

NEPAL: POLITICAL AND ECONOMIC UPDATE

This note is an update of developments in Nepal provided in the board information paper (BIP) of 31 August 2007¹ and the Nepal Country Operations Business Plan (2008 – 2010) circulated on 27 July 2007.

A. Recent Political and Security Developments

1. The political stalemate which began even before the Communist Party of Nepal/Maoists' (CPN/M) withdrew from the Government in mid-September 2007, due to their demands on preconditions for the Constitutional Assembly (CA) elections, remains unresolved. While an intense dialogue is ongoing in the context of the seven party alliance² to resolve the impasse, the main issues of contention remain whether to declare a republic and adopt a fully proportional representation system before the CA elections. To press its demands, the CPN/M called a Special Session of the Interim Legislature that in early November agreed to move these motions, which will now need to receive a two-thirds majority during the current winter parliamentary session before the Interim Constitution can be amended and the measures formally adopted. The CA elections, which had been re-scheduled for 22 November 2007, were postponed indefinitely in early October.

2. The situation in the *Terai* (the lowlands), which has been volatile since the beginning of the year, also remains difficult. The passage of the Interim Constitution on 15 January 2007 drew widespread criticism from the Nepal Sadbhawana Party-Anandadevi (NSP-A), the *Terai*-based party in the Government, and other *madhesi* (people of *Terai* origin) groups who reacted by calling for *bandhs* (strikes) and other forms of agitation. The Government has made concerted efforts to resolve the *Terai* unrest through dialogue, and has managed to reach agreement with most agitating parties, including the Madhesi Janadhikar Forum (MJF—the group leading the *Terai* movement). However, the CPN/M is competing with the MJF and other groups to gain a foothold in the region, and has raised serious objections to the agreements, which has perpetuated the unrest. The upsurge of communal violence in the *Terai* in mid-September 2007, which resulted in numerous killings, has subsided though tensions still linger.

3. The *Terai* unrest, various ethnic movements, internal disputes within the political parties, and squabbles among the coalition partners have created considerable instability that is likely to persist for quite some time. The political impasse resulting from the CPN/M's move to walk out of the Government and the indefinite postponement of the CA elections have further complicated the situation and intensified the uncertainty. In the meantime, the economy remains hard hit as Kathmandu and other parts of the country continue to suffer from periodic fuel shortages and power outages, and business activity is frequently disrupted by strikes and blockades, which has forestalled the delivery of a tangible peace dividend to the people.

4. Nevertheless, the improved security conditions in the wake of the April 2006 peace accord and ceasefire have expanded the development space in Nepal. In particular, the CPN/M's continued participation in the Interim Legislature and seven party alliance, and their ongoing commitment to abide by the core principles of the Comprehensive Peace Agreement, have provided a broadly conducive environment for project implementation. In addition, the Cabinet has resumed regular meetings after a brief hiatus following the CPN/M's departure from

¹ ADB. 2007. Nepal: *Political and Economic Update*. Manila (IN195-07).

² Following the merger of the Nepali Congress and Nepali Congress (Democratic) in late September, the original eight party alliance formed last year became a seven party alliance.

Government, and urgent government business and key policy issues are being addressed, including a politically unpopular move to raise fuel prices in mid-October.

B. Response of the International Community

5. The international community is concerned about the indefinite postponement of the CA elections and the apparent failure to break the current political impasse, but recognizes the need to remain engaged and continue providing assistance to Nepal during this difficult transitional period. Given the significant uncertainty and fluidity associated with the current political situation, the international community has adopted a flexible and shorter term approach to its development support in line with the Government's three-year interim development plan. Despite the significant challenges in the current context, many development partners have stressed the critical importance of proceeding with development activities and the urgent need to accelerate the pace of implementation in order to speed up delivery of a peace dividend.

C. Status of ADB's Operations in Nepal

6. ADB's portfolio performance has remained robust despite the implementation challenges in the current environment and it is projected that the significant improvement in performance achieved in 2006³ will be sustained this year. Even in the *Terai* where project implementation is the most challenging, ADB-supported operations have generally not been seriously disrupted given that there is strong local ownership of project activities in view of the positive income and employment impacts generated for local people. The latest assessment (November 2007) by the Nepal Resident Mission (NRM) of the impact of political/security developments on the current portfolio indicates that 16 projects (76%) are not affected, two projects (10%) moderately affected, and three projects (14%) significantly affected. A similar assessment done by NRM in July 2007 indicated 17 projects (68%) were not affected, four projects (16%) moderately affected, and four projects (16%) significantly affected.⁴

7. Looking ahead, it is critically important that ADB remain firmly engaged with Nepal given the urgent need to help Government to deliver a tangible peace dividend. The current Country Strategy and Program (CSP) covering the 2005 – 2009 period was prepared following a thorough analysis of the underlying causes of the conflict and remains relevant in the current context. In particular, the conflict sensitive implementation strategy adopted in the CSP has facilitated effective and safe implementation of ADB's operations during the conflict period, and continues to do so in the present transitional period. However, NRM will be updating its assessment of the country situation and the effectiveness of the current strategy in the context of the midterm review of the CSP next year.

8. As the root causes of the conflict stem from deep-seated social exclusion, large socio-economic and regional inequalities, poor governance, and the unmet expectations of the people, genuine economic and social development must take place if peace is to firmly take root in Nepal. It is therefore imperative that ADB work together with Government and donor partners to accelerate implementation of development programs so that the poor and disadvantaged can begin seeing real improvements in their lives. As a reliable and trusted development partner, the Government is looking to ADB to play a lead role in this regard.

³ The contract award ratio increased to 22% in 2006 from 15% in 2005, while the disbursement ratio improved to 20% in 2006 from 7.7% in 2005. As a result, the net resource transfer during this period rose from \$2.9 million to \$62 million.

⁴ Four projects have closed since the last assessment in July.