



Dispatches from The Hall of Ideas!

ISSUE 06 | DECEMBER 2024

NEPAL AND PROSPERITY*

Dr. Biswo Poudel**

Inclusive institutions lead to sustained economic growth. Driven by the need for robust empirical research, the Nobel prize-winning trio (Acemoglu, Johnson and Robinson) went further than the tradition that was *Kitchen-Sink-Regressions*. Admittedly, the explanations they proposed fit better than the geographical conditions explanation proposed prior. Given this recent context, one might argue that Nepal has a rich history of inclusive institution-building and Nepal presents itself as a paradox. The Constitution of Nepal is arguably one example. Even before the Constitution was promulgated, we adopted varying forms of participatory institutions, such as user committees, forest groups, or the all-party local government functioning mechanism. I would argue for a more nuanced analysis of the situation.

For argument's sake let's focus on just institutions rather than inclusive institutions. The definition of institutions itself is rather vague and broad. Today if I asked someone what they would categorise as historical institutions in Nepal a few things will be named. Among other things they would include the *Muluki Ain* or its revised

iterations in the form of a separate civil and criminal code¹, the *Nijamati Kitabkhana*², the Nepali army and even the Guthi land system³. These are predominantly institutions that have survived for a long time, and they find their origins, at least their recorded origins, during or before a period when the Ranas held power i.e. prior to 2007 *v.s.*⁴ The building of institutions post 2007 *v.s.* is slightly different to the extent that it was premised on the need to support economic growth. Notable examples include Auditor General's Office as an ombudsman, the Public Service Commission as an institution for fair and transparent appointment of public officials, reforms in the property rights system, the establishment of the National Planning Commission, and even the National budget as a way to ensure transparent and rule-based allocation of resources to all public entities including the monarch. On paper, at least these numerous examples highlight the practice of institution building and its rich history in Nepal.

- 1 The *Muluki Ain* of 1854 was the first comprehensive legal code. Since then, it has been revised many times. The most recent revision is in the form of two separate codes—a civil code and a criminal code.
- 2 *Nijamati Kitabkhana* is a bureaucratic structure tasked with the responsibility of maintaining detailed records of civil servants.
- 3 In fact, Mahesh Chandra Regmi argues that the popularity of the Guthi Land Tenure System was due to the restrictions placed on its confiscation by the state.
- 4 *V.S.* refers to *Vikrama Smavat*, the Nepali calendar system. An approximation to *AD/CE* can be achieved by subtracting the *v.s.* date with 57

* The text is an abridged and translated version of the December 2024 edition of *Sambaad @ Samridhi*. *Sambaad @ Samridhi* is a monthly discussion on contemporary issues held on the last Friday of each month. In this edition, Dr Biswo Poudel shares his reflections on institutions in Nepal and Nepal's elusive quest for prosperity. The discussion was moderated by Arpita Nepal.

** Dr Biswo Poudel is Economist and Former Vice Chair of National Planning Commission.

But the reality is something akin to “*One step forward two steps backwards.*”

Nepal’s industrialisation offers an illustrative example. Beginning in 1934 *v.s.* Juddha Shumsher, to his credit, had started the process of industrialization. By 2010 *v.s.* whatever efforts we had made had waned. There are a few explanations for this. Immediately following the democratic revolution of 2007 *v.s.* Nepal put in place a few regulations that made it unprofitable for factory owners to expand. Since the revolution in 2007 *v.s.* was supported by factory workers, regulations expanding worker rights were introduced. It is also worth noting that in the period that followed immediately after 2007 *v.s.* nationalism came to the fore⁵. There were intensive discussions as to whether Nepal would allow foreign nationals, especially nationals from India, to own and operate industries in Nepal. Subsequently, the process of industrialisation in Nepal never took off.



Although, we built a few institutions, our failure lies in the ability to capitalise on them and to build these institutions itself. Institutions are important, but Nepal’s problem today is the

⁵ I would argue that it was in response to how India and China regarded Nepal and Tibet. In their recorded and now [publicly available conversation](#), Jawaharlal Nehru and Zhou Enlai talk of almost every country in Asia, save for Nepal and Bhutan. I would argue that there was a tacit understanding in place i.e. that India won’t bring out issues related to Tibet and in return, China would not speak of either Bhutan or Nepal. This understanding was perhaps premised on the thinking that Bhutan and Nepal were countries India exercised influence on and Tibet was a part of China.

inability of its institutions to collectively work towards a common goal. Take for instance the debate about political will versus bureaucratic push. Politicians have long argued that agendas for reforms have been stalled by bureaucrats and bureaucrats argue that there is a lack of political will. Both these groups are in fact only slightly correct.

Historically, the position of Minister of Finance has been a very powerful position. Before 2030 *v.s.* the Minister of Finance and the Prime Minister were in fact synonymous positions. Subarna Shumsher Rana, Surya Bahadur Thapa, Kriti Nidhi Bista, Gehendra Bahadur Rajbhandari were all simultaneously the Prime Minister and the Minister of Finance. Even Bhesh Bahadur Thapa who was in fact only the Minister of Finance exercised powers no less than the Prime Minister because of his known proximity to the king. These positions and even people who held these positions were not subordinate to the Nepali bureaucracy. Therefore, the explanation that the Nepali bureaucracy has stalled reforms initiated by politicians is not entirely true.

What has likely happened is a mismatch between the structure we have in place and the incentives. Today hardly anyone remembers the bureaucratic apparatus in place before 2007 *v.s.* The apparatus then was exceptionally efficient in collecting revenue and it was in fact structured to meet the goal of collecting revenue efficiently. In subsequent years we built an entirely new apparatus. This apparatus was built not based on the foundation laid before but rather by dismantling everything that lay before. Recall for instance, that I had argued before that institution building in Nepal has failed to capitalise on its pre-existing institutions. Indeed, the bureaucratic structure pre-2007 *v.s.* had some valuable lessons to offer but instead, we completely dismantled it and built a new structure. Take for instance the Public Procurement Act, 2007. The act was supported by multilateral financial institutions and is today admittedly the source of our problems at least within the context of capital spending. Our approach in formulating the new legislation was not to correct problems

that existed in our previous practices and tweak the underlying incentive structure to match the objectives. It was rather to create an entirely new structure that was often guided by what was deemed the best fit by experts⁶.

The hydropower sector offers an illustrative example of this phenomenon. Today Nepal's hydropower sector has become more efficient than it was previously. I would argue that it became efficient because there was scope for "learning by doing" and instead of changing the entire structure we adjusted and tweaked it to allow a gradual process of change. The private sector in Nepal, especially, has adopted this approach better than any other sector. The value of big infrastructure projects today is not the projects themselves but rather the human resources we have been able to train. The Nagdhunga tunnel is a very good example of this, the project has admittedly prepared about 150 tunnel engineers which Nepal can rely on in the future.

More importantly there are illustrative examples of political will failing to deliver despite bureaucratic support. Nepal has still not been able to complete its national pride projects which was in fact a politically driven agenda⁷. Today neither the politicians nor the bureaucrats have the capacity to perform their duties. In my opinion the last finance minister to actually understand the gravity of the job was Dr Ram Sharan Mahat. Since then, we have not had a minister of finance who has a grasp of all the details the way Dr Mahat had. The bureaucracy has the same problem. Let me offer an illustrative example, I was once made the chair of a committee tasked with deciding whether the project completion time for the Upper Karnali

⁶ In fact if one were to look at development spending and the conditions attached to them, one would find that there is almost always some form of regulatory change demanded by the multilateral institutions. For the MCC it was a revised energy policy and an electricity regulatory commission, for the World Bank it was the Public Procurement Act, the Financial Procedure and Fiscal Accountability Act and other regulatory changes. The problem with these propositions is that they rarely seek to build on the underlying structure or even consider local realities.

⁷ Both bureaucrats and politicians alike have used their positions to influence certain decisions. In his memoir, Bhesh Bahadur Thapa talks about how he had used his position to construct highways that would pass through his home district. The Mid-Hill highway project apparently passes through the village of Pitamber Sharma who was formerly the vice-chair of the National Planning Commission.

Hydropower should be extended or not. The committee could not find a single person, from within the Nepali bureaucracy, who could point out, with confidence and authority, the legal consequences of the committee's decision.

It is also worth noting that the bureaucracy today takes the path of least resistance. The analogy of the government banning the production of knives just because someone attempted to stab someone best illustrates the current outlook today. What we have presently is the return of the license raj. Building power plants, establishing school, opening new universities, opening new breweries and distilleries are all discouraged today. I distinctly remember the 1990s when Nepal was freer and all of these activities were permitted. The recent crisis of demand for loanable funds we face today is a result of this approach we have taken. Our history offers us a very good example of how this transpires. In Nepal interest rates were before 2041 *v.s.* controlled artificially. The thinking then was that a low interest rate would lead to capital flight. The gradual freedom accorded to banks and financial institutions to set their interest rates together with an unapologetic dismantling of the licensing policies did lead to an increase in exports between 2052 and 2058 *v.s.* Today, we have an interest rate regime that is flexible but loanable funds are not in demand because we have restrictions in place that discourage investments. In addition, there is also a mismatch between the fiscal policy and monetary policy. Ideally the monetary policy should be guided by the fiscal policy but the practice in Nepal is somewhat different to the extent that the monetary policy and fiscal policy are often at odds.

Today Nepal is a lot less free than it used to be. Importantly, it is also unequal and the state has been built as an unequal apparatus⁸. It remains

⁸ Ludwig Stiller provides a very good analysis of this phenomenon in his book "The Silent Cry". An illustrative example of unequal state building exercise can be gauged through promotions in the Military prior to 2007 *v.s.* Of the 150 people that were promoted 40 per cent belonged to the Chettri community. Promotions and even entry into the military was determined by either the caste of the person or the presence of a family member in higher positions. Since back then opportunities either inside the government or outside of it were limited, the privileges accorded then created the basis for an unequal society.

today dominated by a particular ethnic group. It should then not be surprising that Nepal always remains on the verge of revolutions rooted in systematic discrimination. If one were to travel across Nepal, one would find instances of these inequalities across communities⁹. Some don't have access to drinking water, others don't have access to electricity. Surprisingly, the priorities of the government of Nepal have not been to address them, it has rather been on building airports, conference halls and view towers. To a certain degree Nepal social security spending provides some form of redressal.

Nepal spends a significant fraction of its budget in social protection. It amounts to around 298.57 billion NPR of which the most popular scheme is the old age benefits allowance. A monthly allowance of NPR 4000 is in fact a significant sum for many. In my conversations with people who receive this allowance, I have been informed that it allows them some form of independence and reduces their dependence on children. But today we have many schemes that have been put in place. If one were to look very closely there is a marked distinction between the one taken by the Nepali congress and the communists in Nepal. Back in 2063/64, Dr Ram Sharan Mahat budget focused on social protection but here the focus was not direct transfers but rather on particular schemes such as free textbooks for children up to grade 10, free health services for those below 14 and above 75 and subsidies for farmers, education and health services. The communists on the other hand have focused on direct cash transfer, which is ironically the preferred modality for many classical economists. Today social protection is a combination of both direct cash transfers and subsidy programs. The estimated inclusion and exclusion error is about 25 per cent and there are a lot of irregularities but beyond these numbers there is a certain value that these programs offer that is less talked about. Regardless of the deficiencies, the social protection schemes act as one form of addressing

these inequalities and thus I am not dismissive of them. I would argue that we need to reform them to include those that require it and exclude those that do not but to dismiss them in their entirety based on arguments surrounding their viability would also be to dismiss the value they offer in providing some respite to several communities across Nepal.

So why has prosperity eluded Nepal? First, Nepal has never built institutions in the sense that it has never rigorously evaluated its pre-existing institutions and hence institutions building here have lacked inductive learning. It has always taken the approach of starting anew often missing out on developments that had happened prior. Secondly, both the bureaucracy and the political class lack capacity, specifically the capacity to say "no". Development agenda is driven primarily by donor agendas that is often disconnected from ground realities. Nameless, faceless bureaucrats of donor agencies introduce many initiatives during their temporary stay in Kathmandu. Third and finally, Nepal has traditionally been unequal and unfree country. The state has always been weak, its power of distinguishing between right and wrong has been blurred by its weak judgment capacity. The state's solution to everything is to ban almost everything instead of improving its regulatory capacity and the unequal society we have created further limits opportunities given the state's regulatory approach. Cumulatively, they have resulted in creation of institutions that have weak memory, little learning, missing ownership and are unable to prevent misuse by traditionally powerful groups.

⁹ It became more apparent to me that the Nepali state-building exercise was unequal when I campaigned for elections a few years back. Stories of abuse by the state, especially the police were also shared with me by the Tharu Community in Tikapur. I had also argued this point [elsewhere](#).