



Citizen-Centered Approaches
to State and Market



Nepal: The Future in the Present

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Nepal is currently in an open moment in history, where different futures are possible. Such moments are rare in the histories of countries. Their defining feature is that a rupture with the past becomes possible and the possibility of a future to which people can have a consensus and aspire becomes probable. They do not, however, last long, and unless widened by vision and sustained action, are shut quickly and can be the beginning of vicious circles of stalled development or collapse. The value of time of unusual significance in an open moment as it can be either a friend or an enemy; it is the harnessing of time to the implementation a series of tasks, articulated in a compelling roadmap, which can create a new momentum.

I. Definition of the situation

The defining feature of the situation in Nepal in May 2006 is *unstable dual power*. United in their common struggle against monarchy, the seven party alliance, currently forming the government, and the Maoists, an organized military and political force with a presence across the country, now need to forge an agreement on defining the future system of the country. A tri-partite power structure, with the Monarch at its apex, has been replaced with two sets of actors, who have yet to provide a clear roadmap to the people of Nepal regarding the future destination of the country.

The condition of instability is both legal and political. Having come to power through a people's movement, the restored parliament and the government formed by seven party alliance has declared the Parliament to be above the Constitution of 1990. Its term of office, the nature of its mandate and the limits of its authority are not delineated by law. The legal difficulty has arisen from the provisions of the 1990 Constitution which defined the character of the state as monarchical and Hindu, and provided for no mechanisms for amending these chief characteristics of the system. Pitted against the monarch, who is widely believed to have assumed autocratic power that was not provided for in law, the seven parties and the Maoists agreed to a constituent assembly as a mechanism for defining the nature of the state prior to launching of their mass movement. Therefore, the current government is legally transitional in nature. The more the parties are forced to invoke the will of the people to provide legitimacy for their actions, the more they will be forced to revolutionary terrain; the quicker they move to delineate a legal framework within which they bind the country, the more they can exercise authority.

The seven parties launched their agitation when the security apparatus of the royal regime was used both against the Maoists and them. Now, their ability to use the same apparatus for guaranteeing law and order and the capability of these organizations as credible instruments for ensuring law and order remain questionable. Having been focused on curbing monarchical authority, the seven parties have not formulated a program of governance with any specificity. Further, the parties have been characterised by significant intra-party and inter-party struggles in the past. Judged in terms of effective governance, accountability and transparency, ability to articulate and implement a pro-poor program, ability to resolve conflict, capacity to project the authority of the state across the territory of the country and willingness to put national above personal and factional interest, and capability for inter-party coalitions, the seven-party alliance brings low political capital from its past.

The movement has not produced a charismatic group of leaders. The person that the parties could agree upon is an 84 year old veteran politician with no obvious successor in sight. The mass movement that brought the change is diverse in character. While united in opposition to the old order, the constituents have significant differences on their degree of emphasis, on inequalities resulting from caste, ethnicity, gender, location and class. While inclusion is a goal, and there is broad consensus on the need for restructuring of the state, there is no agreement on pragmatic mechanisms for realization of the goal or an



agreed set of priorities for restructuring the state. The politicization of all spheres of activity has left no neutral spaces. None of the stakeholders could name ten individuals whom the Nepali society could agree on as being neutral to serve as impartial arbiters, mediators or judges in bringing about the necessary compromises. The combination of low political capital in the parties and the raised expectations of individuals and communities has brought about a situation where the organized public is minutely scrutinizing the actions of the politicians and the politicians in turn are watching the street for reactions to every one of their moves.

While demand for public services is high, the mechanisms of delivery from the state to public have been severely curtailed by loss of the state's control over territory on the one hand and by the failure of the regime during the last decade, both during the democratic and autocratic phase, to articulate and implement a credible program of development. There have been some significant achievements of community-level development and some significant acquisition of capacity for future financial management, but the fragmentation of politics and the system of governance is preventing the utilization of these assets.

Nepal has had a significant communist movement for decades. One of the communist parties (CPM-UML), having won the largest number of votes in Parliament, even formed a minority government, earning the distinction of being the only communist government having won through a democratic election. The Maoists were initially one of a number of small splinter groups in the wide array of leftist parties in the country. The factors that enabled them to acquire their current position of influence result both from the failure of the government and political parties and their own combined use of politics and violence. Politically, they have increasingly managed to set the agenda on social, economic issues ranging from money lending, caste hierarchy, subordination of women and the abusive side-effects of alcoholism, to the discarding of monarchy and establishment of a people's republic.

Having launched a "people's war", and demonstrated the incapability of the security sector to defeat them militarily, they are in actual control of a number of districts and are judged to be present in as many as 2/3 of the districts of the country. Their direct destruction of infrastructure is estimated to run into billions of rupees and the war between them and security forces has resulted in the decline of economic growth and increase of poverty, which in the late 90s had declined by as much as 15 percent. They both have an organized military force, estimated between 8,000 and 10,000, and an armed militia estimated between 40,000 and 100,000. They are able to exact resources from a wide range of people, ranging from teachers in government schools, to merchants, land-owners and industrialists. They are also part of a renewed international movement and are believed to be supported by contributions from these movements. They have been active among students and women, have promoted the aspirations of ethnic groups and lower castes, and have espoused the idea of reorganizing Nepal on a federal basis. Many commentators believe that without their support, the seven party alliance alone would have been unable to mobilize the people for the seventeen days that it took to make the king restore the suspended parliament and recognize the supremacy of the political parties.

Their key demands have been for convening a Constituent Assembly, establishment of a republic and a secular state, as under the 1990 constitution, Nepal is a Hindu state, and an all-party interim government to prepare the election for the Constituent Assembly. While they had reached agreement with the political parties on the Constituent Assembly, there has been no agreement on the road map for resolution of the other outstanding issues. There is considerable uncertainty as to whether the Maoists are committed to a principle of multi-party democracy where power is transferred at regular intervals through free and fair elections. Some believe that they see an Interim Government and elections to the Constituent Assembly as steps in a gradual yet systematic strategy of take-over of the state and eventual creation of a one party system.

Looking at Nepal from a comparative perspective of peace agreements concluded within the last 20 years reveals a unique feature. The agreement to resolve the conflict is concluded by parties outside power and the first phase of the agreement entailed radical curtailment of the power of the monarchy. Hence there is a lack of certainty regarding whether the Maoists are truly ready to substitute politics for violence and the uncertainty of whether the political parties, now in government, will be able to articulate and implement a vision of governance that the people of Nepal will find credible. Structural uncertainty creates a climate where stakeholders with various degrees of interest do not act, become extremely cautious or react to signals that they believe are contrary to their interests in ways that could bring about a chain of unintended consequences, including formation of mobs and random violence. Until power is turned to authority, this uncertainty either leads to stalled development or to collapse.

II. Scenarios and drivers for Nepal's future

Given the high degree of uncertainty inherent in open moments in general and in the context of dual power in Nepal in particular, it is best to proceed in terms of scenarios. Scenarios are neither right nor wrong; they are instruments that focus on probabilistic outcomes through identification of drivers that serve as markers to a particular pathway. While the actual unfolding of events may never exactly correspond to a scenario, the drivers and the indicators provide actors and observers with warning signs.

In the current context, we can focus our attention on three potential scenarios:

- i) *Stalled development*, where the surface calm will be maintained but none of the structural underlying causes of instability and conflict would be resolved;
- ii) *Collapse*, where politics will give way to renewal of intensified violence inflicting heavy sacrifices on ordinary citizens; and
- iii) *New Nepal*, where the hitherto fragmented and divided energies of the people will be directed towards the goal of a stable, democratic, inclusive and prosperous Nepal.

The following six drivers will condition the course of events:

- i) *Elite compact*

The willingness and capacity of the elite to form a compact is the first driver. Nepal's political elite, which now includes both Maoists and leaders of the seven party alliance, and leaders of the movements to mobilize constituencies could either seek cooperative or conflictual solutions on the mechanisms of Constituent Assembly, the goal of the system to be ratified by the Constituent Assembly and the type of system of governance that is to implement the new Constitution and the wider political agreement. As the Maoists and the seven parties have agreed on the Constituent Assembly as the mechanism for defining the future system, their capacity and willingness to agree on a timetable for holding the Constituent Assembly, credible mechanisms to ensure free and fair elections to the Constituent Assembly, the form of the government- whether republic or a symbolic monarchy- and the projection and exercise of the authority of the state until the Constituent Assembly and the degree of control of parties over their followers are going to be critical indicators of the viability of the political process.

- ii) *Addressing people's concerns*

The current open moment was made possible by mass mobilization of the urban and rural population. Overcoming their distrust of the political parties and their fear of the Maoists, they mobilized behind a leadership of these two groups to contain the autocracy. Unlike the movement in the early 1990s, which was largely a discussion confined to the Kathmandu elite, the current mobilization is extensive both

socially and geographically. They are now watching as to whether the new elite will behave like the old, or would rise to the challenge of leading them out of the impasse of the past decades. Their judgments are going to be formed by the actions of the political elite regarding the political process, delivery of effective development, the extent to which their life, movement and property are secure, and whether the symbolic issues of inclusion are addressed. Nepal for instance has never had a member of the Dalit community- the least privileged caste- in its Cabinet and women have only made an occasional appearance in positions of leadership. Members of the Brahmin caste, on the other hand, have dominated positions of leadership, including that of the Maoist movement. The public has clearly articulated its desire for a functioning state, society and economy; the street will be both judge and jury and are currently sceptical as to whether direction will be provided. Fairness of the process as judged by mobilized communities is going to be as important as the outcomes that are achieved and delivered to building of trust between the government and the people.

iii) Handling of the economy

Corruption and cronyism on the one hand, and declining growth and rising population on the other, has allowed for slow economic and social mobility. Migration has become the main safety valve, and remittances from Nepalese abroad are more significant than the foreign aid that the country receives. While there are some examples of innovative approaches to taking advantage of globalization, the economic sphere is notable by the absence of a strategy for its constitution and expansion. Given the political weight of the Maoists in the current moment, owners of land and managers of industry have a high degree of anxiety regarding the security of their property. The mood of the country has shifted decidedly to the centre-left. While slogans for state-led developments have become common, the global reality is that efforts at forced collectivization have only led to exacerbation of poverty and food insecurity [e.g. USSR under Stalin from 1928 to the 1939, China during the Great Leap Forward and Cultural Revolution, North Korea in the 1990s] and poverty has been significantly reduced by pursuing models of wealth creation that have pursued a balance between releasing entrepreneurial energies and reinvesting some of the fruits of their endeavours for social protection through redistributive mechanisms to include disenfranchised groups. Unless the new political elite of Nepal grasps the importance of the economy as a driver of future stability and prosperity, and makes a commitment to the creation of credible and fair mechanisms for expanded wealth creation and containment of corruption and cronyism, they would still be unable to respond to the quest of a mobilized population for inclusive development.

iv) The regional dimension

Placed between India and China, Nepal's future will depend on how leaders of these two emerging global powers perceive developments in Nepal. The role of India is particularly significant. Indian leadership is increasingly concerned about the rising Maoist threat in India, and unless the new elite in Nepal is seen to focus on Nepal's developmental issue, it may decide to put its considerable weight to define the boundaries of the acceptable solutions for them. Simultaneously, India is home to the largest number of Nepalese migrants in the world, has a long open border with Nepal, and India could provide the funds for investments in energy. Although China's common border with Nepal is in the world's most difficult terrain, the rapid pace of development in China can offer opportunities for Nepalese trade and investment. Nepal's most significant economic challenge is ability to create jobs, for its under-employed and unemployed youth in general and the men and women who are bearing arms in particular are a risk that can only be mitigated through a wealth creation process.

v) International community

The international community more broadly will be called upon to perform a number of roles including possible provision of honest brokers for the peace process, monitors for elections and facilitation and



monitoring of security arrangements. In addition, they are likely to be asked by one or others of the Nepalese society to take a stance on multi-party democracy, accountability of the state and adherence to norms and conventions of human rights. The critical drivers are the extent to which they can tailor suggestions to context, how well they are able to define the boundaries of accepted behaviour and to invoke their convening power to act as facilitators and referees.

Nepal has been often cited as an illustration of ineffectiveness of aid. Although foreign aid contributes only roughly \$300m out of an annual budget of \$1.6bn, its weight in setting developmental fashions is far higher than its contribution. The value of aid is opaque, given that the value of an aid dollar is a small proportion of a dollar that can be procured through the national system, and its effectiveness is questionable. Aid has created a series of parallel mechanisms, resulting in a situation where for every dollar going through government processes, \$1.3 flows entirely outside, creating a series of organizations that compete with government organizations for determination and delivery of policy in the same space. While there has been acceptance of harmonizing aid in principle, most donor organizations are struggling to understand what this would mean in practice. In a context of high structural uncertainty, the mental models and practices of aid agencies could have unintended consequences for the social, political and economic processes in the country. The challenge to the aid system is not just to mobilize resources but to shift to co-producer, and strategic partner, around medium to long term goals that truly put the government and people of Nepal in the driver's seat. The criterion by which the aid system would be judged is the degree to which it promotes rule of law through allowing its own conduct and participation to be governed by the rules of Nepal and the degree to which it can act as a facilitator for trade and investment.

III. Critical Tasks

Nepal's leaders face an enormous number of demands on their time and energy. Addressing the daily crises will quickly consume them, preventing from focusing on the requirements for leading a process of change that an open moment requires. If the vision of New Nepal is to be transformed from a slogan to a coherent program of action, this will require aligning the energies of the leadership around a series of tasks to which they will be paying sustained attention. Our analysis shows that the following 6 tasks are essential to transforming the open moment into a coherent process for marshalling the energies of the people of Nepal into creating a New Nepal:

i) Defining the system

There is a consensus that Nepal needs a medium to long term vision to coordinate and direct the energies of its people towards a collective project of human security and prosperity. The new leaders have to face the challenge of agreeing both on the long term vision defining a pathway for moving towards the goal and taking credible action in an organized sequence of activities to make the population realize that the vision is feasible.

The new leadership has agreed on the Constituent Assembly as the mechanism for defining the system, but they have not agreed on how the Constituent Assembly should function, and what should be the mechanism for moving from the Constituent Assembly to the process of implementation of their agreement. The country's entire energies are currently focussed on this political process, seeming to result in a neglect of other critical tasks.

To assure the population that the mechanism will resolve the uncertainties, and not be the renewal of a new wave of indecisiveness or violence, the leaders need to agree on a sequence of activities that both lead to the Constituent Assembly and follow it. Among other activities, they need to agree on precise definitions of free and fair elections, timing and modality of voting, monitoring of elections, drafting of a



Constitution, agreement on modalities of reaching consensus and binding decisions in the Constituent Assembly, the nature and limits of exercise of power until the Constituent Assembly meets, and mechanisms of transition to an elected government after the Constituent Assembly. Particularly important is whether the leaders will agree on a commission that drafts options for a constitution prior to the Constituent Assembly and makes it available for public hearings and discussion.

Whether or not justice is sought for past abuses, it is particularly important that mechanisms are found to ensure the cessation of any future abuses, and justice to be afforded should they occur. The vision of New Nepal is of a government in which the rulers are themselves subjected to law, rather than above the law. This requires investment in an independent judiciary that would both have the vision, the capability and the political support to establish its independence, and to assure stakeholders that the rules will be credibly interpreted and fairly enforced. In highly polarized societies, transforming group conflicts into individual disputes can only happen through a credible judicial system. Hence classification of types of disagreements that could lead to group conflicts and formulation of rules that would provide credible and timely arbitration pertaining to civil law is a priority. The economic domain is also a priority as elaborated below. Arbitration of the political space will also be important, in terms of recognition of political parties and their accountability vis-à-vis financing in the conduct of elections, and in the conduct of press and civil society. Each of the critical tasks that is pursued ultimately requires a functioning judiciary, hence the need for a five- ten year framework of investment in and reforms of the judiciary to establish the trust of the citizens and various categories of stakeholders that the rule of law will be upheld.

ii) *Restructuring the state through new rules*

There is widespread agreement that the state has been a mechanism for exclusion and that the lack of agreement among the political elite on a developmental vision has resulted in its simultaneous softness and harshness. It has been too soft and ineffective to become the anchor for people's trust but it has been harsh enough to deny the formation of mechanisms for wealth creation and to inflict loss of life and denial of freedom of assembly and debate.

As a result, there is widespread agreement on the need to restructure the state, yet no concrete proposals on how to restructure the state have yet been put forward. Discussions with stakeholders indicates that the ten functions that we have delineated as necessary to performance of the state in the contemporary world are the critical areas for state restructuring [FN]. If our perception is correct, then a clear concept for performance of these functions and the corresponding organizational changes, people and processes that are required for performance of these functions need to be undertaken. In contrast to other developing countries, there is a consensus on devolution of power from the central government to communities. There have been significant and impressive developments in community-led processes of development in areas ranging from forestry to hydro-power to education. However, there are significant disagreements on whether the current territorial division into 75 districts should continue, whether Nepal should be reorganized into a federal system along ethnic lines or whether a unitary system should be maintained but work on the basis of significant devolution to fewer administrative levels and direct devolution of financial and administrative authority to the villages.

During the last ten years, Nepal has witnessed a significant increase in its human capital and the emergence of a significant number of individuals with management skills and capability. These people, though by and large operating outside the government also exist within the government and have a good knowledge of governance. The challenge in Nepal therefore, is not of importing outsiders to perform the functions but of ensuring that the political space for placing capable Nepalese in critical positions within the government bureaucracy takes place. Such a move would be critical to ensuring that the organizations of the state are aligned to implementation of the articulated goals of creation of an inclusive state.

The success of such a move would depend on whether rule of law becomes the guiding principle of the new system. Comparative analysis reveals that while some elites deny the rule of law altogether, others rule through law, meaning that they provide a predictable system to their subjects but themselves are not subject to rule of law. A few accept rule of law, meaning that the state in general and the elite in particular are bound by rules and derive their legitimacy and authority from the rules. Given the history of the security institutions and the widespread violence, a credible judicial system is not only necessary for creation of the economy but for ensuring the movement of the country towards stability.

iii) *Consolidating security*

A perceptible rise in insecurity and increasing violence has been a noticeable feature of the last decade. Nepal has been unable to spend the resources that have been available, and despite the rising expectations of the people for infrastructure and services, the country has actually witnessed a significant destruction of its infrastructure and an inability to conceive or finish a single major visible infrastructure project during the last decade. It is also argued that due to prevailing insecurity, a generation of young men and women have lost the opportunity for education and that tens of thousands of young people have forced to migrate so as to avoid being recruited by Maoists or harassed by the security sector for accusation of being Maoist.

To operate in Maoist-held areas, state employees ranging from teachers to project managers have had to come to informal agreements with the Maoists entailing payment of a percentage of their salaries or a sum for cost of protection to make the work possible. The first test of the new situation is therefore creation of a predictable space for delivery of development. The existence of such a space would be judged by the degree of unimpeded access of developmental actors from the government and non-governmental organizations to the administrative divisions within the country. Ironically, there are some principles for ensuring the access of non-governmental actors, but these rules do not encompass an agreement for ensuring the open movement and effective performance of the assigned Nepalese government staff. Were the Nepalese leaders to agree to the rules for the operation of developmental space, international actors and communities could play a useful role in monitoring adherence to the agreement and in judging the effectiveness of developmental interventions.

A critical test of commitment to political solution is going to be agreement that the monopoly on the means of violence can only rest with a restructured state. Comparative experience shows that while ceasefires form the first step of such a path, demobilization, demilitarization, reintegration of the armed oppositional movements on the one hand, and restructuring of previously repressive security apparatus on the other hand constitute the essential set of activities that ensure a lasting peace. Rather than following received wisdom on “DDR” whereby former combatants are given cash or short term jobs but later released without skills to ensure their livelihoods in the long term, finding imaginative ways to link this category of the population to job opportunities in the market, for example through a voucher scheme with a number of firms or through vocational training programs in China for a period of time. Use of armed forces for ensuring internal security is generally a sign of weakness rather than strength of the state. Creation of an accountable and respected police force is the key to law and order. Formation of such police forces, however, is a difficult challenge and requires a horizon of five to ten years to be effective. There are also lessons to be drawn from the experience of community policing that could be useful for a territory where absence of reliable transport poses a major obstacle to easy deployment of people. Comparative analysis also shows that security can best be achieved through a wider strategy of creation of credible institutions and investment in human security. A focus on the security institutions in isolation from a wider perspective of generating trust between the state and its citizens may not only result in erosion of trust, but in undermining of rule of law as such.

iv) *Delivering inclusive development*

Failure of the autocratic regime to focus on development was a key contributing factor to its demise. Similarly, the failure of the political parties during their decade of rule to agree on a coherent agenda of development and deliver benefits to the people was a critical factor in their delegitimation and marginalization. If the new leadership are to retain the trust of the people, they must be seen to act on issues of daily concern to the vast majority of the Nepalese population. Fortuitously, they have an opportunity to use the forthcoming budget process to offer a coherent and credible program of action for the next year. For this to happen, the budget process should become the central arena for making decisions on the key priorities of the country. Technocrats who have worked slowly and steadily to put in place a medium term expenditure framework and are now capable of asking for developmental outcomes and not just inputs should be given room to offer options to their political leaders and their leaders should be seen to be giving precedence to the general interest of the public rather than the narrow circles of their personal and party interest.

An effective budget process would require systematic consultation within the government and with stakeholders outside the government to arrive at priorities. As powerful interests are considered themselves above the law, the budget process could signal the public commitment of the politicians against corruption by taking strong action against defaulters who have borrowed large sums of money from the banks but have been protected from payment. Visible actions against corrupt individuals within the government and contractors for the government could also signal commitment to the public good.

To underline their commitment to inclusion, the political leaders should give clear instructions to rationalize, consolidate and expand pro-poor programs. Some of the existing programs can be consolidated into programs that are national in scope and scaled up for effective delivery. Elimination of duplication at the village level and careful piloting and monitoring at the district and central level are going to be necessary for success.

Addressing exclusion requires both symbolic and real action. At the symbolic level, capable people from excluded communities should be given visible positions within the government and a prominent voice in developmental fora to raise their legitimate concerns. Substantively, programs must be undertaken to ensure the participation of excluded groups into the educational system, particularly in the privately provided educational system through merit based scholarships and removal of the legal and cultural barriers to upward mobility.

The work on the medium term expenditure framework provides a basis for thinking about a medium term goals and targets that could be the harbingers of a New Nepal. This work in turn can provide the foundation for the long term vision. Experience from countries that have engaged in visioning exercises shows that attention to implementation is key to realization of such visions. Focus on implementation forces leaders to make choices regarding sequencing of actions in light of constraints, on devising innovative strategies for removal of constraints and tailoring of prevalent theories to their own context and capabilities.

v) *Constituting the market*

The market in Nepal is not a level playing field. The predatory tendencies of a small elite composed of politicians, businessmen and bureaucrats has resulted in rent-seeking behaviour that puts enormous burdens on firms and individuals that respect the formal rules. The crooked nature of the playing field and the widespread perception that the elite are either above the law or manipulate the legal system with impunity is resulting in questioning of the market institution as such. Maoist slogans for public provision of goods that the private sector has entered into are increasingly sounding attractive to the poor and even to the middle class. For the market to play its catalytic role in the creation of wealth, investment in

credible market institutions should be a priority. The first block is the banking sector. Action against defaulters would send a signal to the public that the new elite is serious about creating a level playing field. This should be followed by a thorough overhaul of the central bank, strengthening its regulatory capacity and examination of how to make credit available to investors who can lead competitive firms. Making the existing financial institutions transparent and accountable and developing new financial instruments, such as leasing operations, guarantees, domestic venture capital funds etc are prerequisites to creating the enabling environment for a cluster of competitive firms in Nepal. To determine the competitive advantage of the country, business and government could join to undertake a rapid study of competitiveness and identify the key constraints that stand in the way of investment in these sectors. Then Nepalese business and government, in collaboration with bilateral and multilateral organizations could convene a series of investment workshops with regional and international investors to secure their participation and investments that would create jobs and enhance economic growth.

The most critical issue for Nepal's stability and prosperity is the handling of labour. Working under one of the most protected labour laws in South Asia, the Nepalese simultaneously work under the most flexible labour conditions in South Asia and the Gulf. Domestically, the business sector has to play a constructive role in spearheading efforts to create jobs in the country. Labour organizations need to show a willingness to enter into new pacts with the business on a pilot basis to test the implications of new regulations that could then be scaled up and generalized. Whether working at home or abroad, the Nepali young men and women need a coherent strategy in investment in upgrading of their skills. The high drop-out rate from institutions of tertiary education underscores the case that Nepal's human development strategy needs thorough examination and overhaul. In the short term, vocational training is going to be critical for both peace and development, particularly for people who have been bearing arms. Serious attention to be paid to the possibility of organizing a program in India or China, where people who have been bearing arms could be invested in for a period of one to two years.

If vocational training is the urgent short term need of the moment, investing in the state's capacity to regulate the market is urgent from the short, medium and long term perspectives. Both comparative analysis and discussion with Nepali officials and business people underline the need for a regulatory regime that is tailored to the conditions of the country and has enforcement capability. Regulation can be a major instrument for both bringing in investment to deliver effective services, to create meaningful competition, and to contribute to the enhancement of the revenue of the government, which in turn can provide the basis of its redistributive policies and investments in people.

vi) *Resource mobilization*

If Nepal is to chart a path towards the future and deal with the critical tasks facing it in an effective manner, it needs to mobilize its human resources in an imaginative manner. The issue is not scarcity of human capital, but effective deployment and alignment. There are a significant number of Nepalese outside the government with the necessary leadership and management skills that could rally around a vision and help steer the process to implement that vision. The country also has an asset in experienced managers who have retired from the government but have both knowledge and energy to play a positive role in dealing with the critical tasks. There are also people within the bureaucracy with sufficient understandings of systems and processes that could focus on enhancement of short term development and design of the restructuring of the state and other tasks. If the issue is not absence of capacity but its mobilization, then the government is in a position to use its convening power and authority to make rules to create the space for the mobilization of the patriotic energies of its people for achieving a New Nepal. Non-governmental organizations, be they national or local, could help the government by seconding their staff or volunteering their time to work with the government for dealing with these critical tasks.

There is sufficient knowledge on the nature of leakages in the collection of revenue and patterns of expenditure that makes a series of measures for dealing with these areas imperative. Given the erosive impact of corruption and the local political capital of leaders of parties, credible and rapid movement on revenue and expenditure can both signal the seriousness of the resolve and serve as an education for the population in understanding the fiscal constraints that the country faces. If the energy of the public were mobilized in favour of accountable, transparent and effective processes of governance, the public's expectations would be lowered but delivery on their key priorities would be speeded up. Being placed in the middle of the two most dynamic economies of the world, Nepal's leadership would need to think creatively about win-win strategies that would allow the people of Nepal to take maximum advantage of the rapidly growing economies of their neighbours. This requires sustained attention to issues of trade, tariffs, regulation and creation of business-friendly environment for investment by neighbours and modalities of maximizing the participation of Nepali businesses in an expanding regional economy. As the country has not undertaken a major developmental project that has captured the imagination of the people, it may be worth giving considering preparing several "national projects" that could be carefully prepared and promptly implemented.

Nepal has historically focussed on aid as the dominant instrument of its relation with OECD countries. Aid, however, is only one component in a range of possible relations with these countries. Relentless focus on trade and investment, including obtaining risk guarantees, insurance and venture capital funds, could provide mechanisms and assets that would bring about substantial private sector investment in the country. Obtaining these instruments, however, requires careful attention to detail and preparation of relevant programs. Nepal could also make use of new aid instruments such as the Millenium Challenge Account, if it were to assign a special team to familiarize themselves with the relevant criteria and to undertake the necessary measures to meet the criteria of accountability and transparency that are demanded by that organization. In addition, a dedicated team drawn from government, business and civil society could be mandated to prepare projects and programs to access a number of vertical funds.

In terms of established aid mechanisms, there is need for differentiation between three areas; first, resources that have been already committed should be rationalized and spent more effectively in the context of the new budget. Second, the government may consider setting up a special fund mechanism to focus on the critical tasks that it faces. Were the donors to pool their resources under a fund for supporting the government's critical tasks, it would avoid a lot of time and duplication of effort. Third, Nepal's new leaders need to prepare for an international conference on resource mobilization to take place immediately after the nature of the system has been determined. If Nepal were to take maximum advantage of such a conference, it could focus both on established aid mechanisms through a careful preparation of a public investment program that would show its seriousness in addressing the challenge of inclusion and creation of an effective state. Preparing such a public investment program is time consuming and requires the energies of a dedicated team. In addition, however, Nepal could also use the conference to obtain support from vertical funds and attract private sector participation from both the neighbouring countries and the world at large.

Nepal has made significant strides in empowering its rural communities to take charge of management of their collective resources and to reverse the loss of common assets. Sustaining this momentum, through giving decision rights and financial resources to communities can be critical to stability. Additionally, Nepal has the opportunity both to scale up and rationalize the programs at the community level and to embark on creative strategies that would enable the communities to use their existing collective resources for participation in the market and wealth creation strategies through networks of communities both with each other and through creating and participating in value chains.

IV. Constraints and assets

At the level of the central government, there are a number of constraints. First is the legacy of the past, where leaders- autocratic and formally democratic- have been deemed ineffective or corrupt, where dependency on aid has been immense, where fragmentation in decision-making has been high, and where attention to effective implementation has been low. Dominated by a small elite, the state has been simultaneously harsh and soft. The state has been harsh in terms of its tendency to prevent or repress democratic politics, use regulation to create an un-level playing field, to deny opportunities for effective voice from bottom-up and to reverse rules arbitrarily. It has been soft in terms of delivering on promises of development, effective governance or rule of law. At the level of political leadership, factionalism has been high, rendering the elite incoherent. Parties or factions have formed around individuals rather than ideas, and through their frequent fragmentation, parties have added a new word –“splitt-ism”- to the lexicon. Some parties are seen as family enterprises, and all parties, including the Maoists derive their leadership from a narrow group of male Brahmins and Chetris.

Second is their lack of control over the means of violence. Conflict with the Maoists has revealed on the one hand the inability of the security sector to repress the insurgency and on the other that the security sector can unleash violence on the civilian population. As a result, the mobilized public opinion will not easily tolerate official sanctioning of violence, and if the security sector was to be deployed, there would be no guarantee that it would not harm innocent civilians. The most important liability is likely to be the failure to recognize the open moment and muster the sense of urgency that is required for making use of such open moments. A complacent mental model could be the greatest danger to the utilization of the assets.

It is imperative that Nepal does not become a prisoner of its past; the country also has considerable assets that could be mobilized by its leaders to overcome these constraints. First is an unnoticed but significant increase in capacity both at the level of the central government and in communities. The series of changes in the Ministry of Finance have resulted in the creation of information management systems, budgeting procedures and understanding of the need for a shift from inputs to outcomes that could now be harnessed to implementation on a much larger scale through national programs. Furthermore, Ministries of Education and Health are making serious effort to shift from project to sectoral-wide approaches, which approach can now be expanded to other sectors.

Decades of experience with development with villages have resulted in a major enhancement in social and institutional capital and an increased technical capability. A case can be made that Nepal has made significant strides in reversing the tragedy of the commons, as it is a country where communal management of resources ranging from forestry to micro-hydro and now education are providing ground-breaking results that could be scaled up in the country and made available to other countries. The district presents a more mixed picture, but there are some districts from whose experience a lot can be learned for a more general approach to improving governance at the district level.

These developments could not have been possible without a considerable improvement in the human capital of the country as a whole. From a comparative perspective of ten years, it can be argued that there has been significant enhancement in the human capital in business, government, civil society and community organization. The issue, therefore, is not one of import of technical skills from outside, but mobilization of existing resources and their effective deployment. This particularly applies to the government, as there are people at all levels of the bureaucracy who have reflected deeply on the problems and solutions for their country and who can make a commitment to meaningful change under the right vision, management and incentives.

Governing is a continuous process, as people need the government to function to deliver services to them or not prevent them from undertaking their own initiatives. Consequently, the government is morally obligated to focus on agenda-setting. Stability in the country will depend on whether the government articulates an agenda that the population finds credible. As politics cannot tolerate a vacuum, in the event of failure of the government to set the agenda, this critical role will be assumed by other groups in society. The uniqueness of the government's convening power is that it can bring coherence to views of all stakeholders and to strike the compromises that are necessary for a complex society and polity. Equally significant, the government's convening power can be used to rally and direct the international community's efforts and project the image of Nepal to the rest of the world through interactions with the media and other international fora.

V. Redefining the Role of International Actors

International actors, after decades of involvement in Nepal, are engaged in reflection over lessons learned and the role that they can play in defining the future of Nepal. They can play a range of roles from facilitator, referee, monitor to co-producer with the government and people of Nepal. Their convening power and voice at this moment could be even more significant than the material resources that they bring to the table. Taking a stance on principles, such as rule of law, multi-party democracy, free and fair elections and an accountable and inclusive state could signal to the stakeholders in the process the boundaries of acceptable behaviour and the centrality of the political process as the means of solving differences of opinion among mobilized if not agitated groups and communities.

International actors could also play a helpful role in making available a range of experience from other countries in dealing with the critical tasks that they have faced. The more the international community can focus on the how rather than whether of assisting the Nepalese to articulate their vision of the future and the restructuring of their economic, social and political institutions to achieve that vision the more they would be able to play the role of catalysts and midwives to the forging of a strategy and solutions that are tailored to the uniqueness of Nepal.

There are several ways that the international community can play a constructive role to support Nepal on its path. As the defining characteristic of the current situation is unstable dual power, political and security issues are going to require systematic attention and intermediation by neutral and credible international actors. There is no replacement for the UN's political function in this area. Were the UN to be invited to offer its good offices in assessing the time of the convening of the Constituent Assembly, the holding of fair and free elections, reaching of ceasefire agreement and its verification and the reform of the security sector, it could bring a wealth of comparative experience and understanding to these areas. Engagement of the UN in this domain could also serve the useful function of focusing the international community's attention to Nepal's progress and timely feedback from the international community to Nepal's leaders and its neighbours. Should the UN's engagement not be politically feasible, then the good offices of either credible international or non-governmental organizations that have developed a professional expertise in one or other of these domains or neutral countries that have invested considerable resources in facilitating transitions from conflict such as Norway could be called upon.

As donors, international actors have in the past created parallel organizations and processes to the state, and in dealing with the least privileged sections of the population substituted for the state. If Nepal is to move towards a scenario of New Nepal, then it will be essential to ensure that only development outcomes are delivered to the people, but that the government is seen to be delivering to its people and responding to their needs and aspirations. As long as there are multiple budgets, development cannot take place and there will be no effective accountability. As a pilot for harmonization and translation of DAC principles into ground-breaking practice, Nepal can be the site for giving the aid system a new chance for



demonstrating its relevance and capability first for a process of co-production of developmental strategy and policy with the government and then a systematic hand-over of functions to the government.

More specifically, this will mean reaching agreement with the government on a national legal system for procurement, budgeting, auditing and accounting that can be easily implemented, meets international standards for accountability and systematically improves its performance over time and reaching agreement on moving from projects to program and budget support, either through direct budget support or through intermediate mechanisms such as a trust fund. It will require a transitional strategies for NGOs and INGOs which brings increasing accountability and transparency to their operations through full disclosure of their activities and finances and the handover of functions to communities or government, making the proper distinction between genuine civil society organizations that are sustained through voluntary donations, and those NGOs that are a by-product of foreign financing. It will require using technical assistance in a sparing and catalytic way, ensuring that where it is used, knowledge transfer takes place in a time-bound way, mobilizing the talent of the country and facilitating exchanges of information between countries, rather than hiring hundreds of technical assistants. It will require avoiding the installation of many different information management systems, instead thinking through an integrated information management system that promotes coherence and transparency across the government.

UN agencies can play an important role in supporting national organizations in participation in global initiatives, such as the Human Development Report. Given that many agencies are currently positioned to substitute for government functions, rather than support the production of public value by the government, there is a need for a clear stock-taking existing projects, arriving at concrete and time-bound mechanisms of exit from activities or functions that can easily be performed by government, business or civil society. Sub-contracting directly from bilateral donors to agencies creates parallel budgets which undermines good governance. Those areas that they could add clear value on the basis of clear criteria for accountability and effectiveness can then be defined. As the report of the Secretary General on system-wide reform makes clear, the system is in major need of reform itself.

Many bilateral donors and NGOs are engaged in worthwhile activities but there is considerable duplication. For the whole to be greater than the sum of its parts, a stock-taking exercise with the government to rationalize and scale up these activities, particularly at the village level, ensuring uniform rules for governance, should take place. Practically all of Nepal's domestic borrowing is being used to service its international debt. A plan for reduction, elimination or sound management of this debt needs to be undertaken.

The demand of the people of Nepal for an inclusive system cannot be satisfied without a dynamic economy. Trade and investment are therefore going to be as critical as sound governance and international aid. Trade is first and foremost regional, as Nepal could and should benefit from the impressive growth of the Asia's two dynamic economies, but despite its primacy, the regional focus alone is not sufficient for some Nepali businessmen have shown enormous imagination and capability in finding a niche in the globalizing economy. As one of the least developed countries, Nepal should be assisted with value chain analysis to enable it to benefit from the favourable tariffs and conditions that OECD countries can offer. Sectors that can unleash major growth and provide employment such as tourism need special and early attention. Investor workshops can be organized where international and national investors, government and bilateral and multi-lateral organizations can identify constraints and agree on credible strategies for overcoming them. As a country where labour remittances are critical to the well-being of the population and where labour migration is providing an outlet for the young, it is critical that a credible strategy for enhancing the abilities of Nepalese to increase their wages abroad and find better wages at home is articulated and implemented.



Achieving the goal of the New Nepal is going to require mobilization of resources nationally and internationally. The key to the ability of Nepalese leaders to mobilize international support is going to lie in the credibility of their medium to long term plan of action in utilizing aid and in mobilizing domestic resources to provide an exit strategy from aid. A double compact would be the key to such resource mobilization. On the one hand, the government and the various domestic stakeholders would need to enter into a social compact on good governance and constituting a functioning state and a functioning market. On the other, international actors would need to enter a compact with the government to making resources available through aid, trade and investment instruments, to support a country-led strategy of growth and development. Instruments such as guarantees, creation of venture capital funds in support of domestic entrepreneurs, and supply chain management, insurance and quality control to provide for exports are some of the mechanisms that can be deployed imaginatively.

VI. Conclusion

Governance is a process, and as such has its rhythms and routines. Regardless of the pre-occupation of the people with the nature of their future system, they proceed with their lives, encountering the daily problems of education, health, human security and deprivation. Addressing and focussing on the long-term vision of the future, the immediate needs of their people cannot be ignored. Those in a position of formal authority have not only the right but the obligation to govern. Effective governance is going to require a division of labour among the new elite of Nepal. The scenarios are delineated to highlight the critical role of leadership in creating either a virtuous or vicious circle, as both are possible. Our discussion of drivers reveals the centrality of the challenge confronting the political leadership. Politics can be a vocation, a calling that places the public good above all and makes ordinary people perform extraordinary feats in open moments of history. But for people to perform such deeds, the space for harnessing their imagination and an opportunity for bringing their latent capacities for leadership and management must be created. The leadership already possesses a range of assets, including access to resources, ability to make rules, authority to take decisions, potential to determine priorities that give a sense of the road ahead and to convene a wide range of stakeholders.

Were the political leaders of Nepal to appoint a special committee for overseeing the preparation of measures for dealing with these critical tasks, for monitoring the course of events and for ensuring that necessary decisions are made properly and rapidly, they will have taken their first step for realization of a New Nepal. The committee could then convene task forces, composed of members of various stakeholders, and authorize these task forces to hold public hearings, collect information, and prepare plans and implementation arrangements for devising the best ways for dealing with these tasks in a time bound manner. The cabinet and parliament then would be in a position to demonstrate to the public that they deserve the trust that the people have shown in them during their mass mobilization.