**REPORT ON THE NEPAL DEVELOPMENT FORUM**
**5-6 May 2004**

## I. INTRODUCTION

1. The Nepal Development Forum (NDF) 2004 was held in Kathmandu during 5-6 May 2004. Dr. P. C. Lohani, Minister for Finance chaired the Forum. Delegations from 27 countries and international development agencies attended.

2. Prime Minister S. B. Thapa opened the Forum on 5 May 2004, followed by three working sessions with Government's presentations on progress of its Poverty Reduction Strategy (PRS), reform agenda, and aid and development effectiveness. The Forum concluded with a session for donor delegations to make statements, followed by a press conference by the Finance Minister. A copy of ADB's statement is attached as Annex 1.

## II. BACKGROUND

3. This is the second time the NDF was held in-country and the first time the Government chaired the Forum. The NDF was preceded by a series of interactive pre-consultation meetings during 1-16 April 2004 with the participation of political parties, civil society, academia, private sector, media, and development partners. Senior Government officials presented several background papers on key macro, sectoral, and thematic development issues. These meetings facilitated open debate on key issues and challenges currently facing Nepal, and set the stage for the NDF discussions. All delegates appreciated the Government's strong leadership in and ownership of the NDF process.

4. Despite their participation in the pre-NDF consultations, the five agitating political parties called on the donor community on 27 April 2004 to postpone the NDF in view of the escalation of their agitation against the Palace/Government and the heavy handed actions of the security forces. In response, a group of bilateral European donors agreed to consider deferral of the NDF provided that the political parties held unconditional dialogue with the Palace to resolve the deepening political crisis and proposed a consensus Prime Minister prior to the scheduled NDF. The political parties were not able to do this, and the Government decided to hold the NDF as scheduled. Although the political parties boycotted the NDF, they participated in an informal meeting arranged by UNDP and the group of European donors on the eve of the NDF to discuss only political issues outside the NDF agenda. All NDF delegations including ADB attended the meeting.

5. The political parties expressed support for Nepal's development agenda, particularly the Tenth Plan and the PRS as preparation of these was initiated by an elected government and based on wide participation of stakeholders including the political parties. They however questioned the legitimacy of the current Government and hence its 'right' to implement certain reforms. In particular, they expressed concern about some major policy and institutional changes effected through ordinances in the absence of Parliament. Faced with criticism about poor governance during the past decade of multi-party democracy, the political parties acknowledged their shortcomings while insisting that the donor community also recognize the responsibility of the Palace in creating the present political crisis. The donor participants urged the political parties to set aside the past, and initiate unconditional dialogue with the Palace to resolve the political impasse, which is undermining resolution of the conflict and, hence, Nepal's development and

poverty reduction efforts. In response, the political parties emphatically stated that they could meet the King to seek a resolution of the political impasse if he would invite them collectively for talks.[1]

## III. KEY POINTS OF DISCUSSIONS

6. In the Government's assessment, notwithstanding the difficult conflict and political environment, there has been considerable progress in the implementation of the PRS, especially in maintaining macroeconomic stability, reviving economic growth, public expenditure management to support poverty reduction, devolution to improve delivery of basic social services, public sector governance including anti-corruption measures and privatization of public enterprises, private sector development, and financial sector reforms. The Government however recognized less satisfactory progress in achieving stronger agricultural growth, promoting social inclusion, and rural development particularly in the deprived and conflict-affected regions.

7. While committing to scale up the implementation of the PRS and deepen the reform agenda supporting it, the Government sought the donor community's support in financing the resource gap required to implement the PRS. The gap is estimated at $550 million per year. It also sought donors' cooperation in harmonizing external assistance. Specifically, the Government requested the development partners to further align donor assistance with the Government's Foreign Aid Policy, PRS, and operational procedures. In this respect, the Government proposed a National Action Plan comprising a three-tier framework – overall program, individual program, and financial modality levels. While harmonization at the overall program level seeks to align donor assistance with the PRS, sector strategies, and the Medium-term Expenditure Framework, harmonization at the individual program level encourages donors to follow programmatic and sector-wide approaches. Harmonization at the external financing modality level proposes a shift from the traditional project financing to more budget and program support. The Government proposed formation of a joint task force to prepare for implementation of the National Action Plan starting FY2006.

8. The donor representatives broadly supported the Government's PRS and reform agenda and appreciated the candid assessment of implementation progress to date. However, they expressed serious concern about the sharp deterioration of the conflict and political situation since the last NDF in 2002, which have undermined effective implementation of the PRS. Despite the reasonably sound macroeconomic management, they were particularly concerned about the increasing difficulty in implementing projects in several rural areas due to deterioration of the security situation. They were also critical of widespread human rights violation by both sides in the conflict. In addition, the deepening political impasse between the Palace/Government and the agitating political parties has made the situation worse. Donor representatives expressed a view that the PRS targets need to be significantly prioritized based on the ground realities and that innovative and effective implementation modalities need to be put in place to ensure effective delivery of development benefits in the remote and conflict-affected areas.

9. The development partners, including ADB appreciated the progress of the Government's broad reform agenda which supports the PRS despite the difficult circumstances. ADB delegation raised concerns over the slow pace of implementation in some important areas – civil service

[1] Under increasing pressure from the agitating political parties, Prime Minster Thapa resigned on 7 May 2004. As a new government is not yet in place, Prime Minister Thapa and his Cabinet have been continuing as a caretaker government. Conceding to the political parties demand, the King granted a joint audience to them on 19 May 2004. While the King also held separate consultations with the leaders of the major political parties subsequently, the political stalemate remains unresolved. The King is reluctant to agree to the parties' demand for an all-party government led by a Prime Minister of their choice and reinstatement of the dissolved Parliament. The parties, on the other hand, have not been able to agree upon a consensus Prime Minister due to inter-party differences.

reforms, revenue administration, reform of public enterprises, and corporate and financial governance. The importance of enhancing domestic revenues to raise public savings was also stressed. This remains an important fiscal policy issue in Nepal due to its low revenue/GDP ratio (12%). ADB delegation urged the Government to stay the course on reforms as these are critical for higher economic growth, enhancing implementation of government policies and programs, and effective delivery of basic services, all crucial to poverty reduction.

10. While supporting the Government's donor harmonization initiative, most development partners stressed the need to recognize the diversity of aid modalities of different donor organizations and ensure a realistic degree of flexibility. Some donor representatives were apprehensive of the proposed shift to program/budget support. ADB delegation, while fully supporting increasing harmonization, advised a realistic approach which would first assess the suitability of programmatic approaches/budget support modalities in each sector and consider experience of other countries in implementing these approaches.

## IV. CONCLUDING REMARKS

11. The NDF stressed the importance of urgent actions to restore peace and political stability for Nepal's development and poverty reduction efforts. It was also recognized that peace building and development and reform initiatives are mutually reinforcing and need to be pursued simultaneously. Given that the deep-seated economic, social, regional, and ethnic inequalities are the underlying causes of the insurgency, sustained development and poverty reduction can contribute significantly to attaining peace and stability. Compliance with human rights was also stressed by some donors as part of the peace-building and development agenda.

12. Some development partners also strongly urged establishment of a representative government and restoration of democratic processes and institutions to facilitate peace building, good governance, and acceleration of development activities. Early election was emphasized to restore representative governments at all levels. The absence of local government has left a 'vaccum' and made it easier for the insurgents to extend their influence. Several bilateral development partners highlighted the severe difficulties they faced in implementing their projects and programs due to escalation of the conflict.

13. ADB delegation stressed the importance of improving governance and portfolio performance to address the underlying causes of the conflict. It also stressed the need to stay the course on reforms. The conflict also provides a historic opportunity to Nepal to take concrete actions and accelerate the pace of reforms to deliver development benefits to the poor and marginalized segments of the population. Strong political commitment at the highest level is therefore necessary to implement the Government's governance reform agenda, along with the wider agenda of reforms aimed at broad-based and pro-poor economic growth. This would depend on reducing the conflict in the short-term and achieving a lasting peace in the medium-term.

14. In conclusion, the development partners assured the Government of their continued support for implementation of the PRS. However, they urged the Government to work with the donor organizations in devising creative modalities for effective implementation of the assistance programs in the present conflict environment. Above all, they urged the Government to resolve the impasse with the political parties and seek peaceful resolution of the conflict as an immediate priority.

## Asian Development Bank's Statement at the Nepal Development Forum
## 6 May 2004
## Kathmandu, Nepal

1. ADB wishes to congratulate the Government for chairing the Nepal Development Forum (NDF) for the first time, and we are pleased to take part in it. We are also encouraged by the extensive preparations led by the Government through the pre-NDF consultations with a wide range of stakeholders, including the political parties, civil society, academia, private sector, and the media. The Government's strong ownership of the NDF process is crucial for the success of the reform and development program in Nepal.

2. On the macroeconomic side, some indicators are encouraging. The economy is experiencing a recovery in the past 2 years, and it has strengthened this year. Revenue mobilization has increased significantly in the past year. However, the revenue/GDP ratio still remains very low. Strong efforts will thus be needed to enhance revenue mobilization to generate substantial public savings so that the overall share of domestic resources in financing development can increase over time. We are encouraged by the Government's budget projections yesterday which show positive public savings. We feel nevertheless that it is crucial to track and manage recurrent expenditure to prevent negative public savings. This will permit external assistance to finance only development expenditures. We were also heartened to hear yesterday, that preliminary CBS surveys are indicating a declining trend in poverty. We await the final results of these surveys. Looking ahead, we feel, however, that the downside risks of a slowdown in the recovery have increased due to the significant deterioration in the political situation and the insurgency.

3. The country context since we last met at NDF in February 2002 has changed and the development challenges facing Nepal have become much more complex. The Tenth Plan or Nepal's Poverty Reduction Strategy has been prepared with the participation of all stakeholders. The country's development partners have supported it and are committed to its implementation. While this is a landmark event, the political and security situation has deteriorated making the achievement of the objectives of the Poverty Reduction Strategy much more difficult. The conflict has had an adverse impact on the economy in terms of the loss of economic output. While GDP growth averaged 5% in the 1990's, it has dropped to an average of 2.2% since 2000, lowering per capita GDP growth from more than 2% to near zero. The cumulative effect of this has serious implications for poverty reduction in the country.

4. ADB is also concerned about the more visible adverse impacts at the meso and micro level on Nepal's development and poverty reduction efforts. The conflict has impeded the mobility of commodities and people seriously affecting rural livelihoods. With the destruction of local government offices and infrastructure facilities, looting of bank branches, and emigration from the conflict zones, development activities have been experiencing greater impediments. As a result, delivery of basic services in the rural areas has deteriorated markedly. The absence of local government representatives has made the situation worse. There is an urgent need to put in place effective implementation modalities to sustain and enhance service delivery and development activities in rural areas. Rehabilitation of the displaced population and reconstruction of damaged infrastructure are also urgently needed to improve rural livelihoods seriously affected by the conflict.

5. The conflict has exposed long-standing and deep-seated economic, social, regional, and ethnic inequalities within Nepali society. Wide disparities in access to economic opportunities and social services, caste, ethnic and gender discrimination, and failure to deliver greater development benefits to rural areas, especially in remote regions, have caused widespread grievances and contributed to the conflict. The current crisis presents both a challenge and an opportunity for Nepal. These unresolved issues have long hindered development and poverty reduction efforts, but can now be addressed with firm and sustained resolve. Reforms aimed at addressing widespread poverty and economic, social, regional, and ethnic inequalities, pervasive exclusion, and institutional strengthening are therefore critical for development and poverty reduction. Such reforms along with sustained development will address the root causes of the conflict.

6. The Government is continuing to pursue a wide range of economic reforms – in the areas of public expenditure management, public sector governance, decentralization, and financial and corporate governance – under difficult circumstances. These reforms are fully in line with Nepal's poverty reduction strategy and there has been encouraging progress in many areas of reform. However in certain areas the reforms have progressed at a slow pace. These include governance, including civil service reforms, revenue administration, reform of public enterprises, and corporate and financial governance. These reforms are critical for improving the effectiveness and efficiency of the public sector, effective delivery of basic services to the poor, and private sector development – all important for poverty reduction.

7. Weak implementation of reform and development programs are a part of the much wider problem of governance. Unless decisive and concrete actions are taken to address reform implementation and accelerate the pace of reforms, the people of Nepal will continue to be disappointed by weak governance. This will make it more difficult to address the root causes of the conflict. Strong political commitment at the highest level is necessary to implement the Government's governance reform agenda, along with the wider agenda of reforms.

8. ADB is also concerned about the low utilization of external assistance in recent years. Portfolio performance of development projects including those of ADB needs to be strengthened significantly to achieve their intended benefits. We are working closely with the Government in this regard and are pleased by recent actions taken by the Government to improve portfolio performance.

9. Political stability is a necessary condition for reform and development. In Nepal's current situation, it will be difficult to implement the Government's reform and development agenda and achieve the objectives of the poverty reduction strategy without the broad participation of all stakeholders, including the opposition political parties, and without achieving a peaceful resolution of the conflict. We therefore hope all stakeholders will try to resolve these serious issues to realize their common vision of a peaceful, stable, and prosperous Nepal.

10. ADB fully recognizes the difficult circumstances Nepal is facing, and the complex environment within which the Government is trying to implement the reform and development agenda to achieve the objectives of the poverty reduction strategy. ADB strongly supports the Government's reform and development agenda and remains firmly committed to continuing its assistance to implement the poverty reduction strategy. We believe that continuing assistance to Nepal at this critical period is vital. ADB is currently preparing a new Country Strategy and Program (2005–2009) for Nepal in close consultation with the Government, other stakeholders, and the development partners. The CSP will address the development challenges currently facing Nepal including those relating to the conflict, and identify key priorities of the poverty

reduction strategy for which ADB assistance would be provided. The CSP proposes an assistance level of about $100 million per year for the next 3 years, which is similar to our lending levels in recent years. However, we are also committed to increase our assistance levels to support rehabilitation and reconstruction if peace is restored. About 15% of ADB's ongoing assistance to Nepal is provided as budget support, the rest is sector or project support. Our projects span virtually the entire country. The absorption of ADB's assistance in the future will thus depend in large measure on the resolution of the political impasse and the conflict. ADB therefore hopes for early resolution of these fundamental issues through negotiations among all parties concerned.

11. In concluding, ADB wishes to express its deep appreciation to His Majesty's Government of Nepal for making such excellent arrangements in organizing the NDF, and the hospitality extended to the participants.