Challenge of Inclusive Federalism in Nepal: A Political Settlements Analysis of Madhesh Province

Summary Paper

November 2022

**Mushtaq Khan, Pallavi Roy, Sagar Prasai,
Anurag Acharya, Avinash Karna, Saumitra Neupane**

ABOUT POLICY ENTREPRENEURS INCORPORATED

Policy Entrepreneurs Incorporated (PEI) is a policy research center based in Kathmandu. Our team brings in the essential local expertise and experience to deliver impactful results that support inclusive and sustainable growth in Nepal. Through our collaborations with national and international partners, we offer evidence-based insights and engage with decision-makers in the public, private, and social sectors to help them make informed decisions.

https://pei.center

Challenge of Inclusive Federalism in Nepal: A Political Settlements Analysis of Madhesh Province

Summary Paper

November 2022

Mushtaq Khan[1], Pallavi Roy[2], Sagar Prasai[3], Anurag Acharya[4], Avinash Karna[5], Saumitra Neupane[6]

SOAS University of London   PEI POLICY ENTREPRENEURS, INC

1   SOAS University of London

2   SOAS University of London

3   Kathmandu-based researcher

4   PEI, Kathmandu

5   PEI, Kathmandu

6   PEI, Kathmandu

ABSTRACT

Nepal's federal constitution marked the end of a long conflict. Despite its limitations, it is hugely successful in one respect: peace has endured. The political settlements framework looks at how changes in the distribution of power in the years preceding the conflict made earlier institutions unworkable. However, the new constitution did not fully reflect the emergent distribution of power nor is it established that the way in which the constitution is being implemented will fully support economic development and political inclusion. Constitutions everywhere are works in progress and Nepal is no exception. However, in the face of challenges, this evolution can proceed in different directions. The interdependent evolution of the distribution of power (the political settlement) on the one hand, and the constitutional, institutional and policy rules that satisfy these groups on the other is important to track. This is what our political settlement studies contribute to.

Madhesh province and the broader Terai were critical contributors to the mobilizations that led to the new constitution. However, unlike other parts of Nepal where inclusion was also strongly demanded, in the Terai, mobilizations were often organized around ethnic identity and ethnic exclusion issues. The demand for strong *provinces* based around ethnic identity was also a particularly strong demand in Madhesh province. Irrespective of the motivations behind the demands for strong provinces, the province is an essential coordinating body for making federalism work in an inclusive rather than centralizing way. Otherwise, with a federal sphere and 753 local governments, evolution is likely to revert back to centralization. Unfortunately, because the demand for powerful provinces was initially interlocked with ethnic identity issues, the balance of forces that put together the current constitution ensured that the powers of the provincial sphere were severely limited. Moreover, many of even these constitutional powers are not fully implemented. Looking at the implementation problem using the political settlements lens allows us to understand this paradox and the problems it generates. It also helps to identify the forces pushing in different directions.

For Nepali policymakers and development partners wishing to ensure that future policies and interventions support the broadening of inclusion and economic opportunities, these underlying forces are important to understand. This can help to ensure that policies work to strengthen the embedding of inclusion rather than inadvertently supporting organizational interests seeking a reversion to excessive centralization.

Executive Summary

The federal constitution in Nepal was an outcome of a decade-long conflict. Its roots go back to a centralized polity that could not adequately address growing dissatisfaction with political and economic exclusion, particularly of some ethnicities, castes, classes and regions. The conflicts began when disadvantaged groups began to mobilize, within existing parties, in new parties, through armed militias and informal networks. These mobilizations challenged existing institutions and power structures. The mobilization in the Terai-Madhesh in what later became Madhesh province was particularly important.

The federal constitution that eventually emerged reflected (to some extent) the new configuration of power that was emerging across Nepal. However, some demands coming from well-organized groups were contested and pushed back, while others were recognized. These were the outcomes of many fluid networks and coalitions at a time of considerable uncertainty and unrest. The new institutions set up by the 2015 constitution are still contested in their implementation. Their implementation could develop in more inclusive directions or regress towards new concentrations of economic and political power. Understanding these dynamics can help to identify programmes and policies that support evolution in more inclusive directions. Despite these considerations, it is also important to remember that Nepal's federal constitution is in one respect a great success. The constitution has been institutionalized in two successful rounds of elections held for all three spheres of government since 2017 and the violence of the preceding years has ended.

The roots of this new constitution lie in both the Maoist movement that started in 1996 and the identity-based Madhesh Andolan, specifically of 2007. The 2007 movement was a mobilization that swept through all districts of the current Madhesh province and resulted in the emergence of several new regional parties and powerful leaders who have now made the transition from regional/provincial to national politics. For the first time in Nepali politics caste and religious categories like Yadavs, Other Backward Classes (OBCs), Dalits and Muslims became politically significant (demands for gender representation from civil society would follow later). These mobilizations had far-reaching consequences that clearly signalled a move away from the 'business-as-usual' politics dominated by upper castes belonging predominantly to the hill, non-Terai areas, who had long opposed Madheshi identity politics[7].

The geographical region of Madhesh is often identified by both locals and non-locals as having an identity distinct from the rest of Nepal. It's strategic location on the porous border with India was also a cause of legitimate concern for some nationalist Nepali leaders. While this led to efforts to bring it more firmly within a mainstream Nepali fold, Madheshis viewed this as a politics of exclusion. This historical, social and political exclusion found expression

---

7   Roy, Pallavi and Mushtaq H Khan 2017. *Nepal's Political Settlement and Inclusive Growth: Not Quite Business as Usual*. SOAS Working Paper. London: SOAS. <https://eprints.soas.ac.uk/25828/>.

in the Madhesh Andolan and finally led to the creation of Madhesh Province, driven by what was initially a unified mobilization strong enough to bargain successfully with Kathmandu.

This mobilization led to the formation of new 'intermediary' actors including provincial and local political entrepreneurs, private businesses, and civil society leaders that has created new organizational capabilities and is changing the distribution of power within the province and between the province and the federal government. The newly organized forces could affect the distribution of resources in significant ways, both productive and unproductive, and in ways that consolidate provincial power or result in further pushbacks. Moreover, significant segments of Madheshi society remain relatively excluded, including Dalits and Muslims, and the dynamics of possible future inclusion strategies is also of interest. Finally, in an important way, the evolution of federalism in Nepal as a whole depends to some extent on what happens in Madhesh. A strong role for the provincial sphere was a specifically Madheshi demand. Indeed, this is one reason why other interests in Nepal ensured that the powers of the province were severely limited in the 2015 constitution. In many respects, the formal powers of the province are not only too limited for federalism to work properly, even these limited formal powers are often very slowly implemented. The evolution of this critical part of the constitution depends on how Madheshi organizational structures further evolve and how effectively they can institutionalise a working provincial sphere. These specificities are a compelling reason to consider the context of Madhesh province as the key to understand some of the challenges and opportunities for provinces arising from the new constitution.

Our provincial political settlements studies, including the Madhesh study are part of a tracking exercise at national, provincial and local spheres of governance in Nepal. Our aim is to identify the drivers of change in a context of considerable flux, and the directions in which power and capabilities are developing. This can help to assess what is happening to inclusive development, and also to assess whether programmes and policies supported by government and development partners are likely to be effectively implemented in ways that support inclusive development. It can also help to assess whether policies and programmes are on the right track in terms of contributing to the deepening of federalism or require rethinking to make them more effective. The summary presented here is based on a longer paper on the evolution of the political settlement in Madhesh province.

We begin in Section 1 by introducing the political settlements framework with its focus on how the distribution of organizational power affects the formal and informal ways in which rules and laws are implemented. In section 2 we look at how the new constitution reflected changes in the distribution of power in Nepal, but also contributed to further change the distribution of power. In section 3 we describe the processes of mobilization in Madhesh province and identify three 'inflection points' over the last decade that signal a break from the earlier Kathmandu-dominated politics. In section 4 we focus on mobilizations in Madhesh since 2017 and the possibility of moving towards broader inclusion. In section 5 we examine how the evolution of the political settlement in Madhesh may affect the future of federalism in Nepal, and in particular the development of the critically important provincial sphere of governance. Finally in section 6 we conclude by comparing three plausible scenarios for the trajectory of federalism in Madhesh province.

1. The Political Settlements Framework
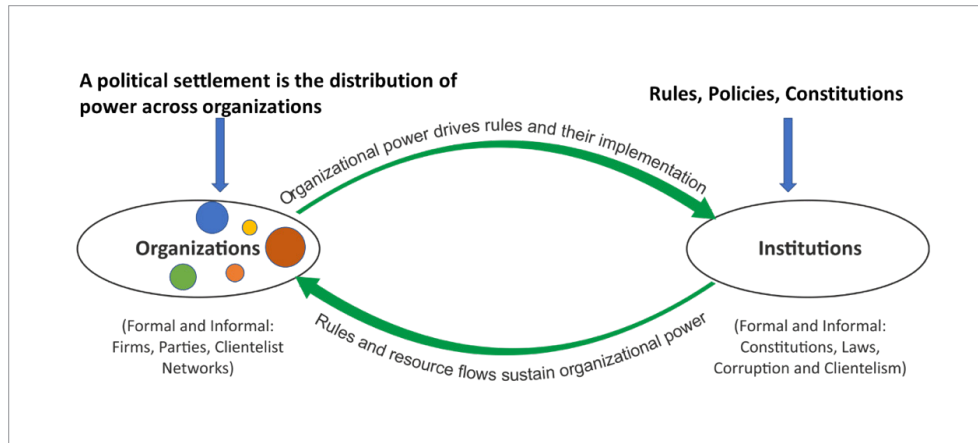
Source: Authors

Figure 1 Institutions and Organizations in a Political Settlement

The political settlements framework says that *institutions* emerge and operate in ways that depend on the power and interests of *organizations*. Institutions are the formal and informal *rules* that describe how organizations (and individuals) can behave. Institutions can be formal (legally enforceable) or informal (self-enforced or enforced by extra-legal processes). Examples of institutions range from constitutional rules that describe how representatives are elected in different spheres and their powers, banking rules, informal rules within parties that describe how candidates are selected, or the informal rules of gift-giving or corruption that may be required in many activities. Organizations are the 'actors' who are subject to institutional rules. Organizations can be formal like firms and political parties, but also informal like clientelist networks, familial or caste networks or factions within political parties loyal to a particular leader. Organizations also exercise their power to try and change particular rules in line with their interests, or to block or distort their implementation when they are not. We describe the distribution of power and capabilities across relevant organizations as the 'political settlement'[8].

Figure 1 shows that the distribution of power across organizations *tends* to support the creation of institutions (rules) that help powerful organizations reproduce the distribution of power. For instance, if large firms are powerful, they are likely to ensure that rules of trade and taxation reflect their interests and help to reproduce their power. They may try

---

8   Khan, Mushtaq H. 2010. *Political Settlements and the Governance of Growth-Enhancing Institutions.* Research Paper Series on Governance for Growth. London: SOAS, University of London. http://eprints.soas.ac.uk/9968; Khan, Mushtaq H. 2018. Political Settlements and the Analysis of Institutions, African Affairs 117 (469): 636-55. <https://academic.oup.com/afraf/article/117/469/636/4690667>

to change other rules that do not reflect their interests, or they may try to distort the implementation of these rules through corruption or informal arrangements. In addition, organizations that are themselves informal or organizations that have low productive capabilities, are more likely to support informal institutions like corruption that allow them to reproduce their power. The social interaction between organizations and institutions is therefore one of ongoing evolution, and outcomes may develop in the direction of greater productivity and inclusion or the reverse, depending on the relative power and capabilities of different types of organizations in a society.

Institutions and organizations therefore need to be looked at together. Institutions that work in one context may not work in the same way in another if the power and capabilities of organizations are very different. Organizations are likely to try and formally change rules that are against their interest, or informally interpret and implement the same rules differently depending on their power and interests, including, in many developing country contexts, engaging in different types of corruption or informal mobilizations to influence agencies or bypass rules that do not suit them. Instead of trying to identify the 'best' institutions, the most practical way of influencing the direction of travel is often to identify the institutions that are most likely to support inclusive development given the power and capabilities of organizations.

Figure 1 may give the impression that there is always an exact relationship between what each organization gets and their relative power to influence. This is, of course, only approximately true, and indeed the mismatch between what particular organizations get from the existing structure of rules, and what they think they *should* get given their understanding of their relative power, drives political mobilizations, conflicts and institutional change. Organizations are therefore continuously driving processes through which institutions *change* and this is how political settlements and societies evolve. In post-conflict contexts like Nepal, where a new constitution is being embedded, understanding and tracking these processes of change is particularly important. The organizations that are relevant include formal ones, such as parties, businesses, or trade associations but also informal ones, such as networks based on patron-client relationships, caste, ethnicity, and so on. Governments and development partners are organizations amongst many other organizations. That is why governments and development partners cannot just announce rules and programmes and expect that the relevant actors will simply comply. The political settlements framework says what can be actually achieved by specific policies and institutions depends on the power, capabilities and interests of other organizations and how *they* interpret and implement these rules. The political settlements framework allows us to track these interactions.

The mismatch between the growing organizational power of excluded groups in Nepal, and the limited benefits or resources they could access, drove the conflict in Nepal and defined the outlines of the new constitutional arrangements of 2015. The earlier centralized institutions of Nepal involved formal and informal 'rules' of resource allocation that favoured restricted groups from the upper castes and hill areas. Despite pressure gradually building up, these institutions did not evolve in time in response to emerging mobilizations, particularly in Madhesh and the Tharu regions in the years prior to the conflict. The growing mismatch between institutions and increasingly powerful demands was the driver of the conflict that ensued, and eventually also of the institutional changes in the direction of the federal constitution.

Source: Authors

Figure 2 Tracking Changes in the Political Settlement

Figure 2 shows how the actions of organizations *changes* the distribution of power and capabilities over time. The trigger is often new political mobilizations, or changes in economic opportunities. These enable new political organizations to mobilize or new firms to engage in new businesses. If the existing institutions allow them to thrive then this is sufficient to change the distribution of power. Often, however, the emerging organizations drive additional changes in institutions that further strengthen their power, for instance by changing electoral rules or the financial power of different spheres of governance in line with the interests of newly empowered political parties or movements or changing company laws, tariffs or taxes in line with the interests of new types of firms. Organizations may become more powerful if they can institutionalize their power with rules that support new economic and political opportunities and older organizations may similarly decline for the opposite reason.

As Figure 2 also shows, the emergence of new organizations and the changes in the distribution of power they bring about are not necessarily always in the direction of greater inclusiveness. If the process of organizational and institutional change supports the development of new productive firms or new political organizations that represent excluded groups, the direction of travel may indeed be in the direction of greater inclusiveness. But the new organizations could also be extractive ones, such as new structures of patronage or clientelism that talk of inclusion but benefit a new set of restricted groups, or new 'firms' with low capabilities that survive on political patronage and corruption. In these cases, the direction of travel may be regressive, with power and resources still in the hands of narrow groups, though they may be new ones. A deeper analysis of the power and capabilities of emerging organizations, business, political and other, and the strategies they are following to sustain their access to resources and reproduce their power is necessary to understand if the direction of travel is towards greater inclusiveness or not.

2. Power, Conflicts, and the Emergence of the Federal Constitution

The conflict in Nepal prior to the federal constitution of 2015 was driven by cross-cutting mobilizations of ethnicities and castes, men and women who sometimes acted together, sometimes separately and occasionally in opposition to each other. A powerful element in the conflict was the mobilization of different ethnicities, particularly in the Terai-Madhesh, that led to demands to recognize Madheshi identity and the creation of a Madhesh province. Elsewhere in the Terai, the Tharus too demanded a territorial entity that would allow them to exercise political control over their destiny. However, it was the Madhesh movement that generated the strongest demands for a constitutional recognition of ethnic identities. An important demand was to draw provincial borders along largely ethnic lines and the recognition of provincial rights that would allow previously disadvantaged ethnicities (and castes) to organize, claim, and allocate fiscal and other resources according to their own priorities.

But these mobilizations were also perceived to be threatening by other groups, especially the dominant upper caste hill ethnicities who saw these demands not just as a challenge to their authority, but potentially also as a threat to the territorial integrity of Nepal. The fear was that the identity-based movements of the Terai regions would become too autonomous or too closely associated with India. Given the historical connections of the Madhesh region with Northern Bihar and North-Eastern Uttar Pradesh (UP), these apprehensions were not unfounded but were also likely to have been exaggerated for political reasons.

There were therefore serious disagreements about the type of federal arrangement the constitution should set up. These disagreements reflected the conflicting interests of different (mainly informally organized) coalitions and were the source of many conflicts during the constitution-making phase. While some well-organized groups in the Terai wanted ethnic identity-based federalism, other powerful groups elsewhere in Nepal were determined to ensure that federal rules should enable a devolution of power without strengthening ethnic identities, for instance by ensuring that major ethnicities were split across provinces. Yet other groups wanted to preserve a greater measure of central power by pushing for older variants of decentralization where a strong centre coordinated resource allocation across a very large number of local governments, entirely or almost entirely bypassing the provincial sphere. The eventual outcome reflected a compromise that did not fully satisfy any group. Competing interests are likely to continue to adapt the implementation of these and other aspects of the constitution even if formal constitutional amendments are not immediately on the agenda.

A second set of important cleavages involved castes. Caste exclusion sometimes overlapped with ethnic exclusion but often also cut across ethnicities. The mobilization of specific

castes in new political coalitions and in the armed struggle played an important role in achieving caste representation for Dalits and Janajatis in the new federal constitution. Finally, the mobilization for social justice encouraged and involved the participation of women in politics and in the armed struggle to a much greater extent than before. Their voices too were represented in the new constitution. Demands for greater representation and rights were recognized in seats reserved for women in different spheres of governance.

In each of these dimensions the constitutional rules that emerged did not necessarily reflect the precise distribution of organizational power, which was in any case very fluid at that time. Many compromises were made in a context of violence, conflict and uncertainty about the organizational strength and commitment of different groups and their willingness, or ability, to fight for their demands. The demand for provinces with strong powers reflecting regional ethnic identities was the most strongly contested demand and affected Madhesh the most. It acquired an international dimension in 2015 with the economic blockade at the border that many in Nepal attributed to Indian support for Madheshi demands. India argued it was an internal blockade driven by the Terai-Madhesh movement, but India was clearly very sympathetic to this movement. The outcome of these conflicts was to strengthen the opposition elsewhere in Nepal to Madheshi demands for a province along the whole of the Terai. This demand was eventually successfully obstructed by other coalitions. The geographical shape that province 2 (later named Madhesh) actually took therefore fell far short of Madheshi demands and appeared not to satisfy many Madheshi groups that had organized to articulate these demands.

The demands of the Madhesh movement combined a demand for a strong province with the demand for ethnic-identity based provinces. The push back against the second demand also meant there was by association, a tacit rejection of the first demand. This had profound implications for the constitution. First, the geographic boundary of province 2 fell far short of Madheshi demands. But secondly, and more importantly for the future of federalism in Nepal, the formal powers granted to the provincial sphere in the constitution were in the end also very limited. This undoubtedly reflected the fears of other powerful groups that ethnic-identity based politics threatened their interests, and perhaps Nepal's sovereignty as well. But an implication of the constitutional provision of weak provinces is that devolution has been difficult to fully operationalize.

A sustainable model of devolution is likely to require an intermediate level of effective (and not just nominal) coordination between the centre and local governments. For coordination to be effective, there has to be an effective intermediate sphere between the centre and local governments where competing claims for resource allocation across local governments can be assessed and resolved. Moreover, many critical public goods in areas such as health, education and infrastructure necessarily span across local government jurisdictions. Coordinating these decisions requires a provincial sphere with the power and resources to make decisions about where to locate colleges, hospitals, or roads. Otherwise, these decisions go further away, back to the federal sphere. Decisions on investments in many public goods are best made at scale and is likely to require provincial coordination, rather than wholly devolved to a very large number of local government authorities (LGAs). However, the federal constitution has deliberately limited provincial rights including limiting its fiscal resources from the federal government, its own tax-raising powers, and effective coordination powers across local governments.

There is therefore a danger that despite its intentions, the constitution may gradually begin to replicate some of the features of centralized resource allocation that characterized the earlier Panchayati system that Nepal had under the monarchy. Such a large number of local governments will require more than formula-driven resource allocation and any coordination and decision-making by the centre will inevitably tilt the balance of discretionary power back towards organizations operating at the federal sphere of governance. Going forward, the sustainability of devolution may therefore well depend on the power and effectiveness of groups that demand greater provincial coordination and rights.

3. The Economic Background to Madheshi Political Demands

In the 1950s and 1960s the political and economic focus of Kathmandu shifted from expanding Pahadi settlements in Madhesh to ensuring Nepal's sovereignty along the highly porous border with India. This resulted in new policies of centralization in the form of King Mahendra's 'nationalisation' plan, and the enforcement of the use of Nepali currency and political control under the Panchayati system.[9] This helped the emergence of a new group of mainly Madheshi upper caste elites with links to Kathmandu. The development of the east-west highway and industrial corridors alongside it, coupled with the expansion of agriculture in the Terai regions that successfully exported to a food deficit India at that time also helped sustain the region's economy. This was the period when Birgunj emerged as a prosperous urban centre.

However, with the wave of liberalization sweeping across South Asia in the 1990s, Nepal's agriculture-based export economy also started faltering (Fig 3). By this time India's green revolution had made it a food-surplus country and farm exports into India from the region had drastically reduced. The large industrial investments (eg in tobacco-based products) set up under the nationalisation era had also largely failed as did subsequent attempts at privatisation.[10] The decline of industrial and agricultural growth and a greater reliance on services and remittances contributed to a growing discontent in the region.[11] The concentration of power and decision-making in Kathmandu and within upper caste Pahadis became more contested, and a growing mismatch emerged between the demands of new Madheshi political groups and businesses, and the institutions they could access to address their problems.[12] While some regional business elites could relocate to Kathmandu the younger population facing growing youth unemployment had no such recourse and this provided popular impetus for the Madhesh movement. Aspects of caste-based exclusion added to the churn.

9   Consing, Arturo Y. "The economy of Nepal." *Staff Papers* 10, no. 3 (1963): 504-530; field interviews.

10   KC, Fatta Bahadur. "Performance of public enterprises in Nepal." *Nepal Rastra Bank Economic Review*, Kathmandu 15 (2003): 203-226.

11   Dahal, Madhav Prasad. "Sinking in Premature Deindustrialisation or Revitalising Industrialisation? Nepal's Prospective." *Economic Journal of Development Issues* (2017): 35-70.

12   Hatlebakk, Magnus. "Economic and social structures that may explain the recent conflicts in the Terai of Nepal." (2007); field interview.
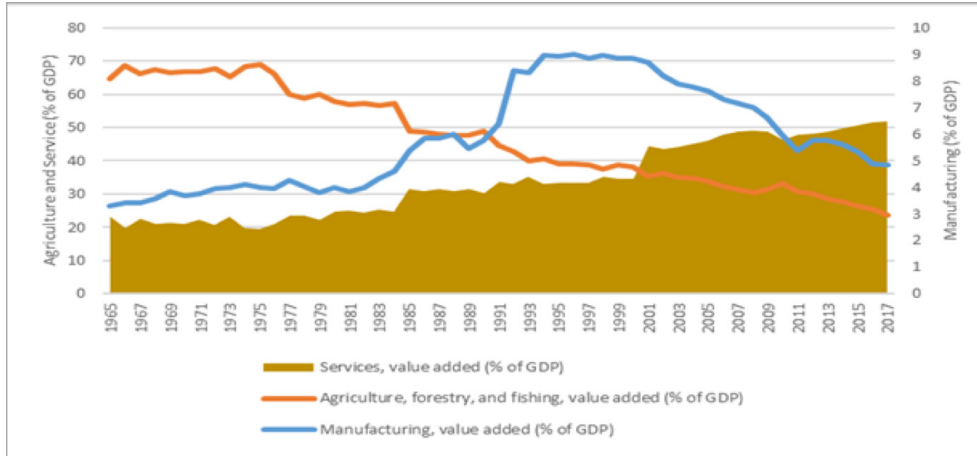
Source: World Bank national accounts data

Figure 3 Sectoral Development in Nepal 1960-2017

A limited redistribution of power was attempted under a new constitution in 1990 but this failed to generate an economic turnaround of Madhesh. Instead, landed elites, upper caste Madheshis, and Pahadis maintained their relative power and access to resources. In neighbouring Bihar and UP, socio-political violence and economic failure spiralled into the politics of mobilization around the recommendations of the Mandal Commission for affirmative action for backward castes. This had repercussions in Madhesh by polarising politics under a Madheshi-Pahadi binary. The demands for a new constitution coincided with both the Mandal discourse across the border and the lack of economic opportunities for Madhesis within the region and in India, where they could once find work. Armed insurgent groups drawn mainly from Dalits and Janajatis joined the Maoist insurgency, and the federal government began to lose effective control over the region. There was acute instability from the late 1990s as the Maoist conflict escalated. This was followed by the Royal massacre, the crowning of King Gyanendra and the popular Janandolan II movement before some form of stability was restored with a return to democracy in the first Constituent Assembly elections in 2008.

These events gradually led to profound changes in the distribution of power in the region. Mobilizational power shifted from landed, upper caste, traditional elites to leaders from the Madhesh Andolan who mostly came from Other Backward Classes (OBCs) and lower castes. The new leaders could mobilize the dominant demographies of Madhesh. The political and economic landscape of Madhesh was greatly changed by the end of 2008. A new group of regional leaders from backward caste backgrounds began to displace upper caste Pahadi elites. These leaders had gained political credibility both from their involvement in the Madhesh movement as well as from the backward caste-led state governments in UP and Bihar.

However, while the new Madheshi politicians had organizational power, they still lacked economic power. They did not initially have access to assets like land or the connections that the Kathmandu elite could use to access government resources. Democracies are expensive for political parties and when 'clientelist' parties compete, they have to raise relatively large sums often through informal processes. Individuals and informal networks that invest in politics can generate high returns for these 'investors' if their parties come to power. They can expect policy changes that benefit them, contracts, and jobs for themselves or their clients, as well as informal rent sharing that can involve different types of sharing of the returns from corruption. Politics across South Asia involves a combination of manifesto

promises of public goods or welfare schemes together with significant off-budget offers to cadres and voters that are critical for sustaining the organizational power that wins elections. Nepal is no different than other South Asian and developing country patterns, but there are important differences in detail across regions and over time.

Clientelist politics of this type can often result in wasteful resource dissipation that harms growth even while it keeps political organizations in power by meeting the demands of powerful groups. But it can sometimes also result in economic accumulation by political entrepreneurs that may be reinvested in businesses to generate profits and jobs. When this happens, there may be more or less rapid development despite the presence of substantial corruption and clientelism in the system. As new productive businesses develop, this can gradually further change the distribution of power and capabilities and eventually generate stronger demands for better governance and developmental policies. The path towards more rule-following behaviour, and more inclusive economics and politics is usually gradual and uneven across developing countries.

The emergent politics of new political entrepreneurs in Madhesh is already creating new relationships between political actors and the business community, very often at the expense of older elites. New politicians have access to increased government budgets under the federal constitution, and there is some evidence of higher levels of private investment particularly at local government levels that may partly be due to the recycling of resources acquired through political access. The remittance economy has also widened opportunities for consumption and investment. There are new urban clusters forming with large investments in real estate driven by the greater government resources being directed to local governments and provinces as a result of federalism. Despite all this, Madhesh continues to fall further behind the Nepali average. Table 1 shows that while Madhesh has grown, its growth has been lower than the Nepal average. As a result, in relative terms, its per capita income declined from 79 percent of the Nepal average in 2011 to 59 percent in 2019.

Table 1: Gross Domestic Product and Per Capita Income of Madhesh Province

District	GDP (NPR Billion)		Per Capita Income (NPR)	
	2011	2019	2011	2019
Nepal	*1,367*	*3,464*	*51,879*	*121,747*
Madhesh Province	*222*	*444*	*41,064*	*72,173*
Saptari	23	46	35,838	64,937
Siraha	19	39	30,820	55,984
Dhanusa	31	63	41,951	75,649
Mahottari	19	38	30,436	54,081
Sarlahi	28	56	36,177	63,051
Rautahat	23	46	33,840	56,224
Bara	45	91	66,175	111,868
Parsa	33	66	54,706	93,600

Source: Province Profile, Madhesh Province

We identify three economic inflections in the years around 2015 that changed some important characteristics of the province and defined some of the background conditions driving further developments. The first was a large outflow of migrant labour. Five of the ten districts in Nepal with the highest migrant outflows are in Madhesh. Table 2 shows the exponential rise in migration figures. Labour shortages followed and resulted in a relatively rapid mechanization of agriculture in the province (and in some other regions of Nepal). It is likely that agricultural productivity also increased somewhat as a result, but further growth may require substantial policy support. At the same time, migration also generated large remittance inflows. But many rural areas have gradually emptied out leaving behind an older population that can neither migrate abroad nor move to urban centres. High-migration areas therefore also have aging populations in need of social care.

Table 2: Foreign Employment related out-migration Nepal and Madhesh 2008-2009 to 2016-2017

District	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Nepal	*163,886*	*225,200*	*240,977*	*260,030*	*395,661*	*441,117*	*448,520*	*366,921*	*353,982*
Saptari	4,072	7,286	7,480	7,332	11,273	13,418	14,008	13,404	13,374
Siraha	7,508	9,543	10,290	9,223	13,944	17,191	17,055	14,508	16,083
Dhanusha	10,950	11,942	11,923	11,643	18,894	21,357	22,259	19,946	20,693
Mahottari	6,136	25,223	13,687	9,476	12,606	15,640	16,723	15,294	15,893
Sarlahi	3,478	5,200	5,719	5,723	10,335	13,330	14,603	13,117	14,810
Rautahat	1,552	2,134	2,873	3,298	6,606	8,858	9,700	7,786	9,053
Bara	1,774	2,527	3,639	4,158	7,200	8,928	9,014	7,538	8,427
Parsa	885	1,194	1,743	2,244	3,804	6,470	6,159	4,885	5,563

Source: GON/DoFE *(Compiled by authors)*

The second important inflection was a rapid increase in the gap between the faltering growth of agriculture and manufacturing on the one hand and the boom in services and construction on the other. The decline of border towns in Bihar helped push this change, with emerging urban areas on the Nepali side like Butwal and Birgunj providing services linked to tourism, hotels, casinos and so on. It is likely that much of the wealth of the new class of political leaders and businesses associated with them is invested in these sectors.

A third inflection was the rapid growth in fiscal spending in general and greater allocations to dispersed geographies as a result of the federal constitution. Compared to FY 14-15, government spending more than tripled in FY 20-21. Projected capital expenditure for FY 20-21 was NPR 35,292 crore. While provinces do not directly have much revenue-generating powers, they can negotiate a share of federal spending to be spent in their province, and much also depends on how local governments in the province are allocated funds. Provincial assembly members also get NPR 30 million every year as constituency development funds. The new spending has created pockets of construction and prosperity in provincial towns, even if the precise distribution of beneficiaries is not yet clearly known. Although the funds available to provincial assembly members are smaller than those available to MPs in the National Assembly, provincial assembly politicians are also likely to develop their

own constituency and clientelist bases that can play a significant role in institutionalising federalism by developing provincial government constituencies that benefit from federalism.

Going forward, the consolidation of the power of emerging provincial political actors will depend on the extent to which they can generate revenue within the limited powers that provincial governments have in terms of tax collection and increasing the attractiveness of the province for investors. For now, transportation and vehicular tax generate the most revenue for the province, but this is too narrow a source of internally generated revenue and can hardly enable the provincial government to make necessary public investments. A sector with potential that is likely to continue to languish due to hard budgetary constraints is agriculture. Madhesh is one of the most fertile parts of Nepal yet all the respondents we spoke to with knowledge of the sector admitted it was performing well below its potential. This is largely a result of budget-induced policy constraints, for instance the lack of agricultural extension services, and timely and adequate supply of fertilisers.

While the limited head room for provinces to generate their own tax revenues is not a problem limited to Madhesh, the province does seem to have a specific perception problem when it comes to attracting investments. The Madhesh movement was characterized by strong popular mobilizations which often led to political violence and street protests. While this has long since ceased, at least since 2017, the perception that Madheshi politics is violent and uncertain remains, hampering business sentiment. Leaders of the Madheshi parties have also had to remain focused on mobilizing their grassroots to ensure the success of their movement and have therefore had little experience of governing and policy making. This has not been the case of leaders from other national parties who are prominent in other provincial governments.

Madhesh's proximity to India has long been seen as an economic opportunity for many on both sides of the border. However, this has had mixed effects. It has made it easier for labour to move from India into Nepal in specific skill deficit areas. While there is data available on the presence of Nepali workers in India and most policy makers acknowledge this fact, there is limited recognition of the fact that the open borders have allowed business owners and large farmers in Nepal to import Indian workers in low skilled work (like brick kilns) or for higher skilled work that requires operating sophisticated machines. One reason for this has been a damaging politicisation of trade unions in Nepal that has a negative effect on productivity. Going forward, provincial politicians have to find solutions in cooperation with unions and labour representatives that allow investors to engage local workers on a much larger scale. This may well require institutional and policy changes.

On a positive note, one emerging opportunity for the province is likely to be religious tourism as the temples in the province, especially in Janakpur, have started attracting high value Indian tourists. One way of expanding the appeal of shrine tourism would also be to attract East Asian tourists, and not just Indians, to localities associated with Buddhism.

4. Madheshi Mobilizations after 2017

The recognition of caste and gender representation in the new constitution has changed the distribution of new leaders and political organizations at the provincial and local government levels. This could drive politics in new directions, but only if the new representatives have effective power. For instance, female representation has undoubtedly increased but to exercise power, female politicians need to belong to powerful informal networks. Not all of them are successful in achieving this. Progress in developing their own powerful networks is necessarily going to be slower than progress in achieving representation as a result of constitutional provisions. Some of our ground-level tracking have shown that women leaders at the local government level who exercise significant agency and decision-making power are embedded in powerful informal networks. Others without such networks often lack real power and male colleagues work around them.

Similar considerations affect the constitutional representation of backward classes and castes. If these representatives are not able to rapidly develop their own organizational power, their access to power and resources may be limited. The political settlements analysis suggests that formal representation without powerful organizations backing the representative, whether formal or informal, may limit their ability to use these institutions to their advantage. Some backward class groups are therefore much more likely to benefit from formal representation than others.

An important question at the time the constitution was adopted, was whether it would be accepted by Madheshi organizations given that many of their demands were not conceded. Would they continue to demand a strengthening of the role of the province? Or would they give up this fight and focus on accessing resources in other ways? If the leaderships at the provincial level and enough of their followers could access resources directly from the centre, they may eventually accept that fighting for a bigger role for the province was no longer necessary for their own interests. But such a strategy may have unexpected implications for achieving a sustainable broadening of the distribution of power. Sustaining devolution is likely to require an effective intermediate level of decision-making at the provincial level.

When the constitution was being deliberated on in 2015, the demands for stronger provincial powers could be ignored despite the mobilization in Madhesh because similar demands were relatively less strongly articulated in other parts of the country. In the western Tharu area, the mobilization for identity-based provinces began later, primarily due to an unwillingness on the part of many Tharus to be part of the broader Madheshi movement led by the Madheshis. Similarly, in Karnali the demand for a separate Karnali province began when the decision to divide districts under the former Karnali Zone into different federal provinces was opposed by leaders in the region who believed the remote Karnali region should remain undivided. As a result, the central Terai districts where the Madheshi organizations had mobilized successfully were initially the strongest voice demanding a powerful provincial structure. Both Madheshis and Tharus were also strongly resisted locally by powerful non-

Tharu and non-Madhesh groups and organizations, mostly led by hill-caste group leaders who were influential in driving Kathmandu's constitutional bargain. The Tharus were eventually split across three provinces. In other parts of Nepal, excluded groups demanding inclusion were numerically too small to demand entire provinces for their ethnic identities, and demands for inclusion were more likely to take the form of demands for strong local governments and caste or Janajati representation.

In the subsequent implementation of federalism, the initial Madheshi discontent over the federal demarcation appears to have subsided. But the demand for a greater devolution of power and resources to the sub-national spheres (provincial and local) remains strong. For instance, the government of Madhesh Province has filed at least four different cases against the federal government for impinging upon its jurisdiction, including over the recruitment of government officials, provincial police personnel, and the utilization of natural resources like forests within its territory. Madhesh politicians have also demanded revisiting the population weightage that is used to determine electoral constituencies across the provinces, or to disburse federal government revenues. Provincial politicians and activists, particularly from the Madhesh Province, have demanded that budgetary allocations to the provinces should be in proportion to its population.

Province-wise population
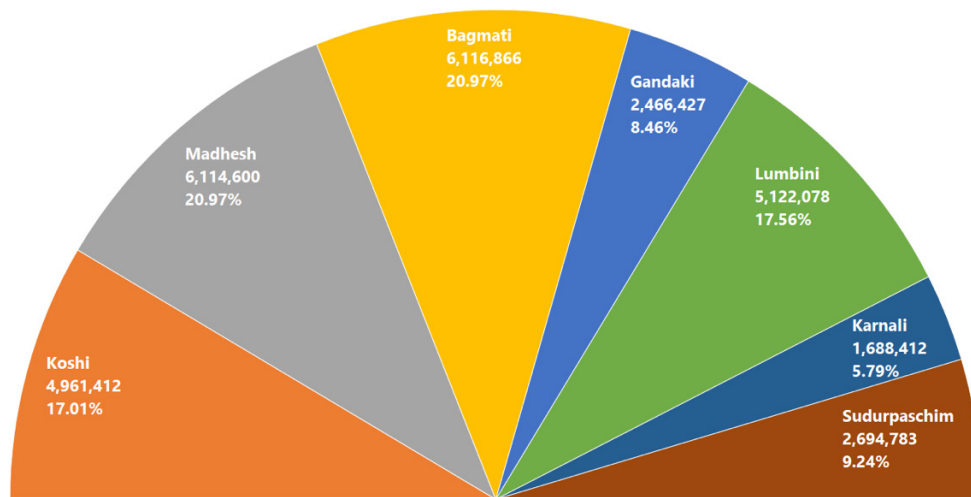
Source: Nepal Census 2021

Figure 4 Province-wise population of Nepal

Table 3: Population and fiscal transfers from the federal government to the provinces

| Province | Federal Electoral constituency | Population Percentage (Census 2021) | Fiscal budget to provinces | | | |
| | | | (NPR in billion) | | (In percentage) | |
			2020-21	2021-22	2020-21	2021-22
Koshi	28	17.01%	15.114	16.294	15.13%	15.71%
Madhesh	32	20.97%	13.406	13.903	13.42%	13.41%
Bagmati	33	20.97%	14.870	14.727	14.89%	14.20%
Gandaki	18	8.46%	13.360	13.030	13.38%	12.56%
Lumbini	26	17.56%	14.070	15.613	14.09%	15.06%
Karnali	12	5.79%	14.837	15.556	14.86%	15.00%
Sudurpaschim	16	9.24%	14.218	14.580	14.24%	14.06%
Total	**165**	**100.000%**	**99.874**	**103.703**	**100.00%**	**100.00%**

Source: Ministry of Finance (Compiled by authors)

The bureaucracy that has traditionally looked towards promotions and a future in the federal government has been another powerful organization that has often quietly worked to limit the strengthening of the provincial government. This is one reason why politicians who want to develop provinces have been keen to have their own provincial administration cadres. A case in point is the recurring conflict between District Administration Offices (DAO), under the federal Ministry of Home Affairs, and the sub-national governments. Both provincial and local governments see DAOs as an extension of the federal government. This is not surprising because bureaucrats belonging to the federal bureaucratic structure will naturally want to interpret and implement constitutional rules in ways that protect the interests of the federal bureaucracy. All seven provincial governments have also expressed their dissatisfaction over budgetary allocations and their inability to generate their own revenue. However senior bureaucrats in the federal government have so far remained powerful enough to ensure federal politicians do not accede to these demands. Such senior bureaucrats ensure continuity in a political context where ministries revolve frequently among political parties and hence are valued for the political and technocratic information that they provide.

The discontent was especially marked when provinces found they were not able to satisfactorily respond to the COVID-19 pandemic, which overwhelmed Nepal's sub-national health infrastructures. The provincial ability to coordinate activity within the province was limited as a result of their limited control over finances. Despite this broad discontent with limited provincial powers across all provinces, Madhesh is widely seen as the province that is most likely to lead the pressure for interpreting and implementing provincial powers in more robust ways. This pressure has not been as strong in recent years as some had expected. This could be because powerful Madheshi organizations may have assessed that the forces ranged against the province are still too strong to allow feasible changes. It could also reflect the possibility that some important Madheshi politicians and parties may be temporarily content with the resources they are being able to access in other spheres using their mobilizational and organizational capabilities. On the other hand, new groups are also emerging at the provincial level all the time. If newly mobilized groups cannot be

sufficiently accommodated by federal resource allocation or by the resources available at local government levels, the demand for stronger fiscal rights at the provincial level can again become important.

The developmental implications of these choices depend on the answers to several related questions. What types of organizations at the provincial level are getting access to new resources? Our research suggests that fighting elections is expensive but also a way of generating incomes for political entrepreneurs who win positions. How are the funds for fighting elections being generated and how are the resources generated by the new politics being invested? Are the 'investors' in the new politics who gain access to new resources and contracts after elections investing in new businesses at the provincial level, or are they more interested in investing in businesses in Kathmandu, or are they reinvesting resources in politics to further strengthen their organizations at different spheres of governance? Early observations suggest that all of these processes are going on, but their relative strength will take a longer period of tracking to assess. The relative strength of different strategies will determine whether the evolution of federalism will be towards more or less inclusion, and stronger or weaker provinces.

5. Madhesh Province and the Future of Federalism

The adoption of the name 'Madhesh' for Province 2 would have been difficult to consider a decade ago because it associates an ethnic identity with a province. But the fact that it has been adopted without much controversy is a reflection of the evolution of ethnic identity politics in Nepal. It would not be wrong to conclude that federalism has acted as a 'safety valve' by providing a formal channel for Madheshi organizations to both gain representation as well as access resources and address grievances. Frequent fragmentation and reorganization characterized Madheshi parties well before the federal constitution. This has now evolved into what can best be described as *competitive clientelism* with no single regional party being strong enough to confront the centre. How is this likely to evolve?

An emerging trend in Nepal in the years since the first elections under the new federal constitution is the increasing influence of political factions within parties, and this is especially true in Madhesh province. The competition between parties, and factionalization within them, weakens concerted action by politicians who would benefit from a stronger provincial government. The competition also means that deals between federal and provincial parties are unlikely to be very stable. The People's Socialist Party-Nepal (PSP-N), the largest political party in the province, was comprised of factions led by powerful leaders who represented various caste and ethnic groups. Since 2021, the competing factions within PSP-N split into competing political parties. On the surface, it seems the splits may have been about competing strategies about whether and how much to align with larger national parties like the Nepali Congress and CPN-UML. However, there is also a caste and ethnic undercurrent to the split, whereby leaders of two dominant caste groups in Madhesh, the Yadavs and non-Yadav Other Backward Classes (OBCs), are competing for influence while challenging the traditional political influence of Terai upper caste groups and their leaders.

On the other hand, the Janamat Party led by CK Raut, the former radical leader who had campaigned for an independent Madhesh and has been opposed to doing deals with more mainstream Madheshi parties, seems to have 'settled' into the formal structure of the new constitution. There was some expectation that the party would perform well enough to be a serious electoral threat to the PSP-N in the 2022 local elections, but that did not come to pass. However, the party might make some gains in parliamentary and provincial elections. Despite its smaller formal presence, the mobilizational capability of the Janamat Party and its attraction among young Madheshis remains strong. This competition is likely to ensure that the larger, more mainstream Madheshi parties cannot be seen to be compromising on Madheshi ideology in exchange for 'rents' from Kathmandu, at least in the medium term. This distribution of power could also force Madhesh-based parties like PSP-N to expand beyond the province and consolidate their position in Kathmandu, rather than relying solely on the political support they can get within Madhesh province.

The local election in 2022 also led to the re-emergence of the Nepali Congress across all seven provinces. There are no strong regional parties in six out of seven provinces, so

Madhesh is again an exception. But Madheshi parties have lost significant ground since the last elections, even though PSP-N has managed to establish a formal electoral and organizational presence in all provinces, except Karnali (though it has no mayors or deputy mayors in Bagmati, Gandaki and Sudurpashchim). It is the fifth largest party in Nepal. A new emerging regional force is likely to be Resham Chaudhury's nascent Nagarik Unmukti Party (NUP), which has mobilized in districts that had witnessed the Tharuhat movement. This party poses a challenge to the traditional Tharu leadership in the mainstream larger political parties. The party has a strong identity base as it emerged out of Tharu discontent when this ethnic group was split into three different provinces under the new constitution. While it is based mainly in Lumbini (province 5), its future performance is likely to influence how Madheshi identity politics develops. However, its top leaders including Resham Chaudhary remain imprisoned over allegations of mob violence and murder during the Tharuhat movement in 2015, which led to deaths of several police personnel and a child. Evolving politics in Lumbini-Madhesh would therefore have a bearing on how the issue of identity politics evolves, and whether regional political forces become dominant in the provinces.

What is as yet unclear is whether Madheshi identity politics can create the space for a meaningful Dalit representation. As in India, backward caste politics in Nepal also seems to be dominated by Yadavs and non-Yadav Other Backward Classes (OBCs) who are demographically, economically and politically influential. There is however an important distinction between the origins of backward caste mobilization in neighbouring UP and Bihar, and Nepal. The history of caste politics in Bihar has been violent and bloody with anti-Dalit massacres being conducted by upper-caste private militias in the 1970s and 1980s. As a result, there were backward caste mobilizations leading to their own militias being formed. The Lalu Prasad Yadav/Nitish Kumar governments of later years helped assuage the political aspirations of the more 'forward' backward castes like the Yadavs, Kushwahas and Kurmis (sometimes called Triveni or grouping of three in Indian caste politics). Dalits do not have significant political representation in Bihar, unlike Uttar Pradesh (UP) where they are represented by the Bahujan Samaj Party (BSP). Much of the Dalit representation in Bihar is in the Naxalite Communist Party of India (Marxist-Leninist)-Liberation which now has 12 seats in the Bihar Assembly and remains popular in Scheduled Caste or Dalit areas.

Inter-caste violence has not been a feature of Madheshi politics. Nor has Dalit representation and leadership reached the levels achieved by the BSP in Uttar Pradesh. However, as in Bihar and to an extent UP, non-'upper' caste politics has been dominated by elite members of backward castes, called the 'creamy layer' in India, and they have essentially taken over from the 'upper' castes who had enjoyed traditional influence and power. Most of the economic benefits of greater backward class and Dalit representation in India has remained with the upper leadership and very little has trickled down to the millions of supporters. India's mixed experience with backward class and Dalit political representation shows some of the challenges that caste politics is likely to face in Nepal going forward.

Dalits in Nepal have mobilized through various political movements including the Maoist and the Madhesh movement, rather than through their own organizations. Although they have gained in terms of electoral representation in Madhesh, and in the drafting of Dalit Empowerment Bill which seeks greater inclusion of the group across all sectors in the province, there is still a leadership gap constraining the development of effective Dalit political organizations. Yadavs and non-Yadav OBC leaders continue to dominate provincial politics and are able to forge alliances with larger parties at Kathmandu level, based on their

local political organizational power. Leaders of the Madheshi movement are now frequently part of the federal government. These alliances are unlikely to be upset by the weaker Dalit leadership which has little access to the rents that are now shared between Kathmandu and Yadav/OBC-led parties in Madhesh. Violent anti-'upper' caste mobilizations of the kind seen in Bihar are also unlikely.

Another group that is struggling for a meaningful representation in the province are the Muslims. They account for almost 12 percent of the provincial population but are spread across various districts and do not have the regionally concentrated presence that is required for strong electoral representation. They too have a leadership gap within the community. Our research in Lumbini province suggests that the rise of Hindutva politics across the border in India over the last decade, and unexplained assassinations of Muslims leaders across various districts in the past may also have contributed to their subdued political mobilization in Nepal.

Table 4: Caste and ethnic composition of Madhesh Province

Ethnic Group	Percentage population
Hill Dalit	0.88%
Marwadi	0.22%
Muslim	11.79%
OBC (non-Yadav)	32.84%
Others	1.60%
Terai- Dalit	15.41%
Terai- High	2.87%
Terai- Janjati	3.62%
Tharu	5.26%
Yadav	14.78%
Grand Total	**100.00%**

Source: Nepal Census 2011

Table 5: Caste and ethnic representation in local governments of Madhesh Province

Ethnicity	Local Level Elections, 2017			Local Level Elections, 2022		
	LG Head	Deputy	WC*	LG Head	Deputy	WC*
Hill Castes	8.10%	14.00%	12.20%	12.50%	12.50%	11.90%
Marwadi	0.70%	0.00%	0.10%	0.00%	0.00%	0.10%
Muslim	5.90%	9.60%	9.70%	3.70%	10.30%	8.60%
OBC	37.50%	44.90%	36.40%	35.30%	42.60%	37.30%
Terai Dalit	1.50%	1.50%	1.70%	0.70%	1.50%	1.80%
Terai High	5.10%	5.10%	4.20%	5.10%	4.40%	3.50%
Terai Janjati	0.00%	0.70%	0.70%	0.00%	0.70%	0.30%
Tharu	5.90%	9.60%	8.20%	7.40%	10.30%	9.00%
Yadav	35.30%	14.70%	26.80%	35.30%	17.60%	27.50%

*Ward Chair
Source: Election Commission of Nepal *(Compiled by authors)*

If we compare Table 4 showing the caste and ethnic composition of Madhesh province with Table 5 showing the composition of the leadership at the local government level in the province, it is clear that the organizational power of different groups is significantly different. The big gainers from devolution have been the Yadavs, who are significantly overrepresented in elected positions relative to their actual numbers in the population. In contrast, Non-Yadav OBCs, and even more so Dalits and Muslims are significantly underrepresented. As in India, Yadavs in Madhesh appear to have greater organizational capabilities in mobilizing their community in electoral contests and in organizing and deploying the informal resources required to sustain political power. How the organizational capabilities of other class and caste organizations evolve will affect the inclusion of these groups in Madhesh. Thus, while the growing strength of Yadav OBCs in political organizations in Madhesh has made politics more inclusive, if other groups remain excluded this could develop into a new exclusionary outcome. The dynamics of this will depend not only on whether other groups can develop their own political organizations and capabilities, but also on whether the economic benefits of devolution result in the growth of businesses and economic activities in the province that are led by members of other communities.

A key question for us is whether the new political representatives and the entrepreneurs they support can use the new political resources productively. For countries like Nepal, SME-based growth strategies are necessary to ensure broad based employment to generate growth. Building productive SMEs is also one way of addressing the damaging cartelisation of Nepal's economy. Early results from our survey of SMEs show that successful firms in Madhesh and elsewhere in Nepal almost always had some form of access to political networks. Successful manufacturing firms in particular report strong links with provincial and local government politicians. Although provincial politicians do not have much to dispense in the form of resources, they play an important role in providing information and solving problems. These findings suggest that promoting broad-based economic development requires strengthening the provincial sphere of governance to coordinate and provide information to emerging SMEs.

6. Conclusion: Possible Scenarios Going Forward

The balance of organizational forces that drove the development and implementation of the current constitution resulted in the creation of inadequate provincial powers. For devolution to work properly, the constitutional arrangement requires an effective political level to coordinate development spending across local governments and organizing the delivery of public goods that cover a geographical area beyond a single local government. This coordination is currently happening in an ad hoc way, in which provinces are indeed involved, but need to be more clearly involved, beginning with a full implementation of existing constitutional provisions.

As provinces lack significant formal resources and tax-raising powers, and their control over administrative services is still only developing, they have relied on informal coordination and bargaining to influence resource allocation. This is not sustainable. Our three scenarios paint different trajectories of how the interaction between emergent business and political organizations and the interpretation and evolution of constitutional rules can play out. The evolution may move in the direction of greater centralization, which may solve some immediate problems of inefficiency, but build up longer term problems of inclusion and unbalanced development. But the evolution may also develop in the direction of strengthening the intermediate level of the constitution, the province, which is likely to be critical in creating the institutional conditions for embedding devolution.

Provincial political players in Madhesh are likely to be critical players in helping to determine how Nepal's constitution evolves. The features of new organizations and strategies that we have described point to three possible scenarios developing over the next few years.

1) The first scenario is one where political centralization in Kathmandu becomes stronger and may even gradually undermine devolution. This could happen if regional parties, particularly in Madhesh, increasingly rely on negotiating resources from politicians at the federal sphere, and if the emergence of new political entrepreneurs within the province is not fast enough to disrupt the arrangements they make. Paradoxically, this becomes an attractive strategy for provincial politicians if there are unstable coalitions in Kathmandu, and smaller parties become critical to keep coalitions in power in the federal parliament. Province-focused parties, especially in Madhesh and Lumbini, could then use their pivotal position in coalition governments to extract resources and payoffs for parties and themselves, as well as their provinces. But this short-term strategy would be at the expense of developing the institutional powers of the provincial sphere.

2) A very different, and potentially more inclusive outcome would be one of gradual strengthening of political and business organizations at the provincial level, which will make demands for economic and political coordination at the provincial level become more effective. This is also likely to be driven by a strengthening of identity-based politics in Madhesh. Provincial politicians who are driving the strengthening of provincial bureaucracies are part of this process. This scenario is likely to be further strengthened if

regional parties cannot achieve satisfactory inclusion and accommodation with older, all-Nepal parties at the centre, and/or if the pace at which new parties and intermediate class/caste organizations emerge in Madhesh is too rapid for accommodation at the federal level.

Given the initially lower capabilities of provincial organizations, moves towards scenario 2 may well be associated with higher levels of short-term inefficiency in the delivery of services and lower levels of productivity of the businesses that emerge through the patronage of provincial politicians and local governments. It may also be associated with evidence of corruption involving provincial and local government politicians. But over time, scenario 2 is likely to result in a broader range of political and productive organizations and ownership across more diverse communities, supporting a more inclusive trajectory in the longer term.

3) At the time of writing, tendencies towards both scenarios were evident in the strategies of competing organizations in Madhesh. The first scenario appears to be the dominant one but could rapidly be superseded by the second given the fluidity and factionalism of Madheshi politics. The third scenario describes a continuation of the current hybrid based on competing tendencies towards scenario 1 and 2. In this mixed scenario the competing tendencies towards a stronger centre or stronger provinces remain in an uneasy balance till the organizational power and interests in favour of one or other of the two scenarios become decisively stronger. It would be plausible to expect that this trajectory would result in the lowest levels of efficiency and productivity because coordination by provinces would be obstructed by federal interests, and coordination by the federal government may face strong demands for provincial rights. Most development in this scenario is likely to be driven by local governments and therefore largely uncoordinated across the province.

In each scenario, what happens to economic opportunities is a separate question that depends on how the resources that political entrepreneurs can access and allocate are being used. In scenario 1, where regional parties shift their focus to compete for resources at Kathmandu, their commitment to developing the local economy may be somewhat muted. We are likely to revert, even if gradually, to a more centralized polity and economy, with Madheshi politicians and organizers investing their resources at the centre where the action is, and where they need to invest in politics and businesses to maintain their influence. In contrast, the second scenario provides possibilities for more inclusive outcomes, with greater investments in political and economic organizations within the province. These are of course hypotheses, but plausible ones to test and track as we go forward.

In each case, development partners would face different types of challenges in supporting political inclusion, controlling different types of corruption challenges in programmes, and supporting economic development. Our analysis points to the dangers of focusing only on immediate service delivery and efficiency. If that is the only criteria, development partners and Nepali policymakers may inadvertently support moves towards Scenario 1. However, by looking at the longer-term trajectories and interests involved, and working with actors whose self-interest is directing them towards Scenario 2, it is possible to achieve more sustainable and inclusive outcomes.