

SECTOR BRIEFS

1. **Agriculture and Natural Resources.** The agriculture and natural resources (ANR) sector contributes close to 40% to Nepal's gross domestic product (GDP). The sector remains the main driver of the country's economy and about 80% of the population depends on agriculture for their income and employment. The Government's preliminary estimates¹ of Nepal's total food production (paddy, wheat, maize, millet, and barley) for the fiscal year (FY) 2006/2007 indicate a 2.5% decline over the previous period while the total area covered by food crops is likewise estimated to decline by 1.7%. The share of food crops and cash crops to total agricultural production in FY 2006/07 was estimated to be 47.8% and 52.3% respectively compared to 49.4% and 50.5% in the previous period. The total area covered by the production of food crops and cash crops remained unchanged at 76% and 24% respectively. Irrigated areas increased to 1.2 million hectares (ha) in 2007 compared with an average of about 90,000 ha from 2002 to 2006. It should be noted, however, that only about 60% of the total agricultural land is irrigated. A total of 22,000 km of rural roads have been constructed in the country as of 2007 indicating a need for additional farm-to-market roads that would enhance the link between farmers and their markets. Livestock also figures prominently in Nepalese farming systems, household income, and nutrition as it contributed 32% to the agricultural GDP in 2007 or an increase of 2% compared with the 2006 level.

2. In order to enhance the productivity of the sector, boost food security and, consequently, address poverty (particularly in the rural areas) the Government drafted the 20-year Agriculture Perspective Plan (APP) in 1996 and updated in 2004. The APP seeks to modernize and commercialize the sector by (i) increasing food production and productivity; (ii) maintaining food sovereignty by ensuring food productivity; (iii) making agriculture and livestock sector competitive by transforming subsistence agriculture into commercial agriculture; (iv) improving employment opportunities for rural youth, women, *madhesis*, *muslims*, and other disadvantaged communities; and (v) conserving, promoting, and utilizing agricultural biodiversities through the development and dissemination of environment-friendly technologies. Moreover, the Biodiversity Policy (2007), which was announced for the purpose of food security and poverty reduction, has the following objectives: (i) promote the development of agriculture and consolidate food and nutrition security by conserving, promoting and utilizing agro-bio-diversity; (ii) promote and protect the farmers' rights to traditional knowledge, skills, innovations, technology uses and practices; (iii) secure equitable and fair distribution system of opportunities and benefits created through the access and uses of agro- genetic sources and substances; and (iv) contribute to the promotion of eco-balance through conservation. The Irrigation Policy (2003) and Regulations (2004) aim to (i) develop water resources based on integrated water resources management with users participation, social inclusion, gender and representation of stakeholders in decision making and management; and (ii) promotion of groundwater irrigation, and large, medium, small, and micro-irrigation schemes ensuring benefits to all segments of rural population. To address deficiencies in rural roads, the Local Infrastructure Development Policy (2004) aim to develop rural roads by devolving planning, design, construction, monitoring, and maintenance of local infrastructure to district development committees, municipalities and village development committees with the involvement of beneficiaries and local communities for improvement in service delivery, cost effective operations and maintenance, and sustainability of the roads.

3. ADB's assistance to Nepal's agriculture sector from 2004 to 2007 consist of projects that aim to reduce poverty and enhance rural productivity through \$89.0 million worth of loans and grants covering projects that are intended to improve rural infrastructure and livelihoods,

¹ Ministry of Finance. 2007. *Economic Survey 2007*. Kathmandu.

promote gender equality, and develop commercial agriculture. On the other hand, about \$1.4 million worth of technical assistance (TA) approved over the same period cover projects that aim to improve the capacity of agricultural institutions, provide market-oriented agriculture support, and promote pro-poor and gender sensitive service delivery.

4. **Education.** It is acknowledged that education is one of the key elements that would help Nepalis to break out from the poverty trap and is considered a pre-requisite for development. Education allows them to acquire the necessary skills and technical competence to secure employment. Education attainment is reportedly one of the key factors behind income inequalities in the country. The education system of Nepal consists of 5 years of primary education, 3 years of lower secondary education, 2 years of secondary education, and 2 years of higher secondary education. A school-leaving certificate is awarded at the end of the two-year secondary education which entitles the recipient to enter higher secondary or tertiary education (providing certificate-level, diploma level or university-level qualifications). Non-formal education is provided through community-level adult education and programs for out-of school children. Higher education is provided mainly by five universities as well as other public and private institutions. The technical education and vocational training comprises a range of training providers (either from government or private sector). With a view to uplifting the living standards of people belonging to unprivileged classes, especially women, the Government initiated a 10-month pre-service primary teacher training in 2007 to 700 people belonging to *dalits*, unprivileged classes and women who have passed school leaving certificate examination.

5. The Government faces significant challenges in providing access to and in delivering quality education at all levels. Many schools have inadequate facilities and learning materials due to resource constraints. But despite these, about 91% of the households have access to a primary school and the net enrollment rate in primary schools improved from 64% in 1990 to 87% in 2006. Yet, about 13% of eligible children are not enrolled in primary school, majority of which live in rural areas. There is a wide disparity in education participation between regions and social groups. The adult literacy rate is at 52% in 2006 or a slight improvement over the 49% 11-year average from 1995 to 2005. Moreover, most people (particularly those who would like to enter the labor force but were poor and disadvantaged) do not have access to technical and vocational training.

6. In order to address the challenges in the sector, the Government's Tenth Plan seeks to (i) expand and develop quality education, (ii) produce internationally competitive human resources to support the national economy, (iii) enhance social development, and (iv) contribute to poverty reduction. Decentralization will be the primary strategy for improving education planning and management. Teacher training and development will likewise be strengthened including the recruitment and capacity development of female teachers and those from disadvantaged groups. The "Education for All"² program envisions that 3.7% of GDP will be allocated to the education sector. Reiterating the objectives of the Tenth Plan, the Government's Three-Year Interim Plan (2008–2010) aims to make education equitable and inclusive at all levels. It intends to implement, among others, basic level, grades 1–8 program, and secondary level, grades 9–12 program, on an experimental basis under School Sector Reform (SSR) program. It is expected that lessons learned and experiences gained from the implementation of grades 1–8 basic education in selected districts and schools will result in better preparedness of the Government to implement SSR on a country-wide scale from 2010 onwards. The SSR transition process is supported by the pooling of development partners, including ADB. ADB

² The Education For All program is jointly supported by seven funding agencies (ADB, Danida, DFID, Finland, Norway, UNICEF, and the World Bank) under a sector wide approach.

provides assistance to the SSR transition process through the Education Sector Program subprogram II (approved in January 2008).

7. ADB's support for the sector from 2004 to 2007 consisted of \$52.0 million worth of loans and grants and \$2.0 million worth of TAs. Assistance mainly covers projects that aim to support the "Education For All" program, skills enhancement for employment, and capacity development initiatives. ADB's assistance has evolved from a project approach to a program approach. ADB is supporting the government to prepare and implement SSR in a phased manner.

8. The education sector, which is implementing SWAP aligning donor assistance with reformed government systems and procedures under joint financing arrangement (JFA), and SWAP is fairly a unique concept for Nepal. ADB is providing technical assistance support for the sector to develop a modality of school sector reform (SSR) to expand the SWAP initiative to the entire school system. This sector needs to be evaluated to learn how relevant are ADB's support and how ADB should move forward.

9. There are different kinds of SWAPs. The central idea behind SWAP is to align donor assistance to government systems, which are normally country-specific. Viewed in this perspective, Nepal is implementing Nepal SWAP in the education sector making it compatible with Nepal's context. Local Development, which handles community-based projects, is another sector targeted next for the introduction of SWAP. The relevant question is how effective is the implementation of SWAP in the education sector, and how replicable is the approach to other sectors.

10. **Finance.** Nepal's financial sector is mainly characterized by a strong government presence particularly in the operations of financial institutions i.e. through major ownership interests in almost all commercial banks. As of 2007, Nepal has 74 finance companies, 47 financial NGOs, 38 development banks, 20 commercial banks, and 12 micro-credit companies. However, despite the presence financial institutions, only about 30% of Nepali households have a bank account.

11. A number of issues were noted in Nepal's finance sector. For instance, the country's central bank – Nepal Rastra Bank (NRB) holds a dual function as the government's representative to the financial institutions' Boards of Directors and as the regulator of the same institutions. This dual role has weakened the sector's good governance and affected the proper supervision of the financial institutions. The prolonged conflict situation has also affected the banking system as the Government borrowed heavily from domestic sources to finance defense spending. A poor credit culture has also led to the accumulation of nonperforming loans.

12. The Government's Financial Sector Reform Strategy Paper (2000) aim to initiate reforms in Nepal's finance sector by (i) strengthening the NRB; (ii) building and maintaining a strong banking and non-banking sector; (iii) improving the existing legal and judicial aspects of the financial system; (iv) promoting financial discipline through adequate disclosure and competition; (v) initiating focused interventions towards programs to uplift the poor; and (vi) re-orient the activities of the Government and NRB from being an active participant of the financial institutions to a regulatory body. The policies under the Government's Three-year Interim Plan (2008–2010) targeting the finance sector underscores (i) the need to maintain financial discipline in the banking system; (ii) reduce Government borrowing from the financial system for making finance available to the private sector; (iii) expand access to credit for deprived sections of the population; (iv) continue the policy of making it mandatory for commercial banks, development banks, and finance companies to undertake deprived sector lending; (v)

encourage commercial banks to prioritize lending to infrastructure sectors; (vi) maintain financial indicators that are on par with global financial standards; (vii) enhance the capacity of NRB's supervisory and regulatory functions; and (viii) re-establish state-owned bank branches that were closed during the conflict. Moreover, the ongoing restructuring of government-owned banks aim to reduce state presence, recover nonperforming loans, and enhance the role of private commercial banks.

13. ADB's support for Nepal's finance sector from 2004 to 2007 includes loans and grants totaling \$65 million and TAs amounting to \$0.5 million. Areas of support include the provision of credit lines for micro-, agricultural and rural enterprises; strengthening the basic foundations of Nepal's corporate and financial sector; developing a sustainable rural finance system for the provision of affordable services to the rural poor; and capacity building in rural finance institutions.

14. **Transport and Communications.** Nepal's Country Strategy and Program (2005–2009) noted that isolation and a general lack of connectivity to domestic and global markets are the key impediments to growth and poverty reduction in Nepal. The country's difficult terrain makes connectivity a challenge. A key part of the road system is the strategic roads network (SRN) consisting of national highways and feeder roads. This constitutes about 36% of the country's total road network. As of 2007, there are about 7,400 kilometers of SRN in Nepal serving close to 80% of the population. Road access between Kathmandu and many district capitals remains a problem as 20% do not have access to the SRN. Buses (operated by public and private companies) are the leading form of public transport in the country and supports about 90% of all passenger traffic. The road freight transport industry carries over 90% of freight traffic. On the other hand, for remote towns and villages, air transport is the only practical means of access. Thus, civil aviation provides vital support to the country's trade, commerce and tourism. Currently, there are 47 domestic airports and one international airport in the country. However, constraints such as weak institutional capacity in operations, lack of access to aviation facilities, capacity constraints in the airports as well as regulatory restrictions continue to hamper the growth of civil aviation in the country.

15. The Government's Three-Year Interim Plan (2008–2010) aims to address the issues facing the roads subsector by (i) connecting all the remaining district headquarters by road; (ii) developing North-South trade and transit corridors; (iii) constructing 780 km of new roads; (iv) improvement and rehabilitation of 2,500 km of roads; and (v) periodic maintenance of 1,450 km of roads. On the other hand, the Plan also aims to connect all village development committees by telephone (extending telephone services to 1,007 villages yet to be served) within the Plan period. In civil aviation, the Government's National Civil Aviation Policy (1997) aims to (i) contribute to the promotion of tourism; (ii) develop and promote the national flag carrier for international air services; (iii) encourage competition in the private sector; (iv) develop and expand airports in remote areas; (v) foster reliable and safe air transport through modern equipment and facilities; and (vi) encourage recreational and adventurous air service activities. The Three-Year Interim Plan will reconstruct and rehabilitate physical structures of airports damaged during the insurgency in the rural and remote areas; strengthen airports and aviation safety to make air service of Nepal more safe and reliable; and expand domestic and international air service by involving the private sector in the development and operation of infrastructures and facilities related the air transport sector.

16. ADB's involvement in Nepal's transport and communications sector is mainly focused on roads followed by civil aviation. From 2004 to 2007, ADB funded a total of \$84.2 million in loans and grants and provided TAs amounting to \$3.6 million covering projects ranging from road

construction, the development of information and communications technology, and the preparation of the civil aviation strategy.

17. **Governance.** Since 2000, ADB has approved three loans totaling \$72.3 million from Asian Development Funds. Nine TA projects totaling \$8.85 million have been approved to support reforms to corporate and financial governance public sector governance. The corporate and financial governance project loan³ included a piggybacked TA cluster project to help in preparing further sector interventions, assist in addressing key sector issues on an urgent basis, and support the establishment of a conducive framework in a more strategic and comprehensive way than would a single-TA approach. The governance reform program loan aimed to assist the civil service to become more results- and people-oriented and gender responsive.⁴ It included a piggybacked TA to support (i) core program management reforms, (ii) civil society support for reform measures, and (iii) independent program monitoring and reporting. In addition, a standalone TA was approved to support loan implementation.⁵ A stand alone TA was approved in 2003 to strengthen performance based management.⁶ In 2006 a project preparatory TA was approved to design a loan to support the Government's decentralization plans.⁷ In 2007, a TA was approved to build on the anticorruption legislation passed and institutions created under the program loan.⁸ The public sector management program loan⁹ included a piggybacked TA to help the Government (i) develop and implement an effective privatization/liquidation process, (ii) build capacity within the Government for undertaking divestment, (iii) manage and supervise the transactions, (iv) implement an effective and fair policy for labor retrenchment, and (v) support overall management of the Program. In addition, a standalone TA was approved to reduce government involvement in public enterprises.¹⁰

18. The Government has adopted result-based approaches in the Three-Year Interim Development Plan with ADB's MfDR support. ADB is currently assisting the government to adopt and internalize MfDR approaches in selected ministries and four major district development committees. Capacity for preparing logical framework varies across sectors; while education, local development, and water resources ministries have been able to come up with results-based framework with baseline and target data, other ministries do not have such capacity. The capacity building support needs to be extended to cover all ministries, as the government intends to implement and institutionalize MfDR nationwide. The Government has now realized that with the results frameworks in place, it can monitor and backstop projects,

³ ADB. 2000. *Report and Recommendation of the President to the Board of Directors for the Proposed Loan and Technical Assistance Grant Corporate and Financial Governance (Nepal)*. Manila. (Loan 2002-NEP, for \$35 million, approved 8 July.)

⁴ ADB. 2001. *Report and Recommendation of the President to the Board of Directors for the Proposed Loan and Technical Assistance Grant Governance Reform Program (Nepal)*. Manila. (Loan 1861-NEP, for \$30 million, approved 27 November.)

⁵ ADB. 2001. *Technical Assistance to Nepal for Capacity Building for Institutional Support for Governance Reforms*. Manila. (TA 3622-NEP, for \$1,525,000, approved 18 January.)

⁶ ADB. 2003. *Technical Assistance to Nepal for Strengthening Performance Based Management*. Manila. (TA 4249-NEP, for \$275,000, approved 12 December.)

⁷ ADB. 2006. *Technical Assistance to Nepal for Capacity Building for Governance Reforms and Decentralization Cluster Program I*. Manila. (TA 4834-NEP, for \$500,000, approved 31 August.)

⁸ ADB. 2007. *Technical Assistance to Nepal for Support to Anticorruption Institutions*. Manila. (TA 4962-NEP, for \$400,000, approved 30 August.)

⁹ ADB. 2003. *Report and Recommendation of the President to the Board of Directors for the Proposed Loan and Technical Assistance Grant Public Sector Management Program (Nepal)*. Manila. (Loan 1811-NEP, for \$7.3 million, approved 14 December.)

¹⁰ ADB. 2003. *Technical Assistance to Nepal for Supporting Government Disengagement from Public Enterprises*. Manila. (TA 4141-NEP, for \$425,000, approved 8 July.)

sectors and country performance more effectively. The framework will also enable the government to monitor sustainability of project impact into the future after physical completion. This calls for making MfDR as part and parcel of government's planning and monitoring process.

19. Capacity building of state is generally an issue in post-conflict countries. As Nepal's state structure was weakened, disrupted and even destroyed, particularly at the district level and below during insurgency, rebuilding state capacity has become a priority for enabling the government to deliver essential public services to its people. For all practical purpose, this essentially means state building. In Nepal's case, the task of state building has been further exacerbated by the impending restructuring of state into a federal system. The issue is how good ADB is at supporting state building. Unlike the World Bank which tends to operate outside the government structure (e.g. Poverty Reduction Fund, Power Fund), ADB works with and within government. This gives it an edge. However, the requirements of state building should be assessed and understood in relation to ADB's competence.

20. Donor-assisted projects are usually implemented using a separate project implementation unit, and the unit is closed down after physical completion of a project. The outcome and impact of the projects are not monitored. In certain sectors, outcomes are measured at the sector level (for example, using GIS in roads) but are not attributed to specific projects. ADB conducts project performance audit of completed projects after a lapse of certain time from completion to assess their sustainability but it is one-off activity done only for a sample of projects. It is, therefore, imperative to explore feasible ways to support institutions for "sustainability monitoring" of completed projects (possibly, integrating this aspect in MfDR framework).

21. Difficulty in complying with ADB's safeguard policy is a persistent problem faced by the government. The government considers the ADB guidelines on resettlement is too rigid and not that suitable to Nepal's rural settings. However, it has recognized the need to upgrade its systems and processes to be compliant, and is going in the right direction in this respect. While supporting the government in its upgrading efforts, the scope of flexibility in the relevant ADB guidelines needs to be explored.