

ECONOMIC PRECONDITIONS FOR A STABLE FEDERAL STATE: WITH REFERENCE TO NEPAL

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BACKGROUND

Federalism is a political organization that involves relationships between the central government and the regional units.¹ In several countries, federalism has made significant contribution in bridging the gap between the government and people and providing resilience to democracy. Since there is division of power in a federal system between the centre and the regional units, each of the unit has independent jurisdictions to make decisions with regard to governance and other developmental activities.

Since the purpose of federalism is to remove disparity in representation of different geographical units of a state, the chances for addressing the problems of weaker sections of the society become greater in this system. In cooperative federalism, the centre, states and even the local bodies are expected to work in cooperation with each other to ensure the growth and stability of the nation for which intergovernmental relations are promoted.

Under the federal structure, the different tiers of government not only ensure checks and balances, but they also ensure accountability and generate opportunities for greater competitiveness. This provides larger scope for the optimal and efficient use of the resources for the balanced growth of the economy. Prospects are often high in the federal system to meet the needs and aspirations of diverse groups of population.

Yet, federalism has not one but different hats. Activities of one federal regime vary with that of the other. In minimal federalism, the states are loosely allied. On the contrary, most of the power lies with the centre in maximal federalism. At the global level, 25 countries including major democracies like India, the United States of America and Canada, accounting for nearly 40 % of world population, have adopted a federal system.² Nepal happens to be the youngest federal democratic country in the world.

FEDERALISM IN NEPAL

Nepal promulgated its federal constitution on September 20th 2015. With 28 million populations, the country is quite small as compared to two of its two giant neighbours i. e. India in the south and China in the north. But it is widely diversified in terms of language, ethnicity and religion. As per the 2011 National Census report, there are 123 languages spoken as first mother tongue in the country. Besides, there are over 100 ethnic communities, apart from the presence of 10 religions.³

In Nepal, a great need had been felt for the introduction of a federal regime due to the failure of Kathmandu to address the genuine aspirations of diverse ethnic communities. As far back as in the 1950s, Vedanand Jha, the leader of Nepal Terai Congress raised demand for the introduction of a federal system. But with the defeat of this party in the General Election of 1959 and the imposition of authoritarian party-less Panchayat System in 1960 by King Mahendra, the voice in favour of federalism was subdued.

Political development in Nepal took a different course after the restoration of multi-party system in the country in 1990. The Terai-based Nepal Sadbhavana Party formed by the Madheshis revived their old demand for federal structure. Subsequently, the Communist Party of Nepal (CPN-Maoist) put forward federalism as one of its core agendas after the People's Movement in 2006. As per the popular demand by the people, the Interim Parliament passed a bill

on December 28th 2007 to make Nepal a "Federal, Democratic Republic". Subsequently, when the CPN (Maoist) emerged as the largest political party in the first Constituent Assembly (CA1) elections in 2008, the tilt in favour of federalism grew more than any time in the past. Accordingly, the first meeting of the CA1 on May 28th 2008 officially declared Nepal a federal country.

Nevertheless, federalism remained more as a political rhetoric rather than a reality. The CA1 was not able to draft a federal constitution till it was dissolved in 2012, which was mainly due to its failure to resolve the contentious issue of restructuring of the states. Even after the CA2 elections in November 2013, not much headway was made in constitution making process until the deadly earthquake of April 25 and May 12 in which over 9,000 people were killed and physical property worth over US \$ 7 billion was destroyed.

In early June 2015, when the earthquake victims needed urgent care to address their problems, three or four persons from the major political parties, including the Nepali Congress (NC), Communist Party of Nepal-Unified Marxist-Leninist (CPN-UML) and Unified Communist Party of Nepal-Maoist (UCPN-Maoist), which until its unification with Communist Party of Nepal (Unity Centre-Masal) was known as CPN (Maoist), made a decision to make the constitution on a fast track basis. Unfortunately, the Madheshis and Tharus, the two most dominant ethnic communities living in low land of Nepal's Terai (plain) area bordering India, were deliberately excluded in the constitution-making process and their concerns were overlooked. Estimates of Madheshis and Tharu population in Nepal vary from one-third to one-half of the country's total population. The constitution was passed by CA2 following "majoritarian" principle despite the strong opposition from the Madheshis, Tharus and other Janajati (indigenous) communities.

Consequently, the nation was polarized. A section of the people applauded the new constitution and made jubilation in Kathmandu on the day of promulgation of the constitution on September 20th

2015. But at the same time the Madheshi, Tharus and other Janajati groups observed this occasion as a black day. They staged strong protests against the constitution as they have a feeling that the present constitution is more regressive than any of the past six constitutions introduced in the country ever since the 1950s.

It cannot be denied so easily that the new constitution has several flaws. In the fiscal area, power is disproportionately concentrated in the hands of the central government, which has sole monopoly over foreign grants, aid and loan. As such, the states will have to live just at the mercy of the central government because they have limited power to manage resources for their development. Of course, even the states have been allowed to receive foreign grants and aides, but for this they would have to take prior permission from the centre. In no case, they can mobilize resources from loans.

Besides, the distribution of fiscal power between the centre and states is vague. Both the central and state governments have been given authority to levy service charge and mobilize resources through penalties and fines. Similarly, both the centre and states have been allowed to impose excise-duty (Annex One and Two). This kind of duplicity in imposition of a certain tax will not only increase the cost of production and thereby affect the growth of industries, but it would also inflate the prices whose burden will ultimately be shifted to the consumers.

Another flaw in the constitution is that it entitles the centre and not to the state governments to introduce programmes aimed at poverty alleviation. Even in the matter of trade and business, it is only the federal government that enjoys the monopoly of doing trade with the foreign countries. The states can only trade within their given boundaries.

Moreover, the centre enjoys monopoly over customs, value added tax (VAT), corporate income tax, individual income tax, passport fee, visa fee, tourism fee, service charge, penalties and fines. On the other hand, the states are left with the only option to mobilize

resources through tax on remuneration, land and house registration fee, vehicle tax, entertainment tax, advertisement tax, tax on tourism and agricultural income. This will give them limited scope to mobilize funds for their development.

However, the common mass of the Nepalese population hardly discuss the impact of the above fiscal arrangements in the constitution on the economy. This is due to the fact that the agitation in the Terai region by the Madheshis against the constitution has overshadowed all other issues. In the seven-provincial model in the new constitution, most of the ancestral land of the Madheshis in the flat land of Terai has been mixed with the hill districts. The Madheshi people have been given only one small patch of state in the Terai covering eight out of seventy-five districts in the country; while the other twelve districts in the region have been mixed with the hill states. This is in violation of the agreement made between the government of Nepal and the Madheshi leaders in 2008 in which the government had agreed to provide "one state" to the Madheshis comprising all the twenty districts in the Terai region from the Mechi river at one end of the country in the east to the Mahakali river on the other end in the west.

Initially, the UCPN (Maoists) wanted ethnicity to be the factor made base for the demarcation of state boundaries. Other political parties wanted to carve the boundaries of the states vertically comprising geographical regions from the north to the south covering the mountain, hill and Terai region. In fact, this was based on the concept of five Development Regions of the authoritarian Panchayat era to suppress the voice of the Madheshis living in the Terai region.

Over and above, the constitution has been opposed for its failure to ensure that the Madheshi people are properly represented in state mechanism. All through the history, those people have been discriminated by the state in recruitments in administration, diplomatic jobs, security agencies, judiciary and other fields. As compared to their population their representation in all such fields is far from satisfactory. Statistics show that the Madheshis comprising 33 % of

Nepal's total population had only 8 % share in government jobs in 2012; while the hill Brahman and Chhetris with 31 % population had 79 % cent share in such jobs.⁴

Moreover, the electoral constituency of both the lower and upper house of the parliament is based more on such factor as geographical land area rather than the size of the population, which is against the democratic principle. The Madhesh-based political parties want electoral constituencies of both the lower and upper house of the parliament to be carved on the basis of population.

In the constitution, provision was made in way that the Madhesh / Terai region with 51 % of Nepal's total population could not get more than 65 seats in the 165-member House of Representative i.e. the lower house; while the hills with 49 % of the population were likely to be allocated 100 electoral constituencies. Even in the 59-member National Assembly, the upper house, each of the six hill-based states are likely to be given eight seats making the total number of hill-based representatives in this body as 48; while the Madhesh-based state in the Terai is entitled to make claim for only 8 seats. Accordingly, the Madheshi and Tharu people in the Terai would be forced to remain in perpetual minority.⁵

Of course, two amendments have been made in the constitution to incorporate some of the grievances of the Madheshis and Tharus, but there is a feeling that this would not address their concerns. During the amendment of the constitution, it was accepted that population would get priority over the geography while making demarcation of the electoral constituencies. But it is not known how much weightage would be given to population over the geography. As per the amendment of the constitution, each of the seventy-five districts would be given at least one electoral constituency for the 165-member House of Representative. In this case, the Madhesh / Terai region with 51 % of the country's total population may get far less of electoral constituencies as compared to the hills with only 49 % population as the number of districts in Terai is only 20 against 55 in the hills.⁶

Moreover, the constitution has made certain provisions whereby the spouse of the Nepalese marrying foreigners would be discriminated in citizenship related issue. Apart from the foreign spouse of the Nepalese, the children borne from such parents are also subject to discrimination. Such children are entitled to get citizenship by naturalization and not by descent. Those with citizenship by naturalization would not be able to reach top government positions. The Madheshi people – who often marry across the border in India – have a feeling that this provision in citizenship issue is discriminatory.

During the six-month long Madheshi agitation, more than 50 people lost their life.⁷ Besides, the Terai region remained paralyzed as most of the industries, educational institutions, government offices, shops, transport services and other economic activities were closed. The impact of blockade of the Birgunj-Raxaul trade point at the Nepal-India border during the agitation created acute shortage of essentials like the petroleum products, cooking gas and medicines as over 70 % of the goods coming from India to Nepal pass through this custom point. The supply of essential items from India to Nepal was also hampered because many of the trucks loaded with goods found it difficult to enter into Nepal due to the deteriorating law and order situation in the country.

As the supply of goods from India to Nepal was affected due to Madheshi agitation, prices of such commodities shot up unprecedentedly in the market. For example, an LPG cylinder (cooking gas) cost NRs 10,000 against its normal price of NRs 1,400.⁸ As a result, the smuggling of such goods from India to Nepal, apart from the black market in the country increased manifold.

During the Madhesh agitation, Nepal incurred huge economic loss.⁹ Nevertheless, the government of Nepal did not address the grievances of the agitating Madheshi communities. Instead, to divert the attention of the people from the core demand, the government made India the "scapegoat" by holding it responsible for the unofficial economic blockade of Nepal.

Apart from Nepal, India also suffered a huge loss on account of the turmoil across its border in Nepal. India incurred an economic loss of US \$ 4 billion ever since the conflict began in Madhesh.¹⁰ Most of the 500,000 Indians, including labourers, cobblers, barbers and vendors of fruits, vegetables and fish working in Nepal were equally affected by the agitation. Indians working in companies, businesses or employed in schools and hospitals in Nepal suffered most from the rise in prices of commodities.¹¹

During the visit of Nepal's Foreign Minister Kamal Thapa to Beijing, China agreed to provide 1.4 million liters of fuel worth 10 million yuan in grant to Nepal to meet its emergency needs. Earlier in October, too, Nepal received 1.3 million liters of petrol from China to counter severe fuel crisis on account of the Madheshi blockade.¹² But the oil imported from China to Nepal could hardly meet Nepal's needs for more than a week. Due to geo-economic constraint, China could not do anything significant to meet the shortage of goods in Nepal.

Subsequently, considering the plight of the people both in Madhesh / Terai and the hills, the agitating Madhesh-based political parties lifted the economic blockade of the Birgunj-Raxaul trade route early in February 2016 after 135 days.¹³ Accordingly, all business and economic activities, including the industries, government offices, educational and health institutions were allowed to open.

Of course, there had been over two-dozen rounds of talks between the government team and the agitating Madheshi leaders to resolve the constitutional and political crisis in Nepal, but they all remained inconclusive. In the meantime, the government "unilaterally" amended certain clauses of the constitution. Besides, it also constituted 11-member political mechanism on February 19th 2016 for the demarcation of federal boundaries within three months' time.¹⁴ But the agitating Madheshi groups rejected this body. And, the Madhesh agitation that started against Nepal's federal constitution is still continuing, though the forms of protests have changed.

ECONOMIC PRE-CONDITIONS OF STABLE FEDERAL STATE

Be it in Nepal or in other countries, federalism in itself is not a panacea to resolve all problems. It does not guarantee peace, prosperity or stability of a nation. Nor does it guarantee automatic transformation of power to the deprived communities. Also, it does not provide any clue to the exploited and oppressed groups to establish their identity, protect their interests, and have self-rule in the states. However, this is not due to the fault of the federal constitution, but it is more due to the lack of feeling of ownership of the disadvantaged groups in the constitution. An attempt has been made below which considers some of the economic pre-conditions that could help the disadvantaged groups to generate the feeling of ownership in constitution, which is so important for the establishment of a stable and successful federal regime.

Resource Mobilization

Often, inadequate supply of financial resources both at the federal and state levels creates political discontent. Therefore, the state governments need to be encouraged to generate resources sufficient enough for the development of their regions and also to meet their constitutional obligations.¹⁵ In this context, they could be empowered to levy taxes, borrow funds through internal sources and also to enter into agreement with foreign countries and multilateral institutions to mobilize more of funds for development, if necessary.

Today, there is growing realization among the provincial governments to make negotiation with the bilateral and multilateral agencies for attracting investment for the development. The provincial governments in India today are not solely dependent on the central government for the resources that they need for their development. They have been supplementing resources from the foreign sources as and when needed. Recently, a private Chinese company has made an agreement with the government of Indian state of Haryana for the establishment of an industrial park in the state at the cost of US \$ 1 billion. In fact, this is a marked departure from the situation in the past.

Financial Autonomy

The states cannot have self-rule if they do not have financial autonomy. The entire purpose of federalism gets defeated if the centre controls the resources and all other states are made dependent units. Overdependence of the states on the centre for financial resources at all time is against the spirit of federalism. This might also tend to take the federal states back to the unitary state.

Stability of the federal system largely depends on financial autonomy given by the central government to the states and local units. Such autonomy provides an opportunity to the states to take self-decision and execute the projects as per the requirement for the development of the regions. Financial autonomy to the states also provides opportunities for the healthy competition among the constituent units for mobilizing more and more resources for development.

In the process of providing more financial autonomy, certain federal countries provide up to two-thirds of the public revenue to the states for their development. In India, the Finance Commission in its report has made recommendations to raise the share of the states in the net tax revenue to 42 % from 32 %. A number of federal countries have generously shared revenue with the states by introducing Goods and Services Tax (GST). In India, the Lok Sabha, the lower House of Parliament, passed a bill for the introduction of GST in May 2015 to remove double taxation between the centre and the states, provide relief to the industrialists and the consumers and at the same time raise adequate resources for the country, which might ensure more financial autonomy to the states.

Fiscal Sustainability

Sufficient care should be taken to see that fiscal discipline is maintained in the states. Budget of the states should be balanced. There should not be much gap in revenue and expenditure of the states. Sometimes in the absence of such discipline, the states often have a tendency to get heavily indebted and to address this problem

external intervention becomes unavoidable. So the states should be encouraged not to cross their limits and spend only to the extent their revenue allows them to do so. Those states which somehow become bankrupt by violating the fiscal discipline should not be supported as it would create further threat to the existence of the federal system. Hence apart from the performance based budget, the monitoring and evaluation system should be strengthened so that fiscal discipline is maintained at all levels.

Capacity to Spend

Often, the states do not have much ability to spend. Even the centre has this problem. In such a situation, service delivery becomes challenging. Therefore, the states need to evolve a system whereby the civil servants are empowered enough to discharge their duty to spend funds for the development of the regions. In Nepal, the civil servants do not want to release funds for the development activities fearing that the anti-corruption body would put them into trouble. This is one of the reasons why the budgetary amount is only partially spent. Besides, the timing for the allocation of funds for the development projects is also faulty in this country. Often, the funds are released during the last few months of the fiscal year when it becomes difficult to work. Therefore, it is absolutely necessary that each level of federal units is bestowed with sufficient powers to transfer the funds for development projects in time.

Governing Capacity

Governance is a great art in which very few states are efficient. The states cannot discharge their responsibilities effectively if they are weak in governing. It is through greater interaction between the centre and the states that the governing capacity of the states can be promoted. Only the interdependence rather than independence in the relations between the centre and the states could help the states to improve their governing capacity. For this, what is essential for the centre and states is to ensure greater exchange of information,

share each other's competence, negotiate funding arrangements and create joint institutions. Also, it is necessary for the states to make appointments for the civil servants through a certain independent agency without any discrimination. Rules and regulations for the recruitment need to be transparent and based on open competition. There should be no compromise in merit during the promotions of the civil servants. Only the civil servants selected through some of these criteria could contribute to a growth-oriented governance system and be effective in service delivery, accountability and effective utilization of public resources in the states. In addition, protection of human rights and maintaining rule of law could also be possible through such committed staff.¹⁶

Ground Greening

The way the climate change is posing a threat at the global level is a major challenge for the survival of human beings and other species on the earth. All the essentials of human life including water, soil and air are polluted and getting bad to worse each successive day. Measures to improve the situation on these fronts are far from satisfactory. Against this backdrop, it will neither be possible for the centre alone nor by the states to address this gigantic problem. Therefore, the centre and state governments need to work in cooperation with each other to make the ground green through tree plantation and also by taking measures to reduce the level of pollution of earth, water and air.

Infrastructure

The stability of federal states cannot be envisaged in the absence of adequate development of infrastructural facilities like education, health, roads, railways, airports, power, irrigation, etc. Hence, they need to develop those crucial sectors either independently – if the federal law allows them to do so – or else, they could get the support of the central government for the development of those projects. Infrastructural facilities are pre-conditions for poverty alleviation as well as for wealth creation.

Entrepreneurship

The entrepreneurship quality helps create something new and innovative business of small size. Often, the entrepreneurs do not follow any prescribed path and grab opportunities wherever that is available. Because of some of these skills, the entrepreneurs are regarded as change agents in the federal states. They not only create jobs but also reduce poverty. As such, most of the business companies in today's world are driven by the entrepreneurs who reallocate resources for business promotion in the most productive way. The United States of America are developed mostly due to their highest level of entrepreneurial activity. Most of the companies in this country have been created by the entrepreneurs. About the need for entrepreneurship development in India, Gauravraj Deshpande has recently said that this country needed 10 million entrepreneurs to resolve the problems of a billion people.¹⁷

Information and Communication

In today's world, information and communication have become a most powerful tool in bringing about change in the society. It influences people as to how they should live, learn and work. Also, its role is crucial in facilitating a dialogue between government and civil society, which is so important for the implementation of policies and programmes in the states.

Vertical and Horizontal Interaction

For the success of the federal system, there should be vertical interaction between the central government and the constituent units. Equally important in this system is the horizontal interaction between different constituent units. Such kind of interaction has brought desirable result in the United States of America, Switzerland and Germany. In the United States of America, it was possible to sue the tobacco companies to recover health costs through the horizontal cooperation between forty state governments.¹⁸

Vertical and horizontal interaction between the centre and the states and also among the constituent units is both formal and informal. Formal interaction is made through certain constitutional and legislative provisions; while informal interaction is made through political understanding. Such interactions at the horizontal level enable the constituent units to have a common stand on certain issues that are necessary to influence the national policy debates and also to neutralize the growing centralization of authority.

Cooperative Federalism

Just passing responsibility to the states through the allocation and distribution of resources does not automatically produce desired results. Therefore, the centre should try to undertake projects together with the states and share expenditure with them. In such an effort, let the states be allowed to make decisions on their own while executing certain projects. Besides, they should also be encouraged to advice the centre, if necessary, for the improvement of the situation during the phase of implementation of projects as per "bottom-up approach".

Competitiveness among the States

In competitive federalism, the states compete with each other to attract investment and for better delivery of services and public goods and also for the removal of disparities among the constituent units.¹⁹ Healthy feeling of competitiveness among the states is essential to reduce the level of disparities among them. It is also desirable to enable each state to catch up the economic growth rate of other states that are doing better or even exceed the other in this area. In India, during last few years, competitiveness among the states for better performance in all such sectors as investment, job creation and development has been growing. As such, development has become one of the agendas of each major political party in the country to win the elections both in the states as well as at the centre.

CONCLUSION

Federalism begins from where the unitary form of political system fails. However, merely a change in the political system from unitary to federalism is not likely to address the problems of the weak, exploited, marginalized and other disadvantaged sections of the society. Therefore, it would be necessary for the federal regimes to meet certain economic pre-conditions for the better delivery of the service. Some of those countries that have met the economic pre-conditions have done better and achieved desirable result. But the others who did not do so lagged behind.

Unfortunately, Nepal's newly promulgated federal constitution has failed to meet the genuine aspirations of disadvantaged communities like the Madheshis, Tharus and other indigenous communities in the country who together comprise over two-thirds of the country's total population. Also, not much effort was made by the constitution makers to consider economic pre-conditions that are so essential to generate the feeling of ownership among different sections of the society. Hence, it is unlikely that the constitution would be implemented in its present form.

If the government of Nepal does not resolve the Madheshi agitation soon by introducing suitable changes in the federal constitution, it is likely that the country would be engulfed in a bigger conflict, which would be worse than the situation of Maoist insurgency between 1996 and 2006 in which nearly 18,000 people were killed and there was immense loss of physical property. Ominous signs like the radicalization of forces both at the end of ruling political parties and the Madheshi, Tharu and other indigenous groups are observed because of government's inability to make the constitution inclusive. If conflict in the Terai region is triggered, it would derail democracy and federal structure. In such a situation, chances are high for Nepal to fail and join the club of failed states.

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Annex One

LIST OF FEDERAL ECONOMIC POWER / JURISDICTION

1. Central planning, Central bank, financial policy, currency and banking, monetary policy, foreign grants , aid and loan
2. Customs, excise-duty, value added tax (VAT), Corporate income tax, individual income tax, passport fee, visa fee, tourism fee, service charge, penalties and fines
3. Central level mega projects for electricity, irrigation and other projects
4. International trades, exchange, ports and quarantines
5. Mining exploration
6. Land use policy, housing development policies, tourism policy, environmental adaptation
7. Social security and poverty alleviation

Source: Constitution Drafting Committee: Constituent Assembly Secretariat, 2014. *Constitution Bill of Nepal 2015*, Kathmandu: IDEA and UNDP

Annex Two

LIST OF PROVINCIAL ECONOMIC POWER / JURISDICTION

1. Banks and financial institution, Cooperatives, and foreign grants and aids with consent from the Centre
2. Tax on remuneration, land and house registration fee, vehicle tax, excise duty, entertainment tax, advertisement tax, tax on tourism and agricultural income, service charge and penalties and fines
3. Provincial level electricity, irrigation projects, drinking water, transport
4. Trade/Business within the province
5. Provincial highways
6. Infrastructure management and other necessary matters of province government offices
7. Land management, record keeping of land
8. Exploration and management of mines
9. Management of national forest, water resources and ecology within the province
10. Agriculture and livestock development, factories, industrialization, business, transportation
11. Guthi (community trust/endowment) management

NOTES

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