizations tend to avoid addressing them. These tensions affect commerce and the way citizens and businesses engage with government. International organizations can work with local partners to find solutions that are sensitive to local contexts, especially outside of Kathmandu, where the tensions are different.

INTRODUCTION

This report has two main purposes: first, to thoroughly examine how well federalism has been implemented in Nepal, how much federalism reforms have improved Nepal's governance, and what directions federalism might take in the future; second, to evaluate the Center for International Private Enterprise's (CIPE's) and other stakeholders' work in supporting Nepal's ongoing governance reform and to conduct an analysis to inform CIPE's future strategy in and engagement with Nepal.

This report covers the most important aspects of federalism in Nepal, including its current state and future trajectory, costs and benefits, and (in)effectiveness in curbing corruption and addressing challenges in governance and public service delivery. This report is unique because it draws heavily on the perspectives of stakeholders: those participating in and supporting federal reforms in Nepal, those objecting to the reforms, and analysts examining the impact of the reforms. Thus, we draw on state and non-state actors involved in implementing and analyzing these critical reforms throughout this report.

Although this report focuses primarily on domestic determinants of the state of federalism in Nepal, it also pays some attention to foreign influences on domestic political and economic dynamics. This angle is vital because Nepal is a small, landlocked country, which makes it heavily dependent on its much larger neighbors, India and China, for trade and resources, among many other things.

Given Nepal's short journey toward federalism since the promulgation of the new constitution in 2015, the boundaries of state powers are still not clearly delineated between the federal, provincial, and local governments, and tensions among the three have increased with the ongoing subnational governance reform.

POLITICAL, ECONOMIC, AND SOCIAL BASIS OF FEDERALISM IN NEPAL

BRIEF HISTORY OF FEDERALISM IN NEPAL

Nepal's first constitution was Baidhanik Kanun (Constitutional Law), which was promulgated by Prime Minister Padma Shamsher Rana in 1948 during the final years of the century-long autocratic Rana regime. Baidhanik Kanun gave minimal rights to the people to placate rising anti-Rana sentiments and a bubbling pro-democracy movement led by the Nepali Congress Party. The constitution promised some inclusivity in governance institutions, but this element led to strong opposition from the Rana oligarchy, thus thwarting Padma Shamsher's efforts to institute constitutionally required reforms (Mahat, 2020).

The second constitution—the Interim Constitution of 1951— was established in 1951 by King Tribhuwan after the popular uprising of 1951 ended the Rana regime and restored political power to the king. It introduced some democratic reforms but did not sufficiently constrain the monarch. The third constitution, the Constitution of the Kingdom of Nepal, 1959, was promulgated eight years later by King Mahendra, Tribhuwan's eldest son and successor. The 1959 constitution introduced a pluralistic parliamentary democracy, but the king retained constitutional authority to dissolve the parliament at will. Mahendra exercised that authority in 1962 and promulgated the fourth constitution, which established the partyless Panchayat system. The system permitted limited democracy at the local level but banned political parties.

People took to the streets again in 1990. The uprising (Jana Aandolan I) upended the Panchayat constitution. King Birendra, Mahendra's successor, subsequently promulgated the fifth constitution, the Constitution of the Kingdom of Nepal, 1990, which introduced a constitutional monarchy and democratized the country with a multi-party parliamentary system. In the first half of the 1990s, the first elected government, led by Prime Minister Girija Prasad Koirala, spearheaded waves of liberal reforms that emphasized macroeconomic stability, gross domestic product (GDP) growth, private sector empowerment, and nongovernmental-sector mobilization.

The Koirala government committed itself to "dismantling the overbearing regulatory edifice of the past" (Mahat, 2020; p. 34). Major economic reforms included terminating import quotas, decreasing excise taxes, allowing commercial banks and private individuals to maintain foreign exchange accounts, and permitting foreign investment in domestic industries. Major infrastructural plans, including hydropower, agricultural, technological, and transportation development initiatives, were initiated. The economic and democratic reforms led to high economic growth (around 5% GDP growth rate per year in the early 1990s) and public optimism.

However, the reforms did not last long. In 1996, just six years after the reforms began, a splinter group of the Communist Party of Nepal (Unity Center) led by Pushpa Kamal Dahal formed the Nepal Communist Party (Maoist) and announced "the people's war," an armed struggle that would last a decade and claim over 13,000 lives (Whelpton, 2005; Jha, 2014; Mahat 2020). Political instability and a severe deterioration of state capacity defined the subsequent two decades. After the gruesome Royal Massacre in 2001, King Gyanendra became the regent and was thereafter crowned the new king. In 2002, Gyanendra dismissed Prime Minister Sher Bahadur Deuba and assumed full executive authority but was forced to reappoint Deuba in 2004 following pressure from major political parties. In 2005, Gyanendra dismissed Deuba again and declared a state of emergency, citing Deuba's reluctance to hold parliamentary elections

and his inability to deal with the Maoists' violent insurgency (Jha, 2014).

Gyanendra's hostility to all political parties brought the mainstream political parties closer to the Communist Party of Nepal (Maoist). Leaders of the seven major parties met with Nepali Maoist leaders in New Delhi in 2005 and signed a 12-point understanding to seek "permanent peace" and "full democracy." Hoping for the same things, people once again took to the streets. The massive public uprising of 2006 (Jana Aandolan II) forced King Gyanendra to renounce political power and restore the House of Representatives in April 2006. The House of Representatives chose Girija Prasad Koirala of the Nepali Congress Party as the new prime minister. The restored House of Representatives formally suspended all of the king's political and military powers. In November 2006, the Koirala government signed the Comprehensive Peace Agreement with the Communist Party of Nepal (Maoist), thus formally ending the decade-long Maoist insurgency. An interim constitution (the sixth constitution of Nepal) was announced in 2007, which brought the Maoists into the formal political process. The Comprehensive Peace Agreement paved the way for Constituent Assembly elections for represen-tatives who would draft the seventh constitution.

Nepal held its first Constituent Assembly elections on April 10, 2008. The Communist Party of Nepal (Maoist) won the largest share of seats with 38%. On May 28, the First Constituent Assembly voted overwhelmingly to end the Shah dynasty's 239-year rule and declared Nepal a federal democratic republic. King Gyanendra was asked to vacate the royal palace within 15 days (Jha, 2014).

The First Constituent Assembly failed to draft a new constitution within its original term and even within the next four terms, owing to serious ideological disagreements between the major political parties. The assembly was dissolved on May 28, 2012 after the Supreme Court declared the date non-negotiable. After several postopnements, elections for the Second Constituent Assembly were finally held in November 2013. On September 20, 2015, the new assembly ratified the federal constitution of 2015, the seventh constitution of Nepal and the first one written by elected representatives.

CASTE, ETHNICITY, AND POLITICAL INSTABILITY

The astounding diversity of the Nepali population, including its multiplicity of languages and cultures, has fascinated linguists, anthropologists, and other scholars for centuries. More than 100 languages and dialects are spoken in Nepal.[1] However, this diversity has brought with it political challenges for every generation. Various Nepali rulers, such as Jayasthiti Malla and Junga Bahadur Rana, have attempted to reorganize Nepali society along hierarchical ethnic or caste lines. After Prithvi Narayan Shah's successful unification campaign, which brought various warring kingdoms and city-states together and led to the founding of modern Nepal, many politically autonomous groups, such as the Kirats of the East and the Newars of Kathmandu, were forced into the lower tiers of the Hindu caste-based hierarchy. Other ethnic groups, such as the Magars and Gurungs, that assisted Prithvi Narayan's campaign were rewarded with land and administrative positions (Toffin, 2014).

The first legal code in Nepal, the Muluki Ain of 1854, provided the legal basis for a caste-based division of labor and hierarchical organization of Nepali society (Regmi, 2001). The Muluki Ain classified all castes in Nepal into four categories: Tagadhari (castes wearing sacred threads), Matawali (alcohol- drinking castes), and touchable and untouchable "impure" castes.[2] Although the Muluki Ain stated that caste does not determine one's occupation, it legalized caste-based discrimination and allowed Tagadhari groups to assign occupations to castes. In addition, it established highly discriminatory caste-based rules governing marriage, social behavior, and food and non-food transactions (Cameron, 1998). Over a century later, the New Code of 1963 replaced the Muluki Ain and abolished the caste system. However, by then the old code had infused caste-based discrimination into every aspect of Nepal's culture, economy, and society.

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[1] In 2002, the House of Representatives officially recognized 59 ethnic minorities. Its classification lumps together many groups with supposedly similar languages and cultures.

[2] Although the Nepali and Indian caste systems share many features, they have distinct institutional legacies.

Long after the code's repeal, the formerly codified social behavior and caste-based hierarchy continue to shape private interactions and determine economic opportunities. When the Muluki Ain was ratified in 1854, Brahmins and Chhetris (the two Tagadhari castes) occupied 98% of the top civil-administration positions. By the mid-1990s, Tagadhari dominance had slipped by just 6 percentage points to 92% (Lawoti, 2007).

The institutional legacy of the state-enforced caste hierarchy remains to this day. Even after the democratic reforms of the 1990s, political power remained largely concentrated in the hands of Brahmins and Chhetris, particularly those from the hill areas of Nepal. Even Brahmins and Chhetris of Madhesi (non-hill) origin lacked proportional political representation. Despite some formal reforms after 1990, much of the countryside was governed by corrupt bureaucrats and semifeudal landlords of Brahmin and Chhetri origin. Thus, it should come as little surprise that Maoists rightly perceived that the conditions in the countryside of Nepal were "ripe for launching, building, and sustaining an armed struggle" (Onesto 2007, p. 120). In 1996, a small fraction of the Communist Party of Nepal (Unity Center) led by Pushpa Kamal Dahal ("Prachanda") launched a "people's war" —a guerrilla war based on Mao Zedong's theory of protracted warfare—with the goal of establishing a People's Democracy. As noted, the Maoist insurgency lasted for a decade and claimed over 13,000 lives. Much of the Maoists' initial success can be attributed to widespread support from the indigenous groups of western Nepal, particularly the Magars of the Rolpa and Rukum Districts, for their agenda of "breaking down of caste oppression and discrimination against minority nationalities" (Onesto 2007, p. 128).[3]

The Maoist insurgency brought an ethno-federalist agenda into the national political discourse.[4] The insurgency was fueled primarily by the "acute marginalization" of many castes and ethnic groups—such as Dalits (considered untouchables in the Hindu caste system), Janajatis (an indigenous nationality), and Madhesis (a nationality from the southern Terai plains)—and their desire for broader political participation (Thapa, 2014).[5] Although mainstream political parties, notably the Nepali Congress Party and Communist Party of Nepal (United Marxist Leninists), later adopted a federalist agenda, they hesitated to draw political boundaries along ethnic lines, citing the possibility of inciting ethnic tensions and evoking secessionist tendencies.

The Madhes movement, which followed the promulgation of the 2015 federal constitution, is yet another episode in a long series of ethnic and caste-based conflicts in Nepal. However, the Madhes movement, unlike those of the Janajatis,[6] has a geographic aspect. The Madhesis are a "non-tribal, caste Hindus of Indian origin" that live in the Terai, the southern plains of Nepal bordering India (Miklian, 2009). Following the Comprehensive Peace Agreement of 2006, many top Maoist leaders of Madhesi origin broke from the party (CPN(Maoist)) and banded with other Terai-based parties to form United Democracy Madhesi Front (UDMF). Terai-based parties and Madhesi leaders formerly of major parties participated in the first Constituent Assembly election of 2008 under the banner of UDMF with the election slogan "Ek Madhes, ek Pradesh" (One Madhesh, one province). UDMF gained 11.3% of the vote and won 81 of 601 seats in the Constituent Assembly. When the Constituent Assembly promulgated the federal constitution in late 2015, Madhesi representatives were unsatisfied. They declared that the provincial restructuring process was unfair to the Madhesis and that many Madhesi demands, including greater inclusivity and citizenship provisions, had not been adequately addressed. UDMF, with support from the Tharuwan Joint Struggle Committee (TJSC), launched a nationwide protest and indefinite strike demanding a constitutional amendment to ensure greater inclusion of Madhesis (Gurung, 2017).

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[3] Ironically, Maoist leadership then comprised mostly hill-origin Brahmins.
[4] Interviewee 6.
[5] The Prem Singh Dhami commission in 1997 and the Sher Bahadur Deuba Committee in 1999 were formed to investigate the causes of the Maoist rebellion. Both committees concluded that underrepresentation of Janajati groups were among the main factors.
[6] Janajati groups such as Rais, Limbus, Newars, Tharus, and Chepangs have, at various times, launched independent and/or joint movements demanding greater inclusivity. See Lawoti (2007) for more details.

GEOPOLITICAL CONSIDERATIONS

Nepal shares borders with India to the east, west, and south and with China to the north. Since the country's founding, Nepal's rulers have understood the necessity to grapple with geopolitical tensions between its two large neighbors. King Prithvi Narayan Shah, Nepal's founding monarch, described Nepal as "a yam between two stones." To avoid being dragged into regional conflicts, various Nepali rulers have repeatedly emphasized Nepal's commitment to the ideals of Panchasheel—peaceful coexistence based on the principles of non-interference and cooperation. In 1973 King Birendra declared Nepal "a zone of peace" and formally beseeched the global community to accept the proposition.

Birendra's proposition was endorsed by 130 countries, but India, Nepal's closest neighbor, declined it. Moreover, although Nepal was never directly colonized, colonial powers, notably Great Britain, have exerted influence in Nepal throughout its history. For instance, during the British reign in India, Nepal agreed to supply Gurkha soldiers to the British East India Company to support Britain's rule in its territories in exchange for a guarantee of non-invasion. The flow of Gurkha soldiers from the hills of Nepal to London continues to this day, long after the end of the company's rule in India.

Kunda Dixit, a prominent Nepali journalist, once explained that Nepal's fate is like that of "a planet between two suns, pulled by competing gravitational tugs" (Dixit, 2013). Nepali leaders have routinely harne-ssed the gravitational pull by switching diplomatic affinities between Indian and Chinese regimes for political and financial gains (Murton & Lord, 2020). Most recently, the pull towards China intensified in 2015 following two critical junctures in Nepal's modern history: the 7.8-magnitude earthquake in April and the promulgation of the federal constitution in September. In response to the devastating earthquake, China provi-ded the largest amount of humanitarian assistance to date in Nepal's history. At the International Conference on Nepal's Reconstruction, held in June that year, the Chinese foreign minister committed RMB 4.8 billion (US$ 480 million) for infrastructural repair and develop-ment (Khatry, 2015). India's response to the two critical events, on the other hand, severely strained Nepal–India relations. In August 2015, India imposed an "unofficial blockade" along Nepal's southern border, citing security concerns stemming from the Madhes protests, thus escalating anti-Indian nationalistic sentiments in Nepal and bringing Indo-Nepali relations to a nadir.[7] Prime Minister Khadga Prasad Sharma Oli was quick to capitalize on the growing anti-India nationalistic fervor by deepening diplomatic ties and trade relations with Beijing.

These geopolitical challenges continue to evolve as Nepal transitions from a constitutional monarchy to a federal republic. India's cold response to the promulgation of the federal constitution in 2015, along with the rising political dominance of major communist parties in Nepal, has led to a revitalization of Sino-Nepali relations. In 2017 Nepal signed onto the Chinese Belt and Road Initiative. Beijing agreed to finance Nepal's nine major infrastructural projects, including an expanded highway, a transboundary transmission line, and the trans-Himalayan railway. Two years later, at the second Belt and Road Forum in Beijing, China formally incorporated Nepal into its grand Belt and Road Initiative vision (Murton & Lord, 2020). In addition, China has opened six transit points along Nepal's northern border and granted Nepal access to four seaports and three land ports. China is now Nepal's largest foreign investor (Gokhale, 2021).

The adoption of a federal system of governance will further complexify the geopolitical tensions with India and China and other major international players. India wanted the federal structure to draw a "clear separation" between the Madhesis near the Indian border and the hill people residing in northern Nepal (Paudel and Le Billion, 2020). This separation could be achieved by demarcating a separate Madhes province (or Madhes provinces). Although the Constituent Assembly and the main political parties outright rejected the proposition, the issue is far from settled. India's central government and the governments of its northern states of Uttar Pradesh, Uttarakhand, and Bihar may find it to their strategic advantage to engage directly with politicians of Nepali provinces, particularly Provinces 2 and 5, that share

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[7] India's official position is that it did not impose an economic blockade on Nepal. Instead, Indian diplomats hold that what they call a "supply interruption" was due to Nepali protestors' blocking the transit points. A fact-finding mission by Sri Lanka–based South Asians for Human Rights concluded that very few in India or Nepal believe this official narrative. The common Nepali perception is that India orchestrated the blockade to hinder the promulgation of the federal constitution, which, according to Indian officials, did not adequately address Madhesi demands.

borders exclusively with India. To Nepal's north, China may find it beneficial to directly engage with leaders of Gandaki Province, the largest beneficiary of the proposed Belt and Road Initiative projects in Nepal. If India and China choose to increase direct economic and political ties with select provinces, Nepal's federal government may decide that the direct ties violate Nepal's national sovereignty and draw back from allowing greater autonomy to provincial governments. Other nations and international organizations with economic interests and active developmental projects in Nepal may also find it difficult to navigate the tensions that may arise between the federal and provincial governments over jurisdictional issues.

FEDERAL CONSTITUTION OF 2015: A BRIEF OVERVIEW

As noted in its preamble, the federal constitution of Nepal is a culmination of several historical movements and armed struggles to establish democracy and the rule of law and to end all forms of discrimination created by the feudalistic, autocratic, and centralized regimes in Nepal's history. Although the constitution expresses an explicit commitment to socialism, the path to socialism must include democratic norms and values, human rights, religious freedom, press freedom, private property rights, judicial independence, and the rule of law. The constitution guarantees a competitive, multi-party democracy and requires that governments at all levels be formed through periodic elections.

The federal constitution of 2015 departs from all previous constitutions of Nepal in two fundamental ways: first, it is the first to be drafted by elected representatives of the people, and second, it states that the sovereign power rests in the hands of the people. All previous constitutions except the interim constitution of 2007 were promulgated by kings. Even after the end of the Rana regime in 1951 and the promulgation of the democratic constitution of 1959, monarchs held partial or complete constitutional authority to suppress political parties, dissolve democratically elected parliaments, and form their own government.

The 2015 constitution restructured Nepal into three tiers of government—federal, provincial, and local —and it includes the provision that governments at each level retain their autonomy. At the federal level, executive authority rests with the Council of Ministers, chaired by the president appointed prime minister. The president is the formal head of state with largely ceremonial authority and accountable to the Council of Ministers. The legislature, or federal parliament, is bicameral, comprising the House of Representatives and National Assembly. The House of Representatives contains 275 members, 165 of whom are elected through the first-past-the-post electoral system to represent the 165 electoral constituencies determined by geography and population.

The remaining 110 are elected through a proportional-representation electoral system in which voters vote for parties, the whole country is a single constituency, and parties select candidates to reflect the ethnic, cultural, and gender makeup of the country. The National Assembly comprises 59 members, 56 of whom are elected from the Electoral College, which includes members of the Provincial Assembly, chairs and vice-chairs of village councils, and mayors and deputy mayors of municipal councils. The president nominates the other three members of the National Assembly.

At the provincial level, the executive branch comprises the provincial head and the Provincial Council of Ministers, to which the provincial head is accountable. The Provincial Councils of Ministers are formed under the leadership of the chief ministers. The provincial legislatures are unicameral and formally known as Provincial Assemblies. The members of the Provincial Assemblies are elected through both first-past-the-post and proportional electoral systems. At the local level, the Village Executive, comprising a village head, a deputy village head, and ward chairs, retains executive authority in villages, whereas the Municipal Executive, comprising a mayor, deputy mayor, and ward chairs, does so in municipalities. Village Assemblies and Municipal Assemblies, comprising local representatives, hold legislative power at the local level. Judicial authority rests with the independent judiciary, which is divided into three tiers—a supreme court, one high court in each province, and one district court in each district (representting several villages and municipalities). Additionally, the constitution allows for the creation of specialized courts, judicial institutions, and tribunals for special cases.

METHODOLOGY

This report relies on several sources of data to draw conclusions about the contemporary state of federalism in Nepal. First, the report draws on interviews with key stakeholders in the country. These include government officials, political party leaders, researchers at prominent Nepali think tanks, both in Kathmandu and outside the capital, international-development implementors, international donors, and CIPE staff. The team interviewed more than 30 people in more than 22 interviews from March until November 2021. Interviews were transcribed and analyzed. Many interviewees were identified using a snowball sampling method. Others were identified as key interviewees by CIPE.

Second, the report draws on original quantitative data, including public opinion surveys and economic indicators, such as the Asia Foundation's SoNP and the World Bank's economic indicators. Local research organizations in Nepal also shared original economic and bureaucratic data.

Third, this report draws on the extensive literature on the history of local governance and federalism in Nepal. This literature consists of peer-reviewed academic studies and reports by think tanks and research institutes in Nepal and around the world (including CIPE partner organizations).

LIMITATIONS

This report is an attempt at providing "balcony-level" programmatic analysis and recommendations for CIPE.

The team was not able to travel to Nepal for this report, and the entire process was conducted remotely. The recommendations therefore are broad and less specific, and the effort is focused on providing a comprehensive study of the state of federalism that is based on perceptions of partners, donors, and policymakers. For the reason given above, as well as the focus of prior programs and the category of stakeholders engaged, private sector organizations were not included in the list of interviewees.

CURRENT STATE OF FEDERALISM IN NEPAL

PUBLIC ATTITUDES TOWARD FEDERALISM

An increasing proportion of Nepalis are confident that the country is effectively implementing federalism. According to SoNP (conducted in 2020), 65.6% of Nepalis believe that the country is transitioning toward federalism and greater political stability. In 2017 only 52.9% believed that to be the case.

Findings from SoNP indicate that the increasing optimism is due to a rapid increase in the development of infrastructure, including roads, and improved access to electricity, health services, and education (Giri, Pyakurel, & Pandey, 2021). Although implementation of federalism has been slow, the state's restructuring and devolution of authority have increased hope among the people to the point that 58.6% of respondents believe that the federal restructuring of the governance system is the cause of improved local governance and public goods delivery.

People no longer need to visit district headquarters and the national capital for basic administrative services such as the provision of birth and citizenship certificates, saving many Nepalis money and time.[8] SoNP finds that access to public services in municipalities and rural municipalities has become significantly easier. A strong majority of respondents reported that the following services were "easy" or "very easy" to obtain: recommendation for citizenship (88.2%), social security allowance (95.3%), birth, marriage, death, and migration certificates (95%), judicial services (89.9%), and police services (86.4%). Moreover, most citizens feel that they now have a say in local development projects. SoNP notes that most respondents (58.9%) believe that their local governments have become more responsive relative to previous years. Even when their desired projects are not included in local budgets, citizens report that their voices are being heard.[9] Nearly three-quarters (74.1%) of respondents believe that their local elected representatives care about the general public. The corresponding numbers are lower for provincial (62.2%) and federal (62.1%) representatives. This gap indicates higher trust at the local level relative to the provincial and federal levels.

In the context of Nepal's turbulent history, marked by political uprisings and a violent Maoist insurgency, public safety has improved remarkably since the promulgation of the federal constitution. The vast majority (85%) of SoNP respondents said that they felt no security threats in their locality. 3.4% reported feeling unsafe, compared to 4.9% in 2019 and 6.1% in 2018. In addition, the most cited security threats included alcohol abuse (39%) and theft (32.6%) but not political instability or civil conflict.

A comparison of survey data from 2018 to 2020 shows that people believe all three tiers of governments are becoming more responsive to their needs (see figure 1). In 2018, 48.8% reported that their local governments' response to their needs had improved in recent years. In 2020 that number jumped to 58.9%. At the provincial level, public perception of increased governmental responsiveness rose from 35.7% to 44.2%. At the federal level, it rose from 35.9% to 43.6%. Even respondents from Sudurpaschim Province, the most remote and least developed of all seven provinces, demonstrated these same patterns, with public perception of increased local governmental responsiveness growing from 57.2% to 65.3% in Sudurpaschim from 2018 to 2020. Similarly, perceptions of increased responsiveness at the provincial and federal levels rose from 45.3% to 55.6% and from 43.9% to 57.4%, respectively.

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[8] Interviewee 6.

[9] Interviewee 6.

Figure 1: **Views on government responsiveness to the people's needs (2018 vs. 2020)**
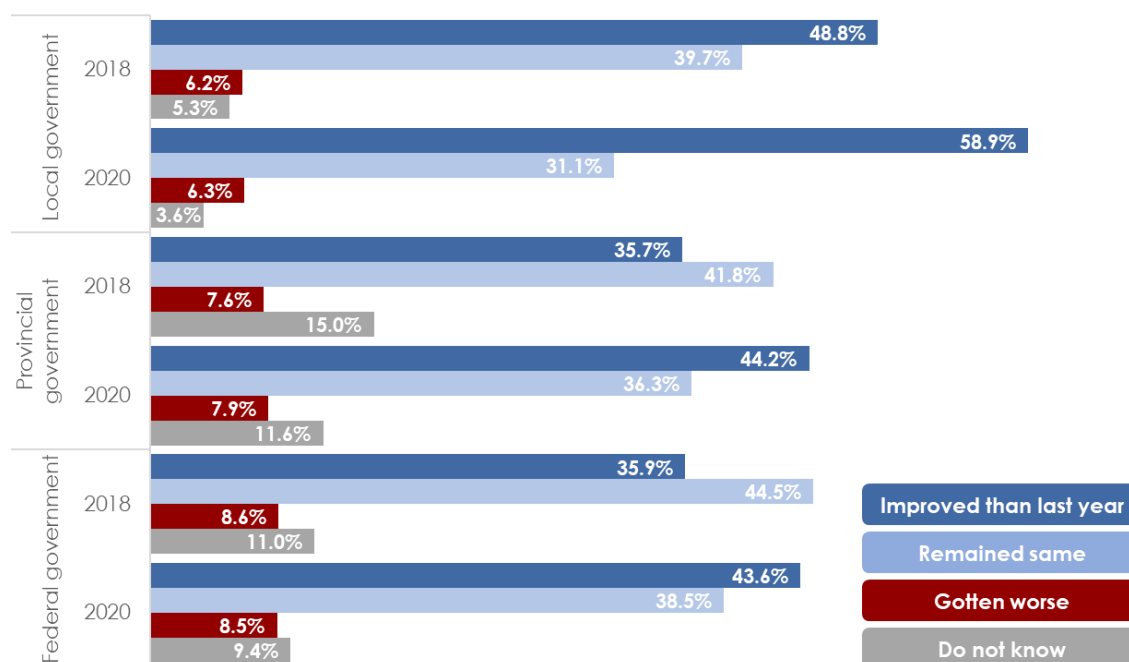
Source: Asia Foundation's *A Survey of the Nepali People in 2020* (see Giri 2021).

FEDERALISM AND THE COVID-19 CHALLENGE

The coronavirus pandemic may have been a defining challenge to Nepal's nascent federal system. The pandemic posed governance challenges across all three levels: local, provincial, and federal. The Nepali legislature has yet to draft and pass infectious-disease laws compatible with federalism. The legal framework most applicable to pandemics was established by the Disaster Risk Reduction and Management Act of 2017 (DRRM), which assigns clear roles to each level of government. Article 57 of the federal constitution entrusts local governments with exclusive authority in health care, sanitation, and disaster management. However, in the absence of updated laws directly applicable to pandemics, the federal government chose to execute old laws such as the Infectious Disease Act of 1964, which do not recognize provincial governments or the autonomy of local governments (Pokharel, 2021). Thus, the federal government did not involve the subnational governments in its decision-making. Instead of working with local governments, federal authorities issued directives that local governments had to comply with in order to receive any financial and administrative assistance.

The federal government imposed a nationwide lockdown on March 24, 2020 without any forewarnings or consultation with subnational governments. The lockdown was implemented in a matter of a few days. The central government directed provincial and local governments to "prepare and allocate resources to build facilities for quarantine and isolation" and to cooperate with district health officials (Adhikari & Budhathoki, 2020). The central government issued guidelines about proper quarantining measures but did not provide the resources to implement them. For example, the guidelines required that for every 100 people placed under quarantine, there must be one doctor, one nurse, and one paramedic (Sapkota & Paudel, 2020). However, many rural municipalities have no doctors. Local governments have a very limited budget to hire required health professionals, and many lack the administrative capability to collect taxes without assistance from the federal bureaucracy. The pandemic posed different challenges to local governments in different ecological belts. Local governments in the Terai region were particularly hard hit because of their proximity to populated urban centers in India (Adhikari & Budhathoki, 2020). As India began to

implement lockdowns, Nepali labor migrants started returning in large numbers without tests, overwhelming poorly managed quarantine centers in municipalities along the southern border (Sapkota & Paudel, 2020). The central and provincial governments issued directives, but they neither provided logistical assistance to implement them nor acknow-ledged the difficulties and feasibility challenges created by their top-down mandates.

Despite gross neglect by central and provincial authorities, many local governments took innovative approaches to respond to pandemic challenges. In fact, various news reports and academic studies indicate that local governments fared better than both provincial and federal governments in handling the pandemic (Adhikari & Budhathoki, 2020; Pokharel, 2021). Despite severe resource limitations, many local governments responded promptly and effectively. A local program officer for a development organization noted, "As the coronavirus began to spread, local governments took the lead in prohibiting public gatherings, establishing information centers, setting up hand-washing systems, allocating isolation beds, and instituting quarantine procedures at public and private hospitals" (BK, 2020). A leading national newspaper reported, "Local governments have been pretty innovative in handling the crisis, ranging from the management of returnee migrants at the quarantine and isolation centers to the mobilization of a unit action team to record, recognize, regulate and report about the locals affected by the coronavirus to the establishment of food banks to help the poor" (Pokharel, 2021).

Many local organizations adapted their existing programs and strategies to provide relief to citizens, assist in vaccination programs, and disseminate information about the virus to the public. Bikalpa– An Alternative, a CIPE partner and provincial think tank in Biratnagar, mobilized local volunteers to conduct aware-ness campaigns and developed an online registration system to facilitate vaccination and relief efforts. Bikalpa leaders used their social networks to gather financial and logistical support from the United Nations Development Project and other organizations to fund their efforts. Samriddhi Foundation, another CIPE partner, focused on identifying key policy hurdles that interfered with citiz-ens' efforts to cope with COVID-19. Policy scholars at Samriddhi communicated their findings to policy-makers and facilitated public interactions between relevant stakeholders to reduce policy hurdles.

Various urban and rural municipalities across the country—such as Bheri (Jajarkot District), Simta (Surkhet District), Siranchowk (Gorkha District), and Limchungbung (Udayapur District)—effectively mobi-lized local volunteers to fill various important roles. Instead of waiting for promised help from federal and provincial authorities, local governments raised funds to purchase their own testing kits, used local resources to produce masks, and printed pamphlets and brochures to raise awareness (Online Kha-bar, 2020). Even rural and resource- limited municipalities such as the Chhatradev municipality of Arghakhanchi District mobilized local resources to ramp up production of masks and sanitizers and generate income locally.

Despite many inadequacies, however, the nascent federal system did prove to be a "real blessing" in dealing with the pandemic in Nepal (Karki, 2019).

As Karki (2021) notes, the Nepali government responded more effectively to the COVID-19 pandemic than the 7.8-magnitude earthquake in 2015. Because of the lack of elected repres-entatives at the provincial and local levels in 2015, civil servants appointed by the central government bore total responsibility for the earthquake response, leaving many commun-ities without a formal voice in the reconstruc-tion and healing processes. In many cases, government-appointed representatives even delayed the government's earthquake response, adding additional barriers for affected localities to overcome. In the face of government delays, many communities mobilized their social capi-tal and devised their own solutions to collective challenges (Rayamajhee & Bohara, 2020). Social entrepreneurs also played very important roles in highlighting local challenges, reducing bure-aucratic hurdles, and gathering resources to rebuild villages (Rayamajhee, Storr, & Bohara, 2020). The introduction of federalism has helped remove many barriers between the gov-ernment and the citizenry. By placing elected representatives in important decision-making roles and allowing communities to voice their concerns, federalism has enabled more direct engage by communities in crisis response.

Undoubtedly, multilevel coordination would have been more effective if the federal government had adopted mechanisms set out by the DRRM instead of invoking obsolete laws that did not recognize the autonomy of provincial and local governments (Karki, 2019). The federal government could not let go of its centralist tendencies and did not trust the provincial governments to implement provisions of the DRRM. Notwithstanding these errors, the experience of dealing with the pandemic provided greater clarity regarding the roles of different levels of government and highlighted the significance of elected local governments. Karki (2021) finds that the outstanding performance of local governments "helped federalism gain wider prominence in a country with still abundant anti-federal sentiment in the air" (p. 4). Overall, just as the 2015 earthquake generated political will to push for the promulgation of the federal constitution, the COVID-19 pandemic has provided the will to accelerate federalization.

ECONOMIC TRAJECTORY

After the establishment of a multiparty democratic system and the adoption of liberal economic policies in the early 1990s, Nepal showed signs of rapid economic growth (Mahat 2020). However, hopes for further growth were dashed abruptly by the Maoist insurgency that began in the mid-1990s. The subsequent decades leading up to the establishment of the federal system in 2015 saw many ups and downs, but the signing of the Comprehensive Peace Agreement in 2006 decreased political and economic uncertainty. Nepal's GDP growth rate stabilized as a result (see figure 2), but its rate lagged far behind those of its neighbors, which were experiencing rapid economic booms (see figure 2).

Once Maoists entered the formal political process and began to participate in the Constituent Assembly, expectations for long-term peace and economic prosperity formed. Between 2006 and 2015, Nepal's GDP growth rate hovered around 3% to 6% per annum. However, the growth rate plummeted to 0.43% per annum in 2016 following the devastating earthquake of 2015.

The following year, the growth rate climbed to 8.97%. Post-disaster recovery and reconstruction efforts fueled by billions of dollars in foreign assistance enabled much of this growth. For the next three years, the growth rate remained above 6%, until the COVID-19 pandemic led to another massive dip in 2020 (–2.08%). Simply looking at the aggregate numbers, it is not possible to form a clear picture of the long-term economic trajectory of Nepal. Furthermore, we are unable to link economic indicators to changes in political systems, including the transition to a federal system. Isolating the causal effect of federalism on economic outcomes is difficult because other major events such as the 7.8-magnitude earthquake also occurred in 2015. Moreover, six years is not enough time to draw informed conclusions regarding the long-term trajectory. Other indicators of economic performance indicate that Nepal is gradually becoming less poor. In the absence of reliable poverty-rate data, we plotted annual infant mortality rates as an indicator of household poverty.

The infant mortality rate has been on a steady decline since 1960. Poverty rates calculated from the Nepal Living Standard Surveys also show a similar long-term trend. In 1995, 41.8% of households fell below the poverty line. In 2010 the poverty rate dropped to 25.2%.[10] Remittance income is the chief driver of economic growth in Nepal. In 2000, remittances constituted just over 2% of GDP. This figure rose to over 27% in 2015. Since the promulgation of the federal constitution in 2015, the upward trend has halted. From 2017 onward, remittance income's contribution to GDP has hovered around 23% to 24%. Although living standards have risen substantially over the last couple of decades, linking the economic growth to any political regime or governance system remains difficult.
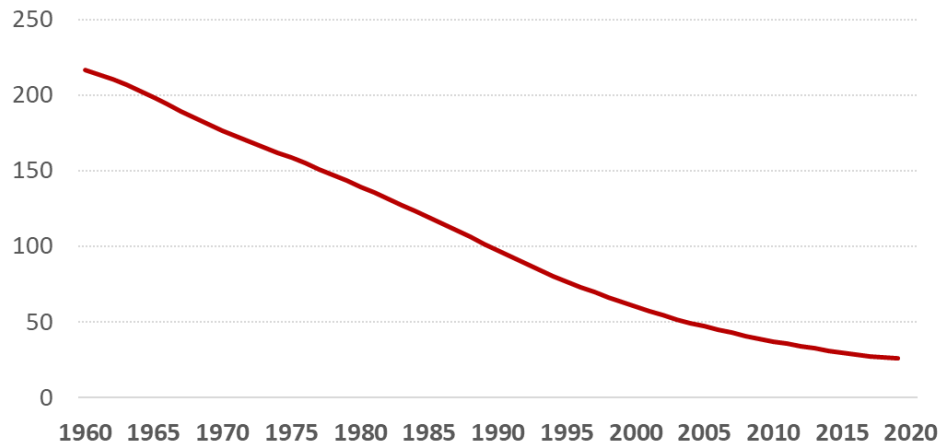
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[10] In 2003 the poverty rate was 30.8%. Three waves of Nepal Living Standards Surveys (NLSSs) have been conducted: NLSS1 in 1995, NLSS2 in 2003, and NLSS3 in 2010.

Figure 2: **GDP growth rates 1990−2020 (annual %)**
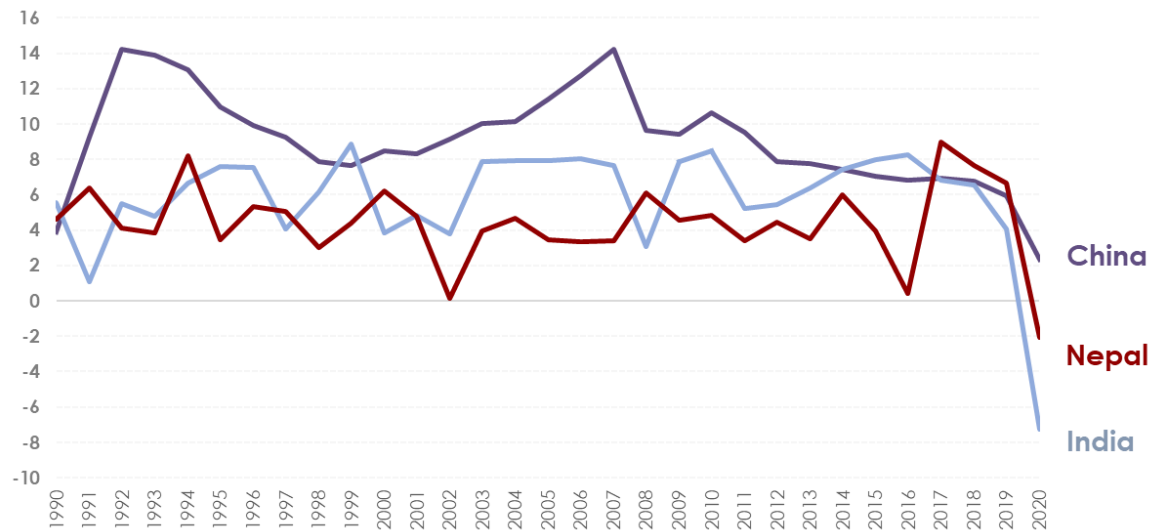
Source: World Bank.

Figure 3: **Infant mortality rates 1960−2020 (per 1,000 live births)**

Source: World Bank.

ACHIEVEMENTS

INCLUSIVITY AND PLURALISM

Nepal has come a long way toward creating an inclusive society since the Muluki Ain legalized caste-based discrimination in 1854. The federal constitution of 2015 carved out a clear legislative path to a more egalitarian and pluralistic society and has accelerated the process of equalizing political and economic access for all castes, ethnicities, and genders.

The preamble of the constitution underscores the national commitment to "end all forms of discrimination and oppression created by the feudal, autocratic, centralized and unitary system" that had governed Nepal since its founding. It expresses a "determination to create an egalitarian society on the basis of principles of proportional inclusion and participation," and it includes a provision for inclusion of at least 33% women in the federal and provincial legislative bodies and at least 40% in local legislatures. The constitutional commitment signals a deep acknowledgment of the oppressive and non-inclusive systems of governance that existed in Nepal. The 2017 elections marked the first step toward materializing that commitment. Following that election, women comprised 41% of elected representatives at the local level, 34% at the provincial level, and 33% at the federal level. Representation of Dalits increased to 25% at the local level and 15% at the federal level.

The second local-level elections, held in May 2022, saw further modest gains for historically under-represented groups. The share of elected female representatives rose to **41.21%**, a slight increase from 2017 (**40.96%**). In addition, **25 women** were elected chiefs, a significant increase from 18 women elected to the same position in 2017. More than **40** people with disabilities were elected as municipality/rural municipality chiefs, almost double the number from the previous elections. These results indicate that voters are adopting a more forward-looking, open, and inclusive mindset ahead of the next round of federal and provincial elections, tentatively recommended for November 2022. Although formal political representation is not enough to fulfill the constitution's commitment to building an egalitarian society, these numbers indicate unprecedented levels of political representation of women, marginalized castes, ethnic groups, and other historically under-represented groups.

Federalization has also brought issues related to ethnic representation and autonomy into the political limelight. The promulgation of the 2015 constitution was followed by a series of protests in the Terai (southern plains) and Karnali (in the far west) regions in which citizens demanded greater autonomy. The political elite accepted the demands of peoples from Karnali, but sidelined those from Madhesis and Tharus in the Terai, for both reasons of territorial viability (Breen, 2018) and a fear among hill-origin elite Nepalis that greater autonomy for Madhesis could increase Indian influence in Nepali politics (Hatlebakk & Ringdal, 2013). Prominent Madhesi activists and scholars cite this fear as the primary reason. Notwithstanding many ongoing ethnic tensions, Nepal has made significant progress in reconciling with its discriminatory past. The data show that political representation of women, Madhesis, and Dalits has increased dramatically since Nepal's first experiment with democracy in 1991 (see table 1). In 1994 and 1999, Dalits had no representation in the national legislature, whereas the 2017 federal parliament had 6.9% Dalit representation. The proportion of seats occupied by Madhesi representatives has also increased steadily—from 9.3% in 1991 to 17.1% in 2017. Although Khas Arya (an ethnic group comprising hill-origin Brahmins and Chhetris) are still politically dominant, their control of the national legislature has slipped from a peak of 62.4% in 1994 to 41.8% in 2017. However, Jayanta Rai (2021), who calculated this data, warns that the decline of Khas Arya representation in the national legislature masks the continuing dominance of Khas Arya men in first-past-the-post elections as well as their significant control of agenda setting and political discourse. Despite these caveats, Nepal has made undeniable progress in ensuring greater political participation.

Table 1: **Representation in national legislature (includes interim assemblies and Constituent Assemblies) by caste, ethnicity, gender, and religion, 1991−2017**

	1991	1994	1999	2007	2008	2013	2017	Population %
Khas Arya	53.7	62.4	58.1	49.4	33.6	40.7	41.8	**31.2**
Adivasi Janajati	34.2	24.9	25.9	30.6	34.1	32.8	30.9	**35.3**
Madhesi	9.3	10.3	14.2	13.6	20.7	16.5	17.1	**15.3**
Dalits	0.5	0.0	0.0	5.2	8.9	6.8	6.9	**13.8**
Muslims	2.4	2.4	2.0	1.2	2.8	3.3	3.3	**4.4**
Women	3.4	3.4	5.9	17.3	32.8	29.5	32.7	

Source: Jayanta Rai (2021).

LOCAL ELECTIONS AND DEVOLUTION OF AUTHORITY

Local self-governance is not new to Nepal. In fact, the history of Nepali communities overcoming a wide range of collective problems by devising self-governing institutions for such purposes as managing community forests and other shared resources is well documented (Agrawal & Ostrom, 2001; Varughese & Ostrom, 2001). Nevertheless, at the time the federal constitution's promulgation, local elections were much needed. In the absence of local elections, central-government-appo-inted bureaucrats, unaccountable to local communities, nominally controlled the villages they governed despite being largely absent from them (Acharya, 2018). Most village officials conducted administrative operations from district headquarters and cities, so citizens had to bear high travel costs to access administrative services. This problem was especially dire during the Maoist insurgency from 1996 to 2006.

In May 2017, Nepal held its first local elections in two decades and elicited a 71% voter turnout. A total of 36,639 representatives were elected across 753 local govern-ments. Women represented 41% of elected represent-tatives, although very few women were elected to non-reserved positions. Both the constitutional provision for proportional representation and the Election Commi-ssion's mandate for women comprising at least 40.4% of elected representatives supported this historic result. The elections have been touted by many, perhaps prematurely, as a major turning point toward greater inclusivity. Prior to the elections, fears about vote stealing were rampant However, they turned out to be overwhelmingly free and fair. An analysis based on SoNP finds that 92% of respondents believed the elections were unequivocally free and fair, and another 3% believed they were free and fair but marred by some violence and other problems (Kumar, 2019). SoNP data show that that sentiment varied little across provinces. Respondents from Province 6 were least sanguine, but even there 97% believed the elections were free and fair. Very few Nepali respondents (0% to 3%, depending on the province) found the elections to be not free and fair.

Nepal held its second local-level election on May 13, 2022. In this election, Nepali citizens voted for representatives in 6 metropolitan cities, **11 sub-metropolitan cities, 276 municipalities, and 460 rural municipalities**, to fill 35,221 local legislative and executive seats. Voter turnout decreased to 64%. Five major parties (the Nepali Congress, CPN-Maoist Centre, CPN-Unified Socialist, Janata Samajwadi Party, and Rastriya Janamorcha) forg-ed an electoral alliance to contest the election together, and this political alliance negatively impacted women candidates' nominations to contest in the election, resulting in only a slight increase in the share of elected women representatives (**41.21%**).

Though a relatively higher number of violent incidents were reported on election day in comparison to the violence that had occurred in the run up to the elections, overall, the 2022 local level election was viewed to be relatively free and fair. The timely selection of public officials in a **free and fair** manner is indeed an achievement for Nepal and a step closer to consolidating the federal system of government.

Data from SoNP also reveal that citizens have high trust in their local governments: 82% of respondents stated that they trust their municipal or rural-municipal council. The level of trust varies for different types of local elected representatives, but only slightly: 73% trust their elected ward chair; 69% trust their mayor and rural-municipal chair; 69% trust their representative in their ward citizen forum; and 70% trust their local political leaders. These numbers indicate that people are cautiously optimistic about their elected representatives. The fact that trust in local councils is higher than trust in individual representatives should also be noted.

Table 2: "Were the local elections free and fair in 2017?"

	Nepal	Province					
		1	3	4	5	6	7
Yes	92	94	90	89	96	87	93
Yes, but with violence	1	1	2	1	0.3	1	1
Yes, but with some problems	2	2	5	2	1	2	2
No	1	1	1	3	0	3	1
Don't know	3	2	3	5	3	7	2

Source: Kumar (2019).

Table 3: Trust in local government (2019)

	Trust (moderate to full)	Don't trust (somewhat to none)
Municipal / rural-municipal council	82	12
Mayor / rural-municipal chair	69	10
Ward chair	73	8
Ward citizen forum	69	16
Local political leaders	70	27

Source: Asia Foundation's *A Survey of the Nepali People*; adapted from Kumar (2019).

The constitution transfers many government functions once administered by national officials at district-level agencies to elected local governments. Schedule 8 of the constitution specifies areas under exclusive jurisdiction of local governments: local-level development plans and projects, schooling, basic health and sanitation, local roads, agriculture and irrigation, environmental protect-ion, watershed management, cooperatives, and disaster management. Local bodies also have the constitutional authority to draft laws regarding taxation and manag-ement. Despite the constitutional provisions, a federal legal framework was needed. The passage of the Local Government Operation Act of 2017 was a major milestone toward the devolution of authority because it provided such a framework to operationalize the constitutional mandate at the local level. The act outlines the functions, powers, roles, and responsibilities of local represent-atives and enables them to implement programs and policies based on local needs (Khanal, 2019). The federal parliament also passed the Inter-governmental Fiscal Management Act in 2017, which provided further clarity regarding the collection, sharing, and distribution of revenues among different tiers of government.

It specifies the types of grants to be distributed by the federal government to provincial and local governments, thus ensuring subnational governments would have predict-able and stable revenue for long-term local development projects. It also contained provisions for financial-equalization grants to bridge the gap between expenditure needs and revenues in rural municipalities with little business activity and revenue (Khanal, 2019). These provisions marked further milestones toward realizing the constitutional promise of decentralization
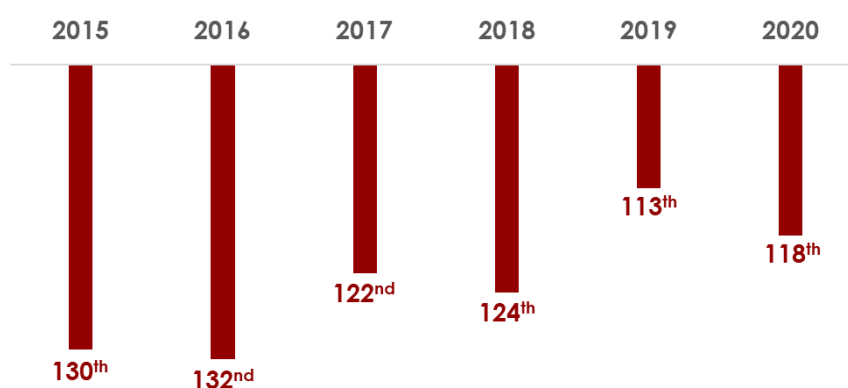
LOCAL ACCOUNTABILITY

Transparency International's Corruption Perception Index (CPI), the leading global public sector corruption index, indicates that the Nepali public sector has become less corrupt since the promulgation of the federal constitution in 2015. In just five years, its CPI ranking dropped (lower means less corrupt) from 130th to 118th. Although this change represents remarkable progress, corruption—both large and small scale—remains rampant in the public sector. SoNP finds that 52% of respondents believe corruption to be the biggest problem in Nepal. Local elections and decentralization have brought corruption closer to home for most Nepalis. However, overall, the devolution of authority to local governments has led to increased accountability.

As one civil society leader puts it, the increased discussion about local-level corruption may be a good sign:

*"**One** thing that is most criticized in Nepal's federalism is that there is heavy corruption in local level. But, in my view, this is not an accurate analysis. We have read about corruption everywhere at the local level. But these incidents of corruption have come out because of the local people. The local people know how much money was allocated for a program, how much was spent and what was the quality of the expenditure. So, if there is corruption, the news will come out immediately. So, it seems that corruption has increased. But in the past, news of such corruption did not come out."* [11]

Figure 4: **Corruption in Nepal - Corruption Perception Index ranking (2015−20)**

2015	2016	2017	2018	2019	2020
130th	132nd	122nd	124th	113th	118th

Source: Transparency International.

Nonetheless, local-level projects have brought new accountability challenges. Many local governments lack the human resources and technical capacity needed to publish information on income and expenditure and lack formal mechanisms to monitor and address public corruption (DRCN, 2019). Nevertheless, in many instances, communities have devised local mechanisms to increase accountability. In a rural municipality in Khotang District, the opposition party formed "a shadow government" to track fiscal expenditure and ensure funds are disseminated appropriately (ibid. p.9). CIPE has partnered with national and provincial organizations in Nepal such as Samriddhi Foundation, Bikalpa−An Alternative, and Pokhara Research Center to design and implement a program to incubate, develop, and support provincial policy think tanks. This initiative has helped fill in some accountability gaps at the provincial and local levels. Provincial think tanks have played important roles in highlighting local issues that are close to people's hearts and putting them in the context of federalism in Nepal. For instance, one successful campaign undertaken by Bikalpa focused on the corrupt practices of local transport management offices that affected people's ability to obtain motorcycle licenses in Kathmandu. By

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[11] Interviewee 6.

increasing bureaucratic red tape and extending wait times, the transportation authorities had created conditions such that citizens were forced to pay bribes to intermediaries and traffic officers. Because motorcycles are the most common commuter vehicles in Nepal, this issue affects many Nepali households, even though it gets crowded out by larger, national-level accountability issues.

LOCAL ECONOMIC DEVELOPMENT

The Local Governmental Operation Act of 2017 handed over responsibilities and jurisdiction over various sectors of the economy to local governments from the federal government. A partial list of these sectors includes local markets, environmental management, agriculture and agro-products management, cooperative institutions, education, and environmental management. To support local development, the share of the national budget allocated to local governments also increased substantially. In 2017/18, the share was 17.6%, compared to roughly 5% before 2015. Moreover, across all provinces, the share of the national budget allocated to local governments has increased since 2017. Figure 5 compares average budget size for both municipalities and rural municipalities across all provinces in the fiscal years 2019/20 and 2020/21.

Figure 5: **Average budget size of local units across provinces, 2019–21 (in 10 million NPR)**
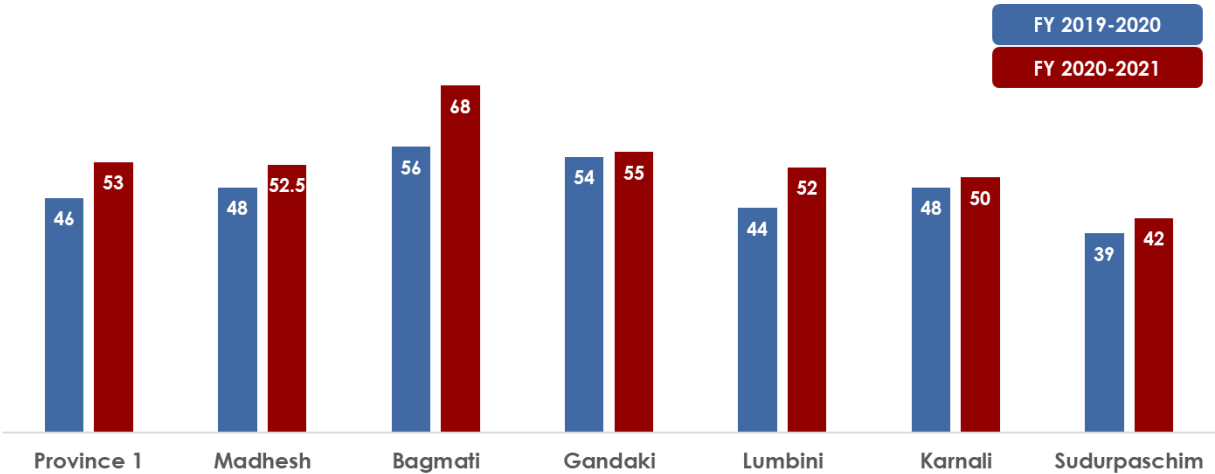
Source: Democratic Resource Center Nepal.

This increase in the operational budget and special grants has led to rapid infrastructural development at the local level, and this spike in development accounts for much of the observed favorable attitude toward federalism (Giri et al., 2021). SoNP finds that 61.4% of respondents cited construction of new roads as a positive change in their municipalities; 38.9% said their local roads are now broader and wider. Although people are concerned about the lack of public participation in the choice of development projects,[12] they are generally optimistic about the prospects for economic development in their communities. An astounding 68.9% respondents said they were satisfied with their local governmental activities.

In addition to increases in local infrastructural development, optimism regarding private sector invest-ment has increased. In many urban centers, such as Kathmandu, the knowledge economy has grown, fueled by young entrepreneurial migrants returning from the

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[12] SoNP reports that only 28.2% of respondents said the existing roads were "properly upgraded." Only 13.4% said that the public participated in decisions regarding local development projects. Numerous media reports document public discontent regarding haphazard placement of local roads has increased soil erosion and landslides and led to many casualties in recent years.

United States and the United Kingdom (Basnett et al., 2014). Out-migrants who return after stints abroad disproportionately engage in entrepreneurial ventures in Nepal. This recent trend has generated much hope among Nepalis. Nevertheless, entrepreneurs face several challenges to conducting business in Nepal, including lack of basic public infrastructure, inadequate and unreliable supply of electricity, and regular political strikes (ibid., p. 15).

However, all these areas have improved greatly since 2015, which has led to constrained optimism in the private sector. The World Bank's Ease of Doing Business indicator shows that conditions for private enterprise have been improving over the last few decades, even though the introduction of federalism in 2015 was followed by a temporary increase in the difficulty of doing business. In 2015, Nepal ranked 100th among 190 countries in ease of doing business. In 2019 its ranking improved to 94th after worsening to 110th in 2018.

Federalism has increased business opportunities in rural municipalities. Although some regulatory barriers owing to jurisdictional ambiguities persist, there are provisions in place to encourage private sector growth. Over the next couple of years, legal clarifications may alleviate many of these concerns, and local and provincial governments have already made some progress in that direction. For example, an entity can register a hydropower plant up to 1 MW capacity with the municipality, whereas plants with 1–20 MW capacity can be registered at the provincial level. Similarly, legal clarity regarding small business

operations has improved. One small business in Eastern Nepal, for example, has been able to carry out transactions up to NPR 800 crores annually, compared to only NRs. 40 crores before federalism.[13]

> "*Roads* and bridges are popping up everywhere in Nepal. Whether this is happening without corruption or with adequate consideration of environmental impacts is not clear. Of course, there are various issues with accountability and long-term sustainability, but we see a lot happening at the local level. There is a lot of frustration because of frequent corruption, but there is a sense of excitement that things are happening locally." [14]

> "*There* is no doubt that federalism has contributed to development. There is no data to say how much local level economic activities contribute to growth, but if we see Nepal's growth rate then we find that it has started increasing rapidly after 2017. Three things can be attributed to this high growth rate,
> (i) increased capital expenditure for post-earthquake reconstruction
> (ii) uninterrupted electricity supply
> (iii) formation of local level government under federal structure.
> Contribution of local level can be might have been channelled through heavy spending in local road and transfer of money into local level. More money in the local level means increased income of local people and high marginal value of money." [15]

Figure 6: **Ease of doing business in Nepal (2008–19)**
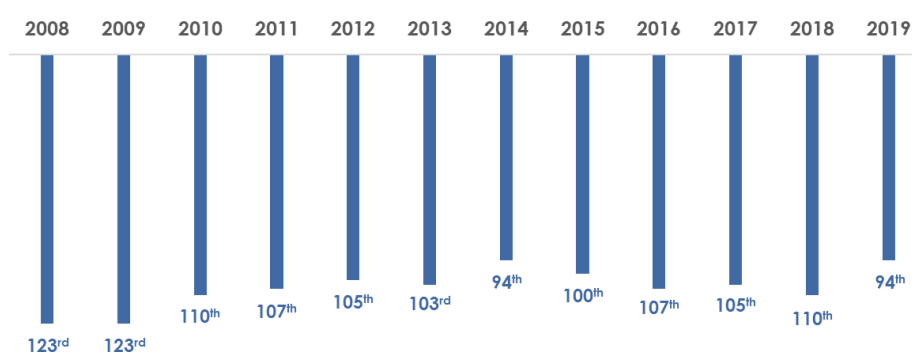
Source: World Bank.

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[13] Interviewee 11. This is an example of a small business in Eastern Nepal provided key interviewee. Small businesses in Nepal are categorized by the amount of fixed capital (not exceeding 150 million NPR according to the Industrial Enterprises Act of 2020), not annual turnover. Thus, a high turnover business with low fixed capital may be formally classified as a 'small business.'

[14] Interviewee 26.

[15] Interviewee 6.

CHALLENGES

With Nepal's historical experience with informal local governance and Panchaya-era formal decentralization efforts, it was able to make significant strides in transitioning to federal governance at the local level. However, the same cannot be said about the provincial level, the new tier of government that did not exist prior to federalism. Of the seven provinces, one (Province 1) has yet to receive a for-mal name. Forging consensus on a name for Province 2 (now Madhesh Province) took seven years. Although about 1,080 provincial offices had been established by 2021, many of these offices have not been able to conduct important governance functions because of a host of difficulties such as lack of buildings and essential personnel as well as inadequate technical and fiscal capability (Devkota, 2021). These challenges exist at both provincial and local levels but have hindered progress more severely at the provincial level.

BUREAUCRATIC CHALLENGES

The Nepali bureaucracy needs to be reformed to make it compatible with the federal system and more accountable to the public. Talk about the need for bureaucratic reforms in Nepal is not new. However, past recommendations for bureaucratic reforms tended to focus on "a wholesale reform" approach that emphasizes "complete modernization of public administration" (Basnett et al., 2014). Such an approach assumes a mono-lithic bureaucratic structure and promotes "capacity building, training, and mentoring" as tools to achieve modernization (ibid., p. 36). That assumption is no longer valid, however, as Nepal is transitioning to a federal system. While some training and capacity building may be helpful, fundamental transformation must begin by abandoning the unitary bureaucratic structure that used to be chiefly accountable to a single ruler.

The Nepali civil service was set up as the Jagir system under the semi-feudalistic monarchy to maximize revenue for the king (Regmi, 1976). *Jagirdars* received income as residual claimants of surplus agricultural production. Only in 1951 was that payment form replaced by modern forms such as salaries and bonuses. Despite several reform attempts, the bureaucratic structure retains a hierarchical and rent-seeking character. Implementing any programs and policies, however small, entails prohibitive transaction costs and requires a series of approvals at various levels. From the standpoint of development planning and policy implementation, the bureaucracy is highly inefficient.

"Many senior bureaucrats seem to believe that the design and structure of federalism in Nepal is costly and ineffective. They can influence decision-making authorities. For example, a secretary of the government (unelected) can influence the decisions of a cabinet minister (elected). This is not how democracy should work. To resolve this, Nepal needs investment in terms of knowledge and capacity on vertical and horizontal institutions, processes, and efficient coordination between them." [16]

"There is an active push by the bureaucracy towards the collapse of federalism. However, having the government close to you is better than having it far away. Structurally, the system of government is not set up to establish provincial and local government. Nepal cannot go back to a centralized system. There are 763 sub-national leaders who are delivering to their people. They have seen that it is better to have people close to you than far away." [17]

Moreover, the Nepali bureaucracy is struggling to attract and retain qualified employees. Until recently, civil service jobs were held in high esteem and attracted some of the best and the brightest (Basnett et al., 2014). As the prominent public administration scholar Prachanda Pradhan (1976) writes, "Despite the complicated bureau-cratic behavior, employment in the government enha-nces the prestige not only of his family, it extends up to his relatives. Thus, government employment is a kind of big prestige prize to all" (p. 67). However, civil service no

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[16] Interviewee 9.

[17] Interviewee 26.

longer offers the same prestige and promise of social mobility. Prolonged political instability and decreasing prospects of social mobility have led to mass out-migration. Not only have the best and the brightest migrated to the United States and other Western economies, but there has also been a mass exodus of low-skilled people to the Gulf states, India, and Malaysia. Thus, the bureaucratic sector now faces stiff competition from foreign employers to attract and retain technically proficient individuals.

Besides the pressure posed by labor market competition, the Nepali bureaucracy faces an even bigger problem: meeting the challenges of the new federal system. This means transforming its opaque, vertical structure into a horizontal system with checks and balances at the local level. As a top government official that we spoke with put it, the bureaucrats need to understand that the people are their real boss.[18] Clear channels of accountability must be put in place. In practical terms, this may mean shrinking the federal bureaucracy and increasing the bureaucratic capacity of provincial and local governments. This shift can be achieved in part by transferring federal employees

to provincial and local governments.[19] Where this is not feasible, provincial and local governments need to create competing subnational bureaucracies that are more innovative and better suited to a decentralized system than their federal counterpart.

> *"**An** elaborate and effective administrative system has not been established at the provincial level. Government employees either choose/wish to work at the federal level, and those that are transferred to provincial and local levels are at their ages of retirement. Mobilization of employees has thus proven to be a challenge. There is a lack of clarity regarding the roles of government agencies and employees at subnational levels, which has led to their increased dependence on federal/central government. This also creates overlapping jurisdictions, which make the system less efficient, and conflicts continue to arise. As a result, the provincial governments are struggling to find their space in the implementation of the federal structure. Many government employees whose expertise lies in implementation now wish to work at the federal level in policymaking, without prior experience."* [20]

POLITICAL PARTIES

The renowned Nepali anthropologist and ethnographer Dor Bahadur Bista uses the term *aafno manchhe* ("my people") to describe the Nepali patronage system of reciprocal norms within an enclosed social network in which contracts, jobs, and opportunities are distributed based on social proximity instead of on qualifications and added value (Bista, 1991). Patronage is pervasive, albeit in varying degrees, in all sectors—business, politics, civil service, police, and military—but especially politics (Hatlebakk, 2017).

Indeed, Nepali political parties are deeply entrenched in the patronage system. One way this characteristic manifest is that party decisions are based on consensus, not on principles or merits. In practice, this means that the members of the party leadership bargain among themselves to decide political priorities, determine roles, and distribute opportunities. Although parties vary in

ideology and political history, almost all influential parties share this attribute (ibid., p. 20).

Top party leaders tend to hold on to their positions for life. Girija Prasad Koirala (Nepali Congress Party) and ManMohan Adhikari (CPN-UML), for example, were party chairs until the day they died. And Pushpa Kamal Dahal of CPN (Maoist Center) has remained the chair since the party's founding. All leading parties—the Nepali Congress Party, CPN-UML, and Communist Party of Nepal (Maoist Centre)—have centralist characteristics, and these characteristics are visible in the composition of the parties' central and standing committees, which are dominated by Brahmin, Chhetri, and Newar men of hill origins. These centralist tendencies also influence parties' distribution of tickets to run for election, which are granted based on allegiance to top party leaders (Hachhethu, 2006).

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[18] Interviewee 11.

[19] Many federal employees hold the view that being transferred to a lower-level government is equivalent to a demotion and are vehemently opposed to proposals for more transfers.

[20] Interviewee 11.

> *"Political parties don't want to cede power, and this is a huge problem. Parties are even pushing anti-federalism platforms so that top leaders can hold on to their power."* [21]

> *"The unfortunate thing is that the political parties continued, as far as I can tell, to move forward without changing. Candidates mostly emphasize that previous practice of putting forward mostly upper caste Hindu people from the hill in the majority of winnable constituencies. And so even though, in theory, these federal provinces should have created much more opportunities for ethnic minority representation in the provincial level legislatures. In practice, most seats have still gone to the majority group elites. As this is a problem with political parties, more so than a problem with federalism, examining the federal structures to create these new pluralities and majorities that will change over time is hegemony of the dominant group that has existed for a long time."* [22]

Moreover, since the 12-point understanding [23] between the seven mainstream political parties and the Maoists was reached in 2005, major political parties have engendered an undemocratic culture of resolving interparty disputes in closed sessions rather than an open and contestable political process. Since no major party has achieved a clear majority since 2008, [24] national government leadership has been determined in bilateral and multilateral closed meetings of various party leaders. Despite the parties' differences in political commitments and ideology, no coalition is unlikely in Nepal (Hatlebakk, 2017). Many hoped that the distribution of political power between the executive and legislative branches would introduce a process-based political system, but party control of both branches has meant that the legislature serves the executive branch. Kunda Dixit rightly dubs this the party-cartel system (Dixit, 2016).

The transition to federalism has forced major parties to restructure to become more inclusive. High-caste, hill-origin men continue to control central positions in all parties, but the parties have seen increasing representation of Dalits, Janajatis, Madhesis, and women at the subnational levels. Although the political parties state that they want to decentralize, their central leaderships remain reluctant to reform party structures. Central leaders fear that party decentralization may mean that they can no longer exercise full control over local and provincial politics. [25] Even so, the introduction of federalism has intensified the pressure to reform political parties, as local representatives and party cadres demand more greater inclusivity and new regional parties now compete for the diverse voter base.

JURISDICTIONAL AMBIGUITIES AND TENSIONS

The Constitution of Nepal of 2015 ended the 256 year-long unitary system of governance and replaced it with a federal system comprising three levels of government: local, provincial, and federal. It distributes legislative and executive authority across all three levels and authorizes all levels to formulate laws, plans, and policies and implement them within their respective jurisdictions. The constitution provides clear directions regarding the legislative authority of each governmental level. Schedules 5, 6, and 8 list specific areas within the exclusive jurisdiction of each governmental level—35 for the federal government, 21 for the provincial governments, and 22 for local governments. However, in some areas, different levels of government have concurrent jurisdiction: Schedule 7 lists 25 areas in which federal and provincial governments have concurrent jurisdiction; Schedule 9 lists 15 areas in which all three levels have concurrent jurisdiction (DRC Nepal, 2020). These provisions, while necessary, present jurisdictional ambiguities that have led to interjurisdictional tensions.

Federalism is a novel exercise for Nepal. The country was governed by a unitary monarchy from its founding until 2008. It had limited experience with formal local governance under King Mahendra's party-less Panchayat system. However, Mahendra's model of decentralization

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[21] Interviewee 13.

[22] Interviewee 4.

[23] The 12-point-understanding was reached in a meeting held in New Delhi of the leaders of the seven mainstream political parties and Nepal Communist Party (Maoist Centre) to end the decade-long violent insurrection and launch a joint struggle to end King Gyanendra's autocratic rule.

[24] The system of partial proportional representation makes a single-party majority highly unlikely.

[25] Interviewee 11.

was not based on the principles of self-governance and pluralism. The Panchayat system suppressed freedom of association, political organizations, and freedom of expression and promoted a unitary Nepali identity. In the absence of historical or legal precedents of formal self-governance, both local and provincial governments are facing immense technical difficulties in drafting new laws consistent with the spirit of the federal constitution. In many areas of governance, provinces and local bodies are having to rely on prevailing centralist federal laws. Moreover, bureaucrats and law enforcement officials at all levels still draw their salaries from the federal government and are thus not fully accountable to local and provincial elected bodies. This has led to legal ambiguities and implementation challenges in the areas of resource distribution, public administration, and employee integration (DRC Nepal, 2020).

> *"There exists a gap between the understanding and beliefs of politicians and bureaucrats on federalism. The gap is also reflected in the lack of coordination and clarity between and among federal institutions. For example, although there exists a mandate for the municipal council to formulate policies in their region, they remain inactive and thus have been unable to play a significant role."* [26]

The federal constitution anticipated such challenges during the initial years of implementation. Article 232 states that such relational matters are to be resolved based on the "principles of cooperation, coexistence and coordination." The constitution designates two bodies—the District Coordination Committee and Interprovincial Council—to deliberate on matters relating to inter-jurisdictional tensions and help resolve them. However, inter-jurisdictional tensions have proven to be more complex than anticipated. Although the constitution provides legislative autonomy to all three tiers of government, it also stipulates those provincial laws cannot contradict federal laws and those local laws cannot contradict federal and provincial laws. In practice, this system has hampered local law-making due to the lack of provincial and federal laws. A study by Democratic Resource Center Nepal (DRCN) finds that local governments have been waiting for provincial governments to provide guidance and legislate on matters related to police administration and civil service. Provincial legislatures have been facing similar delays because of a lack of clear guidance from the federal legislature (DRCN, 2020).

When provincial and local legislatures have passed laws without a supporting legal framework from their federal counterpart, interjurisdictional conflicts have arisen. For example, when Province 2 passed the Act Relating to the Management of Provincial Police Service in 2018, the federal government objected. The provincial government was unable to implement the law and set up a provincial police force because the required federal law regarding management and coordination of security forces was lacking (DRCN, 2019). In instances when local and provincial governments undertook legislative initiatives regarding education, the federal government intervened and hindered progress by retaining control over civil servants.[27] Jurisdictional ambiguities have also hindered effective management of natural resources that are shared by multiple provinces. Shrestha (2021) documents the interprovincial dispute between Lumbini and Gandaki Provinces regarding the Kaligandaki-Tinau Multi-purpose Diversion Project in Lumbini. Leaders of Gandaki argue that while Lumbini is the main beneficiary of the federal project, three districts in Gandaki stand to lose from its negative environmental externalities. Similar interjurisdictional frictions exist in other areas of natural resource management such as forestry and irrigation.

ETHNIC POLITICS

Ethnic frictions will remain an arduous challenge while pursuing a federal Nepal because many factors that led to ethnic tensions in the past have not been addressed. Although the federal constitution contains explicit provisions for broader inclusion of different castes and ethnic groups, high-caste hill-origin elites continue to wield substantial political power and occupy a disproportionate number of positions in bureaucracies, political bodies, the police, and the military. Moreover, many Madhesis and Adivasi Janajatis (indigenous

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[26] Interviewee 9.

[27] Interviewee 4.

nationalities) fear that without complete autonomy, the state will continue to attack their cultures and languages and usurp their individual and communal property.

This apprehension is not unfounded. During King Mahendra's Panchayat era (1962–72), the royal government rigorously enforced his ideology of "one nation, one language, one people" through various education programs, discouraged or banned non-Nepali languages in political discourse and public administration, and promoted a "homogenous vision of the Nepali nation-state unified around the concepts of the Hindu religion, the Nepali language, and cultural practices of the dominant hill communities" (Rai & Shneiderman, 2019, p. 85). Many current leaders of major political parties were complicit in ruthlessly promoting "hillcentric nationalism" and requiring "daura suruwaal and topi" (Brahmin and Chhetri attire) for all government officials during various regimes (ibid., p. 85). That said, federalism has opened a path to reconcile many ethnic differences and address Nepal's history of inequality. The preamble of the constitution expresses a commitment to "embracing multi-caste, multilingual, multicultural and diverse geographical specificities" and "ending discriminations relating to class, caste, region, language, religion and gender." Article 51 empowers

provinces to pursue policies to "preserve and develop languages, texts, culture, literature, arts, and property" (shared historical assets) of different castes and communities. Article 295 even grants provincial legislatures the transitional authority to name their respective provinces to better reflect their priorities and cultural diversity.

While many ethnic demands have been met, several thorny issues remain unsolved. For example, some groups continue to raise demands for ethnicity-based provinces, but ethno-federalism is not popular among the broader voter base.[28] Many attribute the defeat of Maoists in the Second Constitutional Assembly elections to their support for ethno- federalism. CPN-UML and the Nepali Congress Party objected to dividing provinces along ethnic lines out of fear of ethnic and communal violence. Jointly, they managed to win 76% of mayoral seats in the 2017 local elections, which confirmed opinion polls' findings that ethno-federalism is unpopular. Constitutional provisions alone cannot guarantee the resolution of these thorny issues, nor do de jure rules necessarily lead to cultural transformation and harmony overnight. Ethnic tensions are certain to play out in various forms, especially in provincial elections and legislative processes.

RESOURCE LIMITATIONS

The creation of new tiers of government at the local and provincial levels has generated a need to expand the civil service, which requires hiring essential staff and building new offices. Many provinces have had to establish new departments and offices to fulfill their constitutionally mandated roles. For example, Karnali Province established 108 new offices, and Province 1 established 155. The lack of office buildings is especially dire at the local level. This has proved to be a major barrier to devolution of power. In many instances, several ward offices operate from a single room. In others, local governmental activities are carried out from district headquarters. This barrier has led to delays in the delivery of basic public services such as registration for birth, death, marriage, migration, and citizenship (Khanal, 2019). Moreover, there is an acute shortage of qualified personnel to fill these vital positions in rural municipa

lities and provinces. The Ministry of Federal Affairs and General Administration reported a shortage of 40,000 employees in the public sector in 2019. This shortage is exacerbated by the lack of a federal legislative framework for local and provincial governments. For example, Karnali Province struggled to hire 2,364 essential staff for various administrative positions (only 1,312 positions had been filled). Similarly, Province 1 was able to fill only 2,120 of 3,882 positions (DRCN, 2019). The inability of federal hiring procedures to serve the needs of rural provinces has largely caused this gap. Qualified civil servants do not want to move to rural provinces because they tend to view rural assignments as demotions or they are not adequately compensated there.[29] Considering the lower literacy rates and economic backwardness of some rural provinces, hiring standards may need to be loosened.

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[28] Interdisciplinary Analysts' Nepal Contemporary Political Situation Opinion Survey of 2015. See Hatlebakk (2017) for more.

[29] Interviewee 11.

Hiring at the provincial and local levels will require federal laws enabling provincial governments to establish public service commissions, but the federal government is reluctant to release its grip on civil service employees. The federal government ceded health centers and public schools to local governments after the passing of the Local Government Act of 2017. However, many villages and municipalities were unable to manage these vital institutions because they lacked financial resources and faced staffing issues (Khanal, 2019). Currently, local governments raise only about one-third of their operating budget through taxation and fees. For the rest, they rely on transfers from the central government (Acharya, 2018). In the fiscal year 2016/17, the government of Nepal allocated 18% of the annual budget to local governments. The following year, the allocation was 17.6%. However, many local governments lack sufficient staffing to manage the funds or spend them. Moreover, their fiscal dependency has allowed national politicians to influence local development projects and allocate funds to their favored constituencies.

> *"The mindset among civil service employees still is still heavily centralistic. While the system has been built on the concept of federalism, when given a choice, many civil service employees prefer to work at the federal level and not at the provincial and local levels. The system has also failed to calibrate the appropriate size and structure of institutions at all levels; at the federal level, there still exist top-heavy organizations, while those at the local level are very small and numerous. We continue to build large administrative empires, there exist too many associations and institutions that make the structure a lot more expensive. This has widened the gap between the local and provincial level governments and institutions, which is partly also because the role of provincial governments are not clear and succinct."* [30]

TECHNICAL CAPACITY

Despite constitutional guarantees and legal provisions to plan and implement programs at the local level, most local governments still lack the technical and fiscal capabilities to manage their own budgets. According to existing fiscal laws, local governments are to present their budgets at their respective local assemblies by the third week of June. However, in the fiscal year 2020/21, 23% of the local governments were unable to do so. In Madhesh Province, only half of the local governments were able to meet the deadline (DRCN, 2020). A case study conducted by the Democratic Resource Center of Nepal (DRCN) in the rural municipality of Samsi in Province 2 finds that the lack of a dispute-resolution mechanism was responsible for the delay. Elected representatives engaged in frequent disputes over budget allocation and program selection. DRCN notes that the disputes were more frequent among representatives from different political parties (p. 8).

> *"The major problem that inhibits the performance of the local level is their low capacity towards plan formulation and implementation. Nepal itself lacks quality human resources in general; local level lacks even more. Federal government neither has allowed local level to hire required employees on their own nor sent employees as per required. Lack of quality human resources is the major cause behind low capacity. Furthermore, conflict between elected representatives and administrative officers is another factor responsible for poor delivery of public services. Elected representatives want instantaneous delivery of services, but the administration is not cooperating with them due to lengthy procurement processes. This conflict creates ego that has negative externality on overall performance. This is the issue in almost all local levels."* [31]

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[30] Interviewee 11.

[31] Interviewee 6.

The share of the national budget allocated to local governments increased from around 5% before 2015 to over 17% after 2017. Moreover, every year since 2017, almost every local government's budget has seen further increases. As noted in the previous section, the average budget size in the fiscal year 2020/21 across all local governments in all provinces increased relative to the fiscal year 2019/20. The average increase across all provinces was 14% in the fiscal year 2020/21, and this growth in local budgets is a major step toward decentralization (DRCN, 2020). Local governments in Bagmati Province saw the largest increases, whereas those in Sudurpaschim Province saw the smallest increases. However, these figures mask the inability of local governments to spend the allocated budget because of their deficient technical capacities. For example, in the fiscal year 2018/19, local governments were unable to spend 22% of the allocated budget (ibid., p. 13).

ACCOUNTABILITY DEFICITS

The ongoing transition from a unitary to a federal system of governance has generated new accountability challenges. At all levels of government, there is a lack of a clear legal framework to assess the fiscal state of public programs. The Financial Procedure and Fiscal Accountability Act of 2019, which requires public entities undertaking multiyear projects to seek approval from the Ministry of Finance, represents the closest thing to a legislative safeguard against fiscal corruption (Shrestha, Shrestha, & K.C, 2020). The act also stipulates that any contractual arrangement among private, public, or hybrid entities that creates a fiscal liability must be recorded. However, provincial legislatures have yet to formulate relevant complementary laws or set up administrative infrastructures to assess their programs (ibid., p. 42). Local legislatures are far behind and lack the expertise and capacity to understand, interpret, or contest federal and provincial legal provisions.

Lack of adequate formal accountability mechanisms poses a major challenge, as does noncompliance with existing mechanisms. Pandey, Jha, & Maharjan (2020) find that financial reporting and compliance with prevailing fiscal laws by local governments has been "sub-par." In fact, the number of local governments properly reporting their budgetary activities declined from 666 in 2019/20 to 550 in 2020/21. Roughly 27% of local governments failed to satisfactorily report their fiscal activities in 2020. Moreover, Pandey et al. (2020) point out that no local governments submitted their Mid-Term Expenditure Framework; 105 local governments missed the budget deadline in the fiscal year 2018/19; and 107 approved projects well outside their approved budgets (ibid., p. 2).

"There is a general lack of effective checks and balances. Corruption has always been rampant in the country, and the lack of effective check-and-balance mechanisms contribute to the perpetuation of abuse of authority Nepal currently has top-down/ vertical check and balance approach, which creates a lot of friction. To reduce this, capabilities of the institutions must be worked upon and improved and a horizontal/ peer reviewed check and balance system must be put in place, which will lead to a more effective implementation of federalism in Nepal. This can look different in different places. More experimentation is needed, so success stories can serve as template to others." [32]

Before the local elections of 2017, local government heads were centrally appointed by the Ministry of Local Development and reported only to their district-level officers. So, while bottom-up reporting did occur, the reports were not sufficiently publicized because local governments were not accountable to the people. For that reason, while corruption existed, it was less visible. This pattern changed after 2017. Incidents of corruption at the local governmental level now get public exposure because people can access information regarding allocation of funds, public expenditure, and the quality of public works more readily. Local media outlets have proliferated in recent years, which adds an extra source of accountability and keeps local public officials in check. Thus, while corruption may have increased at the local level because of an increase in local funds, it may be that overall corruption has not increased but rather has been brought closer to home.[33]

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[32] Interviewee 10.

[33] Interviewee 6.

CIVIL SOCIETY AND THE MEDIA

Nepal has a very active but heavily politicized civil society sector (Hatlebakk, 2017). Notable student associations, trade unions, and human rights organizations formally associate or align with political parties and promote their agendas. Meanwhile, the media is relatively independent and diverse but has been facing increasing political pressure.

The US Agency for International Development (USAID) gathers annual data to compile its Civil Society Organizations Sustainability Index to assess non-governmental organizations' capacities, challenges, and performance in various countries and better understand the working environment of USAID's local development partners and the challenges they face. The 2020 Civil Society Organizations Sustainability Report for Nepal indicates that the overall sustainability of civil society organizations in Nepal has remained stable in recent years. The report notes that despite the challenges brought by the COVID-19 pandemic, the overall index score remained unchanged in 2020 relative to 2019. Since the promulgation of the federal constitution in 2015, the legal environment has become more favorable to civil society organizations. However, regarding organizatio-

nal capacity and financial viability, Nepal has performed worse following the promulgation (USAID, 2020).

*"**Compared** to United States, Nepal's civil society and non-government sector are still democratizing and have some kind of authoritarian history. In the polls, we see a very high influence of socialist ideology in many of its parties which has an impact on people and might see the role of the private sector. But I haven't really seen that impact in practice on those sorts of things. It's difficult to actually see in many cases the socialist ideology, coming out in those political parties, other than in current revolutionary ideals, and most of them have pursued more or less just kind of liberal economic agenda with some caveats. So, even though it does have a strong socialist inclination, I think that Nepal will continue to open up more to the private-public partnerships in the future. There's a lack of funds so particularly bringing in international investors is probably going to be some-thing that we'll see more of, and opportunities for civil society to participate at the local level I think have been increasing through some participatory forums that some well most local governments have been putting forward."* [34]

Figure 7: **Status of civil society organizations in Nepal – CSO Sustainability Index, Nepal (2014–20)**
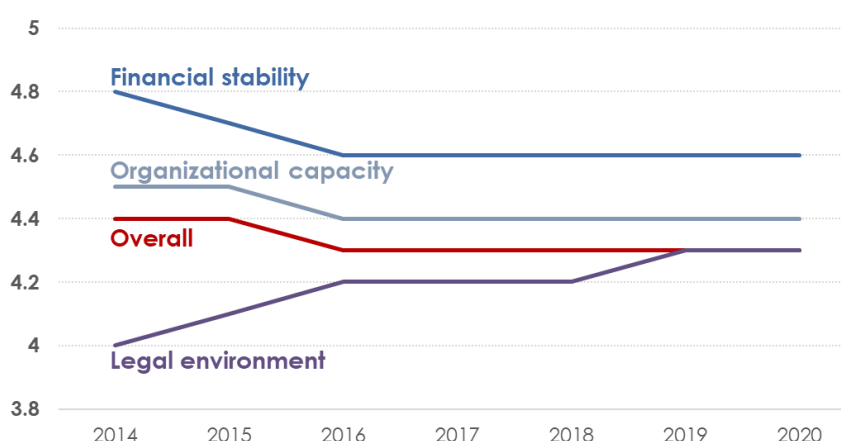
Source: Civil Society Organizations (CSOs) Sustainability Index (USAID).

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[34] Interviewee 4.

Despite some improvements in the legal environment, civil society organizations (CSOs) still face regulatory uncertainties. The federal parliament has not yet finalized basic laws governing civil society organizations and the media. The Social Welfare Council (SWC) is the federal body responsible for overseeing CSOs in Nepal. In 2020, over 50,000 CSOs were affiliated with the council.[35] In addition, community user groups are very active. In 2020, Nepal had 22,415 forest user groups, 5,000 water-and-sanitation user groups, 3,200 irrigation-and-water user committees, and 283 community- electricity user committees (USAID, 2020). It remains unclear how SWC will adapt its roles to fit the federal system.

Moreover, the government has posed numerous threats to freedom of expression. In 2020, it attempted to enact the Media Council Bill and the Information Technology Management Bill, both of which included provisions to curtail freedom of speech. For example, they would have allowed the government to impose heavy penalties on media outlets accused of libel and block social media platforms not registered in Nepal. Media outlets, civil society advocates, and opposition parties launched protests, forcing the government to revise these provisions in the version that was eventually passed (British Council, 2019).

"Non-governmental organizations are found to play an impactful role in Nepal. In recent times, they have done commendable work in some sectors like social mobilization, water and sanitation, health, community resource mobilization, etc. This had led to provisions in place that enable local level governments to outsource tasks and activities to NGOs. However, there are existing controversies over the role of NGOs; there are accusations and grievances that NGOs are more focused on publicity rather than the impact of their interventions. Others also believe that nongovernmental organizations do not carry out proper consultations with the relevant government authorities. For transparency to be maintained at all levels, the organizations working in the region and the local government must co-ordinate and co-operate to bring about effective results. Many NGOs are also found to be carrying out activities in too many different sectors without proper specification of their work. Those that are carrying out their work in specific sectors have made significant impacts in the regions they work in. The general perception on these organizations have also changed, as they have built more rapport and trust among the communities and local governments with the quality of work they have been doing. However, as mentioned, some issues remain to be resolved." [36]

PRIVATE SECTOR CHALLENGES

Despite some improvements in the business environment for private enterprises and growing optimism among young entrepreneurs (see "Achievements" section), various barriers continue to hinder private businesses in Nepal. These barriers fit into three main categories: regulatory, political, and cultural.

The federal constitution of 2015 grants all provincial and local governments the authority to make laws regulating private enterprises, provided that the laws do not contradict federal legal provisions. However, the federal legislature often does not prioritize making laws to govern the registration and operation of private enterprises, thereby frequently lagging behind provincial and local legislatures in drafting such laws. For instance, Gandaki Province passed the Provincial Industrial Enterprise Act in 2020 to clarify and consolidate laws

relating to industrial enterprises operating in the province. A year later, the federal legislature approved the Industrial Business Act, which includes 35 provisions that conflict with Gandaki Province's laws, thus invalidating many of the provincial legal provisions. Moreover, some provisions in the Industrial Business Act of 2021 made it more cumbersome for businesses to register and operate by requiring additional approvals at different government levels. For example, Section 3.2 requires businesses to acquire "recommendations of the concerned locals" but does not detail how they can do so.

Furthermore, legal ambiguities related to owning and leasing land prevent investors and entrepreneurs from acquiring or leasing land to operate businesses. Similar regulatory confusion exists regarding the jurisdictional level governing the operations of "mobile shops" (IT

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[35] SWC affiliation is required for foreign funding.

[36] Interviewee 11. NGO: nongovernmental organization.

firms and transportation companies) and firms operating across provincial boundaries. Moreover, the federal government continues to stifle innovation by implementing outdated provisions such as profit capping based on obsolete protectionist laws.

> *"Based on some obscure law from the 1950s, the government implemented a profit-cap at 20%. A well-known entrepreneur was arrested because he was selling coffee at higher price than what government deemed would be equivalent to a 20% profit. This shows a complete lack of economic knowledge. The entrepreneur is not just selling coffee. S/he is selling an environment where customers can spend a quality time. That wasn't priced in. Internet service that was provided wasn't factored in. But that's not even the point. It doesn't make sense that government can tax individuals 270% on automobiles and electronics, but a hardworking entrepreneur cannot make profits over 20%."* [37]

Cronyism is rampant. Politicians commonly set up contracting companies to profit from government projects. Moreover, various business leaders find it easier to deal with federal regulatory agencies since they have already invested heavily in ties to the politicians and bureaucrats in charge of the agencies. Various special interest groups find it beneficial to increase barriers to entry, which they can do most effectively if authority is concentrated at the top. This is a major reason why delegating roles and authority to lower-level jurisdictions has been challenging.

> *"Private entrepreneurs face an image problem. People do not quite understand what a good private firm or a good business leader looks like. Well-known businessesmen openly work with politicians for private gains and excluding competitors. All major political parties provide tickets to businessmen who fund their campaigns. There is not even an attempt to hide this."* [38]

In recent decades, cronyism has tainted the image of private enterprises and entrepreneurs, who are viewed by the public with suspicion. So has the rise of communist parties. The two leading communist parties—Communist Party of Nepal (Maoist Centre) and CPN-UML—have been critical of capitalism. Their political campaigns have focused on blaming capitalists and capitalist-leaning parties for Nepal's sluggish economic growth. The public's favorable views on profit capping and punishing businesses and business leaders shows that these campaigns have been effective. Over 70% of the members of the federal parliament come from socialist or communist parties skeptical of capitalism and in favor of central planning for economic development. Thus, in addition to overcoming regulatory and political barriers, private entrepreneurs also face the cultural challenge of changing public perception of the merits of market enterprises.

GEOPOLITICAL CHALLENGES

Nepal is situated in a geopolitically sensitive location between two Asian giants with competing economic and political interests. Political analysts often portray Nepal as a buffer between the two giants. As previously discussed, (see "Geopolitical considerations" section), Nepal has aimed to appear neutral. However, Nepal's ties with India run much deeper than with China because of shared religion, culture, language, and history. As Rakesh Sood, former Indian ambassador to Nepal, wrote, "Perhaps no two countries share as close and as complex a relationship as India and Nepal" (Sood, 2016). Nepal and India share an open border that allows free movement of people and goods. India is Nepal's largest trading partner; over 60% of Nepal's trade was with India in 2015 (Wagle, 2018). In comparison, Nepal's direct relationship with China has been rather distant, with a few heavily militarized border entry points (Goodhand & Walton, 2019). However, communist parties in Nepal, particularly the Communist Party of Nepal (Maoist Centre), view China as an ideological ally.

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[37] Interviewee 10.

[38] Interviewee 10.

"The communist party of Nepal (Maoists) tried to integrate some aspects of Chinese governance, based on Mao Zedong's ideas. The Nepali Congress Party have been historically influenced by certain Indian politicians and democratic vision. There's that tension between those two. There is also a tendency to borrow ideas and ideologies without deliberating on how they fit into the Nepali context. And whatever comes out of that ideology-transfer doesn't address any fundamental political problems in Nepal. At the very local level, Nepal used to have this semi-feudalistic mukhiya system, probably something similar to a lot of African communities with chiefs and so forth. Despite all its problems—it was highly extractive and discriminatory—it provided some level of informal governance when formal governance was lacking. Maoist movement tore that apart and instituted parallel governments at the local level because the system was caste-based and discriminatory. The traditional system was highly imperfect, but whatever replaced it wasn't any better suited to address Nepali problems. We can observe similar tendencies to replicate foreign models in Nepal. This is one of the many ways geopolitical tensions play out in Nepal." [39]

Although Nepal and India share deep ties, their relations have always been contentious. Pundits say that no prime minister in Nepal will be appointed without Delhi's consent (Hatlebakk, 2017). While an exaggerated claim, it accurately suggests that India has frequently intervened in Nepal. India's desire to micromanage Nepali politics was most apparent in 2015, when it imposed an unofficial blockade on Nepal in response to the promulgation of the federal constitution. Nepal's Constituent Assembly ratified the constitution without fully addressing Madhesi and Tharu concerns against the wishes of India. The dramatic rise in Khadga Prasad (KP) Oli's popularity following his firm public stance against the Indian response indicates that political parties may pay a heavy price if they openly align themselves with India.

The unofficial blockade severely hurt Nepal–India relations and pushed Nepal closer to Beijing. In response to pleas by Nepali communist party leaders, China committed to financing various infrastructural projects and expanding Sino-Nepali trade volume. As Sino-Nepali relations deepen, it is almost certain to anger India. India and China have a long history of territorial conflict—

including even a war in 1962—that has been intensifying in the last two decades (Ganguly & Scobell, 2018). Most recently, their enduring rivalry and ambitions for territorial control were visible during a military standoff in Doklam, Bhutan in 2017.

"Nepal has many similarities with India—similarities with culture as well as in the bureaucracy. India has always been interested in influencing the political system in Nepal. India is also a close development partner for Nepal. It has supported communities directly by building schools and community health centers and roads. It is a giant economy. But India always has had a vested interest in Nepal. Nepal has an abundance of water resources. India always wants to harness Nepal's water resources—both with respect to hydro power and drinking water. This can be of mutual benefit, but the public attitude regarding India's involvement is not so positive. Young generations are skeptical of India's involvement both in Nepali politics and economic development. It is well known that India wants to have influence in appointing Prime Ministers, and even district administers who agree with Indian interests. They want to appoint those who support India. This is the political economy of India in Nepal." [40]

Although China has positioned itself as a neighbor "that does not interfere or show too much interest" in Nepal's internal affairs, it has also become increasingly involved in Nepali politics since Nepal abolished the monarchy in 2008 (Bhattarai, 2020). Nepal's two leading communist parties have strengthened ties with the Communist Party of China in recent years. Chinese president Xi Jinping visited Nepal in 2019, becoming the first Chinese president to do so in over two decades. Xi's visit occurred during the reign of Prime Minister Oli, who was concurrently the leader of the Communist Party of Nepal (CPN).[41] China's main concern in Nepal has been the more than 20,000 Tibetan refugees who reside in Kathmandu, many of whom support or participate in the Free Tibet movement. However, in recent years, Chinese concerns have extended beyond that issue. In 2020, the Chinese embassy in Nepal charged the editor of the Kathmandu Post, the nation's leading English-language newspaper, of being "always biased on China-related issues disregarding the facts and becoming a parrot of some anti-China forces" (Dixit, 2020).

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[39] Interviewee 5.

[40] Interviewee 3.

[41] CPN (UML) and CPN(Maoist Center) unified in 2018 to form the Communist Party of Nepal. The party faced a series of splits following intraparty factions. CPN is now defunct.

Nepali leaders must navigate these geopolitical tensions carefully. Although politicians may find anti-India rhetoric useful to gain local support, Nepal cannot afford to jeopardize trade relations with India. Meanwhile, strengthening ties to China has created new economic possibilities and a chance to diversify trade relations and reduce dependency on India. China's economic interests in the region are evolving, as it seeks to deepen market ties with South Asian population centers. Nepal stands to benefit from China's market expansion efforts, and numerous infrastructural projects such as the trans-Himalayan network connecting cities in the Himalayan region including Nepal. However, China's territorial ambitions in the region have also been expanding. Thus, turning to China in response to India's hostile approach is also not risk free.

In recent years, the United States' role in Nepal has become more significant. In 2017, Prime Minister Sher Bahadur Deuba signed a Millennium Challenge Corp-oration (MCC) compact with the United States. The MCC was established by the US Congress in 2004 to address poverty in the developing world, as Congress realized that global poverty and terror threats are deeply linked. According to the compact, the United States will provide $500 million in grants to support Nepal's vital infrast-ructural projects, targeting two major areas: energy and transportation. Once the compact is implemented, the US will become a major stakeholder in Nepal's economy and will likely engage in its geopolitical affairs. As Biswas Baral (2022) notes, this development has caught both India and China off guard, as they have historically viewed Nepal as their backyard. Both Indian and Chinese

officials maintain that they have no problem with Nepal's signing of the compact. However, analysts say that Chinese officials view the compact as part of the US's Indo-Pacific Strategy to curb China's regional influence, and Indian officials are suspicious that US involvement will limit their own influence (Baral, 2022).

Domestically, the compact has generated significant strife across and within major political parties. Two of the three leading political parties in Nepal—CPN-UML and CPN (Maoist Centre)—comprise communists who tilt toward China and have been suspicious of Western engagement in the subcontinent. A major point of contention is the compact's Article 7.1, which states that the compact will trump the domestic laws of Nepal. Those opposed to the compact interpret this article as infringing on Nepal's sovereignty. Notwithstanding the geopolitical dynamics and contentious details of the compact, the controversy has perhaps more to do with Nepal's internal political dynamics, as leaders from all three major parties have, at different times, endorsed the compact and asked for parliamentary support while they held political office. As Santosh Poudel of The Diplomat writes, "The debate over the aid project is not about its contents but about American intentions, the integrity of Nepali leaders, and domestic cost-benefit analysis." On February 27, 2022, a day before the deadline of February 28 given by the MCC compact, the federal parliament ratified the compact, after the Communist Party of Nepal (Maoist Centre), the CPN (Unified Socialist), and the Janata Samajbadi Party joined Prime Minister Sher Bahadur Deuba (of the Nepali Congress Party) in support of it.

ROLE OF DONORS & INTERNATIONAL ORGANIZATIONS IN SUPPORTING FEDERALISM

DONOR PROJECTS

Donors providing financial and technical assistance in Nepal have played pivotal roles in supporting developpment activities. However, several partner organizations report that donors work predominantly with Kathmandu-based organizations and focus on Kathmandu-centric programs. They also tend to listen to experts and stakeholders from Kathmandu, who are oblivious of affairs outside the valley.

Stakeholders interviewed for this report believe that it is vital to change this pattern in order for donor efforts to better support the shift to federalism, a key objective of which is to bring the government closer to the people everywhere. These stakeholders also report that donor programs incentivize research, such as reports and programs, that are too focused on advocacy and tend to lack rigor and empirical support. This is challenging because it is so difficult to unpack the impact of federalism in Nepal. Understanding the impact of federalism on a range of outcomes, including public service delivery and private sector development, is not easy, especially given federalism's recent introduction to the country. Stakeholders also underscored that supporting federalism in Nepal is difficult because democracy has not yet

consolidated. They hope that federalism can help consolidate democratic rule, but democratization and federalization are happening simultaneously.

Regarding private enterprise development, the general business environment in Nepal remains unfriendly. Donors tend to focus on policy issues, but deeper cultural and institutional barriers to fostering private enterprise exist. These barriers have to do with informal norms that underpin the relationship between the individual and the state. Changing the business environment takes time and patience, and the results and extent to which changes can be brought about are uncertain. The public perception of entrepreneurs is negative, and public policies reflect this view. While the pervasiveness of cronyism certainly validates some of these views, adopting a blanket approach to cronyism is detrimental to startups and businesses that do not participate in it.

> *"The government can levy 270% tax on automobiles, but an entrepreneur cannot earn more than 20% profit without the intervention of the government. This culture of creating and promoting negative enterprise ecosystems must go."* [42]

ROLE OF CENTER FOR INTERNATIONAL PRIVATE ENTERPRISE PROJECTS

Working with CIPE has helped its partner organizations to network and build rapport with stakeholders. Politicians and bureaucrats, including provincial and local authorities, listen more carefully when they know international partner organizations are involved in programs and projects. These partnerships have also helped

improve partner organizations' visibility among the youth and various other organizations, contributing to volunteer mobilization and management. Funding assistance in this regard has been of great help. Consequently, advocacy and media outreach have improved through CIPE's support.

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[42] Interviewee 2

Stakeholder meetings held by CIPE have been important for knowledge sharing and have contributed to the development of some of Kathmandu's most prominent think tanks. This avenue of CIPE support has advanced research and policy advocacy, and CIPE's involvement with provincial policy think tanks and partners has improved their sustainability, as they are now able to pick their own agendas and are taking strides toward financial independence. The impact of this support is also seen in the private sector. Because there are more programs and financial and technical support available, several startups and other businesses have been able to grow.

Donor organizations tend to have broad working assumptions about what is right for Nepal and view partner organizations as mediators to implement their ideas. However, many partners and organizations have their own ways of working, and this gap brings about confusion, conflict, and issues of ownership and sustainability. While CIPE has given enough room for partners to come up with their own ideas, hiring international consultants and having them form associations and consortia largely ends up making things function and proceed in an inflexible way.[43] Partners appreciate CIPE's long-term view of partnership, as it works with local stakeholders. This allows CIPE to take a longer-term view not only of the contexts they work in, but also of partnerships. They appreciate the care that CIPE brings to nurturing long-term relationships with partners to build their capacity.

DESIRES OF LOCAL STAKEHOLDERS

The challenge of implementing and sustaining federalism must be tackled not only in the capital but outside Kathmandu. This idea was a major trend that emerged in interviews with key stakeholders. We noticed a significant gap between the needs of organizations in the capital and those outside it. Organizations based outside of Kathmandu expressed the need for broader engagement with academics and experts while also indicating interest in doing more rigorous work on fostering entrepreneurship in Nepal. Not many scholars in Nepal support entrepreneurship and economic institutions, while the private sector would benefit from engagement with foreign experts on building capacity for enterprise development. Because of the lack of highly skilled human resources and experts in Nepal, coupled perhaps with their distance from the capital, non-Kathmandu-based organizations have a very raw view of regional problems. Kathmandu tends to overemphasize certain issues and overlook others it deems minor. This implies that creating platforms to share ideas and resources across organizations working in entrepreneurship space, which organizations have expressed interest in so that they can conduct and coordinate broader projects, would be helpful. Non-Kathmandu-centric support, including mobilization of experts and provisions of technical and financial assistance to organizations operating in the provinces, would help increase such organizations' capacities and serve the non-Kathmandu population with better knowledge, resources, and opportunities. Registration of enterprises remains a challenge because of the requirement of registering new businesses at both the local and provincial governments. This mandate creates confusion and makes the business establishment process slow and inefficient. Strict regulations on land acquisition also hinder progress for enterprises. The work of donor organizations to combat these regulations is very limited since successfully doing so requires getting policy makers to make changes. Given these organizations' influence on governments and other authorities, attempting to ease out the establishment and operation processes for businesses to create a more entrepreneur-friendly ecosystem may bring forth tangible impacts. Organizations such as CIPE can support and help formalize private sector development by bridging the gaps between different levels of government and between the public and private sectors, including by generating awareness among the public on the value of entrepreneurship. Such initiatives would reduce negative perceptions of entrepreneurship. Adopting a logical and practical approach to disseminating information and avoiding misinformation, while attempting to educate the public on these issues, would help create collective consciousness.

As research is expensive and time consuming and takes resources away from policy advocacy, organizations must focus on one or the other. In areas in which effective

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[43] Interviewee 29.

policy advocacy requires research, organizations are incentivized to pick the least research-demanding policy issues that allow faster deliverables. Thus, there is a lack of quality empirical research in many policy areas.

Research organizations also face a tremendous scarcity of human resources for supervising research papers, sharing findings and studies, and selecting and executing research methodologies. Donor organizations should help them by mobilizing experts and connecting them with relevant research in Nepal by providing full-time support, as partners always look forward to additional projects and contracts. However, research organizations would be more effective if they operated with more trust-based leverage and flexibility, enabling them to work more freely outside of the context of externally imposed agendas. Donor organizations should consider Nepal's long and difficult battle for democracy and federalism as well as the country's limited resources when communicating with local research and policy organizations in order to more effectively coordinate and communicate.

Stakeholders perceive that donor organizations tend to have broad working assumptions about what is right for Nepal and view partner organizations as means to implement their ideas. However, Nepal's challenges, as with many countries, are highly contextual. For instance, donors often do not realize that civil society and nongovernmental organizations can also be heavily politicized and corrupt regarding certain subjects.

While there may be lessons from projects implemented in other countries, donors should not think that those programs can be replicated in Nepal. More importantly, donors should not assume that their understanding of the problems (or solutions) is correct. There should be room for experimentation and room to make mistakes. Donor organizations should listen more to local partners who admit they do not know the answers but express interest in finding them.

Enterprises would also benefit if donor organizations tried to gain first-hand knowledge and insight on the problems they face and tried to be flexible. They should look at specific organizations and try to solve issues one by one, instead of taking a one-size-fits-all approach.

CIPE partners emphasized the need to move beyond policy advocacy and develop province-focused strategies based on in-depth research. Both Pokhara Research Center (PRC) and Samriddhi have expressed deep interest in creating research programs to better understand the changing institutional landscape of Nepal. They have noted that federalism has brought many new challenges but no clear solutions. They have expressed interest in partnering with researchers and research organizations specializing in federalism issues. CIPE partners regularly seek consultation from experienced researchers on an ad hoc basis, but a more streamlined strategy is needed to increase efficiency. Samriddhi is already reorganizing its board to move in that direction. Likewise, PRC notes that many of its programs are experimental and research oriented. For example, PRC's policy circle program brings together private entrepreneurs and political leaders from Gandaki Province to identify barriers to entrepreneurship and investment in the province. PRC leaders understand that the program might not succeed, but without such experiments, we cannot learn what works for different provinces and localities. CIPE should encourage a systematic approach to identify solutions and to determine their scalability. Collaborating with global research centers such as CGM will go a long way in facilitating partner efforts. CIPE can foster such efforts.

While many donors focus on policy making and implementation, CIPE partners note that barriers to entrepreneurship in Nepal are not entirely due to policies. Rather, private entrepreneurs face the pervasive stigma against profiteering. For instance, entities specializing in facilitating transactions (such as real estate or licensing deals) are routinely referred to as dalals—a derogatory term also used for human traffickers. Bikalpa and Samriddhi conduct many student- and community-focused educational programs to highlight the merits of private entrepreneurship, market competition, and economic freedom as well as the necessary conditions under which private entrepreneurs can benefit society. Their efforts often begin with an acknowledgment that private enterprises have in fact been corrupt, as they routinely abuse government grants received through lobbying. For these programs, Bikalpa produces aware-ness materials, including videos advocating federal administrative reforms to improve local governance and foster private enterprise. CIPE's future efforts should include programs to provide technical and financial support to such activities, and it should encourage novel approaches to educating the public.

All CIPE partners noted significant limits on technical capacity and human capital at the local level, particularly in the least developed provinces. Some of our informants also pointed out that these problems have led to

sluggishness and dysfunction in many rural munici-palities, results which have impeded the implementation of federalism. CIPE has made progress in working with partners in new provinces, but many provinces are not represented. Finding local partners in rural provinces is difficult, but it is a necessary step toward solidifying political gains from federalism. Future programming should include strategies to expand CIPE's reach to underdeveloped provinces, particularly Provinces 6 and 7. It may be beneficial to target efforts toward finding new partners and developing local capacity by connecting them with established partner organizations.

RECOMMENDATIONS FOR CONSOLIDATING FEDERALISM

CIPE's continuing engagement to support federalism in Nepal is vital. In many post-conflict environments, the international community works with local stakeholders to rebuild quickly based on old institutional structures, reasoning that introducing too many institutions during a time of transition would only yield more upheaval. Nepal instead sought to break out of a decades-long vicious cycle of state collapse and conflict through instituting a federal constitution. This move was a difficult decision that could inspire other countries in the region during post-conflict recovery.

Democracy and federalism are powerful tools societies can employ to help avert conflict. While their implementation has been imperfect, this is always the case.

Nepal will face more bumps in the road as it consolidates democratic federalism but overcoming them will only make this system of governance stronger.

The following recommendations for advancing the federalist transition derive from a balcony-level study of federalism in Nepal. They address the critical issues that stakeholders and CIPE's partners have emphasized. The recommendations are broad, and their details can only be specified with the aid of CIPE partners who have an on-the-ground perspective on what is possible. Implementing them will depend on the kind of deep understanding of local dynamics that can only be gained through sustained conversations between CIPE and its local partners.

1.Donors must consider more projects focused on long-term issues. Nepal's institutional reforms will take generations to complete, but most donor organizations prioritize short-term projects with measurable outcomes for quick wins. Local organizations generally feel that donors have outsized expectations of what federalism can do in the short term and focus too little on long-term development issues.

2. Organizations should stress both the successes and challenges of federalism. Several international and local organizations focus on federalism in part because of its potential to improve the delivery of public goods and services, and most narratives about federalism treat service-delivery outcomes and citizen perceptions of them as the most important metrics. However, Nepal selected a federal constitution not only to improve in these respects but to ameliorate deep ethnic divides. Furthermore, while federalism might not be effective in improving service-delivery outcomes in the short term, it has already been successful in addressing ethnic and social tensions.

3. Partner organizations need to think locally. Partners noted that, in general, donors working on federalism issues have focused on developing national-level frameworks. But it is important to also support local organizations and initiatives, and many local governments and provinces remain institutionally weak. International organizations can support such entities in a couple of ways:

- Generate institutional knowledge and capacity, especially at the provincial local levels, through supporting provincial policy think tanks.

- Help clarify the roles of authorities at different levels of government to avoid the conflict resulting from overlapping jurisdiction. Conversations and engagements with CIPE partners may be beneficial to support this.

4. Empower local partners to share examples of federalism's successes. Locally led and internationally supported programs can highlight the successes of Nepali federalism as a laboratory for local and provincial governments and, in doing so, counter negative media coverage of the federalist system. To that end, and to allow successful local governments to share their stories and experiences, CIPE can bring local partners together to collect and publicize examples of federalism's successes at the subnational level.

5. Connect struggling local and provincial governments with successful peers. Many local and provincial governments have overcome challenges resulting from the federal reforms. For example, many are now preparing budgets and reports on time. Officials in such governments can work with and teach less successful government officials, civil society organizations, and private sector groups in other regions by sharing their experiences. This method may be a much more effective way to train these key stakeholders and build capacity.

6. International organizations should address corruption and accountability concerns at the local level. Citizens perceive that federalism has resulted in an increase of corruption at the local level, but in fact overall corruption has declined. The reason for the apparent increase is that many governance challenges are now addressed not at the national level but at the local level, so citizens are more aware of resulting accountability issues. Yet there are more means of ameliorating corruption at the national level than the local level. International organizations can help inform citizens of existing means at the local level through expanding provincial policy think tanks and civil society organizations, facilitating opportunities for public-private dialogue, recording and issuing PPD reports, and engaging in community relations.

7. Use technology to overcome jurisdictional impediments. Jurisdictional ambiguities and resulting tensions are major impediments to implementing federalism. Local organizations should document these impediments on electronic platforms. They can take inspiration from Samriddhi, whose website details such procedures.

8. Local governments need to advocate for their citizens at the national level. The government often does not know the people's needs. This ignorance is particularly acute at the local level. Local organizations could glean citizens' preferences and communicate them to the government.

9. Reform the federal bureaucracy to improve federalization at the local and provincial levels. Without reforming the federal bureaucracy, federalization will be delayed and stunted. Bureaucrats, such as those on district coordination committees, do not seem to know their roles, and most bureaucrats, who work at the federal level, view reassignment to provincial and local jobs as demotions, so qualified people do not take such jobs. International organizations can help find a bottom-up approach to bureaucratic reform by working with its partners, private sector entities, and other key stakeholders.

10. Leverage international partners to address problems in the budgeting process. Provinces often do not prepare their budgets on time, and they face budget-execution problems. Internationally supported but locally led programs can help provinces meet these challenges and in turn allow them to better plead with the national government to address their needs.

11. International organizations should work with local partners on issues tied to ethnicity and caste. Caste and ethnic tensions underlie all major political issues in Nepal, but donor organizations tend to avoid addressing them. These tensions affect commerce and the way citizens and businesses engage with government. International organizations can work with local partners to find solutions that are sensitive to local contexts, especially outside of Kathmandu, where the tensions are different.

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ANNEXURE 1

LOCAL LANGUAGE TERMS IN ENGLISH

Adivasi	Indigenous people, group, or tribe
Aafno manchhe	My people
Baidhanik Kanun	Constitutional law
Brahmin	A caste that wears the sacred thread; Brahmins are the members of a Nepali Hindu group that is perceived as historically having a high socio religious status in Nepali society; Tagadhari caste
Chepang	Tibeto Burman ethnic group who are often characterized as the poorest of Nepal's poor
Chhetri	A caste that wears the sacred thread; Chhetris are the members of a Nepali Hindu group that is perceived as historically having a high socio religious status in Nepali society; Tagadhari caste
Dalal	A derogatory term also used for human traffickers
Dalit	A person considered untouchable in the Hindu caste system
Daura suruwaal	Brahmin and Chhetri attire; national outfit of Nepalese men
Ek	One
Gurung	An ethnic group mainly residing in the hills and mountains of Gandaki Province
Jagir	A type of feudal land grant in South Asia bestowed by a monarch to a feudal superior in recognition of his administrative and/or military service
Jagirdar	The holder of a jagir; a person who received income as residual claimants of surplus agricultural production
Jana Aandolan	People's movement
Janajati	Ethnic indigenous people of Nepal
Janata Samajbadi Party	One of the political parties of Nepal, also called People's Socialist Party
Karnali	One of the seven federal provinces of Nepal formed by the new constitution
Khas Arya	An ethnic group comprising hill origin Brahmins and Chhetris
Kirat	Indigenous ethnic group; Sino Tibetan ethnic group

Madhes	Flat southern region of Nepal, also known as the Terai region
Madhesi	Groups of people living in the Terai region of Nepal; a nationality from the southern Terai plains
Magar	Indigenous ethnic group of Nepal
Matawali	Alcohol drinking caste; now referred to as "Adivasi/Janajati" (indigenous nationalities)
Muluki Ain	General Code; National Code of Nepal
Newar	The historical inhabitants of the Kathmandu Valley
Panchasheel	Peaceful coexistence based on the principles of non-interference and cooperation
Panchaya	A village council
Pradesh	Province
Rai	Indigenous ethnolinguistic group mainly residing in the eastern Nepal
Rastriya Janamorcha	One of the political parties of Nepal, also called National People's Front
Sudurpaschim	One of the seven provinces established by the new constitution of Nepal
Tagadharis	Castes wearing sacred threads; members of a Nepalese Hindu group that is perceived as historically having a high socio
Tharu	An ethnic group indigenous to the Terai region in southern Nepal
Tharuwan	Homeland of Tharu people in Terai region of Nepal
Topi	Nepali hat

ANNEXURE 2

ACRONYMS

Bikalpa – Bikalpa	an Alternative
CIPE	Center for International Private Enterprise
CPI	Corruption Perception Index
CPN	Communist Party of Nepal
CPN (Maoist Center)	Communist Party of Nepal (Maoist Center)
CPN UML	Communist Party of Nepal (Unified Marxist–Leninist)
CPN (Unified Socialist)	Communist Party of Nepal (Unified Socialist)
CSOs	Civil Society Organizations
DRCN	Democratic Resource Center Nepal
MCC	Millennium Challenge Corporation
PRC	Pokhara Research Center
Samriddhi	Samriddhi – The Prosperity Foundation
SoNP	Survey of the Nepali People
SWC	Social Welfare Council
USAID	United States Agency for International Development