

POVERTY REDUCTION PARTNERSHIP AGREEMENT

I. INTRODUCTION

1. This Partnership Agreement between His Majesty's Government of Nepal (the Government) and the Asian Development Bank (ADB) sets out a shared vision for reducing poverty in Nepal, and priorities for joint development cooperation. The Agreement reflects the Government's goals on poverty reduction contained in the Interim Poverty Reduction Strategy and the Ninth Five-Year Plan (FY1997-FY2002). It is consistent with ADB's Country Strategy and Program (CSP), which is based on ADB's recently-completed Poverty Analysis and High Level Poverty Forum for Nepal. The Agreement also serves to focus on attainment of the International Development Goals (IDG) for 2015 as enunciated at the World Summit on Social Development in 1995. Shared goals and targets between the Government and ADB set out in the appendix. These goals and targets are subject to revisions based on the Tenth Five-Year Plan (FY2002-FY2007), now under preparation, and regular reviews to allow the Agreement to remain current and responsive to changing needs. Agreed measures for monitoring the implementation of this Agreement are also outlined. The Agreement recognizes the vital and complementary assistance provided by other aid agencies in support of the Government's poverty reduction efforts, and the need for an effective partnership among aid agencies to achieve the goals, strategy, and actions outlined herein.

II. LONG-TERM GOALS (FY2002-FY2017)

2. The Government's paramount goal is to reduce the incidence of poverty to less than 10 percent of the population by fiscal year (FY) 2017. Other key goals for FY2017 include: (i) reducing infant mortality from 118 to 62.5 per 1,000 births, (ii) increasing life expectancy from 56.1 to 68.7 years, (iii) increasing the adult literacy rate from 40 to 100 percent, (iv) increasing annual economic growth to 8.3 percent, and (v) bringing down population growth from 2.3 percent to 1.5 percent. These goals are as ambitious as they are challenging, and will be reviewed during preparation of the Tenth Five-Year Plan.

3. Poverty incidence in Nepal was estimated at 42 percent in 1996, and the share of national income of the bottom 40 percent of the population declined from 23 percent in 1985 to 11 percent in 1996. There is no conclusive evidence of a reduction in poverty incidence on a sustained basis in the past two decades – a period in which Nepal received substantial development assistance. The Government and ADB have identified a number of causal factors underlying poverty in Nepal including: (i) slow overall economic growth in the face of relatively rapid population growth, (ii) weak Government institutional capacity, (iii) non-agricultural growth without adequate spillover effects on the rural poor, (iv) low productivity and slow growth of output in the agriculture sector, and (v) weak social and economic infrastructure (education, health, drinking water, transport, and energy) leading to inadequate access of poor households to the means for escaping poverty. It is also recognized that poverty in Nepal is exacerbated by deep-rooted cultural practices which have historically isolated and excluded women and other disadvantaged groups from the benefits of growth and development. The Government and ADB recognize therefore that an effective poverty reduction strategy must address all of these constraints.

4. The Government and ADB agree that accelerated broad-based economic growth coupled with continued reduction in population growth and the expansion of opportunities for the poor to participate in the development process are essential to reducing poverty in Nepal. To reduce poverty incidence to 10 percent, it is forecast that per capita income should grow at an average annual rate of at least 6.0 percent until FY2017. To achieve such growth, there is a

need for social and economic infrastructure development. However, sufficiently high economic growth needs to be sustained and made more broad-based. There is a need to focus the Government's functions in core areas of competence and permit the private sector to become the engine of growth. Accordingly, the Government's role as a regulator and facilitator of economic activities should be strengthened to create an enabling environment for private sector development. Creating an efficient environment conducive to both domestic and foreign private sector investment to generate significant employment opportunities will prove critical for long-term poverty reduction. Aside from sound macroeconomic management, sustainable poverty reduction in Nepal requires diversifying economic activities within agriculture and to other sectors of the economy to reduce economic vulnerability.

5. Development performance and sustainable poverty reduction hinge on socio-political stability and on the support that Government obtains from civil society. A key challenge therefore will be to invest in and benefit from improved community relations at both the project and broader institutional levels. Good governance at all levels and in all sectors is a critical success factor for reducing poverty. Effective institutions and a credible legal framework are required for the efficient operation of product, financial, and factor markets, particularly the land market. Building effective institutions in both the public and private sectors and at central, local and community levels to manage and implement the development process are also essential. Addressing these issues will be a daunting and time-consuming challenge, but can be achieved through broad participation and consensus building. The Government and ADB will work together to facilitate broad participation in the development process which is carefully structured so that participants recognize trade-offs and arrive at a broad-based consensus on change. Development initiatives will be designed to improve equity between the poor and the better-off, rural and urban populations, women and other vulnerable groups and those who have not been disadvantaged.

III. MEDIUM-TERM STRATEGY (FY 2002-FY 2007)

6. In the medium term, the Government and ADB agree that there should be a sharper focus on: (i) generation of productive employment opportunities and increased rural incomes made possible by broad-based, more rapid growth; (ii) improvements in basic social services to enhance human development; (iii) creation of an enabling environment for competitive private sector development, and (iv) good governance by improving efficiency, predictability, accountability and transparency in the public, corporate and financial sectors.

7. To achieve these medium term strategic goals given the structural and resource constraints in Nepal, ADB's operational priorities for poverty reduction include: (i) rural development; (ii) improvements in basic social services and infrastructure; (iii) women's empowerment; (iv) private sector development and corporate and financial sector reforms; and (v) governance reforms in the public sector.

A. Rural Development

8. Given 86 percent of the population in Nepal depends on agriculture for its livelihood and 44 percent of rural households live below the poverty line, measures to improve and broaden economic opportunities in the agriculture sector and strengthen linkages with other sectors will be critical to achieving rural poverty alleviation goals. The Government and ADB will endeavor to support and implement the Agriculture Perspective Plan, which aims at reducing rural poverty through modernization, diversification, commercialization, and increasing agricultural sector production and productivity.

9. **Strengthening Rural-Urban Linkages.** Strengthening linkages between rural and urban areas, and within rural areas, is necessary for agricultural producers to benefit more fully from rapid urban development. It will increase access of the rural poor to economic opportunities in urban areas; while the urban sector's access to resources of the rural sector will also increase. Stronger rural-urban linkages will help: (i) transform the subsistence sector into a market-oriented sector; (ii) address increasing international competition, particularly from India; and (iii) strengthen inter-linkages within rural areas, particularly between the *terai* and hill areas on the basis of their location-specific comparative advantage. This approach will require infrastructure investments to connect rural and urban areas, more effective institutional and financial mechanisms to coordinate and channel investments into input and output delivery systems, and adaptive research and extension services to support diversification of agricultural products to meet urban and export demands.

10. **Sustainable Agricultural Development.** The Government and ADB will adopt a holistic approach to agricultural development, in which access to priority inputs (e.g., fertilizers, irrigation, road, power, rural financial services and agricultural technology) will be provided in a more complementary and integrated manner by both public and private sector entities so as to improve the sustainability, productivity and marketability of agricultural outputs including livestock. The strategic focus will be to build and strengthen institutions and remove market-distorting interventions to ensure that the rural poor are able to access these inputs with suitable credit and extension services and to produce and market agricultural products effectively to improve rural livelihoods. In response to increasing economic and social infrastructure needs for agricultural and rural development, ADB will continue to support the Government in the areas of rural roads, rural finance, rural electrification, and irrigation through expansion of shallow tube wells targeted to the rural poor. To improve efficiency and local ownership, active participation of all stakeholders, including community groups, the private sector, and local governments, will be prioritized.

11. **Natural Resources and Environment.** All major economic sectors and potential areas of economic growth including agriculture and tourism depend directly on the sustainable management of natural resources. However, Nepal's natural resource base is under increasing pressure due to high population growth and weak environmental custodianship. Key environmental problems include soil erosion, deforestation, air and water pollution, and lack of proper sanitation and solid waste disposal. ADB will assist the Government in strengthening governance in natural resource and environmental management by focusing on watershed management, solid waste management, air and water quality monitoring, ecotourism, energy conservation, and urban and peri-urban environmental improvement. The Government and ADB will promote public and private partnerships and community participation in environmental improvement to enhance the quality of rural tourism, and to stimulate income generation and poverty reduction in rural areas.

B. Improvements in Basic Social Services and Infrastructure

12. Improvements in basic social services including education, safe drinking water, health, and sanitation to enhance human development are critical to improving livelihoods and reducing population growth. Improved accessibility to social infrastructure such as roads, communication, and electricity are important contributing factors for human development. Measures will be taken to increase public investment in basic social services and infrastructure for targeted poverty reduction interventions for the most disadvantaged groups, the rural poor, and women, and to improve the effectiveness of service delivery mechanism.

13. **Education.** A basic constraint to development in Nepal is the poor status of education, particularly basic education, and high rates of adult illiteracy in rural areas. The efficiency of

basic education is low, with high-grade repetition and dropout rates. There are considerable disparities in access by gender and by geographic location. The quality of education will be enhanced through capacity building for training of primary school teachers and designing strategies for improving the quality of secondary education. Given the high primary school dropout and high adult (especially women) illiteracy rates, nonformal education and vocational training programs will be supported. While basic education is important, there is also a need for a highly trained set of individuals to learn and adapt necessary skills and technologies to achieve greater productivity in both the agriculture and non-agriculture sectors. ADB will work with the Government to support training for a relatively small group of such specialists.

14. **Community-Based Water Supply and Sanitation.** Access to water will have an immediate and substantial impact upon women and children by reducing the time spent fetching water and looking after family members suffering from water-borne diseases. ADB will work with the Government to develop community-based water projects in rural areas, and restructure the provision of water supply in urban areas. Effective service delivery mechanisms need to be established with more active participation of local governments, the private sector, and nongovernment organizations.

15. **Improved Basic Economic and Social Infrastructure.** The poor have limited access to basic economic and social infrastructure such as roads, electricity, and telephone, which limits incentives and opportunities to improve their human capital, the primary asset of the poor to participate in the development process. ADB will assist the Government to improve access by the poor to basic economic and social infrastructure through support for investment projects and policy reform programs in the transport and energy sectors, with particular emphasis on rural areas. Measures will be taken to more effectively channel public and private investments in basic economic and social infrastructure and to promote effective and efficient service delivery by drawing on the expertise of the private sector.

C. Empowerment of Women

16. Many women in Nepal, particularly those who reside in rural areas, are deprived and severely underprivileged. Gender disparity persists in educational attainment, health, and access to productive resources, leading to low participation by women at decision making levels. An effective poverty reduction strategy must empower women in the spheres of governance, economic growth, and human development. Mainstreaming of gender issues and gender sensitization will be promoted at all levels, particularly through policy-based lending operations such as the proposed governance reform program. Interventions will be planned and formulated to empower women in agriculture, nonformal education, rural microfinance, and water supply and sanitation projects.

D. Private Sector Development/Corporate and Financial Sector Reforms

17. The private sector plays a key role in reducing poverty by increasing the efficiency of resource mobilization and providing opportunities and enhancing access to social services for the poor. The ADB's strategy to enhance the private sector's contribution to enhanced growth and poverty reduction in Nepal focuses on the promotion of an enabling environment for private sector activities through ADB's public sector operations, and on generating opportunities for private sector participation in public sector projects. To develop the enabling environment for the private sector, impediments to the development and growth of Nepal's private sector must be removed, to improve governance, transparency and efficiency in the corporate and financial sector. To complement wider financial sector reforms, ADB will support the Government to establish transparent policies and basic structures to improve corporate and financial governance through: (i) streamlining legislative and regulatory frameworks; (ii) capacity building

for regulation, supervision, and enforcement; and (iii) improved information disclosure and accounting and auditing standards. ADB's ongoing Corporate and Financial Governance Project supports these efforts, laying the groundwork for future private sector operations and growth in business activity. Finally, the Government and ADB are committed to support for regional economic cooperation in sectors such as multi-modal transport and communication, hydropower development, trade and investment promotion, tourism, and natural resources and environmental management, all of which provide considerable scope for private sector participation.

E. Governance Reform in the Public Sector

18. Improved governance is critical to reducing the incidence of poverty in Nepal. Poor governance and the unsustainable financial performance of public agencies and state-owned enterprises wastes limited public resources, affects the quality and quantity of public and private investment, constrains the level of economic growth, and weakens the Government's poverty reduction programs. Poor public sector governance, in particular, has contributed to a demoralized and inefficient bureaucracy, misallocation of budget resources, and ineffective implementation of development programs. Poor governance affects the poor disproportionately because they are most dependent on access to public services and resources to lift themselves out of poverty. ADB will support the Government in its efforts to improve governance, focusing on civil service reform, anti-corruption efforts, public financial management and resource mobilization, and decentralization. In particular, ADB will work with the Government to correct administrative, financial, and gender weaknesses in the civil service by: (i) developing an internal capacity within the Government to lead and undertake the governance reform agenda, (ii) improving civil service efficiency, (iii) strengthening anti-corruption units in Government; (iv) enhancing staff competence, and (v) establishing processes for improving standards and performance in key ministries.

IV. IMPLEMENTING THE AGREEMENT: SHORT-TERM ACTIONS (2002-2004)

19. As outlined in ADB's Country Strategy and Program Update (2001), ADB plans to provide loan and technical assistance for Nepal's agriculture and rural development; transport; energy; finance; education; water supply, sanitation and urban development; and environmental management sectors, with emphasis on institutional and governance reforms. The objectives of such assistance are as follows:

- A. *Agriculture and Rural Development* – Promote agricultural growth and increased rural incomes through initiatives in crop diversification, irrigation, rural electrification, and rural finance;
- B. *Transport* – Improve access to markets, social services and efficiency, focusing on sustainable provision of operation and maintenance.
- C. *Energy* – Increase access to electricity in rural areas and improve efficiency through sustained improvements in financial performance and commercialization of Nepal Electricity Authority.
- D. *Finance and Industry* – Improve financial sector performance through greater transparency and information disclosure, and strengthening of regulatory authorities and other agencies including Agricultural Development Bank, Nepal Rastra Bank, Institute of Chartered Accountants of Nepal, Nepal Stock Exchange, and Securities Board.
- E. *Education* – Improve quality of basic education, focusing on teacher training, improvements in secondary education, nonformal education for women, and reduction in school dropouts, particularly girls.

- F. *Water Supply, Sanitation and Urban Development* – Improve access to safe drinking water and healthy urban environment through provision of water supply, solid waste management and sanitation facilities.
- G. *Environmental Management* – Introduce public and private partnerships in environmental improvement, particularly to enhance tourism and urban and peri-urban environment. Improve institutions and infrastructure with community participation to enhance environmental conditions and sustainability of service.

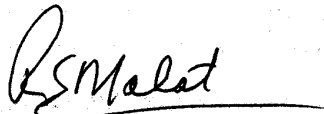
V. MONITORING AND EVALUATION ARRANGEMENTS

20. The Government will develop a system for poverty monitoring and evaluation. To monitor the targets, a team chaired by a senior Minister will be established. The team will comprise members from the National Planning Commission, other ministries and independent experts. The Government will initiate, improve and institutionalize data collection and analysis of poverty indicators with which to assess the impact of policies and projects. The Government will strengthen the Monitoring Division of the National Planning Commission to monitor progress in poverty reduction. Implementation of the second Nepal Living Standards Survey is planned for 2002. The Government and ADB will work together to improve the poverty monitoring and evaluation capacity of the Central Bureau of Statistics.

21. The Government and ADB, in close consultation with other aid agencies and civil society organizations, will monitor progress against achievable and measurable targets, focusing on improvements over the current situation for a period of three years. Progress will be reviewed annually as part of the CSP process. The Nepal Resident Mission will facilitate the collection of relevant data and information for the monitoring process. Analyses and findings of the annual monitoring review will be prepared by Government officers and ADB staff for submission to higher authorities in the Government and ADB, and dissemination to the public.

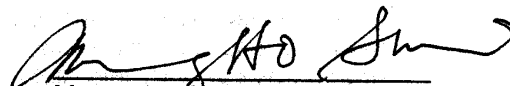
Signed in Kathmandu on 21 October 2001.

On behalf of His Majesty's Government of Nepal



Ram Sharan Mahat
Honorable Minister of Finance

On behalf of the Asian Development Bank



Myong-Ho Shin
Vice President (West)

Selected Indicators and Targets for Poverty Reduction

Indicators	Targets		Medium-Term Strategies	Primary Monitoring Source	Frequency
	Long(FY2017)	Medium(FY2007)			
Overall Goals					
Absolute poverty*	10%	30%	Pro-poor growth Generating employment opportunity for rural population	National Living Standards Survey	Every 5 years
Sustainable economic growth	GDP growth of 7-8%	GDP growth of above 6-7%	Broad-based growth and inclusive social development Improved factor market mobility	National Accounts	Annual
	Population growth of 1.5%	Population growth of 2.0%	Human development with emphasis on females	Population Census	Every 10 years
Sound macroeconomic stability	Inflation less than 5%	Inflation less than 5%	Inflation targeting monetary policy	National Accounts	Annual
	Budget deficit below 4.0%	Budget deficit below 4.5%	Broad tax base and sound public expenditure management	Economic Survey	Annual

Indicators	Targets		Medium-Term Strategies	Primary Monitoring Source	Frequency
	Long(FY2017)	Medium(FY2007)			
A. Broad-Based Growth					
Agricultural and rural development	Improved access to Agricultural Perspective Plan inputs and outputs	Improved access to Agricultural Perspective Plan inputs	Agricultural Perspective Plan strategies		
	<ul style="list-style-type: none"> - Year-round irrigation 64% of total agricultural land - Chemical fertilizer 600,000 metric ton 	<ul style="list-style-type: none"> - Year-round irrigation 45% of total agricultural land - Chemical fertilizer 250,000 metric ton 	<ul style="list-style-type: none"> - Community-based irrigation - Establishing well-functioning market mechanism to improve provision and quality of agriculture inputs - A complete privatization of Agriculture Input Corporation 	<ul style="list-style-type: none"> Ministry of Water Resources Consultations Ministry of Agriculture and Cooperative Consultations 	<ul style="list-style-type: none"> Annual Annual
	<ul style="list-style-type: none"> - Rural road density 0.12 km per sq. km with adequate maintenance 	<ul style="list-style-type: none"> - Rural road density 0.09 km per sq. km with adequate maintenance 	<ul style="list-style-type: none"> - Improving road linkages between rural and urban areas - Reforms and institutional strengthening of Department of Local Infrastructure and Development of Agricultural Roads 	<ul style="list-style-type: none"> Ministry of Local Development Consultations 	<ul style="list-style-type: none"> Annual

Indicators	Targets		Medium-Term Strategies	Primary Monitoring Source	Frequency
	Long(FY2017)	Medium(FY2007)			
	<ul style="list-style-type: none"> - Rural electrification ratio (population covered by electricity in the rural area) 20% 	<ul style="list-style-type: none"> - Rural electrification ratio population covered by electricity in the rural area) 10% 	<ul style="list-style-type: none"> - Improving efficiency and financial sustainability through commercialization of Nepal Electricity Authority - Catalyzing active private sector participation 	Nepal Electricity Authority Ministry of Water Resources	Annual
	<p>More diversified agricultural products</p> <ul style="list-style-type: none"> - Diversification ratio 65% (non-food grains / total agricultural production) 	<p>More diversified agricultural products</p> <ul style="list-style-type: none"> - Diversification ratio 50% 	<ul style="list-style-type: none"> - Improving agriculture research and extension services for diversification of agricultural products - Strengthening training programs 	Economic Survey Ministry of Agriculture and Cooperative	Annual
Natural resources & environmental management	Natural resources and environment protection	Urban and peri-urban environmental improvement	Strengthening governance in natural resource and community based environment management	Ministry of Physical Planning and Works Consultations	Annual
Private sector development / corporate and financial governance	<p>Improved private sector and foreign direct investment</p> <ul style="list-style-type: none"> - investment / GDP 34% - foreign direct investment / total investment 10 % 	<p>Improved private sector and foreign direct investment</p> <ul style="list-style-type: none"> - investment / GDP 27% - foreign direct investment / total investment 5% 	<ul style="list-style-type: none"> - Improving entry/exit policies to be conducive to new investment - Privatizing public enterprises - Transparent and credible corporate and financial governance (CFG) through passage of CFG bills. 	Economic Survey Ministry of Finance Consultations	Annual

Indicators	Targets		Medium-Term Strategies	Primary Monitoring Source	Frequency
	Long(FY2017)	Medium(FY2007)			
B. Social Development					
Improved education	Adult literacy rate (15 years and above) 90 %	Adult literacy rate 60%	Strengthening informal education esp. for female	Ministry of Education & Sports	Every 5 years
	Primary cycle completion rate 95%	Primary cycle completion rate 75%	Improving education quality through curriculum modernization and teacher training	Ministry of Education & Sports	Every 5 years
Empowerment of Women	Female literacy rate (15 years and above) 100%	Female literacy rate 70%	Strengthening nonformal education esp. for female	Ministry of Education & Sports	Every 5 years
	Net enrollment for girls in primary school 100%	Net enrollment for girls in primary school 80%	Improving access to education for girls	Ministry of Education & Sports	Annual
	Substantial increase in percentage of female civil servants	Increase in percentage of female civil servants in line with the Tenth Plan	Improving access for females in civil service	Ministry of General Administration	Annual
	Percentage of female teachers in the primary school above 40 %	Percentage of female teachers in the primary school above 35 %	Improving access for females in the primary school	Ministry of Education & Sports	Annual
Water supply and sanitation	Population served by drinking water facility 100 %	Population served by drinking water facility 80%	Supporting community-based water supply in rural areas and the Melamchi project	Ministry of Physical Planning and Work	Every 5 years
Improved economic social infrastructure	Access to electricity 45% (population covered by electricity)	Access to electricity 25% (population covered by electricity)	Improving power transmission, distribution, and rural electrification	Nepal Electricity Authority	Annual

Indicators	Targets		Medium-Term Strategies	Primary Monitoring Source	Frequency
	Long(FY2017)	Medium(FY2007)			
	Road density 0.15 km per sq. km with adequate maintenance and rehabilitation	Road density 0.11 km per sq. km with adequate maintenance and rehabilitation	High priority on the rehabilitation and expansion of rural roads and strategic networks	Department of Roads Ministry of Physical Planning and Works	Annual
	Teledensity (the number of telephone lines/100 persons)15%, with a higher growth in the rural area	Teledensity (the number of telephone lines/100) 6%, with a higher growth in the rural area	Supporting public/private sector partnership	Ministry of Science and Technology	Annual

C. Good Governance

Improved public sector governance	Sound public expenditure management	Improved public expenditure management	Three-year rolling budget with priorities defined and link annual budget to the Five-Year Plan	Budget Speech and the Five-Year Plan	Annual
Improved efficiency	Significant devolution of non-core functions of government and reduction in size of civil service	Approved policies on transfer of non-core functions of the government and financially viable redundancy and early retirement schemes.	Right sizing of bureaucracy	Ministry of General Administration Ministry of Finance Consultation	Annual
	Full implementation of merit-based personnel system	Approved policies on merit-based recruitment and promotion Revised Civil Service Act	Performance-based recruitment and promotion		

Indicators	Targets		Medium-Term Strategies	Primary Monitoring Source	Frequency
	Long(FY2017)	Medium(FY2007)			
Improved transparency and accountability	Establishment of full effective anti-corruption system	All staff appointed to CIAA and Audit General demonstrate application of investigation skills	Ensuring prosecution of corruption through effective anti-corruption measures and audit	Commission for the Investigation of Abuse of Authority & Auditor General Consultations	Annual
	Implementation of the performance improvement process in all central ministries and local authorities	Successful implementation of the performance improvement process in three key service delivery ministries (Agriculture and Cooperatives, Education and Sports, and Health)	Establishment of effective processes for improving the performance of civil service	Ministry of General Administration Consultations	Annual
Monitoring and Evaluation	Fully effective programs and projects monitoring system	Improved programs and projects monitoring system	Strengthening programs and projects monitoring system in NPC, MOF, and FCGO	Ministry of Finance, National Planning Commission, Ministry of Agriculture and Cooperatives and Office of the Financial Comptroller General (FCGO) Consultations	Annual
	Institutionalized a systematic poverty monitoring mechanism	Establishment of Poverty monitoring unit under a senior Minister	Improving statistical information system in Central Bureau of Statistics and Ministry of Agriculture and Cooperatives		

* The poverty line was estimated to be NRs4,404 per capita per annum on the basis of minimum calorie intake of 2,124 and other nonfood standards.