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DFAT-TAF PARTNERSHIP  
WORKING PAPER SERIES #5

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**ENGAGING IN  
REFORMING  
POLICIES IN NEPAL:  
AN ANALYTICAL  
DOCUMENTATION OF  
THE NITI FOUNDATION'S  
EXPERIENCE IN NEPAL'S  
HYDROPOWER SECTOR**

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January 2016

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# ENGAGING IN REFORMING POLICIES IN NEPAL

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# Foreword

The DFAT-TAF Partnership represents a new form of collaboration between the Australian Department of Foreign Affairs and Trade (DFAT) and The Asia Foundation aimed at supporting programs and policy innovations that can improve aid effectiveness in the Asia Pacific Region. This objective is consistent with the development policy of the Australian government which seeks to promote prosperity, reduce poverty, and enhance stability.

The main premise underlying the Partnership is that investment in knowledge exchange and joint learning at the strategic and program levels can improve both impact and value for money in the assistance provided by both organizations. To this end, we have been developing, testing, and promoting cost-effective innovations that can increase the impact of development assistance that responds to the dynamic and evolving needs of the region. Key areas of innovation include (a) efforts to advance entrepreneurial and politically-informed approaches to reform; (b) improving results through more effective and dynamic integration of research with on-the-ground action; (c) efforts to accelerate country-level reform and development through cross-border and regional solutions; and (d) exploration of quick response assistance to meet local needs as these emerge. In all of these areas, our approach has been to tap the deep knowledge and insights of our partners and staff, and combine investment in the most creative ideas with rigorous assessment of results.

As a contribution to organizational learning within DFAT and The Asia Foundation, the Partnership has launched a *Working Paper Series*. This series draws out some of the rich lessons being learned through the many country- and regional-level initiatives implemented under the Partnership. In many cases, these initiatives have taken on some of the most difficult and intractable development problems in the region, and often build skills, knowledge, and relationships in one part of the region that can be refined and brought to similar contexts in other countries. Ultimately, this analytical work will enhance the knowledge base on which DFAT and The Asia Foundation can draw in their efforts to improve development policy and programs. The series will also be of interest to the broader international community, helping to better ground debates in empirical evidence, advance theory, and ultimately improve development policy and practice across a variety of subject areas.

The fifth paper in this series, *Engaging in Reforming Policies in Nepal: An Analytical Documentation of Niti's Experience in Nepal's Hydropower Sector*, examines the Niti Foundation's unique experiences in engaging politically in the hydropower sector to achieve specific reform outcomes, as well as improve the inclusiveness and sustainability of the policy-making process in Nepal. Despite promising progress, the Niti Foundation's candid reflections also provide a sobering reminder of the deeply entrenched nature of 'wicked' policy problems in Nepal. By drawing insights from the Niti Foundation's experience working in this sector, Niti hopes that its reflections can contribute to the larger discourse on innovation in the development industry – especially as donors attempt to engage more effectively in supporting policy reform.

William Cole,  
Senior Director,  
Program Strategy, Innovation and Learning (PSIL),  
The Asia Foundation

# Preface

The Asia Foundation is pleased to launch this paper, *Engaging in Reforming Policies in Nepal: An Analytical Documentation of Niti's Experience in Nepal's Hydropower Sector*, as the fifth paper in the DFAT-TAF Partnership Working Paper Series. This paper presents reflections from the Niti Foundation, a Nepali non-profit policy institute, on its recent experiences 'thinking and working politically' in the hydropower sector in Nepal. Niti is an actor dedicated to these reforms with or without international donor support, meaning that the thinking and strategies outlined in this paper extend beyond a single project and past support from any single donor. The paper both records Niti's thinking on this critical sector, as well as attempts to articulate Niti's unique approach to supporting policy and reform processes in Nepal. Niti's insights on how they conceptualize their role as an aid implementer, focusing on policy making and reform, adds an interesting voice and counterweight to international dialogue on thinking and working politically. To date, this dialogue has often been dominated by donors, think tanks, and large international NGOs.

The Niti Foundation's candid reflections remind us that solutions to 'wicked' policy problems often only emerge from extended periods of engagement and long-term commitment to reform by local actors. Despite some positive signs in Nepal's hydropower sector, the work of Niti and others in the sector has not yet resulted in transformative impact. This is unsurprising given the extended political crisis, devastating earthquakes in 2015, and the political and economic turmoil that has followed the promulgation of a new constitution. Each of these events has contributed to making Nepal an extremely challenging reform environment. Frustration with the lack of major reform might also be rooted in the 3- to 5-year program cycles that the aid industry usually uses. These timeframes are often disconnected from the complex reality of how reform processes unfold on the ground. Beyond this, the paper also details Niti's attempts to develop and refine its unique approach to supporting reform in Nepal during this challenging period. The fact that this approach is still evolving may further explain why this is not yet a story of major impact.

Despite this being an incomplete story, given the current state of the hydropower sector in Nepal, this reflection piece still captures an interesting voice for those trying to better understand what political or iterative programming means to different actors in development. While much has been written on the common elements of successful 'politically informed' programs, such knowledge naturally needs to be tested, adapted (and sometimes dismissed) in order to fit local political contexts. Doing so requires time, trial and error, dedicated strategic program support and funding, as well as a commitment to learn from the efforts of diverse organizations. In the case of the Niti Foundation, Niti's deep technical and political expertise is evident. Yet the program tools and strategies they deploy to impact the reform process are still being refined. Supporting actors like Niti to experiment, strive for impact, and reflect on their efforts (no matter the result) will be critical to the promotion of positive, locally led contributions to policy making in Asia. The Niti Foundation and other similar actors have much to offer the international community as we experiment and learn about working politically.

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Niti Foundation would like to give special thanks to Mark Koenig and Lavinia Tyrrel of The Asia Foundation's Bangkok Office for their time, expertise, and invaluable suggestions that helped develop this publication. Niti appreciates as well the assistance of Itisha Giri for reviewing earlier drafts of this work and Ann Bishop for final editing.

Finally, Niti Foundation is grateful for the assistance provided by the Australian Government's Department of Foreign Affairs and Trade (DFAT) through the DFAT-TAF Partnership. These funds, delivered through The Asia Foundation, have been an important source of support for Niti Foundation's work in the hydropower sector.

# Abbreviations

ADB - Asian Development Bank

CA - Constituent Assembly

CNI - Confederation of Nepalese Industries

ETFC - Electricity Tariff Fixation Commission

IBN - Investment Board of Nepal

IECM - Interim Election Council of Ministers

IPPAN - Independent Power Producers Association, Nepal

kWh - kilowatt hours

LAHURNIP - Lawyers' Association for Human Rights of Nepalese Indigenous Peoples

MW - megawatts

NCP - Nepali Congress Party

NEA - Nepal Electricity Authority

NERC - Nepal Electricity Regulatory Commission

NHA - Nepal Hydropower Association

NPR - Nepalese Rupees

NPTA - National Power Transmission Authority

PCAWR - Parliamentary Committee on Agriculture and Water Resources

PDA - Project Development Agreement

PPA - Power Purchase Agreement

PTA - Power Trade Agreement

PXIL - Power Exchange India Limited

SAARC - South Asian Association for Regional Cooperation

UMLP - Unified Marxist-Leninist Party

WECS - Water and Energy Commission Secretariat

# INTRODUCTION

Scholars and development practitioners increasingly realize that policymaking is a “complex, multi-directional, fragmented, and unpredictable” process.<sup>1</sup> In Nepal, as in other countries, this observation holds true, but policy-making challenges are further exacerbated by a long history of excluding the public from decision making. Despite the popular mass movements of the early 1990s, which ushered in a multi-party democratic system, and the decade-long armed insurgency that challenged and, to a certain extent, helped transform Nepal’s feudalistic characteristics, Nepal’s policy-making process remains the primary domain of the bureaucracy and continues to demonstrate remnants of the country’s feudal past. As a result, policies are rarely the government’s response to problems raised by the public, but rather reflect the interests and views of those who ‘rule the roost’.<sup>2</sup>

However, as with the policy-making process itself, it is important to acknowledge that efforts to engage stakeholders in reforming policies are inherently complex and political. For example, the success of interventions by development agencies depends not only on the effectiveness of their program’s design and implementation, but also on their constantly evolving context. There is also growing evidence that some of the more traditional approaches of the development sector, particularly in reform programming, have had limited impact in generating transformative changes.<sup>3</sup>

This diagnosis indicates that systemic flaws exist in the way development is understood and approached, especially with regard to addressing problems in developing countries. Traditional development programming has often failed to sufficiently identify,

understand, and address contextual factors that ultimately undermine the success of development interventions.<sup>4</sup> This failure can often be attributed to the way that aid programming is commonly planned, and its delivery is structured, as well as the influence exerted by donors who sometimes must operate with limited information about the context. This last point means many donors must decide what they believe is right or required in the program, and/or what will work well, in the absence of full information about what will achieve impact in that particular context.<sup>5</sup>

To address these shortcomings, innovative programming strategies are being employed which seek to understand the country’s context better and employ this knowledge through a flexible, adaptive approach to development and reform. The body of knowledge being developed through these emerging strategies such as the “Doing Development Differently” framework, provides compelling evidence to warrant this shift. Literature about new program approaches such as Leadership for Results,<sup>6</sup> Development Entrepreneurship,<sup>7</sup> Problem Driven Political Economy Analysis,<sup>8</sup> the Good-fit Approach,<sup>9</sup> Problem Driven Iterative Adaptation,<sup>10</sup> and Politically Smart, Locally Led Development,<sup>11</sup> showcase the strengths and successes achieved through adopting flexible, adaptive, and politically astute strategies. The use of these approaches is especially relevant for policy reform programs that are characterized by high levels of political influence, a dynamic and uncertain context that makes change hard to predict, difficulties in measuring change, and complications in attributing results to program activity.<sup>12</sup>

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1. World Bank 2008.
  2. There is a relationship between the lack of public consultation in policymaking and the technocratic approach to policy reform traditionally preferred by the development sector in Nepal. But while a technical approach might have been relevant in the past, the changing political context, particularly since the early 1990s, and the increased politicization of the policy domain demands a different type of engagement that is better suited for present day Nepal.
  3. Many authors have raised these concerns, including Booth and Unsworth 2014, Andrews 2014.
  4. Andrews 2014.
  5. Booth and Chambers 2014.
  6. World Bank 2008.
  7. Faustino and Fabella 2011.
  8. Fritz et al. 2014.
  9. Booth and Cammack 2013.
  10. Andrews et al. 2013.
  11. Booth and Unsworth 2014.
  12. Chikiamco and Fabella 2011.

Development partners often state their intention to undertake more politically intelligent, context-specific approaches, and ensure more ‘local’ ownership of their programs.<sup>13</sup> Among their approaches, these agencies now frequently employ a political economy lens “to broaden their operational considerations beyond technical solutions to include an emphasis on stakeholders, institutions, and processes by which policy reform is negotiated and played out in the policy arena.”<sup>14</sup> However, because engaging politically requires a different set of working principles than those which donor agency development practitioners are accustomed to, a big gap remains between donors’ rhetoric and their actual behavior. The difficulties donors face in adapting to the changing context has caused development practice to continue to be donor-driven, particularly in developing countries such as Nepal, where lack of capacity in the government and non-government sectors often leads to following donor-prescribed solutions. The motivations of local or international NGOs to win new or secure follow-on donor funding can also discourage local partners from ‘pushing back’ to resist donors’ preferences for how programs should be run.

As a result of such challenges, engaging in reforms using innovative approaches can be a formidable task in Nepal’s development industry. As experience elsewhere shows, reform initiatives are effective when they take into consideration the context and processes where reforms are being pursued.<sup>15</sup> It is essential to be aware of the characteristics of the country concerned, including the socio-economy, cultural fabric, and context of the policy concerned. At the same time, understanding the characteristics of the sponsors, their intrinsic assumptions, institutional biases, and the challenges they pose to the desired policy reform is also equally important. With this understanding, Niti has always taken a holistic approach to identifying problems prevalent in the policy-making process, and this resonates well with the emerging development industry discourse on the need for innovation. As mentioned earlier, this approach is only possible with a good understanding of how Nepal’s policy-making domain has been shaped by its social and political history. Based on Niti’s experience in the policy domain, it is clear that no reform initiative will be likely to achieve long-term, sustainable impact without understanding of the institutional setup and vested interests that influence a policy’s outcome.

This paper analyzes and documents Niti’s experiences in engaging politically to achieve both specific reform outcomes, as well as its more general efforts to improve the inclusiveness and sustainability of the policy-making process in Nepal. This engagement was undertaken with a focus on the hydropower sector, and Niti hopes that by drawing insights from these reform experiences that it can contribute to the larger discourse on much needed innovation in the development industry as it attempts to engage more effectively in supporting and promoting policy reform.

It is important to note right from the outset that the energy sector in Nepal is complex, and the challenges of policy formulation or reform in the sector are more or less similar to policy-making challenges more generally in Nepal. Clearly, policies have been formulated with little deliberation beyond that with political actors, bureaucrats and, to a limited extent, with technical experts. As is the case in other sectors in Nepal, policymaking in hydropower has failed to recognize and represent the interests and expectations of larger constituencies, including consumers, communities, investors, suppliers, labor unions, and the media. Niti’s engagement in hydro sector policymaking should provide valuable insights for others in the development industry that plan to engage in this complex and convoluted policy area. Ideally, the knowledge Niti has gained from its engagement can also be applied to other equally political and fraught sectors, and contribute to policy dialogue on how to influence and support policy reform in Nepal. Therefore:

**Section I** of this paper looks at the systemic flaws in the policy-making process in Nepal with regard to the country’s social, political and economic context.

**Section II** specifically examines the policy reform story in the hydropower sector—focusing both on what Niti did as part of this process, as well as how the reforms themselves unfolded and evolved through Niti’s activities.

**Section III** provides insights into how Niti has approached the policy reform process, and what this means for other donors and implementers that are looking to adopt more politically informed approaches to programming.

13. Foreign development assistance, or colloquially the ‘development/aid industry’, has been criticized for either trying to influence the state bureaucracy to develop policies that fit donors’ ideas about how development should occur, or for trying to influence outcomes using exogenous considerations rather than those that serve local needs. Often by employing these approaches to influence policy, the aid industry fails to recognize the importance of the local context.

14. World Bank 2008.

15. Ibid.



Photo by Saroj Dahal

In writing these three sections of this paper, Niti identifies four key features of the approach it has taken in the hydro sector, namely: (1) engaging politically, based on Niti's formal and informal assessments of the political economy in the context of Nepal's shifting reform environment; (2) strategically using data and research to promote evidence-based policymaking and discourage purely personal or politically driven decision making; (3) needing to strike a balance between 'easier', short-term or opportunistic efforts and remaining focused on, and constantly pushing towards progress on more intractable problems in the hydro sector, and; (4) going beyond simply recommending changes to existing policy and

legislation, to actively helping to negotiate the required solution, and then ensuring that this solution is agreed by all and delivered as promised.

Ultimately, by drawing on Niti's experiences of working on policy reform in the energy sector, this paper aims to offer the development industry insights into what it takes for a local organization such as Niti to work on difficult reform issues in politically informed ways. Ultimately, Niti hopes that the reflections summarized in this paper will provide useful guidance for donors and implementing partners who are trying to engage with local organizations in the most effective manner possible.

# SECTION I: UNDERSTANDING THE CONTEXT

## 1.1 THE POLICY CONTEXT

Niti has made significant investments in critically examining Nepal's public policy regime to understand the context within which it engages in policy reform. As part of this initiative, Niti undertook a comprehensive study of Nepal's policy process in 2010.<sup>16</sup> Among other things, this identified weak citizen representation, ineffective policy implementation, and lack of accountability as three key factors behind public policy failures in Nepal. These findings continue to serve as guiding principles for Niti when engaging in policy reform in Nepal.

**Representation** enables citizens to express their needs and convert them into demands on the government. The most striking feature of Nepali politics is the propensity for citizens to protest and strike—through *bandas*, *gheraos*, and *chakka jams*.<sup>17</sup> The proliferation of these forms of protest is a symptom of a larger systemic problem and indicates the lack of robust platforms that citizens can use to express their needs and negotiate with state institutions.

**Implementation** depends on the systems in place to put policies into practice. But in Nepal, policies are often not supported by clear statutory definitions of different institutions' responsibilities to implement policies. Nor are there binding timeframes for the national level to issue implementing guidelines to local-level institutions. Even in cases when there are already directives and guidelines, these often lack a clear delineation of responsibilities and, at times, even contradict each other.

The implementation phase of policies is also often excessively political. This leads to three problems with regard to those responsible for implementation: (i) they are not selected for their competency; (ii) they often are not committed to the policy they are

supposed to implement, but instead have a vested interest in maintaining the status quo; and (iii) they are not subject to supervision by national government officials to ensure that they carry out policies according to clear, precise rules and directives.

**Accountability** in policy processes means that there are mechanisms by which officials are monitored, evaluated, and sanctioned when they do not fulfill their responsibilities in executing the stated policies. However, the pursuit of accountability in Nepal is severely affected by its current social and cultural norms that have contributed to institutionalizing corruption, nepotism, and cronyism. Thus, there is very little support for holding government employees to account for anything, whether it is the quality of their job performance, their integrity in handling public funds, or their commitment to properly carry out policies. Citizens' groups have become increasingly aware of their political rights, but continue to struggle in navigating their way through the state mechanisms in order to claim their rights.

Even though there are state institutions authorized to monitor government performance and hold officials accountable, many of these, in addition to having limited human resources and technical capacity, are seen as enmeshed in institutional politics and unable to be objective and separate themselves from the individuals and institutions they are supposed to be monitoring. However, despite the weaknesses of formal accountability institutions, there have been sporadic cases in which accountability issues have been brought to the courts and to public debate. While it is beyond the scope of this paper to discuss these instances in detail, it would be fair to say that a combination of factors has led to these cases gaining public attention (e.g. political timeliness, public pressure, and influential individual/s empowered to achieve progress with regard to accountability).

16. For more on this topic, please see the Niti Foundation's Policy Diagnostic Study Report at [www.nitifoundation.org](http://www.nitifoundation.org).

17. *Bandas* are street demonstrations, *gheraos* are the picketing of public buildings and facilities to force them to shut down, and *chakka jams* are disabling public transportation to cause traffic jams.

Unfortunately, all of these are factors that are extremely difficult to replicate.

Finally, there is the question of where the accountability lies. Because Nepal still depends on foreign aid,<sup>18</sup> lines of accountability have become blurred. In order to keep the money flowing, Nepal's agencies and officials are often accused of being more accountable to donors and lenders than they are to their own citizens. This becomes an enabling factor in supporting a donor-led development approach that reflects the priorities and agendas of donor agencies as opposed to a policy agenda arising from the internal challenges facing the state.

While Niti identified representation, implementation, and accountability as the crux of the problem in Nepal's policy process, the reality of policy reform is that it is a tangled web of complexities. The motivations behind particular policy reforms, and the actors involved in these decisions, are often opaque—making each policy reform hard to predict. Thus, it is only by starting to engage with key actors, influential interest groups, and the government itself that development agency and civil society actors can hope to untangle the complex web of interests, institutions, and incentives around any particular issue. With this understanding, Niti decided that the best way to grapple with issues of representation, implementation, and accountability would be through a sectoral engagement—a decision that led Niti to engage in the hydropower sector. This decision was also based on the fact that with power cuts of up to 14 hours per day, this was contributing to political pressure and focus on the issue. Because of this pressure, Niti felt the government and political parties had an important opportunity to implement certain policy reforms that had languished for decades, so it was critical for Niti to take advantage of this opening through targeted programming.

Niti's engagement in the energy sector can serve as a case study to inform national and international constituents of the inherent challenges faced in conducting reform initiatives in Nepal. But before focusing on policy reform, it is essential to understand the policy context.

## 1.2. THE SECTORAL CONTEXT

### 1.2.1 THE MACRO PROBLEM

Nepal has the potential to generate an estimated 42,000 megawatts (MW)<sup>19</sup> of hydroelectricity, but to date it has been able to tap only a fraction of its generation capacity. This fact is especially frustrating given chronic power cuts that last up to 14 hours per day in the winter season, adversely affecting the economy as well as the lives of ordinary citizens. With liberalization of the electricity generation market, ongoing construction of hydropower projects, and signing of additional project development agreements (PDAs) for large hydropower generation projects, Nepal is on track to generate adequate electricity for its national consumption by 2017.<sup>20</sup> However, despite all the progress on the generation side, the government is still not on track to evacuate the electricity generated from power plants to load centers.

### 1.2.2 NITI'S INITIAL ENGAGEMENT

Niti's decision to focus on hydropower was informed by its understanding that access to reliable and affordable energy is the primary engine of the country's economic growth. Everybody understands, or at least claims to understand, that Nepal needs to invest in creating an enabling environment for hydropower development, particularly if it is to meet the government's target of graduating the country from its *least developed country* status to *developing nation* status by 2022.

Niti began its engagement in the hydropower sector with the following critical assumptions:

- The current woes in the electricity sector can be called a “wicked problem.”<sup>21</sup> This term means that the sector is fraught with complex challenges both on the demand and the supply sides, as well as complicated interrelationships between stakeholders and the state. Understanding of the hydroelectric sector cannot be reduced to assuming that if Nepal harnesses its potential for hydro energy, then all of its energy problems will immediately be solved. The reason for the energy deficit is far more than just a technical problem, and therefore one must resist

18. This was about 6% of GDP in 2014 and 13.5% of total expenditure in Fiscal Year 2013–2014.

19. The number generally quoted in Nepal is 80,000 MW, but recently the Water and Energy Commission Secretariat (WECS) reported 42,000–45,000 MW as being financially and technically feasible. However, WECS has not provided the methodology used to calculate this number.

20. This is based on the current prediction by the Nepal Electricity Authority, and based on its load forecast and the agreements it has already signed for generation.

21. Here we refer to “wicked problem” in terms of policy making. Authors, such as Conkin 2006, use this term to describe complex, multifaceted and multi-stakeholder policy problems where the solution is often not immediately clear, is complicated and requiring a series of actions at times, and requires some trial and error to find. These wicked problems all are novel and thus require their own unique solution, and a specific and context relevant approach to achieving that solution in each instance.

the temptation of thinking that simple technical and infrastructure solutions will solve the electricity supply problem.

- Without sufficient attention to the transmission and distribution end of the energy sector, the focus on energy generation will only lead to a ‘flood-drought’ syndrome.<sup>22</sup> Today it is the lack of infrastructure to carry electricity from power plants to users that is hindering potential investments in the construction of new hydropower plants. Similarly, poor distribution networks have not only led to high transmission losses, but also to the poor quality of power supply.
- Policy is inherently a directive that must reflect (or at least not run counter to) the political settlement among various groups in a given society. These settlements are based primarily on the ‘hard’ and ‘soft’ powers that each group possesses. In Nepal’s hydropower sector, the three primary groups are the government, the market (currently private developers of hydroelectricity and, potentially, private builders of transmission infrastructure), and the consumers. All three have different interests and, therefore, see the prevailing “wickedness” from different perspectives, and have demands that, at times, contradict each other.

Niti’s preparatory activity began in 2010 with a comprehensive diagnostic of Nepal’s electricity sector, led by Mr. Dipak Gyawali, a water and energy expert, and previously, a Government of Nepal Minister of Water Resources.<sup>23</sup> As part of this diagnostic, Niti organized three separate consultative dialogues<sup>24</sup> with representatives from the three primary stakeholder groups—the government, the market, and consumers. This was followed by a policy roundtable<sup>25</sup> that took the conclusions from the consultative dialogues straight to senior government policymakers and politicians.

The consultative dialogues were designed to replace the widely held, simplistic narrative on how to solve the energy deficit. This narrative promoted the misunderstanding that the crippling load shedding could easily be rectified if Nepal were to ‘fast track’ building more hydropower projects. This simplistic narrative deflected attention

away from the systemic problems that plagued both the demand and supply sides of the energy sector. The truth is that properly planned projects can only move forward as fast as technically feasible, so therefore a ‘fast-track’ approach is naive. Furthermore, there have been (and continue to be) significant bureaucratic hurdles that severely constrict the rapid development of hydropower projects in Nepal. Combating the overly simplistic narrative on the energy deficit, and focusing instead on removing ‘red tape’ for all present and future projects (rather than just selected ones), was an important focus of Niti’s consultations with the three stakeholder groups. These discussions demonstrated that prioritizing some projects at the cost of others would further entrench the ‘culture of favoritism’ and institutional distortions, while delaying much needed reforms. Instead, effective policy reform should ensure that a ‘level playing field’ is created for all current and future stakeholders in the hydroelectricity sector in a manner that leads to the sector’s healthy development.

Some of the major conclusions that emerged from the consultations Niti organized are summarized below as emerging policy themes.<sup>26</sup> These themes identified areas that required immediate engagement and intervention in terms of policy reform, and helped Niti situate itself as a major actor in unearthing “inconvenient truths” that would allow for “unconventional solutions”.

**Tariff Rationalization:** At the heart of any successful energy market, are utility companies that are able to make a profit from the difference between the rates that they charge their customers (i.e., the consumer tariff) and what they pay to their power producers (i.e., the power purchase agreement [PPA] rate). Unless there is a robust pricing strategy that enables these utility companies to earn a profit while serving their consumers, it is unlikely that they can sustain themselves. In Nepal, the NEA has the authority to negotiate its power purchase rates with its producers, but the task of setting the consumer tariff is up to the Electricity Tariff Fixation Commission (ETFC), and, as a result of the ETFC’s decision not to raise the consumer tariff for over a decade, the NEA has not been able to become a profitable entity. In 1998, the Asian Development Bank (ADB) identified

22. ‘Flood-drought’ syndrome is defined as periods of excess electricity generation immediately after the commissioning of a large hydropower plant, and then due to increasing demands, having an inadequate supply of electricity, leading the electricity provider to start load shedding a few years later. ‘Load shedding’ is the term used when an electricity provider with an inadequate supply cuts off power on a rotating basis in some areas (in Nepal’s case for periods of up to 14 hours), while supplying it to others.

23. The Ministry of Water Resources was later split into the Ministry of Energy and the Ministry of Irrigation.

24. These were held on December 22<sup>nd</sup>, 23<sup>rd</sup>, and 26<sup>th</sup> of 2010.

25. This was held on February 7<sup>th</sup>, 2011.

26. For the full report, please see the Niti Foundation’s 2011 report at [www.nitifoundation.org](http://www.nitifoundation.org).

the need to increase the consumer tariff from the prevailing Nepalese Rupees (NPR)<sup>27</sup> 4.98 to NPR 7.33 per kilowatt hour (kWh), and proposed for it to be increased in two installments—28% in November 1998 and another 20% in 2001.<sup>28</sup> By late September of 2001, the government had enacted only a 22% increase, and despite the government’s decision to introduce a semi-automatic tariff adjustment mechanism in May 2001 to keep up with growing inflation, further increases in the consumer tariff rates were stalled for over a decade. (See the table below for a listing of the key actors in this sector).

By 2009, underpricing of electricity was costing the NEA NPR 1.91 per kWh.<sup>29</sup> This price-cost gap had a further impact on the already-dwindling financial health of the NEA, resulting in losses of NPR 4.7 million in 2009 alone. Before 2012, when the consumer tariff was finally raised, the NEA was facing a loss NPR 2.39 on every unit of electricity supplied. By 2012, the state-owned power utility

corporation had already incurred a cumulative loss of NPR 28 billion. The downward trend in the NEA’s profits also weakened its capacity to invest in new projects. Additionally, despite potentially large private sector demand to invest in new hydropower projects in Nepal, the low PPA rate for domestic producers was frequently cited as an obstacle to attracting new hydropower investors. Between 2001 and 2005, in response to its growing losses, the NEA submitted over half a dozen proposals to the ETFC to raise the consumer tariff—all of which failed to materialize. This is a clear indication that the NEA and the ETFC function as two autonomous entities that appear to be incapable of working together on what is best for the sector and consumers. Their divided interests have been the main reason for the significant losses incurred by the NEA, and the apprehension felt by prospective investors in the sector. The actor mapping table below helps explain why some of these dynamics emerged, and the friction between certain key players with divergent or even competing interests.

### Actor Mapping Table

Key Stakeholder Interests in Tariff Restructuring

Stakeholder	Interests of each stakeholder
<b>Independent Power Producers</b>	IPPs are the strongest advocates for a PPA increase as they want to make an adequate return on their investment. They also wish to review the PPA rates to address the discrepancy between PPA rates for foreign and domestic IPPs
<b>Consumers/Communities</b>	Consumers are concerned about any increase in the consumer tariff. They argue that social equity must be factored in when considering consumer tariff hikes.
<b>Electricity Tariff Fixation Commission</b>	The ETFC claims that the NEA’s continuing loss of revenue is not only a result of low consumer tariff rates, but is also associated with political interference and administrative and financial irregularities within the NEA. The ETFC states that it is willing to increase tariffs on the condition that the NEA reforms.
<b>Nepal Electricity Authority</b>	The NEA is aware of the need to increase the PPA rate to attract private investment to the hydropower sector. However, the NEA is only willing to increase the rate if the ETFC ensures a commensurate increase in the consumer tariff to ensure financial viability.
<b>Political parties</b>	Political parties have reservations about increasing consumer tariffs because they fear a public backlash.
<b>Others</b>	Bureaucrats support increases in the PPA because this presents an opportunity for them to raise license fees. Labor unions strongly oppose tariff restructuring in the face of the ETFC’s call for internal governance and management reform in the NEA as a condition for any hike in the consumer tariff.

27. At the time of writing, the dollar exchange was US\$ 1 = NPR 107. All prices in this report are quoted in NPR.

28. ADB 2009.

29. Nepal Electricity Authority 2009.

**Of Markets and Investments:** In order to transform Nepal's energy sector into a profitable one, it is essential to create a suitable market both on the local and the international level. The NEA estimates that if all projects currently being constructed are completed as scheduled, Nepal's energy demands can be met by 2017.<sup>30</sup> However, simply building generation capability to meet Nepal's current domestic need will not result in a profitable or fully developed hydropower sector. Additional investment will be needed given the projected growth in Nepal's economy, and the state must also find a way to supply power across the border to the North Indian market. This is important to be able to sell excess power to the Indian market during peak electricity generation times in Nepal in order to ensure hydropower investments maximize their earning potential. So even if generation capability is developed, profitability will be undermined by a lack of infrastructure and appropriate pricing mechanisms for transmission that would allow for a more flexible and profitable market for hydropower.

In 2014, Nepal finally signed a power trade agreement (PTA) with India during the visit of the newly elected Indian Prime Minister. This, along with the increasing potential to export to other countries in the region, is expected to increase foreign investors' interest in large hydropower projects in Nepal. However, to build hydropower projects, many believe that Nepal should first tap capital within the country (including remittances and tax income from petroleum products, among others). But experts estimate that Nepal's total domestic capital market is only capable of funding the construction of approximately 150 MW of energy, and therefore, it is necessary to seek foreign direct investment (FDI). The formation of the Investment Board of Nepal (IBN) in 2011, with an explicit mandate to attract FDI to large infrastructure projects, is a major step in this direction. In 2014, after several years of negotiations, the IBN signed a project development agreement (PDA) with GMR Group for the Upper Karnali hydropower project, and another PDA with Sutlej Jal Vidyut Company for the Arun III hydropower project.

Currently, many of the smaller- and medium-sized hydropower projects are being financed by a mix of investment from national and international investors.

An additional mechanism for project financing—and a fairly unique approach in Nepal—has been the sourcing of funds through a direct offering of financial equity, or 'shares', to the general public, including local communities. This 'shareholder model' is seen as a means of providing an equitable and direct approach to promoting local ownership of hydropower projects, while also providing local incentives to make the project development process smoother and avoid costly conflicts and obstructions. In 2015, the initial public offerings for the Upper Tamakoshi and Barun Hydropower Limited raised several times more equity than needed—a positive sign of Nepali citizens' interest in investing in hydropower projects. To take advantage of this opportunity, the government has been promoting the concept of "Citizen's Investment" to raise capital from Nepalis. The proliferation of this shareholder model is cause for cautious optimism; however, several uncertainties and risks remain because the future of hydropower, and what it might mean for Nepali citizens and other shareholders, is still an open question.

**Restructuring the Nepal Electricity Authority:** The NEA was established in 1985, at the behest of Nepal's financial institutions, as a government-owned, for-profit company. It was argued then that a centralized agency with the responsibility to plan, construct, operate, and maintain the country's power system would help overcome the inherent inefficiencies of the fragmented group of organizations in this sector.<sup>31</sup> But the market conditions have radically changed since then, and customers have multiplied tenfold. However, the NEA has not transformed into an organization capable of responding to the shifting dynamics.

Since its establishment, the NEA enjoyed a monopoly over Nepal's power sector by virtue of being in charge of the generation, transmission, and distribution of electricity throughout the country. But, with the increase in private investors in energy generation, there are allegations of conflict of interest as the NEA is said to be negotiating a more favorable PPA rate for its investments (through its subsidiary companies) than for other independent power producers. In the case of transmission, as the NEA is authorized to negotiate purchase rates

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30. However, many organizations, and especially the Independent Power Producers Association, Nepal (IPPAN) do not consider this forecast valid. According to these organizations, the NEA uses its forecast to plan its activities—first, because the NEA is a utility company and not a state institution that is fully authorized to make such forecasts, and second, because the assumptions that electricity has the potential to displace the diesel and liquid petroleum gas (LPG) generators now in use, has not been considered.
31. Earlier, responsibilities within the sector were scattered across the Department of Electricity of the Ministry of Water Resources, the Nepal Electricity Corporation, and related Development Boards.

for all the transmission lines, it can potentially charge different wheeling rates<sup>32</sup> to itself in comparison with other IPPs, causing unfair competition in the energy market. Furthermore, with regard to distribution, the NEA does not have an incentive to expand access to electricity in rural areas because of the high subsidy it has to provide to these groups, leading it to frequently cite rural electrification costs as a major reason for its losses.

At the time of writing this paper, in December 2015, the need to reform the NEA has been discussed because of its dire financial situation, but so far, little progress has been achieved. While some limited measures have been taken to improve the situation, these have not been sufficient for major impact and have not addressed the “unbundling” of the NEA that Niti feels is among the most critical blockages to progress.<sup>33</sup> This is because “unbundling the NEA” is a sensitive political issue and political leaders who use resources from the NEA for their own personal benefit lack the incentive to reform the NEA. Additionally, the NEA is a mammoth institution with a large staff and huge financial resources at its disposal; therefore, any proposed streamlining of the institution is likely to face high resistance from stakeholders such as political leaders, NEA staff, trade unions, etc., all of whom benefit from the NEA.

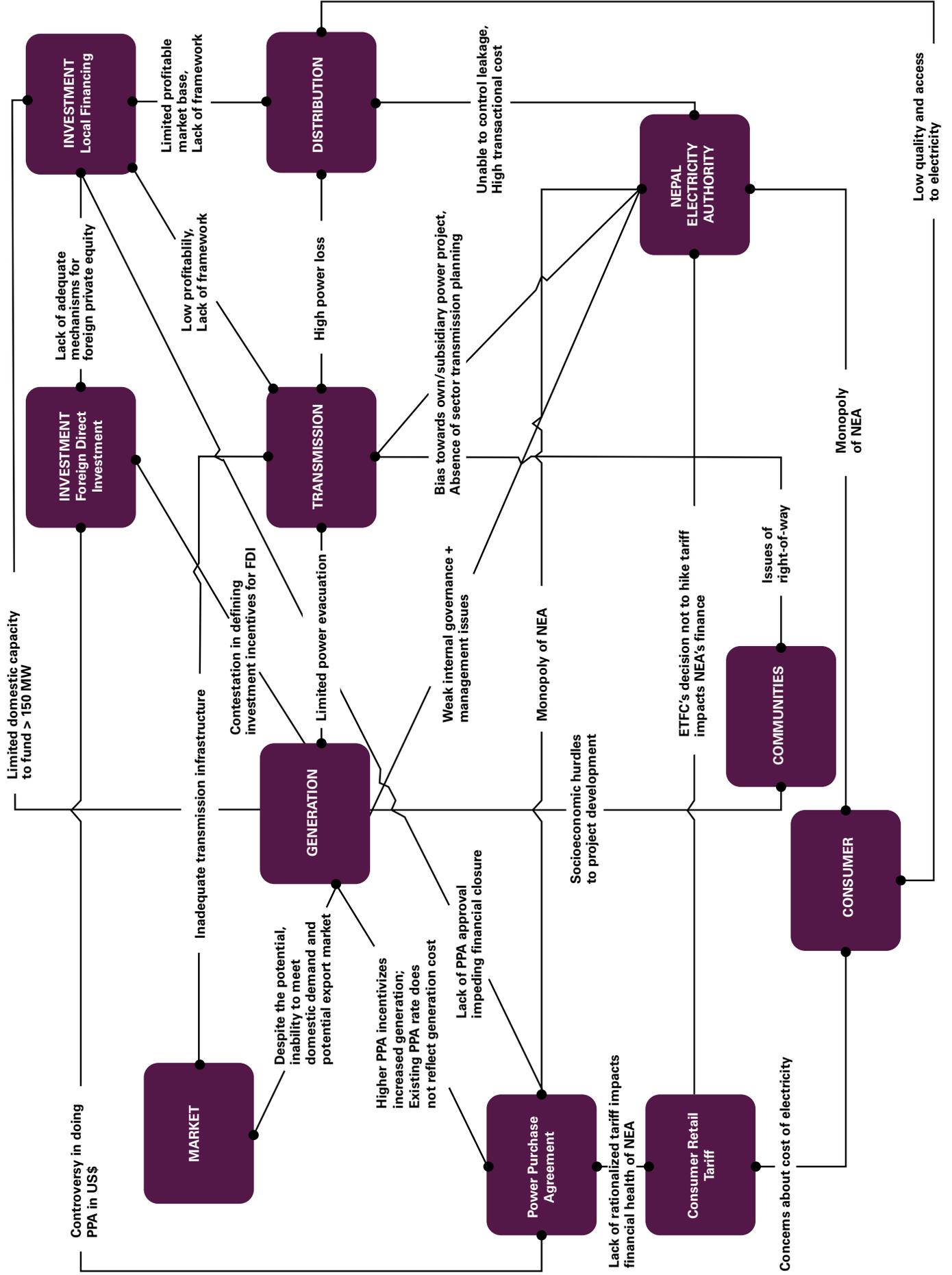
**Policy Gaps:** At the time of writing in December 2015, two major policies for the sector were being proposed by the government—the Electricity Act and the Nepal Electricity Regulatory Commission (NERC) Act. However, because these bills have languished in the executive and legislative maze for a decade and a

half, the government has not been able to bring out corresponding legislation to implement its 2001 Hydropower Development Policy.<sup>34</sup> While implementation of legislation is often hampered in Nepal by varying factors, a delay of this magnitude is unusual—especially given that it is an issue of high national interest in Nepal. As major pieces of legislation, these bills would have a substantial role in shaping the entire Nepali energy sector for years to come, but there are reasonable doubts about two particular things. How much can the proposed bills address the constraints in the sector, especially given the complexity of the sector’s ‘wickedness’ (see diagram below)? Given that there has been very little public consultation on the bills, how much do they actually represent the current needs of the sector, and the Nepali people? In the previous Parliament, parliamentarians from across the political spectrum had registered 142 amendments to the proposed Electricity Act, indicating a significant need for wider consultation. With the dissolution of the previous legislative body in 2013, the bill is currently being reworked by the Ministry of Energy (MoE), and despite all the promises from the current government for a second generation of reforms to drive economic growth, the MoE has yet to present these bills to the cabinet for executive approval. Given the important issues of federalism and how natural resources are used, one can only wonder how long the legislature will take before deliberating the proposed Electricity Act and the Nepal Electricity Regulatory Commission (NERC) Act.

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32. “Wheeling” refers to the transfer of electrical power through transmission and distribution lines from one utility’s service to the service of another. The “Wheeling rate” is the amount charged by one electrical system to transmit the energy of, and for, another system or systems.
33. The Ministry of Energy, in December 2011, authorized the financial restructuring of the NEA by, among other things, increasing the NEA’s share of capital to NPR 50 billion and writing-off the NEA’s accumulated losses which then totaled NPR 27 billion. In addition, the Electricity Tariff Fixation Commission (ETFC) approved a retail tariff hike of 20% on average, thus allowing the NEA to revisit its PPAs with the independent power producers (IPPs).
34. The first Hydropower Development Policy and its corresponding legislation, the Electricity Act, were both brought out in 1992. In 2001, the policy was reworked to introduce major updates, including the decision to allow the private sector to invest in generation.

# The 'Wicked' Constraints in the Nepal Hydropower Sector

(This is not an exhaustive list of all the constraints in the sector)



# SECTION II:

# ENGAGING IN POLICY REFORM IN HYDROPOWER

Those developing Nepal's hydropower policies consistently fail to engage with the larger constituencies or recognize and represent their expectations and interests. As such, a minimally representative policy process fails to cater to the multi-dimensional needs and aspirations of the local constituencies that have a direct or indirect stake in the process.

After years of engagement, it should be evident to development agencies working in Nepal's power sector, that addressing the underlying constraints to hydropower development is about more than offering technical solutions. In reality, it is about the ability of reform agents to understand the driving interests and incentives, and to respond to these appropriately. Niti's engagement in the sector is driven largely by its approach to working politically. Through *thinking politically*, Niti works to shift from the traditional approach of trying to identify the purely technical aspects of policies, to analyzing the *politics* of policymaking. In this context, 'political' may be understood as both the political context under which policies are formed, as well as the different forms of institutional and political capital that stakeholders within the policy regime bring with them to the negotiating table in order to exert their influence.

The following section looks at this strategic thinking as well as Niti's process of engaging in reforming policies in Nepal's hydropower sector. This is divided into two sections: (1) Niti's engagement on transmission infrastructure issues, which looks at how politics and processes drove policy reform engagement, and; (2) Niti's engagement at the community level, which focused on evidence generation (particularly when there was an information vacuum) and engaging directly with stakeholders to come up with a negotiated settlement on a contested issue. It should be noted that Niti's engagement on tariff restructuring is contained in a separate, previously published working paper.<sup>35</sup>

## 2.1 THE CASE IN TRANSMISSION

As mentioned earlier, the NEA estimates that the country will be generating an adequate supply of electricity for national consumption by 2017. But this is a misrepresentation of reality because despite all the progress on the generation side, the government is not on track to evacuate the electricity generated from power plants to load centers. Already-completed projects are compelled to dump power because the NEA cannot connect them to the national grid.<sup>36</sup> Given this major bottleneck in hydropower development, Niti's overall engagement strategy was about identifying a mechanism to manage and regulate the transmission infrastructure that would, in turn, create additional incentives to spur growth and private sector investment in production.

### 2.1.1 IDENTIFYING INITIAL REFORM OUTCOMES AND A MECHANISM FOR ACHIEVING THEM:

Niti began its engagement in this area in early 2013 by convening a series of informal dialogues with some of the key stakeholders in Nepal's energy sector. Based on this, Niti agreed with the diagnosis that a separate institution was needed that would be responsible for the overall planning of Nepal's transmission system and for all regulatory responsibilities in transmission. This would increase focus on allowing and incentivizing the private sector to develop transmission lines and start the process of 'unbundling' the NEA, and creating a separate transmission company. The private sector has become increasingly cautious about working in the transmission area due to their previous negative experiences in generation. They are wary of the NEA's position as the regulatory institution, and its ability to charge unfair wheeling prices, compared to what it charges its own subsidiaries. Additionally, experts have feared that even if the new transmission company was established as a private company, albeit government owned, like the NEA, it would be driven by its own corporate needs and interests, more than to those of the sector or the country.

35. Niti 2013.

36. For example, even about a year after its completion, the Sanima Mai Hydropower Project (22 MW) was still not connected to the national grid.

The response from the MoE to inadequate transmission infrastructure, at this point of time, was through the NERC Act. This bill endorsed the establishment of the NERC and its responsibility to plan for the entire sector, including setting the wheeling charges for transmission. However, the larger issues within the hydropower sector were to be addressed through the much broader Electricity Act, and many experts were of the opinion that the NERC Act, along with the Electricity Act (with its 142 registered amendments), would linger on in Parliament for a long period as many issues had to be resolved before such a large piece of legislation would be approved. Given the immediate need to focus on building more transmission lines, Niti, along with its reform partners, decided to focus on lobbying for the creation of a separate regulatory agency for the transmission sector. The rationale behind this decision was that it was likely to be approved more quickly if it were not combined with other, more complicated, issues.

With this understanding, Niti, in close collaboration with colleagues from The Asia Foundation, designed a program to push for this particular reform. Niti began formal discussions in the sector to develop strategic partnerships with organizations such as the Nepal Hydropower Association (NHA) and the Confederation of Nepalese Industries (CNI). Based on recommendations made in a policy discussion event with former managing directors (MDs) of the NEA, Niti and its partners decided to push formally for the creation of a National Power Transmission Authority (NPTA). Niti followed up on this event to pressure MPs and political leaders by engaging their respective political constituencies, and helping them think through the content of the necessary legislation that would define the transmission institution.

Meanwhile, there was new development in this area: in March 2013, the NEA Board of Directors agreed to allow IPPs to construct transmission lines to link their individual powerhouses to the closest substation in the national grid. This decision was instigated under strong pressure from a small group of IPPs who were at risk of losing significant revenues because the NEA could not ensure that the necessary transmission infrastructure for their projects would be set up on time. Citing a provision in a policy document prepared by the National Planning Commission, the group petitioned the MoE to allow them to build their own transmission lines. Their proposal was to develop the transmission infrastructure for an estimated cost of NPR 500 million under a build-transfer model, with a 15-year payback period. However, implementation of the proposal by the NEA's Board was soon constrained by other policy and bureaucratic hurdles, which included the absence of a clear framework to delineate ownership and third-party access to the newly built infrastructure. Furthermore, speculation regarding inflation of the proposed cost and the need for competitive bidding procedures under the Public Procurement Act (2007) failed to increase risks

such that the package failed to incentivize both the IPP group and the NEA. In the end, the NEA's Managing Director refused to sign off, and the expected decision was stalled. This case bolstered Niti's arguments about the need for an independent regulatory body to oversee the transmission sector, and reaffirmed the analysis that this was a 'wicked problem' for which a solution would have to be multi-faceted. Facing this reality means accepting that 'easy fixes' will not be easy to achieve.

### **2.1.2 INTERNAL AND EXTERNAL POLITICAL EVENTS:**

Policy reform is intrinsically linked to the politics of the country. While the lobbying efforts for reform in the energy sector were gaining momentum, the first Constituent Assembly (CA) in 2012 failed to deliver a constitution. This led to Dr. Baburam Bhattarai, the Prime Minister at that time, announcing elections for the second CA to take place in the following year. However, over time, the trust deficit between the political parties reached its lowest point, and the only plausible compromise was to have the Chief Justice of the Supreme Court lead an interim government the following year by serving as the chairperson of the Interim Election Council of Ministers (IECM). During this period, the IECM had neither the mandate nor the desire to politically commit to policy decisions that could have long-term implications. This not only affected the momentum gathered by the energy sector and Niti's push for reforms, but temporarily put a halt to most meaningful engagements focused on long-term change in the sector. This experience underscores the unpredictable and non-linear nature of how policy processes unfold in Nepal. Thus, to be successful, any external support for policy reform has to be able to adjust to these realities—and not be constrained by pre-determined workplans, timelines, or outputs.

The IECM was successful in holding 'free and fair' elections on 19 November 2013, with some inconsequential opposition from the fringe parties. As a result, on 10 February 2014, the Nepali Congress (NC) Party and Unified Marxist–Leninist (UML) Party, the two largest parties in the newly elected CA, negotiated a power sharing deal that paved the way for the formation of a new government. The NC appointed Dr. Ram Sharan Mahat as the Minister of Finance (MoF) and the UML appointed Ms. Radha Krishna Gyawali as the Minister of Energy (MoE). Mr. Mahat had held the same position in the early 1990s and is often credited with spearheading "the first generation of policy reforms" that produced a fairly vibrant economy. Ms. Gyawali, on the other hand, had no previous experience in Nepal's energy sector, but, given her party's interest and investments in the hydropower sector, there were expectations that she would support necessary sectoral reforms.

The formation of a new government and their stated priorities called for a slight re-calibration of the sectoral reform agendas. Niti re-engaged with key players, particularly the newly inducted political leadership at

the MoE. On 24 March 2014, the team convened a national-level dialogue on power sector reform, which also happened to be the new minister's first official public function. Attended by leading government, private sector, and civil society representatives, the discussion on immediate policy priorities concluded with the understanding that the MoE was going to make certain changes to the two pending laws before sending them back to the legislature. The new Finance Minister later confirmed this intent. He publicly stated that the government planned to introduce "a second generation of policy reforms" in key sectors, including hydropower. This changing context meant that for Niti's reform goals to remain relevant, Niti would have to respond strategically to the apparent interest of the government.

Another major external political event that had significant impact on Nepal's energy sector was the election of Narendra Modi as the new Prime Minister of India. Given Prime Minister Modi's interest in increasing engagement with India's neighboring countries, his first official state visit in August 2014 was to Nepal. Through this, he was able to push for some major policy reforms that had been stuck in the bureaucratic maze for decades. Among these was the signing of a power trade agreement between Nepal and India, an important reform, which would allow Nepali power producers to export electricity to the power-hungry northern Indian states. This event was followed by the 18th South Asian Association for Regional Cooperation (SAARC) Summit in Kathmandu. During the SAARC Summit, the heads of member states signed the SAARC Framework Agreement for Energy Cooperation. This document aimed to contribute to overall development of the power sector in each of the member states, and their interconnectivity through regional institutions.

**2.1.3 RECALIBRATING IN A CHANGED CONTEXT:** As a result of the abrupt changes in the government and the subsequent shift in interests, Niti shifted its reform goal from establishing a separate institution with regulatory responsibilities in transmission, to lobbying for the passing of the NERC Act. There were dissenting voices within the ministry who claimed that the NEA, as a government institution, was already in charge of regulating the sector, and should continue to do so. The private sector, on the other hand, came out strongly against this and began lobbying for quick passage of the bills. For Niti, this was a better scenario for its overall engagement because the passing of the NERC Act would establish an institution that would not only regulate transmission, but also the areas of generation and distribution. This bill would also respond to one key policy area—the rationalization of tariffs. Niti had lobbied for a one-time increase earlier, but this bill would go further by replacing the inefficient

Electricity Tariff Fixation Commission with a new commission. The bill also authorized the NERC to ensure fair competition in the sector and to protect consumers.

At that time there was a rumor that the MoE was considering consolidating the Electricity Act and the NERC Act into a larger omnibus bill for the hydropower sector. Niti was quick to realize that building a reform coalition to push for the NERC also required supporting the coalition in fulfilling their respective interests associated with the Electricity Act. Furthermore, having analyzed the amendments put forward in the CA to amend previous versions of the Electricity Act, it was apparent that the proposed reforms to the Act had little to do with the technical aspects of the energy sector, and more to do with partisan political ideologies. This opened up another area for Niti's engagement, and it quickly modified its strategy to not only focus on forging a strategic alliance for reform of the proposed Electricity Act and the NERC Act, but also to work towards informed, evidence-based policymaking in the Parliament in order to counter any party or individual interests.

With this in mind, Niti took advantage of the recent signing of the power trade agreement with India (late 2014), and Niti, along with the Independent Power Producers Association of Nepal (IPPAN) hosted a discussion between a technical expert from Power Exchange India Limited (PXIL), one of the largest power trading companies in India, and members of the Parliamentary Committee on Agriculture and Water Resources (PCAWR). As follow up after the event, Niti and IPPAN also collaborated closely with the Chairperson of PCAWR to plan a similar program for 29 April 2015 on the need for harmonizing regulations and policies for cross-border power trade, risk sharing, and financial settlement between India and Nepal. These events were important for informing key members of the legislature about the complex technical components of the power trade agreement, and of the need to design structures to implement it.

On April 25, 2015, Nepal was struck by a disastrous 7.8 magnitude earthquake (and many aftershocks) that seriously damaged large parts of the nation. Nepal's hydropower sector also took a hit. According to the Post-Disaster Needs Assessment, the energy sector suffered damage worth around NPR 17.8 billion and incurred losses of around NPR 3.4 billion. While this number reflects physical losses in the sector, there were intangible impacts as well, including the loss of momentum yet again in the policy reform area. The drafting of the two hydropower-related bills, development of new projects, signing of new PDAs, and initiation of electricity sector reforms were all put on hold.

**2.1.4 CURRENT STATE OF AFFAIRS:** At the time of writing this paper in late 2015, Niti has made progress towards its ultimate reform outcome, but it cannot state that this has been achieved in full. While Niti's aim to introduce national legislation to launch an independent regulatory commission on transmission has yet to be realized, the establishment of an independent, government-owned transmission company has been approved by cabinet. Irrespective of the difference between the institution envisioned by Niti versus what has been created, both respond to the urgent need to improve sector efficiency by initiating the unbundling of the NEA. As planned, existing infrastructure and staff in the NEA's transmission department will be transferred to the new transmission company. The company will need to comply with the performance standards and the operational mandate specified for the planned, but not yet set up sector regulator—the NERC. Unbundling would introduce stronger accountability and checks and balances into the system, as well as open up more possibilities for other reforms that might stimulate investment in transmission infrastructure. In combination, these changes make it more likely that a new (unbundled) set of institutions will be more effective than the current NEA at overcoming the hurdles facing rapid development of the hydropower sector.

## 2.2 THE CASE IN MANAGING COMMUNITY ENGAGEMENT

Niti's (2011) diagnostic of the hydropower sector brought attention to the issue of community engagement, but did not initially explore deeply whether this is a major sectoral constraint. In recent years, however, local disputes over the development of large infrastructure projects have received significant attention in the national media. As these projects respond to the expectations and interests of communities, their work is often delayed or halted due to many unfulfilled demands. This not only results in delays in construction and increases project costs, but also fails to establish a healthy and sustainable relationship between communities, the project, and the government. Furthermore, despite some effort, the state has very little understanding of the phenomenon or the ability to respond meaningfully to communities' contestations. Moreover, there is a strong need to ensure an equitable mechanism to manage local disputes, particularly in countries such as Nepal, where the governance structures and human rights systems to protect the lives and livelihoods of local and indigenous communities, are weak. Using the flexibility afforded by its partnership with The Asia Foundation to rethink objectives and operating strategies, Niti has been able to experiment with, and eventually engage, at the community level on issues relating to infrastructure disputes. These were issues that had not only been

somewhat neglected by the state mechanisms, but this was also an area where Niti felt it could re-engage stakeholders in the hydropower debate but from another angle—that of representing and explaining the unique needs and considerations of local actors in infrastructure development.

**2.2.1 DEFINING EMERGING PROBLEMS:** Niti understands that the development of large infrastructure projects can pose a particular problem for the government. On the one hand, the government has the responsibility to provide the infrastructure needed for economic development; on the other hand, the government is responsible for protecting the rights of its citizens. This contradiction begins with the inequities inherent in infrastructure projects. These benefit the population of a large region, while at the same time result in significant costs to the much smaller population living in local areas that are affected by the construction of infrastructure projects. For example, a hydropower project that powers a country's economy may displace thousands of individuals who will forever lose not just their land, but also parts of their culture and traditions. The perceived inadequate compensation to communities for their financial and social losses results in lack of support for such development projects. Increasing claims from local indigenous groups to rights over natural resources intensifies this. This applies, in particular, to groups that historically have had limited influence on national policies, but whose interests the government is now committed to protecting as a result of signing national and international laws such as the Constitution of Nepal and International Labor Organization's Indigenous and Tribal Peoples Convention, 1989 (No. 169), popularly known as ILO 169. From an economic perspective, investments are also made riskier if they are likely to displace local groups or raise community opposition, as these kinds of complications can extend project timeframes, create additional and difficult-to-predict costs, cause reputational risk, and ultimately raise the risk profile of the investment.

As the national discourse about the need to overcome existing infrastructure gaps takes center stage, Niti is engaging directly through its own research and other activities to produce an evidence-based policy response to this important problem. On the research front, Niti has been undertaking an extensive investigation and documentation of hydropower projects and the existing mechanisms in place for managing local expectations and the sharing of benefits. It has also hosted several policy dialogues on emergent issues in this area, including one on the practice of offering direct financial equity or 'shares' to local populations affected by the development of hydropower projects. Niti's preliminary analysis identifies the following as major causes behind current disputes:

- **Information asymmetry:** Project developers in Nepal, public and private, seem to prefer withholding project information out of fear of raising the expectations of the local population with regard to compensation. This information vacuum is fertile ground for the emergence of biased information and fabrications, which create misperceptions about the actual costs and benefits associated with the project.

- **Lack of adequate policy mechanisms or failure to implement them:** Nepal is committed to ensuring the fundamental rights of its citizens as stated in its Constitution and other international laws. For example, Nepal is one of only 21 countries in the world, and the only one in South Asia, that has signed and ratified ILO Convention 169. Among other things, this convention mandates the state to ensure the rights of indigenous people to free, prior, and informed consent.<sup>37</sup> However, through various interpretations of national statutes and lack of national policies with clear directives, these international agreements are often considered to be major roadblocks to infrastructure projects.

- **Inability to address diverse stakeholder expectations:** Addressing the temporal, spatial, and procedural questions—i.e., when should benefits be shared, which geographic area should get what benefits, and how should benefits be distributed—is a complex exercise. Also, whether or not all costs and benefits associated with projects can be measured is an issue that creates problems in compensating for the loss of intangible goods. For example, how can costs be calculated for the loss of access to religious monuments or the loss of access to natural resources? Finally, the absence of locally elected leaders due to the state’s failure to hold local elections for the last decade and a half leaves this space open for multiple actors to try to facilitate, negotiate, and broker deals. All of these pose a problem for projects in trying to correctly identify and negotiate the legitimate concerns of communities.

**2.2.2 IDENTIFYING AND ENGAGING WITH STAKEHOLDERS:** Niti is engaged with many of the key actors and institutions that have a direct stake in hydropower projects. Niti has reached out to the Lawyers’ Association for Human Rights of Nepalese Indigenous Peoples (LAHURNIP), an institution with

a mission to inform indigenous peoples about their rights, empower them, and address the concerns that affect indigenous peoples’ lives. In line with Nepal’s international commitments to indigenous rights, the LAHURNIP has been providing professional support to indigenous peoples by representing their interests and translating them into policies and laws. In recent times, the LAHURNIP has played a prominent role in numerous high-level, public interest litigations filed against major infrastructure projects for failing to appropriately address the rights of indigenous people. This includes the cases against the Melamchi Water Supply Project and the Khimti-Dhalkebar Transmission Line Project.

Concurrently, Niti is working with IPPAN whose members must work with local communities on a daily basis to manage local expectations for the timely completion of their projects. So far, given the lack of adequate policy response from the state, these developers have been making deals on a project-to-project basis, and using ad hoc mechanisms for the sole purpose of driving their projects forward. One of the problems with this approach is that larger projects with more financial resources have an advantage over smaller-scale projects with fewer resources. Niti is assisting IPPAN in developing institutional guidelines that define their collective understanding and approach to benefit sharing.

**2.2.3 CURRENT STATE OF AFFAIRS:** Although the government has yet to develop a coherent policy on how to handle the issue of benefit sharing, it is beginning to show some interest in this area. For example, according to reliable sources, for all future hydropower projects, the MoE is planning to propose a mandatory allocation of 10% of preferential hydropower project shares to local communities. Niti has been reaching out to the MoE, whenever possible, to engage them in this policy discourse. Niti also maintains a close working relationship with other relevant government agencies, including the Investment Board of Nepal (IBN). As a result of signing PDAs for two major hydropower projects, IBN is currently engaged in defining the implementation mechanisms for benefit sharing for the 900 MW Upper Karnali Hydropower Project and similar schemes. Niti has also been engaging with key members of the legislature to engender a discussion about the relationship between development of hydropower projects and local development.

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24 37. “Free, prior and informed consent” is embedded within the ILO’s Convention No. 169, which deals with, among other things, the concepts of consultation, participation, free and informed consent, and prior consultation with the affected indigenous peoples.

# SECTION III: DEFINING THE APPROACH

This section provides insights into how Niti has approached the policy reform process, and what lessons might be drawn for donors and implementers looking to adopt more politically informed approaches to programming. In order to do so, this section is divided into three elements. First, this section articulates the defining features of Niti's approach to reform in the hydropower sector. Second, it outlines Niti's operational strategy for promoting specific policy reforms relating to hydropower. Third, the section concludes with reflections on what funding and program conditions can support or hinder the ability of local actors to work politically and flexibly on difficult reform issues.

## 3.1 EMERGING ELEMENTS OF NITI'S APPROACH

### 3.1.1 REFORMING POLICIES AND REFORMING PROCESS:

As its interventions evolved and the team's knowledge deepened, Niti's overall approach to the hydropower sector eventually became framed around two complementary goals. The first is to promote specific policy changes in the hydropower sector that will ultimately allow Nepal to improve electricity generation and reliability. The second goal is to pursue improvements in the overall process by which policy decisions are made in Nepal. In this regard, Niti's experiences can provide an interesting case study for the broader community of people 'thinking and working politically'. Current literature offers different views on whether politically informed ways of working are trying to change the institutions and rules in which program teams operate, or whether they largely work within (and accept) the status quo in order to achieve a very specific reform outcome. While the reality is ultimately not this clear cut (i.e., the very act of working on a policy reform process may cause it to change), the decision to maximize one or both of these goals can have significant practical implications for how program teams develop strategies and allocate resources.

For Niti, this became most apparent as it deepened its work around community disputes and infrastructure development. Niti's decision to engage at the community level was a function of three factors: (1) In the absence of strong state consultation mechanisms, Niti saw a need to bring to bear a broader set of views, voices and perspectives in national-level consultations and

dialogues on hydropower. This, Niti believed, would not only provide policy makers with a sense of potential end-user impacts for any legislative or policy changes, but also set a more inclusive precedent for decision making by the government, and provide local actors with an opportunity to insert themselves into the national-level political settlement which emerges with regard to hydropower. (2) Niti also saw community engagement as an opportunity to begin working through some of the aforementioned concerns relating to issues such as benefit sharing that have the potential to stall or derail large infrastructure projects. While this is certainly a long-term goal, Niti saw this as a critical impasse to position itself in anticipation of eventual passage and implementation of relevant hydropower legislation at the national level. (3) In the face of stalling national-level policy decisions, Niti's decision to deepen engagement also had an instrumental value. The networks and relationships offered by the local private sector, community, and government actors offer yet another avenue through which to enter the national political debate. These relationships can also help in making progress on necessary changes in the sector even during times of national-level crisis and political intransigence.

Niti's experience also highlighted some of the very practical program implications of pursuing both specific policy changes, as well as improvements to the overall process by which policy decisions are made. While the Niti team did not necessarily seek to maximize both outcomes at every point throughout the program, it still required that individual members had both narratives about impact in mind in order to explain how their actions might lead to progress (these could be called theories of change). In a context where new information is constantly emerging, the interests of key actors are shifting, and thus program assumptions are being challenged, this is no small feat. Furthermore, the programming mentalities that stem from these two objectives can also be quite different. To give a very basic example—one program officer seeking to maximize inclusiveness might focus on how many different people are participating in a meaningful way in a town-hall meeting. However, another program officer, who is working on a specific policy outcome, might focus on whether the most influential local private sector or government officials (regardless of their age, gender or ethnicity) are at the meeting in order to ensure that any decisions made at the meeting are politically feasible.

There are also practical resourcing implications, in terms of staff time, relationship building, program administration, and financial management that need to be weighed up when pursuing these dual program goals. In many respects, Niti found that these decisions had to be made ‘on the run’ and could not be planned at the program’s outset through fixed job descriptions; instead decisions had to be determined according to which activities were reaping rewards. Fortunately, the highly versatile generalists on Niti’s program staff could be deployed relatively quickly to work on new activities. However, with any strategic decision to focus resources in one area comes an opportunity cost of reducing resources in another area. While there is no blueprint to manage this balancing, opportunity costs are mitigated by allowing staff to work on multiple issues at once, and also maintaining relationships even when collaboration with specific actors has ended or been de-emphasized.

**3.1.2 THE QUESTION OF SEQUENCING:** Recognizing that the challenges surrounding reforms needed for hydropower development in Nepal are complex, intermingled, and collectively constitute a ‘wicked-problem’, led to analysis that more than one blockage must be removed to stimulate the whole sector. The need for a series of obstacles to be overcome raised some critical questions about the sequencing of reforms, and the need for an institution like Niti to articulate a plan of action. In reality, however, the ‘low information’ environment and complicated politics of reform, as well as some of the obstacles in hydropower development, make it nearly impossible to plan and sequence a complex series of reforms in advance. As each stage of reform over the course of the next decade will have to be undertaken in evolving political and social contexts, strategies will have to be updated regularly. With this in mind, Niti’s main lesson regarding the sequencing of a multi-stage reform process is that the lack of information or a comprehensive plan should not be an excuse for lack of action or engagement. Some actors mistakenly stay purely in the analysis space because of the great challenge, and perhaps impossibility, of articulating a fully realized reform process at the outset. Niti’s approach was to develop a logic for selecting a critical issue and start working on progress in that clearly defined space. Niti recognized the need to position this reform within the wider environment of needs, but did not let uncertainty paralyze its efforts to offer needed support and engagement.

## 3.2 NITI’S OPERATIONAL STRATEGY FOR PROMOTING SPECIFIC POLICY REFORMS

Niti’s operational strategy for promoting policy reform was developed locally with the understanding that i) policy processes are inherently political, and ii) local organizations can/should have a larger space in policy reform because of their stake and legitimacy in the

political process of policy making. However, Niti’s approach is also influenced by global development concepts such as the *problem-driven, iterative, and adaptive* approach, which center on the challenge of escaping the “capability trap”, i.e., a situation that is created when local counterparts are incentivized to follow or adopt external best-practice solutions, rather than being given the space to experiment and find the most locally salient and relevant path to change. Even though a government may appear to be reforming, externally imposed changes made at the request of a donor are unlikely to work in the specific context where they are operating (even if they worked in other places or are considered technically best practice). This approach puts forth four central ideas that reform programs and practitioners can adopt to address the capability trap: (i) context-driven local problem solving, (ii) creating an authorizing program environment for experimentation and trial and error, (iii) using the iterative feedback of lessons to develop new solutions, and iv) engaging broad groups of agents to ensure political support and implementation potential. As mentioned above, despite the promising economic and social growth potential of hydropower in Nepal, it remains bound by the capability trap. Even after decades of externally driven reform and pockets of progress in the energy policy landscape, the overall performance of the sector remains dismal, as successes have tended to be superficial in nature.

Below is an attempt to describe Niti’s approach to working on reforming policies in Nepal, based on its sectoral engagement in hydropower.

**3.2.1 ENGAGING POLITICALLY:** If policymaking is intrinsically a political enterprise, as indicated by the emerging development discourse, then an effective way to engage in any policy reform should be by engaging politically within the environment. Niti’s engagements so far have been guided by this working principle, which has largely been informed by both its formal and informal political economy analyses. These have helped to decipher the entrenched political interests and incentives in any particular reform agenda. These analyses have helped Niti to understand the context within which it is engaged and identify actors who can serve as potential champions in necessary reform.

One of Niti’s primary strategies has been to work with relevant constituencies within sectors that not only have political capital, but also are willing to leverage it, when and where required. For example, in the hydropower sector, Niti works closely with associations representing a variety of interests. Even though some may be diametrically opposed to each other, Niti sees its engagement with key players such as the Independent Power Producers Association of Nepal, the National Association of Community Electricity Users Nepal, the Lawyers Association for Human Rights of Nepalese Indigenous Peoples, and the Forum for the Protection of

Consumer Rights as crucial to policy reform in the sector. Despite the complications, engaging with such diverse groups, understanding their varying interests, and responding to them in developing a strategy that enables some collective action, is ultimately a far more effective approach than trying to convince anyone to act against their perceived or real self-interest. For example, rather than only trying to convince political actors to do what is best for the sector, Niti would, at times, work with citizens and organizations with strong grassroots connections. In doing so, Niti supported these individuals to better influence key decision makers (MPs and political leaders) so they would see it as in their best political interests to consider some of the reforms being proposed. Overall, despite the varying capacities of these institutions, they represent a wider political constituency within the sector, and have the political mandate to engage directly with national decision makers. Additionally, representing diverse interests and claims in the policy-making process should be an attractive strategy not just for policy improvement, but also for mainstreaming marginalized policy positions and building widespread legitimacy for policy decisions.

Niti has been reaching out to relevant government agencies, but as mentioned at the very outset of this paper, the Nepali bureaucracy largely prefers a ‘closed’ policy-making process. With pressure from civil society for increased transparency, there are a few provisions for public consultation during policy drafting, but how much of that is reflected in the actual policies is highly questionable. Niti has also been reaching out to members of the legislature, partly because they have a defined role in the policy-making process, but also because as representatives of the people, they (particularly the reform minded ones) are more open to engaging with the public. Niti’s reputation as a neutral, impartial convener was crucial in its ability to maintain multiple relationships with stakeholders of different political and employment backgrounds. Niti made particular efforts to ensure transparency in its engagement with these different stakeholder groups, and to provide equal opportunities for each party to raise their concerns and issues.

**3.2.2 EVIDENCE+:** Nepali policy makers are often seen to be making critical policy decisions on the basis of little or no evidence. This is generally the case in developing countries such as Nepal for two main reasons. The first is a demand-side evidence problem where decision makers either have very little access to credible, empirical information that could guide their reform agendas; or even when there is high-quality evidence available, they may be unable or unwilling to make

effective use of it. The second is a supply-side evidence problem where a major constraint to using empirical evidence in policymaking is the lack of domestic capacity and incentives to systematically collect valid and reliable data, and produce credible analysis on issues relevant to institutional reforms.

With this understanding, Niti has been making use of an ‘evidence+’ approach, which refers to the use of research evidence as a basis for increased collaboration and negotiation between government and non-governmental actors on highly contested reform agendas. This goes beyond simply increasing an individual’s capacity to access data and research in their daily work, and focuses instead on what can be done with this evidence once it has been accessed and appraised. In other words, how, when, and where can research and data be presented in persuasive and relevant ways to actually influence policy debate? Such an approach requires building a critical understanding of four questions on the policy process:

1. How, in practice, is policy developed and driven in the country?
2. At which junctures of the policy process are there significant openings for evidence-based debate to occur?
3. Are these openings under-utilized for technical or political reasons?
4. What are the interests of the actors who insulate policy development from open engagement and debate, and how can these interests be reshaped?

If effectively applied, the evidence+ approach encourages the use of research evidence in a timely and strategic manner in order to influence policy decisions, constrain the space for purely political or personal interest-driven opinions (at least in public dialogue), and promote ownership of evidence-based approaches in the overall policy process. However, the evidence+ approach must be demonstrated as technically compelling and politically forceful to overcome the incentives that promote populist decision making. This has been most evident in Niti’s work in managing local expectations in hydropower development—an area that is, as stated earlier, fraught with significant potential disputes between the communities, the private sector, and the government over the use of water resources in producing hydroelectricity. In addition to producing research-based evidence and promoting an open dialogue over this issue, Niti is engaged politically with a broad set of stakeholders to ensure that there is an appropriate and timely response to this particular policy problem.

**3.2.3 FROM RECOMMENDATIONS TO REFORM:** Newer frameworks, such as political economy analysis, have been introduced to challenge the technocratic and formulaic way in which development theory and practice have been traditionally managed. Such an approach delves into the underlying interests and incentives, as well as the ensuing political settlements of stakeholders. However, literature on the idea of “working politically” still reflects the challenges of transitioning from analysis to action, i.e., from “thinking politically” to “acting politically”.<sup>38</sup> The Honorable Gagan Thapa once spoke at a Niti event about the big ‘disconnect’ between the discussions taking place between content experts and the actual policy makers. In order to address this problem, Niti encourages the approach of “thinking politically” whereby the gaze shifts from trying to identify purely technical aspects of policy making or restructuring, to analyzing the politics of policy making. In this context, “political” may be understood as the real and perceived interests of various actors, the political context within which policymaking takes place, as well as different forms of institutional and political capital that actors and stakeholders within the policy regime bring with them when they attend meetings, workshops and so on. Likewise, there is a shift in focus from international aid agencies as the principal drivers of the process to local partners, who have the local expertise and legitimacy to work in the domestic political arena.

Often a lack of political will is identified as the major constraint in going from making recommendations to achieving reform. The underlying assumption here is that reforms are about presenting decision makers with an ideal set of solutions, and hoping that they believe in the need for the reforms, and in the credibility of the solutions, so that they consider them in their decision making. However, for Niti, introducing reform goes beyond just the political will of the government; instead, it is about negotiating a settlement among various interests. Therefore, Niti’s reform engagements are designed to impact this settlement. Thus, Niti has always worked to convene different stakeholders together and present research and data in ways that will foster greater communication between all relevant actors related to the policy concern.

**3.2.4 SEQUENCING REFORM INITIATIVES:** Niti’s initial diagnostic of Nepal’s hydropower sector identified a set of intricately layered constraints hindering sectoral

growth. Overcoming many of these constraints requires reforms across different levels of the government. For example, a tariff restructuring reform requiring a decision from the ETFC would probably be a small feat compared to the restructuring of the NEA, which would need a ministerial-level decision. Similarly, ratification of the proposed Electricity and NERC Acts would require a commitment to reform from the MoE and the cabinet, and then a lengthy process of deliberation and decision making in Parliament.

Based on consultations with experts in the sector, followed by a discussion over programming and budgetary implications with The Asia Foundation, it became apparent that for Niti, it was a matter of finding a balanced approach that would tackle the ‘lower-hanging fruits’—those peripheral issues that might be resolved somewhat more easily and quickly in terms of reform, but also take on the larger reforms essential for sectoral growth. Hence, Niti began engaging in restructuring the tariffs, and while this was probably not a “key-log” policy constraint<sup>39</sup> for the sector, it was one that helped Niti initiate discussion on many of the other related areas. As some of the underlying interests were eventually fulfilled when the government took the decision to increase the PPA rates, Niti continued with its pursuit of a more politically charged agenda for a subsequent hike in the consumer tariff (albeit with certain conditions to ensure equity).<sup>40</sup>

Niti also left room to engage in emerging issues, as has been the case with regard to benefit sharing and managing local expectations in infrastructure development. This particular engagement was a result of a long interaction with the Investment Board of Nepal that started over a discussion on the constraints that the IBN faced in implementing its projects. After several consultations with the IBN, Niti has finally been able to chart a map of stakeholders as well as plan an initial communication and advocacy strategy. But there are other constraints that Niti, by default or by design, has only been able to engage in peripherally. Among these, Niti has yet to find a foothold in the discussions over the restructuring of the NEA. This is a highly political (but important) issue that will require opportune timing for engagement.

38. Sturzenegger and Tommasi 1998.

39. A key-log is the log, which if removed, would free up the whole logjam in a river. In the policy reform context, it is the key policy issue that could potentially initiate a host of other necessary policy reforms in the sector

40. For details, see Niti’s 2013 report “The Political Economy Analysis of Electricity Tariff Restructuring in Nepal”.

### 3.3 THOUGHTS ON CONDUCTIVE CONDITIONS AND APPROACHES FOR SUPPORTING POLICY REFORM

Godfrey Saxe's witty observation in 1869, that "laws, like sausages, cease to inspire respect in proportion as we know how they are made" best reflects how policies have always been made. Niti's own pursuit to define Nepal's policy process showed that policies are being constantly drawn and redrawn within a 'black box'. In other words, policy processes in Nepal, as elsewhere, do not follow a linear path that can be predicted, or necessarily lead toward the most technically sound solution. Instead, policy processes lead toward a settlement, based on technical capacity, stakeholders' interests, and politics that shape the process—in other words, a jumbled mix that leads to unpredictable final outcomes. Therefore, engaging in policy reform requires understanding of the context and the political dynamics of policy change—these include an insight into how and why the reforms were initiated, how they were framed and perceived, and, finally, who will and will not support the policy, and under what conditions.<sup>41</sup>

Niti has, to date, received funds from the Open Society Foundation, The Asia Foundation, and the Australian Government's Department of Foreign Affairs and Trade, and this support has enabled Niti to facilitate an environment for more politically nuanced programming. With an understanding of the limitations and implications of traditional development aid, along with the work Niti has done in policy-making and policy reform in the hydropower sector, Niti is in a position to offer some suggestions on the type of support that can set the conditions for organizations such as Niti to thrive and have the maximum impact possible.

#### 3.3.1 UNDERSTANDING CONTEXT AND FLEXIBLE FUNDING:

As stated earlier, policy processes rarely follow a linear and sequential pathway. Also, policies are generally the reflection of negotiation among multiple interest groups, which, in itself, is a highly political process. Furthermore, contextual complexities are often very difficult to ascertain in advance when projects are being designed. But traditional donor-funded programs are increasingly being criticized for not taking this into consideration. Instead, many require identification of 'solutions' and the intended pathway at the very outset, even before funding is approved. If this approach were used in the hydropower sector, the pre-determined outputs would never have been met because of the constant changes in this heavily politicized policy area.

Instead, policy programs should be highly influenced by the context, which has very little degree of predictability or they should be allowed the required programming flexibility to adapt to the changing needs. Allowing flexibility at multiple levels of programming is the key to ensuring that reform programs remain contextual, relevant, and legitimate. For such programs to remain relevant in contributing to the stated objectives, they are required to read and respond to the changing context, and the factors driving reform. Flexibility to adjust program goals, outputs, and strategies during implementation allowed Niti to continue to be part of the reform discourse.

The programming flexibility offered by Niti's current funders allowed it to navigate major political events, including the second CA elections, Indian Prime Minister Narendra Modi's visit to Nepal, the SAARC summit, and most recently, the earthquake. All of these have had major impacts in shaping the context that frames power sector reform in Nepal. In adjusting to these changes, Niti was required to reassess its immediate and future program goals to see what was feasible and achievable. For example, sensing the low chance of achieving its hypothesized, ex-ante reform goal of establishing an independent transmission line authority, Niti took a politically informed and measured decision to change its reform focus on the NERC Act. On many occasions, Niti had to invest significant time to re-work what it could achieve, as the changing context resulted in temporary setbacks.

#### 3.3.2 FUNDING LOCALLY DRIVEN INITIATIVES:

The efficacy of a policy reform program can be enhanced if donors fund reform goals that are locally defined and developed. Rather than provide funding to actors who the donors think will faithfully implement projects based on the donor's idea of what should be done, funding should be used to bridge the financing gaps of the local actors who are already engaged in reform. This strengthens local ownership and contributes significantly to achieving value for money. As stated earlier, policy reforms do not happen within project cycles. Indigenous organizations like Niti that have sustained engagement in particular sectors, and are working around the local politics of the issue, are better placed for this purpose. These institutions have developed political capital and are willing to expend it for the right reasons. Local organizations like Niti work to create a credible space for themselves in the policy domain by reaching out to all of the constituencies, and building relationships that support the agenda. They work towards building their political capital and spending it when necessary.

41. World Bank 2008.

Perhaps the rule of thumb for any donor should be to support agencies that will continue working on their chosen policy reform, even after external funding has ended. This indicates that the organization has identified a policy concern that they believe is important to their own social, political, economic, and cultural context, and are too invested in the process to be able to walk away simply because funding ends.

A key focus of the political economy framework encourages the employment of an iterative, learning-by-doing process as it cycles through three stages—technical and political economy analysis, development of strategies, and technical and political action—in order to discover which reforms work and which do not. Placing local leaders in the forefront of the reform process effectively promotes country ownership and also allows development agencies to skirt the sensitive issue of infringing upon national sovereignty. Therefore, in building ‘winning coalitions’ or aligning the interests of those seeking reform, development actors must work within the reality of the power struggle inherent in implementing and institutionalizing change. Working politically allows development actors to navigate the various political agendas of relevant stakeholders and capitalize upon incentives and motivations in driving change.

### 3.3.3 UNDERSTANDING AND MITIGATING THE RISKS:

An obvious question at this stage would be whether there are risks associated with the “working politically” approach? Of course, there are risks associated with working politically, as there are in any other traditional approaches, but such risks can be mitigated by careful due diligence on the part of the donor. This means not only carefully assessing organizations’ financial management capacities (and building skills and systems where they are lacking), but also identifying and working with local institutions that can map and mobilize stakeholders to spend political capital to achieve the reform attempted.

This kind of approach to funding also allows the development industry to diversify its portfolio of programs (and therefore increase the likelihood of achieving impact) by making “small bets” through investing in multiple small-scale agencies. By shifting to this approach, the development industry also needs to understand that supporting policy reform requires working with intangibles and, therefore, the outputs often cannot be measured in numbers. The successes of supporting policy reform by working politically could range from building relationships with local constituencies to effectively lobbying for change on an institutional level. This means that alternative models of accountability need to be agreed on between donors,

local implementing partners, and large international nongovernmental organizations (INGOs) that can maintain trust, openly communicate results and failures, and still provide for flexibility at implementation. One such model, which Niti also employed at various points throughout implementation, is The Asia Foundation’s Strategy Testing approach. This tool allows local partners and INGOs to communicate process-level results and document the unfolding reform process for donors, while simultaneously helping local implementers to determine whether strategies and program assumptions are yielding the results they expected.<sup>42</sup>

**3.3.4 FROM PATRONAGE TO PARTNERSHIP:** The relationship between the development industry and the local organizations needs to change from that of patronage to partnership. In order to create an environment where these local organizations have a definitive stake in determining the nature of development practice, a collaborative relationship with the donors is essential. This will also re-define the concept of accountability whereby both the donors and their partners are ultimately accountable to the public instead of to each other. An indigenous idea that springs from a local context and is developed in partnership with the donors can have a definitive impact, as opposed to the prescriptive model of identifying programming needs.

Insanity is often defined as “doing the same thing over and over again, and expecting different results.”<sup>43</sup> However, there is quite a body of literature on why the development sector continues to function as it has for decades. The authors of this paper are not claiming that there is no space for the existing aid industry to use traditional programming, as this is still relevant for the technical aspects of development work. But, unlike typical aid programs, the degree of predictability and the resulting attribution associated with policy programs is often limited. Typically, in the case of policy reform programs, the anticipated results are difficult to observe in 3 to 5-year project cycles. Policy reform programs require much more preparatory work and a constant change in approach during the actual process. Organizations such as Niti that work on policy reform are also accountable not just to the state and development partner/s, but also to all of the local constituencies they have identified in the policy area, and ultimately to the general public. The delicate balance required in negotiating an unbiased space between contesting constituencies and navigating through the intricate web of state bureaucracy is fraught with problems and constant setbacks. But this is the true reality of the context in which organizations such as Niti work, and with a collaborative relationship with Niti’s partners, policy reform can take place.

42. Ladner 2015.

43. This quote is often attributed to Albert Einstein.

# SECTION IV: CONCLUDING THOUGHTS



Photo by Padmendra Shrestha

The story of hydropower reform in Nepal remains incomplete, so Niti's support for hydropower reform is similarly ongoing. The knowledge Niti has developed while implementing donor supported activities, and the links built into the reform process, will extend well beyond the duration of a single donor project. Looking ahead, Niti will continue to provide timely and context sensitive inputs to help push the hydropower reform forward, regardless of what type of financial support it has. While the scale of potential activities and contributions are clearly shaped by the funding, effort and commitment are not. More broadly it should be noted that the Niti Foundation is only one of many local actors in Nepal who will pursue their programming interests and strategies far beyond the reach of any one donor project cycle. However, it has perhaps been the higher flexibility (especially in terms of expenditure, outputs/outcomes, and activities), that has allowed Niti to focus on impact beyond the deliverables of a specific pre-planned project—much more than many other implementing organizations.

This paper has attempted to capture recent events in the hydropower sector, as well as Niti's evolving thinking about the needs and opportunities in the sector, even during a period that has delivered insufficient progress from Niti's perspective. This paper has also provided a platform for Niti to articulate an approach to policy support in Nepal that is still developing, but has taken a clearer shape in recent years through a process of learning-by-doing. This effort is helpful in clarifying this emerging approach, and should be of interest to others in the industry working on their own strategies. Often case studies and papers capture already completed reform processes or represent more pure research processes. Niti is unable to share that complete impact story yet, but hopes that this short think-piece can still make a relevant contribution to others grappling with similarly challenging policy reform processes. Most importantly, the Niti Foundation hopes that someday soon there will be an opportunity to write a follow-on paper to articulate a complete, successful and transformative reform process in Nepal that is so important to the country's development.

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The Asia Foundation is a nonprofit international development organization committed to improving lives across a dynamic and developing Asia. Informed by six decades of experience and deep local expertise, our programs address critical issues affecting Asia in the 21st century—governance and law, economic development, women’s empowerment, environment, and regional cooperation. In addition, our Books for Asia and professional exchange programs are among the ways we encourage Asia’s continued development as a peaceful, just, and thriving region of the world.

Headquartered in San Francisco, The Asia Foundation works through a network of offices in 18 Asian countries and in Washington, DC. Working with public and private partners, the Foundation receives funding from a diverse group of bilateral and multilateral development agencies, foundations, corporations, and individuals. In 2013, we provided nearly \$114 million in direct program support and distributed textbooks and other educational materials valued at over \$10 million.

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