

**ASIAN DEVELOPMENT BANK**

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**COUNTRY OPERATIONAL STRATEGY**

**FOR**

**NEPAL**

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## CONTENTS

	Page
EXECUTIVE SUMMARY	ii
I. BACKGROUND	1
II. SUMMARY OF DEVELOPMENT ISSUES AND OUTLOOK	2
A. Issues	2
B. Constraints	4
C. Development Outlook and Potential	5
D. The Government's Development Objectives and Priorities	6
III. DEVELOPMENT ASSISTANCE EXPERIENCE AND OUTLOOK	7
A. Experience	7
B. Prospects	11
IV. THE BANK'S FUTURE ROLE IN NEPAL	11
A. Broad Thrust	11
B. Criteria for Intervention	13
C. Criteria for Sector Involvement	14
D. Operational Thrust of the Strategy	15
E. Gender and Development	20
F. Regional Cooperation	20
G. Governance	21
H. Private Sector Development	21
I. Aid Agencies Cooperation	22
V. INSTRUMENTS OF BANK SUPPORT AND IMPLICATIONS OF THE PROPOSED ROLE AND STRATEGY	22
A. Modalities of Bank Assistance	22
B. Monitoring, Evaluation, and Feedback	25
C. Risks	26
APPENDIXES	28

## EXECUTIVE SUMMARY

### Evaluation of Previous Country Operational Strategy Study

Agreement was reached with the Government on the last Country Operational Strategy Study in April 1993. Modest improvements have since been recorded in human development and per capita income. However, prospects for substantial further development have deteriorated with declining economic and export growth, a growing fiscal deficit, low investment efficiency, slowing private sector growth, and inadequate domestic resource mobilization. Institutional weaknesses have been compounded by high civil service staff turnover following frequent changes in government. All stakeholders consulted in preparing this strategy identified poor governance and corruption as major constraints.

The goal of the last country strategy was poverty reduction through broad-based economic growth activities, support to basic social services and environmental protection, and private sector development. It guided Bank investment to growth and equity-oriented projects and programs in agriculture, transport, energy, tourism, industry, and social services. While identifying priorities, the implementation of the strategy lacked (i) sector development plans (road maps) to provide a framework for Bank intervention, (ii) performance standards to verify the impact on development, and (iii) a realistic time frame for establishing and developing institutions to sustain development.

Past Bank assistance has created assets, but sustainability and development impact have been limited. Poverty incidence remains high, and social and human development indicators low. Progress has not been commensurate with past investment levels. The anticipated institutional strengthening and policy improvement were not fully realized. All these factors have adversely affected the delivery of development assistance.

### Lessons from the 1993 Study

Achieving better results from Bank assistance will require tangible progress in good governance. Future levels of Bank assistance will be directly linked to progress in addressing this concern. Key lessons for future Bank interventions include the following:

- (i) Lack of local ownership contributed to failures in Bank-supported interventions. The Bank needs to consult more widely with all stakeholders to develop partnerships, not only in the case of investment projects but also when supporting policy and institutional change.
- (ii) Institutional strengthening should reflect broader and longer term sector development needs and include consideration of alternative institutional arrangements.
- (iii) The effectiveness of Bank interventions has been diminished by a failure to enforce loan covenants related to policy, institutional, and financial issues critical to effective project implementation.
- (iv) An appropriate institutional and policy environment is critical to the sustainability of Bank interventions, and needs to be more carefully assessed when planning Bank interventions.
- (v) Good governance – encompassing efficiency, predictability, transparency, and accountability – and eliminating corruption, are critical to the effective delivery of public services and need to be explicitly considered in designing all Bank interventions.

## **Main Elements of the New Strategy**

The overarching goal of the new operational strategy is to achieve a sustainable reduction in poverty through

- (i) generation of productive employment opportunities and increased rural incomes resulting from faster and broad-based economic growth;
- (ii) equitable improvements in basic social services to enhance human development resulting in reduction of population growth; and
- (iii) protection and improvement of the environment to sustain gains.

A major difficulty in achieving these objectives is the lack of efficiency, predictability, transparency, and accountability in key development and market institutions. Thus, building *effective institutions* needed to implement socioeconomic development in a market economy is the strategic approach of the new strategy.

Improved governance will require policy and institutional reforms particularly to strengthen key institutions in undertaking a changing role to promote private sector participation. Support to implement the Government's initiative in decentralization including for local administrations like village development committees and district development committees to plan and implement development activities and better serve local needs is also an important cross-cutting element of the strategy. Other strategic elements include private sector development, gender equity, and subregional cooperation.

The new strategy emphasizes that building capacity in order to maximize and sustain the development impact of investments must take precedence over levels of assistance. The importance of learning from past mistakes and successes by development partners is also highlighted. A clear demonstration of strong stakeholder support for proposed Bank interventions will be a prerequisite for future interventions, as will formulation of long-term institutional development strategies, with clearly identified road maps for sector development. Improved Bank monitoring and supervision will need to include a focus on progress in implementing these road maps as a criterion in annual country programming. The Bank will take necessary measures to ensure compliance of loan covenants during project implementation.

The high rates of staff turnover in the civil service and among managers of Bank-financed projects have adversely affected morale and institutional capability, which has had a major negative impact on Bank assistance. Civil service reform will be an important element in Bank efforts to improve governance. Greater transparency and accountability will be required in national procurement, bidding procedures, and customs administration to ensure compliance with Bank guidelines and policies on anticorruption. Improvements are needed in enforcing contracts and allowing international accounting and auditing firms to practice in Nepal. These will help improve the corporate governance and promote an environment more conducive to private sector participation.

### **Sector and Subsector Focus**

Bank support to particular sectors/subsectors will depend on progress toward strengthening the policy and institutional environment in these sectors. A clearly documented assessment of the policy and institutional environment will be required prior to consideration of new investment projects. Longer term technical assistance will support the policy and institutional reforms needed to create such an environment. To effectively use the Bank's limited concessional resources, a sharper focus on fewer sectors/subsectors will be necessary. In narrowing the Bank's focus, future

involvement in any sector or subsector will require an assessment of the extent to which the following criteria are met:

- (i) Interventions will contribute directly or indirectly to reducing poverty.
- (ii) There is evidence of a Government commitment to necessary policy and institutional reforms, and of adequate institutional capacity to implement these reforms.
- (iii) The Bank will play a substantive role in a sector or subsector where it has a comparative advantage.
- (iv) Interventions will play a catalytic role in mobilizing additional financing from official and/or private sources.
- (v) Interventions will support the development of a competitive market economy.
- (vi) There is evidence of success or progress from past interventions of the Bank or other donors, including compliance with loan covenants.

Based on the assumptions<sup>1</sup> of Bank's current indicative planning figure and the intensity of involvement in any sector over a period of time to sustain desired development impact, the Bank would focus on up to 10 sectors/subsectors compared with 18 sectors/subsectors<sup>2</sup> in the past. Ten indicative sectors/subsectors are identified to allow future Bank assistance to focus on the three operational objectives: (i) promoting economic growth; (ii) enhancing human development; and (iii) protecting and improving the environment (see Figure E1). The sectors/subsectors include: (i) agriculture, (ii) irrigation, (iii) roads, (iv) power, (v) finance, (vi) basic education, (vii) health, (viii) water supply and sanitation, (ix) environment improvement, and (x) natural resources management.

Implementation and monitoring of the Agriculture Perspective Plan (APP) will be the main thrust of rural development efforts. Key areas of assistance will be agricultural technology, irrigation, rural roads, rural electrification, and rural finance. Improvement of corporate governance and legal regulatory functions of prudential agencies within the framework of financial sector reform will help to develop the necessary environment for effective resource mobilization as a key to private sector development. Support to infrastructure will focus on roads and hydropower development, with emphasis on promoting private sector participation in infrastructure development. The Bank aims to promote human development with support to basic education, health, and water supply and sanitation. Environment protection and improvement will be supported through environmental management, and watershed rehabilitation and management. Tourism will be promoted through public and private partnership in improving environmental management particularly to enhance rural tourism. Actual sector/subsector involvement will, however, be assessed and justified during the annual country programming based on the preceding criteria.

Figure E1 summarizes the policy and institutional focus of the Bank strategy. Key institutions are identified as focal points to translate and implement the strategy in achieving the

<sup>1</sup> Assuming Bank's annual lending of \$80 million a year and average loan size of \$20 million in Nepal, the Bank will revisit the sector with an investment project every four years to support the momentum of institutional and policy reform measures. For a 10 year-period, which is a reasonable timeframe for sustainable development, the Bank can assist up to 10 sectors/subsectors.

<sup>2</sup> These include forestry, irrigation, crop diversification, aquaculture, livestock, rural roads, rural credit, primary education, secondary education, technical and vocational education, highways, civil aviation, tourism, rural water supply and sanitation, urban development, power generation, power transmission and distribution, and industrial development.

strategic approach of effective institutions through their changing roles in promoting the participation of stakeholders and the private sector. The operational framework of the new strategy summarized in Figure E2 provides necessary linkages of future Bank operations in various sectors/subsectors to the corresponding objectives with government strategies and activities of other key aid agencies. A sector development framework (road maps) summarizing the policy and institutional development framework for key sectors and subsectors and demonstrating the proposed approach will be prepared and agreed upon by the stakeholders. Performance standards will also be established to measure progress toward the different stages of sector or subsector development.

### **Modalities and Levels of Bank Involvement**

While the strong emphasis on policy and institutional reform in the Bank's strategy may suggest a need for program lending, past Bank experience with this modality in Nepal has not been encouraging. Any additional quick-disbursing program loan will be jointly formulated with the Government. Important elements of such assistance would include demonstrated Government and community commitment and stakeholder support to the reform measures, while institutional arrangements for effective implementation need to be carefully assessed and agreed upon. In this regard, the Bank needs to closely monitor and learn from experiences in implementing the APP and the ongoing program loan in the agriculture sector, which supports liberalization of fertilizer trade and shallow tubewell irrigation facilities and related institutional reforms to promote private sector participation.

The Bank will place much greater emphasis on project design issues. It will seek to ensure strong local participation in and support for the projects, and will assess whether the institutional and economic environment is conducive to private sector development. Promising results have been shown in past Bank projects that involved community groups and non-government organizations (NGOs) in project implementation. The Bank plans to work more closely with these groups to improve project quality, but also recognizes that the capacity and capabilities of local groups are limited, and that long gestation periods will often be required in such interventions. The Bank will need to commit greater staff resources to effectively formulate, monitor, and evaluate projects in Nepal.

The emphasis in the strategy on sector development modalities implies a more important role for economic and sector work as well as longer term advisory and operational technical assistance in sectors and areas where the Bank plays a leading role in policy dialogue and institutional reform. Presently, the sectors include agriculture and rural development, rural finance, water supply and sanitation, power, private sector development, governance, and civil service reform.

Immediate priorities for economic and sector work include institutional support to decentralization, public administration and civil service reform, improve corporate governance, and effectively implement APP. The Bank will support institutional and policy analysis aimed at improving efficiency of service delivery for road, power, basic education including lower secondary, health, water supply and sanitation, urban services, and environmental management with emphasis in promoting private sector participation or public and private partnership. It will work more closely with stakeholders to build support for policy recommendations, and will cooperate with all interested aid agencies in undertaking sector work so as to assist in developing consistent approaches. The Bank will also need to make staff available to participate in and contribute to sector policy and planning initiatives led by other aid agencies.

While aid agencies coordination has improved over time, it is mainly confined to project-level activities to avoid duplication of effort. Efforts to adopt a coordinated approach to sector development, including policy formulation and institutional development, have been inadequate. To maximize the impact of external resources, further collaboration and cooperation – not just coordination – in economic and sector work, policy formulation, institution analysis, and improvement are necessary. The aid community is now focusing on improving such efforts through agreement of common sector development frameworks to increase leverage and ensure consistency in the policy and institutional reforms needed to improve investment efficiency.

Further development of economic linkages with neighboring countries will be an important component of the new strategy. The Bank will continue to be proactive in promoting subregional economic cooperation between Bangladesh, Bhutan, India, and Nepal. The Bank will continue to involve Nepal in regional technical assistance activities to disseminate information about regional best practices, particularly in relation to governance, institutional development, poverty reduction, financing and provision of social services, and private sector development. The establishment of better road network in the region will improve the access to market and trade opportunities. The Bank will consider providing assistance to develop the policy and institutional framework needed to realize potential benefits from regional cooperation with project-level initiatives involving bilateral and trilateral linkages particularly in hydropower development and water resources management.

In line with the Bank's policy on Asian Development Fund allocation among developing member countries, future lending to Nepal will be linked to progress in addressing the major country performance issues that will improve the environment for private and public investments to generate and sustain development impact. Five key areas including (i) human development; (ii) fiscal performance; (iii) civil service reform; (iv) governance; and (v) portfolio performance have been identified and performance standards established accordingly for further monitoring and evaluation of achievements. These key areas are essential to develop effective institutions in order to sustain desired development impact. Progress reports, which will be prepared jointly by the Bank and the Government, will be part of the annual Country Assistance Plan covering the Bank's three year rolling plan of lending and TA program in Nepal.

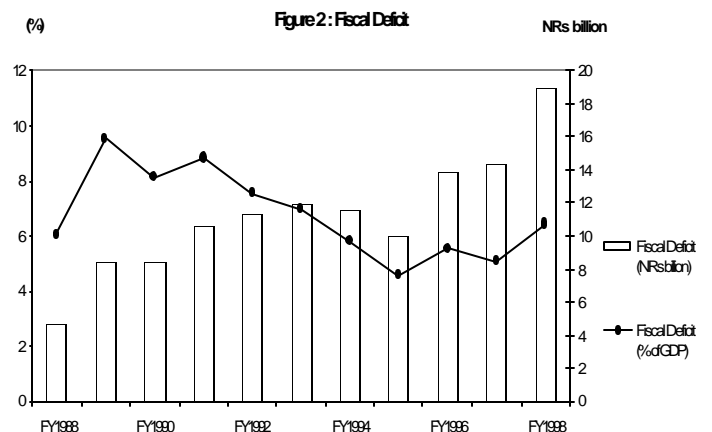
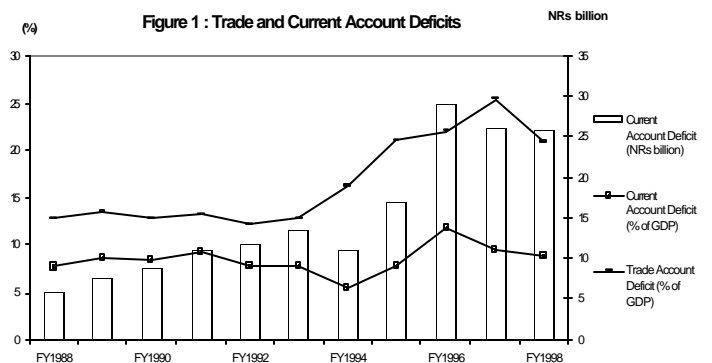
Risks affecting the successful implementation of the new strategy include internal and external risks. Internal risks include (i) continued political instability which diverts resources and attention to focus on development priorities and agenda and (ii) lack of political commitment to undertake necessary reform measures to develop appropriate policy and institutional environment to ensure effective private and public investments. The newly elected majority government in May 1999 may provide better prospects for political stability. The external risk relating to the impact of Asian financial crisis and international downturn is considered minor relative to the internal risks. A key risk, however, lies within the Bank. The strategy emphasizes participatory approaches at all stages of the project cycle and recognizes that much greater emphasis needs to be given to institutional development. Both institutional building and participatory processes are time-consuming. Difficult topography and a limited transport network will require relatively more time for domestic travel to rural areas. The new strategy therefore requires Bank's commitment to allocate greater staff and time resources including those to NRM to effectively formulate, supervise, monitor, review, and evaluate assistance and interventions in Nepal.

## I. BACKGROUND

1. Nepal began to make systematic attempts to develop a modern system of administration, social services, infrastructure, and production only in the 1950s. With adult literacy at only 2 percent, the starting base for development was much lower than for most other Asian economies. While notable progress has been made in many areas including the expansion of road access, schools and health posts, telecommunications and electrification, socioeconomic development still lags well behind that in other Asian countries. The low level of socioeconomic development is reflected in low per capita income, widespread poverty, low life expectancy, high infant mortality, poor literacy rates, and low education standards (see appendix 1).<sup>1</sup>

2. The agriculture sector's contribution to gross domestic product (GDP) declined from around 70 percent in the 1970s to 42 percent in 1998.<sup>2</sup> Agriculture directly provides livelihood for more than 80 percent of the population. Average growth in GDP increased from 2.4 percent in the 1970s to 4.8 percent in the 1980s and 4.7 percent in the 1990s. Because of high population growth, however, real per capita income only increased from \$150 to \$200 in three decades. Growth has fluctuated substantially from -2.3 to 4.4 percent in the 1970s, -3.0 to 9.7 percent in the 1980s, and 1.9 to 8.2 percent in the 1990s.

3. Nepal made good initial progress in improving macroeconomic stability and accelerating economic growth in the early 1990s. Since 1994, however, there have been signs of deteriorating economic prospects, including a growing resource gap<sup>3</sup> particularly after FY1994. The current account deficit has widened, with continuing growth in imports and slow growth in the narrow export base (Figure 1) exemplified by the structural weakness in the industrial and export base. Two major exports (carpets and garments) have experienced setbacks, and the private sector has been reluctant to invest due to a combination of weak market institutions and a politically unstable environment.<sup>4</sup> Political instability has also delayed implementation of key reforms, including privatization and tax rationalization. The fiscal deficit, which gradually declined in the early 1990s, has slowly increased since FY1995 (Figure 2) as a result of stagnant revenue growth and continuing growth in regular expenditures. There is also a trend of increasing reliance on foreign assistance, which has contributed substantially to support the country's development budget (see para. 26).



<sup>1</sup> Asian Development Bank. 1998. *Key Indicators of Developing Asia and Pacific Countries*. Manila, Philippines.

<sup>2</sup> See also CER: NEP 98023: *Country Economic Review, Nepal*, January 1999.

<sup>3</sup> Corresponds to current account deficit or saving and investment gap.

<sup>4</sup> The newly elected government in May 1999 is the seventh government in the past six years.

4. Economic liberalization including interest rate determination, removal of industrial licencing and other barriers to trade, privatization of state-owned enterprises, and liberalization of domestic air routes and finance companies led to strong private sector growth in the 1990s, but state entities still dominate the key areas including agriculture marketing, commercial banking and rural finance, power, and water supply. Low efficiency and poor service delivery characterize public sector investments. The investment<sup>5</sup> to GDP ratio is higher than in other South Asian countries, but output growth is low with the incremental capital output ratio (ICOR) averaging 5.3 during the past six years. Had investments been used more efficiently to achieve an ICOR of 4.0, annual growth would have averaged 5.7 percent. With an ICOR of 3.0, annual growth would have averaged 7.6 percent. Given the fiscal constraints, a difficult external environment, and shrinking global external resources, this basic arithmetic shows the critical need to improve private and public investment efficiency in any development strategy for Nepal.

## II. SUMMARY OF DEVELOPMENT ISSUES AND OUTLOOK

### A. Issues

#### 1. Poverty and Demographic Development

5. Poverty is the most pressing problem in Nepal: more than 9 million people or about 45 percent of the population live below the poverty line.<sup>6</sup> Substantial resources, including Bank assistance, have been targeted at reducing poverty, but there is little tangible evidence<sup>7</sup> of a significant decline in poverty. Poverty is reflected in both economic terms and in poor social and human conditions. Human development in Nepal, as measured by the Human Development Index,<sup>8</sup> is among the lowest in the world (152<sup>nd</sup> out of 174 countries). The estimated annual population growth of 2.5 percent, combined with poor economic performance, place considerable strains on the country's ability to achieve sustainable human development.

6. Poverty incidence varies among geographical regions, with rural poverty incidence almost twice that of urban poverty (Table 1). Within rural areas, poverty is extreme in the more remote areas, particularly in the hills and mountains, Mid-Western and Far-Western regions. Low and erratic economic growth constrains poverty reduction efforts. Of particular concern is the decline in agricultural productivity over the past 30 years, with Nepal shifting from producing a food surplus to having to import food. Environmental degradation is also a major problem, and is both a cause and a consequence of rural poverty. Degradation of farm lands due to marginal cultivation, encroachment in forests and grasslands, and deforestation have contributed to declining agricultural productivity, thereby reinforcing the vicious cycle of poverty.

7. Poverty reduction is the single goal of the country's Ninth Five-Year Development Plan (the Ninth Plan) for the period FY1998-FY2002. The goal is to reduce poverty incidence to 32 percent by the end of FY2002 and to 10 percent within 20 years. The plan recognizes that failure to formulate and implement appropriate policy and programs to meet specific development objectives account for past failures to substantially reduce poverty. The plan also identified long-term development objectives namely poverty reduction, employment promotion, and regional balanced economic growth to be supported by its sectoral development plans. Conducive policy and institutional environment will be pursued to promote private sector participation. Good governance

<sup>5</sup> While public fixed investment has remained stable at 7 percent of gross domestic product (GDP), private fixed investment has reached 15 percent from less than 9 percent of GDP in FY1990.

<sup>6</sup> Central Bureau of Statistics. 1995. *Nepal Living Standard Survey, 1995*. Kathmandu: National Planning Commission.

<sup>7</sup> Poverty studies, with varying objectives and methodologies, have arrived at different results, making it difficult to make definitive conclusions about progress in reducing poverty. There is no consistent time series, but studies suggest that the incidence of poverty is somewhere between 42 and 52 percent during FY1985-FY1995.

<sup>8</sup> United Nations Development Programme. 1998. *Human Development Report 1998*. New York: United Nations.

is important to ensure effective public and private investments. Decentralization is a key element to utilize local administrations like village development committees and district development committees to formulate and implement development activities. This helps to promote ownership as well as better serve local and diverse needs.

## 2. Gender and Regional Disparities

8. Women are generally poorer in respect of income, assets, and access to basic social services. High population growth particularly disadvantages women, as frequent childbirth directly affects women's health and reduces opportunities for them to participate in economic activities. Gender disparities in human development, especially literacy, school enrollment, and life expectancy,<sup>9</sup> are major problems. Barriers to more equitable gender participation result from biases in formal institutions (e.g., property rights, inheritance laws, and labor laws) and informal barriers resulting from social norms. Disadvantaged castes, the poor, and ethnic communities experience relatively higher levels of gender disparities, particularly in education. There is no legal protection from domestic violence, and women often suffer from harder manual chores in rural areas including farm work, fetching water, and fuelwood collection among others.

**Table 1: Regional Disparities in Social and Economic Indicators  
(% of population)**

Region	Chronic Child Malnutrition (< 3 years old)	Population Without Access to Safe Water	Adult Illiteracy Rate	Children Out of School	Population with Poor Income
<b>Nepal</b>	<b>48.4</b>	<b>33.2</b>	<b>62.8</b>	<b>34.1</b>	<b>45</b>
Urban areas	35.4	11.6	36.5	13.9	18
Rural areas	49.3	36.2	65.5	35.8	47
<b>Ecological Regions</b>					
Mountains	56.6	43.3	72.0	41.8	63
Hills	48.7	44.6	59.8	25.9	50
Terai	46.9	21.0	64.1	40.7	37
<b>Development Regions</b>					
Eastern	38.3	36.9	58.1	27.8	43
Central	50.9	24.6	64.9	39.5	34
Western	50.0	26.8	60.5	25.7	45
Mid-Western	51.0	56.9	67.8	44.3	59
Far-Western	53.2	29.3	65.0	34.0	65

Source: Nepal South Asia Center. 1998. *Nepal Human Development Report 1998*. Kathmandu, Nepal.

9. There are also regional differences in human development (Table 1). The largest disparity is between rural and urban populations, but even in urban areas more than one-third of adults are illiterate. Lack of rural infrastructure and difficult terrain in most of the Far- and Mid-Western compared with Eastern, Western and Central Regions deprive the population of easy access to market and economic activities as well as education and health facilities. While Kathmandu is located in the Central Region, the region has the lowest poverty incidence and highest access to safe water, but nevertheless, adult illiteracy and child malnutrition remain high compared to other

<sup>9</sup> Natural selection generally concludes higher female life expectancy, but in Nepal lower life expectancy in females than in males was observed in the past.

regions of the country. Despite a below average rate of population with poor income, the terai<sup>10</sup> has relatively high levels of child malnutrition, adult illiteracy, and children not attending school. While poverty is relatively high in the hill areas, the population is better-off in terms of adult literacy, and the proportion of children attending school. The Eastern Region is better off in terms of most socioeconomic indicators, and the Central Region is generally better-off than the three western regions. But even in the Far-Western Region, where the level of poverty in income is far higher than elsewhere, the level of school attendance is close to the national average, and access to safe water exceeds the national average. Indeed, there are major differences in priority needs even across districts.<sup>11</sup>

### **3. Environmental Concerns**

10. The country's environment is under increasing pressure. High population growth rates, combined with high poverty incidence, especially in the rural areas, are major factors leading to serious environmental degradation. Soil erosion, deforestation, biodiversity loss, air and water pollution, and inadequate sanitation and solid waste disposal in urban areas are major environmental problems facing Nepal.

11. The majority of the population rely on natural resources for their livelihood. In striving for survival, the rural poor increasingly practice indiscriminate collection of fuelwood and cultivation of marginal lands. The results are degradation of watersheds and soil resources and further declines in the productivity of labor and land. High population growth and ecological problems in both urban and rural areas compound the vicious cycle of poverty.

## **B. Constraints**

### **1. Physical and Economic Constraints**

12. Being a landlocked and mountainous country with poorly developed infrastructure and a small domestic market, Nepal faces physical constraints to development. These constraints increase the costs of doing business and weaken the incentives for commercial investment. Per capita costs of infrastructure investments are high due to the mountainous terrain.

13. India is Nepal's largest trading partner and foreign investor, but also a close competitor for most commodities. Until recently, Nepal, India, and other neighboring countries have followed inward-looking economic policies providing few opportunities to develop international trade, tourism, and investment cooperation. In the last decade, these countries have made some progress in opening up to greater economic cooperation. Economic liberalization provides opportunities to promote shared economic prosperity, but also makes Nepal more vulnerable to the impact of the financial and economic crises in neighboring countries. The close linkage<sup>12</sup> of the Nepalese and Indian rupee preempts the pursuit of an independent monetary policy.

### **2. High Transportation Costs and Low Workforce Skills**

14. A poorly developed national transport network, with weak links to other countries, contributes to high transport costs that further impede growth in commercial activity. Labor costs are low in absolute terms, but labor is largely unskilled and the cost structure is relatively high due

<sup>10</sup> Lowland areas in southern Nepal that share borders with the Indian states of Bihar and Uttar Pradesh.

<sup>11</sup> This was confirmed during visits to 10 villages in Surket, Banke, and Kavrepalanchowk districts of terai and mid-hills in Mid-Western and Central Development regions during 15-18 August 1998; three terai villages in Sunsari and Morang districts in Eastern Development Region during 25-26 January 1999; and two mid-hill villages in Gulmi and Syangja districts in Central Development Region during 3-11 March 1999.

<sup>12</sup> The Nepalese rupee is pegged to the Indian rupee at NRs1.60 to Re1.00.

to low productivity. This has been a major constraint in enhancing competitiveness in industrial and export products.

15. Both the public and private sectors suffer from shortages of technical and management skills. The lack of skilled human resources and consequent weaknesses in institutional capacity contribute to delays in the implementation of investment projects. Mechanisms to provide skills and training that are relevant for raising productivity in agriculture and industry will be particularly crucial to future economic development.

### **3. Poor Governance and Increasing Allegations of Corruption**

16. Nepal has many of the formal prerequisites for effective governance, but implementation remains weak and often lacks efficiency, transparency, and accountability in the administrative system. There are increasing allegations of corruption at many levels, and this represents a key constraint to effective delivery of essential services. Basic institutions essential to the effective functioning of a market economy either do not exist or do not operate effectively. Distrust among various institutions is a major constraint to private sector investment. The ineffective performance of the financial system and regulatory agencies is also cause for concern. Weaknesses in financial management include a lack of basic professional standards in accounting and auditing, lack of follow-up on audit recommendations, poor contract enforcement, low revenue collection, and limited capacity for tax administration. Public service performance suffers from an excessive number of ministries, inadequate remuneration, poor record keeping, excessive staff transfers, and manipulation of rules and regulations to serve vested interests. Poor governance and the unsustainable financial performance of public agencies and State-owned enterprises are a major drain on limited public resources.

### **4. Administrative Instability**

17. Frequent changes in Government have often been followed by a high turnover of professional staff in the civil service. The turnover has adversely affected civil service morale and distracted attention from the important policy and institutional reforms needed to secure and sustain accelerated growth and economic stability. It has had major adverse effects on levels of private investment, and has also contributed to distortions and discontinuity in the allocation and distribution of public investment. Administrative instability, combined with increasing allegations of corruption, could lead to social instability as society becomes disillusioned with the ineffectiveness of domestic institutions in fulfilling the needs of civil society. This could constrain future development and undo the limited progress made in the past.

## **C. Development Outlook and Potential**

18. Poverty reduction and accelerated and more equitable human development can only result from developing an institutional environment that encourages efficient long-term investments. There is limited scope for reducing poverty through more equitable allocation of resources, including possible land reform. Thus, substantive progress in poverty reduction will depend on accelerated and more sustainable economic growth and development.

19. Political instability and economic concerns have delayed much-needed structural reforms in recent years. Immediate attention should be given to improving governance and reducing corruption in order to establish credibility in public and private institutions, which is essential to increase confidence among investors particularly in contract enforcement and protection of property rights. This is a prerequisite for encouraging investors to make long-term investments, facilitating more rational resource allocation, and in increasing the alarmingly low investment efficiency in both the public and the private sectors.

20. Macroeconomic management is constrained by structural weaknesses in production and the external sector, low resource mobilization, and the recent slowdown in the Indian economy. Future public sector investments will continue to be constrained by poor domestic resource mobilization and the availability of external resources. Private sector development will be adversely affected by the dominance of public sector entities, continuing policy distortions and institutional weaknesses, and uncertain international economic prospects.

21. As noted earlier, agriculture is the mainstay of the economy. Sustained improvement in agricultural productivity depends on implementation of policy and institutional reforms to liberalize markets for agricultural inputs and outputs. Other potential growth areas include tourism and hydropower development. Nepal has a large but mostly unrealized hydropower potential. There is substantial scope for developing this potential, mainly for export to India. Because of the huge investments required, the Government needs to establish an institutional, regulatory, and legal framework conducive to private sector participation in hydropower development. Tourism receipts could be expanded through better organized tourism promotion efforts, and improvements in tourism-related infrastructure and services. In implementing such promotion and development, the Government must ensure that environmental concerns are fully addressed. Finally, as a landlocked country with a relatively small domestic market, the expansion of trade, investment, and economic cooperation with neighboring countries and the rest of the world will be essential in realizing Nepal's full economic potential.

#### **D. The Government's Development Objectives and Priorities**

22. Poverty reduction remains the ultimate and immediate objective of the Government in the Ninth Plan covering the period July 1998-July 2002. This objective is to be achieved by (i) accelerating the average annual economic growth to 6 percent; (ii) bringing the rural population into the development mainstream, with priority given to agriculture and other growth-inducing sectors; (iii) reducing economic disparities between regions and communities; and (iv) decentralizing the implementation of development programs and projects. Apart from the ambitious poverty reduction targets (para. 7), the plan seeks to "eliminate" illiteracy (currently 60 percent) by 2005, reduce infant mortality to 25 per thousand (currently 86), and increase average life expectancy to 72 (now 57) for males and 75 (now 56) for women by 2017.

23. The Government is committed to achieving higher agricultural productivity and growth as envisaged in the Agriculture Perspective Plan (APP) with a more coordinated approach to providing inputs and services, and especially rural infrastructure (including irrigation, power, and roads), rural credit and marketing, and research and extension services. The Ninth Plan includes a provision for adequate allocation of resources to agriculture as envisaged in the APP. It includes commitments to gradually remove fertilizer and shallow tubewell subsidies and liberalize the fertilizer trade, improve the policy environment for private sector activities, and implement other institutional reforms and strengthening outlined in the APP. It is recognized that substantial improvements will be required in resource mobilization and/or expansion of external support.

24. The Ninth Plan also emphasizes the need for reducing regional imbalances through socioeconomic advancement of the less developed regions. The Government recognizes that prioritization and close monitoring of investments and the preparation of three-year rolling investment plans are crucial to realizing higher and sustainable growth. The Ninth Plan also envisages developing the country's own natural, human, and economic resources to gradually reduce dependence on foreign aid. However, overdependence on foreign financing will be resolved if the Government is able to effectively implement the planned reforms in tax structure and administration, including the value-added tax (VAT).<sup>13</sup>

<sup>13</sup> Introduced on 16 November 1997. Resistance from the business community has delayed full implementation.

25. The major thrusts of the Ninth Plan are in the right direction, but the targets are ambitious. Achievement of these targets will require substantial resources, and an unprecedented commitment to effective implementation of well-targeted programs. Poor domestic resource mobilization, shrinking external resources, and administrative instability are working against the realization of these targets. The Ninth Plan targets an average annual growth of 6 percent, but average growth for the first two years (FY1998 and FY1999) was less than 2.5 percent, which barely matches the estimated annual population growth. Of particular concern is the negative growth of agricultural output per capita for the past two years. In the absence of clear progress in implementing structural and policy reforms and institutional development, there is a real risk that the country will continue to suffer from the constraints that have prevented it from breaking the vicious cycle of poverty.

### III. DEVELOPMENT ASSISTANCE EXPERIENCE AND OUTLOOK

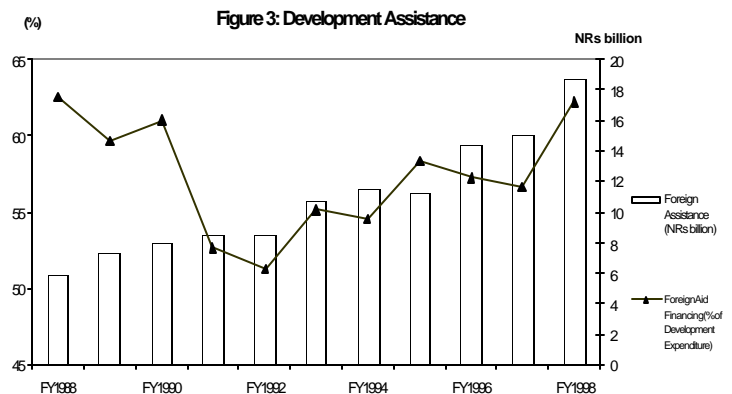
#### A. Experience

##### 1. General

26. Multilateral and bilateral aid agencies have provided substantial and increasing aid flows to Nepal. Foreign assistance increased more than two times in the past decade and financed more than 60 percent of development expenditures in FY1998 compared to barely 50 percent in FY1992 (Figure 3). Total official development assistance (ODA) inflows amounted to 6 percent of GDP in FY1998. Japan is the largest bilateral source, accounting for nearly half of the total bilateral flows, followed by Denmark, Germany, United States, and United Kingdom.

The Bank and World Bank are also important sources of ODA. Most bilateral grant assistance has a regional or sector focus, or both, with a concentration on social sectors and soft components, including capacity building and training. The Government has made it clear that it prefers not to finance these sectors with borrowings; thus, the Bank and World Bank have focused on developing social and physical infrastructure. Past Bank investments have included cofinancing arrangements with bilateral agencies. The size and range of sector assistance provided by the Bank and World Bank give considerable leverage to engage in policy dialogue with the Government and to assist it in pursuing macro and sector-level policy reforms particularly in public expenditures, agriculture, industry, energy, tourism, roads and civil aviation. The International Monetary Fund (IMF) and World Bank have supported the Government in macroeconomic management through structural adjustment programs.

27. There have been major improvements in coordination/collaboration among aid agencies at project and sector<sup>14</sup> levels, especially in terms of avoiding overlapping activities. The aid community is now focusing on improving such efforts through agreement of common sector development frameworks to increase leverage and ensure consistency in the policy and institutional reforms needed to improve investment efficiency.



<sup>14</sup> The process of formulating the APP was a good example of aid agencies working together effectively.

## 2. Evaluation of the Country Operational Strategy

28. The objective of the last Bank country operational strategy was poverty reduction, with emphasis on broad-based economic growth, while supporting basic social services and environmental protection. This guided Bank investment to growth-oriented projects and programs in agriculture, transport, energy, tourism, industry, social services, and projects with distributive effects. The strategy also supported private sector development. Although essential areas of intervention were identified, the planning and formulation of past assistance lacked (i) sector development plans (road maps) to provide a framework for Bank interventions to meet short-, medium-, and long-term objectives; (ii) performance standards to verify the achievement of development impact; and (iii) required time frame to establish and develop the necessary institutions to sustain development. These deficiencies will be rectified in the new strategy.

29. When the 1993 strategy was prepared, Nepal had its first democratically elected government, the IMF was supporting macroeconomic management reforms under an enhanced structural adjustment facility (ESAF), and the first industrial exports (carpets and garments) were recording strong growth. Five years later, the macroeconomic environment had deteriorated on most fronts (particularly saturation of export destinations and slow resource mobilization). The continued political turmoil since 1994 has stalled necessary reform measures to further liberalize the economy. The ESAF program expired in 1995, without the release of the second tranche, because of Government failure to implement the agreed-upon structural reforms including measures to improve resource mobilization, implement the VAT, and expedite privatization. Attempts were made to develop a new program, but the IMF currently has no specific plans to resume the program because of the social and economic environment, and the political instability.

30. While Bank assistance has created assets in key sectors, sustainability in operation and maintenance (O&M), and the generation of longer term development impact have been limited. Poverty incidence remains high, and social and human development indicators low. The limited progress has not been commensurate with past investment levels and benefits envisaged. Anticipated progress in institutional strengthening and policy improvement were not fully realized. All these factors have adversely affected the delivery of development assistance.

## 3. Bank Experience

31. The Bank approved a total of \$1.6 billion for loans and \$49 million in technical assistance (TA) grants<sup>15</sup> to Nepal, between the commencement of Bank operations in 1968 and the end of 1998. Bank assistance has contributed to an expansion of the country's physical assets and some development of human resources, but many of the outputs from past investments have not been sustainable, and the overall development impact has been limited. Substantial delays in project implementation and failure to comply with specific loan covenants remain as major problems in achieving the desired objectives.

32. The performance of Bank-financed projects in Nepal compares unfavorably with Bank-wide performance, and with the performance of Group A<sup>16</sup> and other South Asian<sup>17</sup> countries (Table 2). Of 31 postevaluated Bank projects, 26 percent were classified as unsuccessful, compared with 11 percent Bank-wide, 15 percent in all Group A countries, and 13 percent in all South Asian countries. Of the 10 most recently postevaluated projects, only 2 were considered generally successful, 5 were partly successful, and 3 were rated unsuccessful. Given the importance of the

<sup>15</sup> Bank and Japan Special Fund resources. The Bank also administered another \$36 million in technical assistance funds approved by other aid agencies.

<sup>16</sup> The Bank classified 19 of its 57 member countries in Group A, of which GDP per capita is less than \$600 a year.

<sup>17</sup> Includes Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka.

agriculture sector in the country and its importance in the Bank's investment portfolio,<sup>18</sup> it is of particular concern that three of the eight most recently post-evaluated agriculture projects were rated unsuccessful. The overall agriculture sector performance has been very disappointing, with per capita agriculture output declining during the 1990s (growth in agriculture value added of 2.3 percent per year, compared with the annual population growth of 2.5 percent).

33. Inappropriate project design, inadequate policy and institutional environment, lack of ownership, and insufficient monitoring and supervision are major causes of unsuccessful projects<sup>19</sup> (see also paras. 37-38). Political instability, inefficient administration, policy distortion, and institutional weaknesses continue to hamper private sector development and adversely affect the effectiveness of development inputs to generate and sustain longer term development impact. Poor governance and corruption are of major concern to all segments of society.

**Table 2: Summary of Postevaluation Results  
(as of 31 December 1998)**

Country	Total No. of Projects	Generally Successful (%)	Partly Successful (%)	Unsuccessful (%)
Bank-wide	527	56.9	31.3	11.2
Group A countries	230	47.8	36.5	14.8
South Asia	165	49.7	36.4	13.3
Nepal	31	48.4	25.8	25.8

34. On the positive side, there is increasing evidence in Bank-supported projects that the involvement of local groups and communities can help achieve the desirable impact of development assistance<sup>20</sup> in such areas as rural water supply and sanitation, farmer-managed small-scale irrigation, and labor-intensive rural road construction as seen in Bank investments formulated in the past few years.<sup>21</sup> Greater consultation with stakeholders and their participation at the local level during the formulation and implementation of development assistance are crucial to enhancing ownership and sustaining the favorable impact of investments.

#### 4. Other Aid Agencies

35. The presence of aid agencies in Nepal is substantial. Many different bilateral and multilateral agencies assist most subsectors (see also Table E2). Aid agencies have made increasing efforts in recent years to coordinate their activities to provide complementary assistance. Bilateral assistance generally focuses on social and physical infrastructure projects, and institution and capacity building. Multilateral assistance has included direct involvement in supporting policy and institutional reform. Collaboration between the Bank and bilateral sources in power, irrigation, and livestock development has been strengthened by combining capital investments with policy and institutional reform initiatives.

<sup>18</sup> The agriculture sector contributes about 42 percent of the GDP; 49 percent of the Bank's past investment supports agricultural development.

<sup>19</sup> See also Postevaluation Office. 1993. *Country Synthesis of Postevaluation Findings for Nepal*. Manila, ADB.

<sup>20</sup> The mobilization of community-based groups to implement rural water supply and sanitation schemes has generated favorable results, particularly in promoting ownership, enhancing the sustainability of project benefits, and improving women's status.

<sup>21</sup> Loan No. 1165-NEP(SF): *Third Water Supply and Sanitation Sector*, for \$20 million, approved on 25 June 1992.

Loan No. 1311-NEP(SF): *Irrigation Management Transfer*, for \$12.9 million, approved on 13 September 1994.

Loan No. 1437-NEP(SF): *Second Irrigation Sector*, for \$25 million, approved on 16 May 1996.

Loan No. 1450-NEP(SF): *Rural Infrastructure Development*, for \$12.2 million, approved on 27 June 1996.

Loan No. 1464-NEP(SF): *Fourth Rural Water Supply and Sanitation*, for \$20 million, approved on 24 September 1996.

36. Local aid agency meetings at project and sector levels are convened on a regular basis. The Nepal Aid Group, which normally convenes every 18 months, last met in Paris in April 1996. The group has not met in recent years because of the frequent changes in government. The aid agencies generally agree that it has become increasingly difficult to implement development activities through national-level institutions. More successful experiences are being reported in projects that facilitate the mobilization and/or utilization of local groups like farmers groups, women's organizations, water users associations, and cooperatives to assist in identifying, formulating and implementing development assistance projects. This approach, which is also consistent with Bank experience, not only enhances ownership but also promotes sustainability through local ownership, and the development of local institutional capacity.

## **5. Lessons Learned**

37. The major factors contributing to the poor performance of Bank operations in Nepal include (i) inappropriate project design without sectoral road map; (ii) inadequate Bank monitoring and supervision; (iii) failure to enforce loan covenants; and (iv) inadequate assessment of institutional, policy, and fiscal requirements. The effectiveness of key development and market institutions essential to competitive markets has been weakened by frequent changes in government, inefficient administration, and perceptions of widespread corruption.

38. Key lessons to consider in formulating the new strategy are as follows:

- (i) Stakeholders participation. Local ownership in the design, implementation, O&M, and utilization of Bank-supported facilities will contribute substantially to improve project quality. Broad-based support for policy and institutional reforms is crucial in securing and sustaining meaningful change. The Bank needs to consult more widely with all stakeholders in planning projects, and policy and institutional change, and to clearly document the consultative process and findings.
- (ii) Institution and long-term assistance. Institution-building assistance has too often focused on strengthening Government Agencies and State-owned enterprises to meet project-specific needs. Planning for institutional strengthening should reflect broader and longer term sector development needs and consider alternative institutional arrangements such as development of grassroots institutions, privatization of public utilities and state enterprises, transforming the role of Central Government agencies, and contracting out the provision of public services.
- (iii) Sector approach (road maps). Interventions need to be consistent with the sector development plan with short-, medium-, and long-term development objectives. Performance standards need to be used to verify the achievements and help formulate and justify further interventions.
- (iv) Loan covenants. Loan covenants on policy, institutional and financial issues that are crucial to effective project implementation and ensuring sustainability of project benefits need to be formulated and implemented with extensive stakeholders consultation and strong support. The Bank has often not exercised necessary measures to enforce loan covenants during project implementation.
- (iv) Market conditions. Bank interventions often depended on public subsidies or other market distortions (including State-owned enterprises). By supporting an expanded public sector, these interventions prevented effective private sector participation in distorted markets (e.g., fertilizers, irrigation, rural credit, and power). The Bank needs to focus on promoting a competitive environment.

- (v) Governance/corruption. Problems with transparency and accountability and inadequate competition are major constraints to the effective delivery of public services in all sectors. An analysis of these issues and strategies for improvement needs to be built into the design of all projects.

39. The need to reorient the strategy for future Bank operations in Nepal to take account of these lessons has been highlighted in consultation with government officials, aid agencies, non-government organizations (NGOs), the private sector, community groups, and beneficiaries, as well as within the Bank.

## **B. Prospects**

### **1. Resource Flows**

40. The issue of future resource flows is secondary to the need to achieve greater development impact. Growth will be accelerated with focused investment priorities provided that investment efficiency is raised to levels closer to regional norms. The aid community has growing concerns about the political and institutional constraints that are adversely affecting the utilization of foreign aid. While there is no indication of substantial decline in aid flows compared to the past, some aid agencies have increasingly directed their assistance toward local and grassroot-level organizations. Major sources including the Bank and World Bank intend to link future levels of assistance to demonstrated progress by the Government in implementing policy and institutional reforms needed to achieve greater development impact particularly through a changing role of the Government to promote private sector development and effectively implement decentralization.

41. There is potential for tapping private resources to finance development activities but this will require tangible progress in developing an effective market and key institutions, and in implementing policy reforms to reduce barriers to private sector investment. Immediate prospects for foreign inflow of private capital are poor because of the policy environment and lack of credibility in the formal institutions needed to enforce contracts and protect property rights.

### **2. Prospects for Greater Development Impact**

42. The economic and financial problems in Asia, the international economic slowdown, and the global reduction in the availability of official development assistance make it increasingly urgent that the Government quickly address fundamental domestic constraints to attracting and making more efficient use of investment resources. While resolving institutional constraints is a long-term task, immediate steps can be taken to substantially improve the prospects including civil service reform and measures to improve governance and reduce corruption. External resources may facilitate this process, provided there is strong commitment and tangible progress. The Bank needs to allocate more resources to monitoring and evaluating the development impact of Bank interventions. Equally important are the issues of governance and decentralization, both of which are determinants in achieving greater development impact. Bank resources will be needed to complement the work being done by other donors in this areas and to support the implementation of the Local Self Governance Bill, More work needs to be done in developing operational models that involve the stakeholders more effectively in every stage of the project cycle.

## **IV. THE BANK'S FUTURE ROLE IN NEPAL**

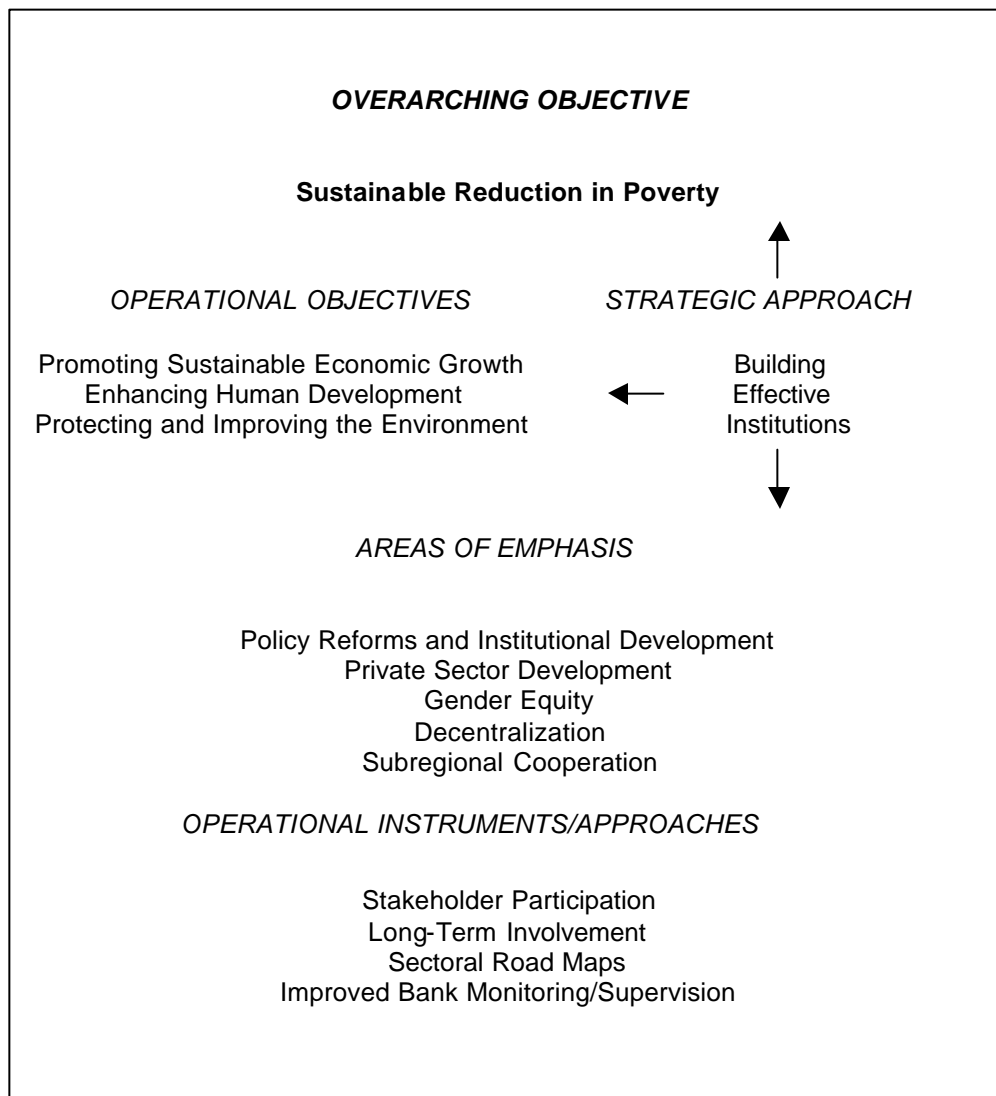
### **A. Broad Thrust**

43. The overarching goal of the Bank's operational strategy is to achieve sustainable reduction of poverty through

- (i) generation of productive employment opportunities and increased rural incomes resulting from faster and broad-based economic growth;
- (ii) equitable improvements in basic social services to enhance human development resulting in reduction of population growth; and
- (iii) protection and improvement of the environment to sustain these gains.

44. Achieving this goal is particularly difficult in Nepal because of the lack of efficiency, transparency, and accountability of key development and market institutions essential to the development process. It is difficult to achieve any sustainable improvements in social and economic well-being without public confidence and support for these key institutions. Thus, building *effective institutions* needed to implement development activities and to support a market economy is the strategic approach that will be taken. Improved governance will require policy and institutional reforms, capacity building, and strengthening of key institutions to adapt to a changing role of promoting private sector participation. Support to implement the Government initiative in decentralization including utilizing local administrations to plan and implement development activities are also important cross-cutting elements of the strategy. Other strategic elements include private sector development, gender equity, and subregional cooperation. A thematic representation of the Bank strategy is summarized in Figure 4.

**Figure 4: Bank Strategy**



## B. Criteria for Intervention

45. The new strategy emphasizes that building capacity in order to maximize and sustain the development impact of investments must take precedence over levels of assistance. The importance of learning from past mistakes and successes by development partners is also highlighted. Bank interventions will be most effective under the following environment.

- (i) Stakeholders participation. Bank assistance has been most successful when activities and interventions have been formulated and implemented with extensive stakeholder consultation and strong support. A clear demonstration that such consultations have taken place — and that there is strong stakeholder support for the proposed Bank interventions — will be prerequisites for all Bank interventions under the new strategy.
- (ii) Sectoral road maps. The formulation of long-term institutional development strategies with clearly identified road maps for sector development is critical in planning future assistance. Performance standards with verifiable and monitorable indicators need to be established to guide future interventions. Improved Bank monitoring and supervision must include a focus on progress in following these road maps as a criterion in annual country programming.
- (iii) Civil service reform. Institutional development strategies endorsed by the 1992 Administrative Reform Commission and the Ninth Plan need to be vigorously implemented. Political interference needs to be minimized in routine civil service operations. Of particular concern is the high rate of turnover of civil servants and managers of many Bank-financed projects. Such interference has adversely affected civil service morale and institutional capability, and has had a major negative impact on the effectiveness of Bank assistance. Progress in civil service reform will be a key criterion in annual programming.
- (iv) Governance/corruption. While civil service reform will be an important element in Bank efforts to improve governance, future Bank assistance will also be linked to tangible progress toward achieving greater transparency and accountability in national procurement, bidding procedures, and customs administration to ensure compliance with Bank guidelines and policies on anticorruption.<sup>22</sup> Improvements are needed in enforcing contracts and property rights. Allowing international accounting and auditing firms to practice in Nepal will help improve corporate governance and promote an environment more conducive to private sector participation.
- (v) Policy and institutions. Bank support to particular sectors/subsectors will depend on actual progress — and the prospects for further improvements — in strengthening the policy and institutional environment in these sectors. A clearly documented assessment of whether the policy and institutional environment is conducive to achieving sustainable development impacts will be required prior to consideration of any new investment projects. Longer term technical assistance will support the policy and institutional reforms needed to create such an environment. Satisfactory progress in pursuing policy and institutional improvement under past Bank assistance will be most important.

<sup>22</sup> Asian Development Bank. 1998. *Anti-Corruption Policy*. Manila: ADB.

### C. Criteria for Sector Involvement

46. To effectively use the Bank's limited concessional resources, a sharper focus on fewer sectors/subsectors will be necessary. Future involvement in any sector/subsector will require that the following criteria be met:

- (i) The interventions will contribute directly or indirectly to reducing poverty.
- (ii) There is evidence of Government commitment to the necessary policy and institutional reforms, and of adequate institutional capacity to implement these reforms.
- (iii) The Bank will play a substantive role in a sector or subsector where it has a comparative advantage.
- (iv) Interventions will play a catalytic role in mobilizing additional financing from official and/or private sources.
- (v) Interventions will support the development of a competitive market economy.
- (vi) There is evidence of success or progress in past interventions of the Bank or other donors, including compliance with loan covenants.

47. Based on the assumptions<sup>23</sup> of Bank's current indicative planning figure<sup>24</sup> (IPF) for Nepal and the intensity of involvement in any sector over a period of time to sustain desired development impact, the Bank would focus on up to 10 sectors/subsectors compared with 18 sectors/subsectors<sup>25</sup> in the past. Ten indicative sectors/subsectors are identified to allow future Bank assistance to focus on the three operational objectives: (i) promoting economic growth; (ii) enhancing human development; (iii) protecting and improving the environment (see Figure E1). The sectors/subsectors include: (i) agriculture, (ii) irrigation, (iii) roads, (iv) power, (v) finance, (vi) basic education, (vii) health, (viii) water supply and sanitation, (ix) environment improvement, and (x) natural resources management.

48. Implementation and monitoring of the APP will be the main thrust of rural development efforts. Improvement of corporate governance and legal regulatory functions of prudential agencies within the framework of financial sector reform will help to develop the necessary environment for effective resource mobilization as a key to private sector development. Support to infrastructure will focus on roads and hydropower development, with emphasis on promoting private sector participation in infrastructure development. The Bank aims to promote human development with support to basic education, health, and water supply and sanitation. Environmental protection and improvement will be supported through environmental management, and watershed rehabilitation and management. Tourism will be promoted through public and private partnership in improving environmental management particularly to enhance rural tourism. Actual sector/subsector involvement will, however, be assessed and justified during the annual country programming based on the preceding criteria.

<sup>23</sup> Assuming Bank's annual lending of \$80 million a year and average loan size of \$20 million, the Bank will revisit the sector with an investment project every four years to support the momentum of institutional and policy reform measures. For a 10 year-period, which is a reasonable timeframe for sustainable development, the Bank can assist up to 10 sectors/subsectors.

<sup>24</sup> Corresponds roughly to the average annual disbursement of Nepal.

<sup>25</sup> These include forestry, irrigation, crop diversification, aquaculture, livestock, rural roads, rural credit, primary education, secondary education, technical and vocational education, highways, civil aviation, tourism, rural water supply and sanitation, urban development, power generation, power transmission and distribution, and industrial development.

## **D. Operational Thrust of the Strategy**

49. Figure E1 summarizes the policy and institutional focus of the Bank strategy. Key institutions are identified as focal points to translate and implement the strategy in achieving the strategic objective of effective institutions through their changing roles in promoting the participation of stakeholders and the private sector. The operational framework of the new strategy summarized in Figure E2 provides necessary linkages of future Bank operations in various sectors/subsectors to the corresponding objectives with government strategies and activities of other key aid agencies. Sector development plans (road maps) summarizing the policy and institutional development framework for key sectors/subsectors and demonstrating the proposed approach will be prepared and agreed upon by the stakeholders. Performance standards will also be established to measure progress toward the different stages of sector/subsector development.

### **1. Economic Growth**

#### **a. Agriculture and Irrigation**

50. Sustainable improvements in rural development are essential to reducing overall poverty, as the incidence of rural poverty is more than 2.5 times that in urban areas. Despite the large investments in agriculture in past decades, agricultural productivity has declined. The main thrust of Bank assistance for rural development will be to support and monitor the implementation of the APP. The APP aims to address institutional and policy weaknesses that have constrained past agricultural development efforts, and to achieve a sustainable annual agricultural growth of 5 percent over the next 20 years. It includes a packaged approach to agricultural development, in which priority inputs (fertilizer, irrigation, roads, power, credit, and agricultural technology) will be provided as an integrated package to boost productivity. The investment requirements and priority needs for improvements in the institutional and policy environment are specified with clear objectives and targets. The participatory process adopted in formulating the APP will continue during its implementation.

51. The Bank's ongoing agriculture program loan<sup>26</sup> aims to address policy and institutional impediments to realizing the planned increase in agricultural productivity under the APP. The program includes liberalization of fertilizer trade and removal of the remaining distortions in irrigation, food grain marketing, and rural credit. Successful implementation of the program loan is crucial to successful implementation of the APP and future sector investments.

52. Interventions in agriculture will contribute to diversification of production opportunities and improvement of productivity. Bank assistance to the irrigation subsector will aim at mobilizing community groups to directly involve them in identifying, designing, implementing, and maintaining the project. Any additional assistance to the irrigation subsector will depend on demonstrated improvements in implementation capacity in the Bank's ongoing assistance.

#### **b. Rural Roads**

53. In developing other rural infrastructure and supporting services, a more flexible approach will be taken, but for increased efficiency of Bank assistance there still needs to be clear and active participation of all stakeholders, including community groups and the private sector, at all stages of

<sup>26</sup> Loan No. 1604-NEP(SF): *Second Agriculture Program*, for \$50 million, approved on 22 January 1998. With full compliance with all first tranche release conditions, including first phase removal of subsidies on urea and shallow tubewell irrigation facilities, action plan to restructure Agriculture Inputs Corporation, Nepal Food Corporation, and institutional reforms in Ministry of Local Development, the first tranche amount of \$25 million was released soon after the loan was declared effective on 9 March 1998.

the project cycle. The Bank will continue to support reforms and institutional strengthening needed for O&M of completed facilities in a sustainable manner. The implementation of the rural infrastructure strategy and the road network master plan will be crucial to successful implementation of the APP. The promotion of labor-intensive methods in rural road construction, which has effectively increased the participation of and ownership by local communities, will continue to be pursued.

### **c. Rural Electrification**

54. Bank assistance in power transmission and distribution will be directed to supporting APP implementation. Although substantial assistance has been provided to the Nepal Electricity Authority (NEA), NEA still suffers from high technical and nontechnical losses and its financial performance is not sustainable. The commercialization of NEA is critical to improving the efficiency and financial sustainability of the sector. Priorities include reduction in high nontechnical losses; and implementation of NEA's commercialization strategy including strengthening of management capabilities, pursuing public-private partnership in generation and distribution, and ensuring increased autonomy for NEA. Compliance with the financial covenants of Bank loans is a prerequisite for sustainability, commercial viability, and future Bank assistance. Modalities will be sought for more effective and efficient delivery of electricity in rural areas through cooperatives or such agencies.

### **d. Finance**

55. Improvements in financial intermediation and a deepening of the financial sector are needed to enhance resource mobilization and to facilitate private sector development. Inefficiencies in the three Government-owned banks dominating the sector — Rastriya Banijya Bank, Nepal Bank Limited, and Agricultural Development Bank of Nepal (ADBN) — impede the development of an efficient financial sector. These banks urgently need to be restructured to operate on sound commercial principles. The ADBN is the major supplier of rural finance in Nepal, but despite decades of Bank TA for institution building, the ADBN is nonviable due to major problems with project appraisal, loan monitoring, loan recovery, and financial management.<sup>27</sup> These weaknesses constrain APP implementation and financial sector development. The Bank will also actively support efforts to develop an institutional and policy environment to improve corporate governance and legal regulatory functions of prudential agencies including the Nepal Rastra Bank (the central bank) in the financial sector to enhance resource mobilization and private sector development. Interventions to facilitate the delivery of rural savings and credit institutions including microfinance institutions such as the five regional development banks and the new apex institutions of rural microfinance will be consistent with this framework. Efforts in the financial sector reforms pursued by the World Bank and IMF will be complemented.

### **e. Roads and Hydropower**

56. The key focus will be on promoting private sector investments in major roads and hydropower projects. Adequate provision of O&M for existing roads and facilities continue to the key policy and institutional agenda. In particular, the Bank will work with the Government to formulate a well-defined institutional, policy, and legal framework for private sector participation in hydropower development, and in developing modalities for effective public/private partnership. While the Bank will adopt a flexible approach to promoting private investment, assistance will be considered only where interventions are consistent with a coherent water resources policy for developing water supply, irrigation, and hydropower, with appropriate environmental safeguards. The current regulatory framework is particularly weak in providing incentives for private sector

<sup>27</sup> Postevaluation Office. 1998. Loan NEP(SF) 831: Fifth Agriculture Credit. Manila: Asian Development Bank.

investment in export-oriented power development. Bank interventions will be planned in the broader context of efforts to develop subregional cooperation, particularly in developing the road network to enhance linkages to trade and market opportunities.

## **2. Human Development**

57. Accelerated improvements in human development are critical in achieving sustainable poverty reduction, and greater social stability. They are also critical for accelerating growth in labor productivity, reducing population growth, and efficient and sustainable investment. Sustained improvements in human development are constrained by weak institutional capabilities and the limited availability of public resources, the traditional source of investment in the social sectors. Unless necessary policy and institutional measures to ensure effectiveness of the delivery mechanism and sustainability of sector investments are undertaken, increased investments will have limited impacts on human development and will increase future liabilities with higher O&M costs. Although there have been good results in using community and local groups to formulate and implement subprojects, substantive improvements in human development will require strengthening of the institutional capability to deliver and sustain investments. Greater efforts are required to encourage private sector participation in the delivery of social services.

58. Given the overall goal of poverty reduction, the major geographical focus of Bank assistance will be the rural areas. Community groups must be the primary targets in planning and delivering assistance for human development, but there is also a need to support policy and institution building at the national level. The Bank will support community initiatives in the rural areas to develop water supply facilities that will be maintained by local communities or private enterprises. The Bank will also look for opportunities to support the development of other social services in local communities, including literacy and skills training. Efforts will be made to link the identification and planning of such services with the implementation of other community projects, such as water supply projects. This will allow the Bank to build on past investments that have proven to be effective in meeting community needs and in developing good working relationships with community groups. Support to community initiatives will focus on women's groups as experience has shown that this approach generates more sustainable results.

### **a. Education**

59. A basic constraint to rural development is the poor status of basic education and high rates of adult illiteracy in the rural areas. Literacy and school enrollment rates are particularly low among women. This makes it more difficult to mobilize and coordinate community groups, to transfer new ideas and technologies, and to develop the capacity to initiate local development activities. Improvements in basic education have the potential to generate substantive development impact at all levels. The Bank will support institutional and policy reforms and development of a sectorwide strategic framework to address the major policy and institutional constraints to effective delivery of basic education services.

60. Bank assistance to the education sector will be guided by the Bank's sector strategy study<sup>28</sup> and will focus on the Government priority for basic education, which comprises primary and lower secondary education. While access to primary education (grades 1 to 5) has improved dramatically, the efficiency of primary education is low, with high repetition and dropout rates. There are considerable disparities in access by gender and by geographic location. The quality of education needs to be improved through teacher training, curriculum development, and better school management, maintenance, and supervision. In line with the Government's decentralization policy, the Bank will support the delegation of management responsibilities to the local level, so

<sup>28</sup> TA No. 2421-NEP: *Education and Health Sector Strategy Study*, for \$345,000, approved on 13 October 1995.

that local communities become responsible and accountable for resource mobilization and O&M of school facilities. Experience has shown that this will make primary education more responsive to local conditions and needs.

61. As part of basic education subsequent to completion of the primary level, Bank investment will also be made to the lower secondary education (grade 6 to 8). Bank's interventions will depend on the progress in providing adequate O&M for completed facilities and will aim to strengthen institutional development and quality of service delivery in the sector, as well as expand and upgrade physical facilities, teaching materials, and teachers' training.

62. Given the high primary school dropout and high adult (especially women) illiteracy rates, the expansion of nonformal education (NFE) is essential. NFE is effective in providing other life-related knowledge and basic skills. The Government has taken initial steps to facilitate and coordinate NFE by forming a National Council for NFE, and establishing district NFE committees under each district development committee (DDC). There is still a need to improve the quality of public and private partnership. Bank assistance for NFE will include (i) developing a long-term policy and strategy framework for NFE; (ii) institutional building to strengthen national, regional, and district coordination and implementation; (iii) quality control; and (iv) aid agency coordination to mobilize financing.

#### **b. Health**

63. Given that weak institutional capacity and governance are the major bottlenecks in the health sector, Bank assistance will focus on addressing structural and management issues (footnote 28). The Ministry of Health (MOH) issued its Second Long-Term Health Plan (1997-2017) in April 1997. The plan gives priority to providing cost-effective but high-quality interventions, including health prevention and awareness, on a needs basis. This is to be done using decentralized management and community participation. Major emphasis will be on developing an appropriate public-private mix in providing and financing health services including family planning. Past priorities had been on improving access by adding new facilities. Some 40 percent of past Government expenditure on the health sector were spent on a few hospitals in Kathmandu, leaving inadequate funds for providing basic primary health care services.

64. While MOH has developed an appropriate policy framework to address the above-mentioned constraints, more work needs to be done to improve public health sector performance, allocation efficiency, management, and quality of care, and to increase the coverage of the most cost-effective interventions. Bank assistance will closely coordinate with that of other aid agencies and will be limited to (i) defining the roles and responsibilities of government (central and local levels), private sector, and NGOs in the sector; (ii) developing district and village-level health services with increased autonomy and authority; (iii) enhancing the management of district hospitals, primary health care centers and subcenters, personnel, and logistics; (iv) delineating responsibilities for curative and preventive/promotive services; and (v) promoting a public-private mix in health sector financing.

#### **c. Water Supply and Sanitation**

65. Large gender disparities in levels of human development have emerged mainly from biases in the social norms. The reform and strengthening of education services will be critical to long-term changes in the social norms. More immediate results can be achieved by increased investments in projects that particularly benefit women and children. Access to safe water has demonstrated an immediate and substantial impact on women and children in terms of time saved in fetching water and looking after sick family members suffering from waterborne diseases. It has given women more time to participate in development and income-generating activities, and improved the prospects for children to remain in school.

66. Public sector financing will be extended to develop community-based water supply projects in rural areas, and to restructure the provision of urban water supply services through strong public-private partnership under the proposed Secondary Towns Water Supply and Melamchi Water Supply Projects respectively. Both initiatives require continued Government commitment to fundamental changes in existing institutional arrangements, including a major restructuring of the Nepal Water Supply Corporation. Progress in implementing these reforms is crucial to sustaining future sector investments.

### **3. Environment**

67. The Bank will support environmental education to improve public awareness of the opportunities for participating in environmental management. There is good potential for positive synergies in environmental management and human development, and efforts to promote wider involvement of the private sector, local communities, NGOs, and the general public are urgently needed. The Bank will support the development of alliances and business cooperation between the general public, private sector, and central and local governments to deliver environmental management services in both rural and urban areas. The Bank will pursue further involvement in solid waste management and sanitation in collaboration with local communities and the private sector; air and water pollution monitoring in cooperation with NGOs; and introduction of policy measures and economic instruments for better environmental management in tourism, renewable energy, energy conservation, and urban development.

#### **a. Environment Improvement**

68. There is an urgent need to address urban environment issues. Protection of the environment is particularly critical to sustainable economic development in Nepal (see appendix 2). All major economic sectors, and potential areas of economic growth including agriculture, hydropower, and particularly tourism depend directly on the sustainable management of natural resources. Poor air pollution controls and waste management in urban and other tourist areas are adversely affecting the health of the people and the potential for tourism development. Given the weak government institutions, it is critical to have a more direct involvement of community groups and the private sector in resolving these issues. Future assistance will depend on progress in the institutional development of the Kathmandu Metropolitan City to establish effective delivery mechanisms for urban services in a sustainable manner and the Nepal Tourism Board to develop public and private partnership in environmental management to enhance rural tourism.

#### **b. Natural Resources Management**

69. Natural resources need to be managed in a more sustainable manner. Air, water, and soil pollution from industrial and agricultural activities need to be reduced. Forest encroachment, poor watershed management, and increasing agricultural cultivation in marginal areas represent major threats to the sustainable development of agriculture, forestry, and livestock, and to future utilization of the country's considerable water resources. Poor natural resource management is also a threat to rural tourism, which has tremendous potential to increase rural employment and reduce poverty. Developing and implementing the institutional and policy reforms needed to promote private sector participation in investments to protect and improve the environment, and providing environmental management services are key priorities.

70. The Bank will complement the work of other aid agencies in the forestry sector through watershed rehabilitation using ecosystems approaches and collaborative links between the Government, local community groups, and specialist NGOs. The institutional arrangement and capabilities of the executing agencies will need to be thoroughly analyzed and, if necessary,

restructured to support further expansion of the cooperation between the Government and the private sector in further promoting community-level management of forestry and watershed development activities.

## **E. Gender and Development**

71. In line with the emphasis of the Ninth Plan on elimination of gender inequality, the Bank strategy takes a holistic approach to systematically addressing key constraints at the policy, institution, sector, and project levels. The gender strategy for Nepal (see appendix 3) includes (i) assistance to policy support, capacity building, and awareness raising and (ii) gender analysis of proposed projects.

72. Bank assistance will emphasize women empowerment in the development process, consistent with the Bank's policy on gender and development.<sup>29</sup> The Bank has appointed a gender and development specialist at the Bank's Nepal Resident Mission (NRM) to further enhance these efforts in the field. Future interventions will aim at addressing multiple constraints women face particularly limited access to and control over productive resources, low educational attainment, and low social and economic status. Interventions will be planned and formulated to enhance economic opportunities and status of women, for example in rural microfinance, nonformal education, and water supply and sanitation projects.

73. Mainstreaming of gender issues and gender sensitization need to be promoted at all levels. Moreover, empowerment at the stakeholder level will be the focus of the new strategy. Women can be empowered when economic opportunities are preceded by social mobilization/preparation, often with literacy programs. Positive group dynamics have been noted in a number of water supply projects where drinking water groups were formed. These projects have added advantage of lessening women's work burden and helping to reduce morbidity and mortality.

## **F. Regional Cooperation**

74. The Bank will build on past success in developing bilateral partnerships to further enhance growth potential through regional cooperation between Bangladesh, Bhutan, India, and Nepal. The Bank aims to address constraints identified under past regional cooperation initiatives and to continue consultations with governments and other stakeholders on the modalities for pursuing economic cooperation under the South Asia Growth Quadrangle initiative. The Bank will continue to involve Nepal in regional technical assistance activities to disseminate information about regional best practices, particularly in relation to governance, institutional development, poverty reduction, financing and provision of social services, and private sector development. Potential areas of cooperation include multi-modal transport and communication, energy (particularly hydropower development), trade and investment facilitation and promotion, natural resource utilization and environmental management, and tourism.

75. The establishment of better road network in the region will improve the access to markets and trade opportunities including Bank's recent assistance in providing support for the upgrading of the north-south transport corridor in West Bengal. Further support is being envisaged through a TA for inland waterway in West Bengal. The Bank is also planning a regional technical assistance to examine the potential of nontradable and service sectors for broadening the subregional initiatives among South Asian countries. Development of Mahakali basin will also be a potential area of cooperation between governments of India and Nepal in water resources management. The Bank is working closely with the Chambers of Commerce and Industries of the four countries to strengthen their advocacy role in subregional cooperation and to promote closer cooperation

<sup>29</sup> Asian Development Bank. 1998. *Policy on Gender and Development*. Manila: ADB.

among the private sectors groups in these countries. Further assistance will be planned to develop the policy and institutional framework needed to realize potential benefits from regional cooperation with project-level initiatives involving bilateral or trilateral linkages.

## **G. Governance**

76. The Bank will support initiatives to implement decentralization through policy and institutional measures to strengthen the local administrations including village development committees and district development committees, which will plan and implement development activities to ensure ownership and better serve local needs. Working with other development partners, the Bank will support Government efforts to implement the institutional development strategies endorsed by the 1992 Administrative Reform Commission and the Ninth Plan. The formulation and implementation of an action plan for civil service reform is a key priority of the Government. Issues to be addressed include reduction in the number of ministries (and nonessential staff), improved remuneration, effective human resource planning, performance planning, reducing staff turnover, and better enforcement of financial and other regulations. The Bank will also support improvements in tax administration, and corporate and financial governance, including regulatory and institutional reforms aimed at encouraging increased competition and higher standards in accountancy, audit, and legal services. Training and advisory services will be provided to improve (i) enforcement in key regulatory agencies, (ii) record keeping, and (iii) interdepartmental coordination so as to increase investment efficiency, reduce investor risk, and better protect individual rights.

77. Political interference in the civil service, reflected in the unusually high rates of professional staff turnover, is a particular concern as it affects staff morale and further weakens the institutional capabilities of the civil service, thereby directly reducing the effectiveness of Bank assistance. Progress in addressing this issue will be closely monitored during strategy implementation. Bank support will also depend on tangible progress in the timely publication of performance and expenditure reports by government agencies and state enterprises, and in achieving greater transparency and competition in national procurement and bidding procedures based on the Bank's guidelines and policies on anticorruption (footnote 22).

## **H. Private Sector Development**

78. Private sector development is a key Government objective outlined in the Ninth Plan. The Government aims to develop the institutional framework as well as infrastructure such as energy, telecommunications and transport to encourage private sector investment. Despite its past efforts, private sector growth remains limited as it requires necessary reforms in good governance and institutional development as well as improvements in social and physical infrastructure, including human resources, roads and power.

79. Among reforms in good governance and institutional framework that sustained private sector growth include development of credible systems for enforcing contracts and other property rights, transparent and credible accounting and financial reporting systems, and an effective regulatory and supervisory system for good governance in the financial sector. Past failures to develop effective corporate governance practices has undermined company performance and private sector credibility, with negative consequences in terms of the availability and costs of financing.

80. The Bank's strategy for enhancing private sector development involves twofold approach: (i) the promotion of an enabling environment for private sector activities such as the enhancement of corporate and financial governance through the public sector window, and (ii) direct investment

in private sector companies in such forms as loan and equity through the private sector window. The Bank will support the Government's efforts in establishing transparent policies and basic mechanisms for corporate and financial governance, which are most essential for sustained private sector development. The Bank's direct investments in private sector companies will be considered for those projects that meet certain investment criteria such as commercial viability, catalytic effect and development impact. Investments that not only meet these criteria but also supplement and contribute to the promotion of an enabling policy environment will be given priority in view of promoting public and private partnerships.

## **I. Aid Agencies Cooperation**

81. The community of aid agencies increasingly recognizes that good governance and institutional reforms are the most immediate and crucial priorities in ensuring better use of external assistance. While aid agencies coordination has improved over time, it is mainly confined to project-level activities to avoid duplication of effort. Efforts to adopt a coordinated approach to sector development, including policy formulation and institutional development, have been inadequate. The APP provides a positive model in formulating a long-term perspective plan that involves all major stakeholders including the funding community. To maximize the impact of external resources, further collaboration and cooperation — not just coordination — in economic and sector work, policy formulation, institution analysis, and improvement are necessary. Aid agencies should agree on a development framework, which lays out the requirements for policy and institutional reforms and resource requirements for each sector, and to plan their interventions accordingly. Improved cooperation will be particularly important in power development, water resource management, and the delivery of health and education services.

## **V. INSTRUMENTS OF BANK SUPPORT AND IMPLICATIONS OF THE PROPOSED ROLE AND STRATEGY**

### **A. Modalities of Bank Assistance**

82. While the strong emphasis on policy and institutional reform in the Bank's strategy may suggest a need for program lending, past Bank experience with this modality in Nepal has not been encouraging. The Bank and the Government have tended to focus on the quick-disbursing feature of these loans with an apparent lack of ownership and realistic timeframe of the reforms that the program was intended to support. As a result, these agreed-upon reforms were often not implemented or properly enforced. Any additional quick-disbursing program assistance will be jointly formulated with the Government. Important elements of such assistance would include demonstrated Government and community commitment and stakeholder support to the reform measures, while institutional arrangements for effective implementation need to be carefully assessed and agreed upon. In this regard, the Bank needs to closely monitor and learn from experience in implementing the APP and the ongoing agriculture program loan (footnote 26).

83. Given the critical importance of policy and institutional constraints to development, a sector approach utilizing the cluster TA modalities will figure more intensively in future Bank operations. This modality is being planned for the environment sector. The Bank must recognize that major efforts in consensus building are needed to achieve a real sense of ownership, and that longer term support will produce meaningful change. In this regard, smaller and simpler projects that are commensurate with the institutional capabilities and at the same time support the building block approach in generating a multiplier effect from previous development efforts may be more appropriate.

84. In recent years, the Bank's NRM has been instrumental in improving project performance and facilitating project administration. The monthly project managers meeting<sup>30</sup> organized by NRM since 1995 has been most useful to address project implementation bottlenecks at an early stage. NRM has also actively assisted in involving all key stakeholders in program identification, formulation, implementation, and evaluating the long-term development impacts of Bank investments. This process has proved to be effective and well appreciated by all stakeholders. However, it is not possible for NRM to expand its current role towards this end without increasing its staff and financial resources.

## 1. Technical Assistance

85. The Bank will give greater emphasis to (i) improving the quality of project design and formulation by including strong local participation and support, and (ii) assessing whether the institutional and policy environment is conducive to private sector development and sustained development. Specific requirements for participatory approaches in both design and implementation, and for detailed analysis of institutional development needs would be included in the project preparatory stage. Extended advisory TA preceding project preparation can be important in improving project quality. More importantly, the Bank will need to allocate greater staff resources to effectively formulate, monitor, and evaluate projects in Nepal.

86. The emphasis in the strategy on sector development modalities implies a more critically important role for longer term advisory and operational TA in sectors and areas where the Bank plans to play a leading role in policy dialogue and institutional reform. Presently, the areas include agriculture and rural development, rural finance, water supply and sanitation, power, private sector development, and civil service reform.

87. Further development of economic linkages with neighboring countries will be an integral component of Bank support. The Bank will continue to take a proactive role in promoting subregional economic cooperation in South Asia, including the provision of regional TA to facilitate research and dialogue. Nepal can learn from the development experiences and best practices of other countries in South and East Asia. The Bank will continue to look for opportunities to include Nepal in relevant regional TA activities so that relevant best practices can be imparted to the appropriate authorities. Activities related to governance, institutional development, poverty reduction, financing and provision of social services, and private sector development will be particularly relevant to Nepal.

## 2. Lending Scenarios

88. The Bank's IPFs for Nepal have been based on the availability of Asian Development Fund (ADF) resources, the needs of the country, and its absorptive capacity. As the Bank emerges from a project-financing institution to a full-fledged development institution, Bank assistance will be result-oriented and ensure that the desired development impact will be generated and sustained. In line with the Bank's policy on ADF allocation,<sup>31</sup> future lending to Nepal will be linked to progress in addressing the major country performance issues that will improve the environment for both private and public investments. This is to ensure future levels of Bank investments will be commensurate with the necessary development of the policy and institutional environment of the country to generate and sustain the desired development impact. Five key areas have been identified and performance standards will be used for further monitoring and evaluation of achievements.

<sup>30</sup> The annual project manager award initiated by NRM since 1997 has added incentive and morale for the project managers of Bank-assisted projects.

<sup>31</sup> Asian Development Bank. 1998. *The Allocation of ADF Resource Among DMCs*. Manila: ADB.

89. Achieving a sustainable development impact from future Bank assistance will require tangible progress in (i) human development, (ii) fiscal performance, (iii) civil service reform, (iv) improving governance, and (v) portfolio performance. These key areas are essential to develop effective institutions in order to sustain desired development impact. Annual IPF will be guided by the progress and achievement in these areas.

- (i) Human development. Progress towards achieving a 20 percent share of government spending and 20 percent of ODA for basic social services in line with the agreed 20/20 targets under the initiatives of UNICEF is important to address the human resources problem in the long term. Good performance requires sustained achievement of these targets.
- (ii) Fiscal performance. Fiscal discipline is the core of public sector and macroeconomic management. There should be no increase in regular expenditures as a ratio of GDP – except as justified by revenue performance – and improvement of domestic fiscal revenue to at least 11 percent of GDP. Good performance requires sustained progress in improving fiscal revenue to GDP ratio beyond 11 percent consistent with a manageable fiscal deficit.
- (iii) Civil service reform. Adopting an action plan for civil service reform; good performance requires satisfactory progress in implementing the action plan.
- (iv) Good governance. Adoption of an action plan to improve contract enforcement and to allow international accounting and auditing firms to practice in Nepal. Adoption of an action plan to reduce corruption including a regular review process to evaluate progress towards its implementation. Good performance requires satisfactory progress towards implementing the action plans.
- (v) Portfolio performance. Compliance with loan covenants; project managers remain at least two years.

90. Average performance in these areas would be consistent with an annual IPF in the range of \$70-80 million at the current level of ADF availability.<sup>32</sup> Poor performance would result in a lower IPF. Good performance would indicate achievement of a policy and institutional environment conducive to the generation and sustainability of the desired development impact from higher Bank investment. Under this circumstance, the Bank will consider favorably of raising the current IPF. Actual lending levels will depend on meeting the criteria for intervention and sector involvement noted in paras. 45-47.

### **3. Economic and Sector Work**

91. The Bank will continue to cooperate with the World Bank and IMF in supporting sound macroeconomic management through regular public expenditure reviews and Article IV consultations (see appendix 4). Inappropriate project selection and design can be avoided through more thorough and vigorous economic and sector work. The new strategy emphasizes sector approach and long-term institutional development. This requires the Bank to devote more resources to formulate and monitor the sector development plans, which identify the policy, institution, and investment requirements and respective performance standards to achieve short-, medium-, and long-term objectives.

<sup>32</sup> Performance-based lending is currently being operationalized for Bankwide application. Its application to Nepal will be revisited as necessary.

92. Immediate priorities for sector work to effectively implement the new strategy include efforts to develop effective institutions. These are (i) institutional support to decentralization; (ii) civil service and public administration reform; (iii) institutional support to improve corporate governance, (iv) assessment of progress and institutional requirements in implementing the APP. Bank assistance is also needed to support institutional and policy analysis aimed at improving efficiency of service delivery for (i) road; (ii) power; (iii) basic education including lower secondary; (iv) health; (v) water supply and sanitation; (vi) urban services; and (vii) environmental management including tourism with emphasis in promoting private sector participation or public and private partnership. These efforts will require working more closely with all stakeholders – not just executing agencies – to build support for the findings, recommendations, and implementation.

93. The Bank will cooperate closely with all interested aid agencies in undertaking sector work so as to assist in developing consistent approaches, particularly aimed at increasing private sector investment. The Bank will also need to give priority to making staff available to participate in and contribute to sector policy and planning initiatives led by other aid agencies.

#### **4. Others (Private Sector Operations)**

94. In addition to lending and TA through the public sector window, the Bank will provide direct assistance to private sector companies in the form of loan, equity, co-financing and guarantee through the private sector window (see also para. 80). Such assistance will be provided to (i) financial sector; (ii) social and industrial infrastructure projects; and (iii) in limited cases, industrial, tourism and other sectors that will meet such criteria as commercial viability, catalytic effect and development impact. The Bank has so far assisted four private sector projects: two projects in manufacturing, one in hotel and one in hydropower sector. Future opportunities will be actively but carefully explored, particularly in view of promoting public-private partnership where specific project opportunities arise from regulatory and sector reforms assisted by the Bank's public sector operations. With the country's abundant resources in hydropower, relatively large investment requirements for the sector, and the ratification of the Mahakali Treaty with India, the power sector may offer opportunities for Bank assistance to the private sector.

#### **5. Working with Nongovernment and Community Groups**

95. Promising results have been shown in previous Bank projects involving NGOs and community groups in project implementation. Increasing cooperation and consultation with local groups are also potentially important in improving the effectiveness of project identification and design activities. However, it is also important to recognize the limited capacity and capabilities of local groups. A long gestation period may be necessary for these groups to be viable and sustainable. Bank policy documents<sup>33</sup> specify modalities for further collaboration with NGOs in Bank operations, including programming, country-level work, lending and TA activities, and policy and institutional development. These policies are consistent with the Government's approach to implementing the Ninth Plan. The Ministry of Agriculture recently issued some policy guidelines to encourage cooperation with local groups.

#### **B. Monitoring, Evaluation, and Feedback**

96. The formulation of the new country strategy has benefited from consultations with the Government and other stakeholders both national and local levels in the country as well as within the Bank. The participatory process will continue during its implementation, including regular monitoring and assessment of its implementation to support the annual country programming

<sup>33</sup> Asian Development Bank. 1998. *Cooperation between the Asian Development Bank and Nongovernment Organizations*. Manila: ADB.

exercises to ensure that future Bank assistance is appropriate and effective. Successful implementation of this strategy will require more effective Bank monitoring and supervision of ongoing projects to ensure that the desired development impact is generated and sustained including proper enforcement of loan covenants. The Bank will need to commit more staff resources to review missions to allow (i) necessary measures to ensure compliance of loan covenants and (ii) regular assessment of the development impact of projects through direct consultations with the intended project beneficiaries.

97. A committee made up of representatives from the Ministry of Finance, National Planning Commission, Financial Comptroller General Office, Ministry of General Administration, and the Bank will review the performance in the five areas discussed in paras. 89-90. The committee will meet three times a year – July, November, and March – to coincide with the annual government budget release, the Bank's country portfolio review, and country programming exercise, respectively. An annual progress report will summarize the achievement and progress in each area. The progress reports will be prepared jointly by the Bank and the Government and will form the basis for strengthening the development partnership in future Bank operations in the country. The Bank's NRM will help to coordinate these efforts. Accordingly, future assistance will be realigned during the Bank's annual country programming exercise to make it commensurate with the progress and achievement in the key areas as well as the respective sectors' performance. A progress report on the implementation of the strategy will be part of the annual Country Assistance Plan (CAP), which summarizes the Bank's three-year rolling plan of lending and TA program in Nepal.

### **C. Risks**

98. Risks affecting the successful implementation of the new strategy include internal and external risks. Internal risks include (i) continued political instability which diverts resources and attention to focus on development priorities and agenda and (ii) lack of political commitment to undertake necessary reform measures to develop appropriate policy and institutional environment to ensure effective private and public investments. An important factor contributing to the recent deterioration in economic performance has been the high level of political instability. This has had adverse impacts on civil service staff turnover and morale, on policy consistency, and on commitment to addressing critical development constraints. The current strategy is based on a scenario of only marginal improvement in political stability during the course of the strategy. The strategy recognizes that progress in institutional and policy reform, especially civil service reform, can be slow in an unstable political environment. This assumption needs to be reflected in the design of interventions to support change. It is also another reason for the relatively strong focus on working through community groups, which are generally less politicized and more accountable to local stakeholders. The newly elected majority government in May 1999 may provide better prospects for political stability. More substantive improvements in political and social stability would increase the probability of success in addressing key policy and institutional reform, and could increase the opportunities for the Bank to broaden the scope of assistance.

99. There are growing concerns about possible social instability, as the credibility of formal institutions has diminished in the view of large segments of the population. In particular, there is a growing perception of corruption in the administration, and concerns that the economic benefits of the limited progress in development are not being distributed equitably. This disquiet is reflected in the growing number of districts where there has been increasingly violent conflicts between the dissidents and the establishment. The strategy has been designed to directly address inequities with a focus on human and rural development through community groups, and assumes gradual improvements in social stability. If social instability increases, the Bank will need to review the continuing relevance of the strategy. The NRM plays an important role in monitoring the situation.

100. The Government's decentralization program is a welcome initiative for many reasons, including its potential impact in increasing accountability and equity in development and the potential improvements in investment efficiency and sustainability from a decentralized approach. However, institutions like district development committees and village development committees have yet to demonstrate their capacity in delivering investments, and it is yet to be proven that the mechanisms are in place to ensure their accountability. While the Bank remains committed to supporting the strengthening of local government institutions, there is a real risk that a too rapid buildup in the resources channeled through these institutions could increase the probability of failure. The Bank should continue to monitor the progress in developing local capacity and, if it is demonstrated that those institutions can effectively deliver increased levels of development assistance, the Bank may need to consider directing more resources through them.

101. The external risk relating to the impact of Asian financial crisis and international downturn is considered minor relative to the internal risks discussed above. Nepal has so far been relatively unaffected by the Asian financial crisis and international economic downturn although this may have dampened the impact of the Visit Nepal 1998 campaign. Nepal's strongest economic links are with India, which has recently experienced slower growth compared to early 1990s but still maintained almost 6 percent annual output growth. Recent international trade and investment developments could contribute to a slowing of economic growth in India, with negative implications for Nepal's economy, but these external risks are considered minor relative to the internal risks. At a macro level, the key risk is the possibility of further deterioration in budget revenue collection and increase in strain of the fiscal performance. Political instability exacerbates this risk and also increases the risk that limited public expenditure resources will be allocated to suboptimal activities for political reasons. This could have negative implications for the availability of counterpart resources for Bank-financed interventions. The Bank will continue to work closely and cooperate with the World Bank and IMF in supporting measures to improve fiscal performance and public expenditure management.

102. A key risk, however, lies within the Bank. The Bank needs to commit sufficient staff to make the strategy operational. The strategy emphasizes participatory approaches at all stages of the project cycle and recognizes that much greater emphasis needs to be given to institutional development. Both institution building and participatory processes are time-consuming. Difficult topography and a limited transport network will require relatively more time for domestic travel to rural areas. The new strategy therefore requires Bank's commitment to allocate greater staff and time resources including those to NRM to effectively formulate, supervise, monitor, review, and evaluate assistance in Nepal.

## **SUMMARY OF ENVIRONMENTAL CONSIDERATIONS IN NEPAL**

### **A. Key Issues and Constraints**

1. The country's natural resource base is under increasing pressure. High population growth, poverty, and environmental problems are all negatively linked to the same degradation process perpetuated by slow economic growth. Soil erosion, deforestation, degradation of the natural ecosystem and its biodiversity, together with air and water pollution, and lack of sanitation and solid waste disposal in urban areas are among Nepal's major environment problems. The poor rely on exploitation of natural resources for their survival, e.g., cultivation of marginal lands and uncontrolled fuelwood collection. This increasing pressure on natural resources, coupled with rapid population growth, leads to further decline in labor and soil productivity in agriculture, and is the main factor contributing to poverty and environmental degradation. To achieve sustainable development and effectively preserve its natural resource base, the country has to break this vicious cycle by effectively addressing poverty, high population growth, and ecological imbalances in both rural and urban areas.

### **B. Key Legislation and Institutions**

2. Recognizing the crucial importance of proper environmental management and effective implementation of the existing environmental policy and legal framework, the Government has in recent years taken important steps toward a more systematic approach. Policies to protect the environment were included in the Seventh and the Eighth Development Plan; the National Conservation Strategy (NCS) was prepared in 1989 and the Nepal Environmental Policy and Action Plan (NEPAP) in 1993. More recently, a comprehensive process to establish and operationalize an environmental impact assessment (EIA) system was undertaken. The Environment Protection Council (EPC) was created in 1993, and the Ministry of Population and Environment (MOPE) was established in September 1995. The Environment Protection Act was approved at the beginning of 1997 and, more recently, the Cabinet enacted the Environment Protection Regulations. These important legislative developments are crucial institutional steps toward improved enforcement and overall effective implementation of environmental policies. Environmental management in Nepal has reached a crucial point and two factors will play a crucial role in the future: (i) the level of commitment and ownership at the highest institutional and political levels; and (ii) the degree to which continued, coordinated, and streamlined external assistance will be able to effectively assist the country in achieving its main environmental objectives.

### **C. The Strategic Framework for Environmental Management**

3. Deforestation and soil erosion have to be addressed through practical land use management, rehabilitation of degraded lands and environmental guidelines that are implemented effectively. At the same time, employment opportunities in nonagriculture sectors should be increased and alternative energy sources developed.

4. When considering various proposals and feasibility studies for water resources management, the country must follow appropriate decision-making approaches based on (i) integrated resource planning and demand-side management, (ii) environmental strategic planning at the basin level and project EIA, as well as (iii) social assessment and community participation. While the ratification of the Mahakali treaty in September 1996 has given Nepal new opportunities for water resource development, large-scale hydropower generation projects for export will be subject to the same consideration. Demand-side management, removal of

subsidies and price controls, fuel substitution, and afforestation are the key measures to help in the transition to another energy source and reduce soil erosion.

5. With regard to the management of forests and protected areas, initial successes in community forestry in the hill areas need to be replicated in the terai where these programs have not been supported on a significant scale. Environmental sustainability in forestry calls for the development of home gardens, woodlots, and other agroforestry systems as well as forest plantations to meet the people's basic needs and to supply individual wood, with the support of the empowered forestry institutions and in partnership with the private sector and nongovernment agencies (NGOs). National parks and wildlife conservation will be effective in preserving genetic resources and biodiversity. Ecotourism in protected areas is substantial and should be seriously pursued, together with establishing a trust fund for biodiversity conservation. In general, programs need to contribute more to the welfare of local communities and indigenous groups.

6. Specific attention needs to be given to the formulation and implementation of urban and regional development strategies. Each strategy will identify the overall settlement system, then guide sectoral policies, particularly in the context of site selection for industries that contribute to water or air pollution. The broad range of service facilities (not only health care and education, but also public advisory services, community centers, markets) and municipal infrastructure (most importantly water, sanitation, waste management, electricity, and traffic) will be the key issues to address in urban development.

7. The strategic framework should have sector directions as well: the central challenge in the agriculture sector is to accelerate agricultural growth while avoiding natural resources degradation and polluting processes. With respect to industrial pollution, misinterpretation of legislation such as the Environment Protection Act and the Environment Protection Rules must be corrected. A range of tourism practices has to be adjusted to support sustainable tourism.

8. In respect to institutional strengthening, MOPE should be empowered to coordinate with the economic development actors within and outside Nepal and have a cell or unit that reviews existing policies, revises concepts and tools, conducts action research, and liaise with other policy-making bodies within the country. The unit should also keep environment-related information; analyze the activities of NGOs, international NGOs and the private sector; and incorporate this information into the policy and planning processes of MOPE and other relevant institutions. MOPE also should promote people's participation in its activities and devolve decision-making power and resources to the local level.

## **GENDER STRATEGY FOR NEPAL**

### **A. Key Issues and Constraints**

1. Women in Nepal face multiple constraints. Because Nepal is one of the least developed countries of the world, the majority of the population survive through low-productivity agriculture requiring long hours of work to meet the family needs. A substantial proportion of women in Nepal (40 percent) are economically active; most of them are employed in agriculture. Rural women's workload is especially heavy due to household drudgeries, such as fetching water and collecting fuelwood. Culturally, marriage is seen as the best socially acceptable option for women to gain access to property and land, which is inherited patrilineally. The legal provisions that deny married daughters the right to inherit parental property reinforce that concept.

2. Because of their low levels of educational attainment and lack of skills, women in Nepal work primarily as unpaid family workers or occupy low-level, low-paying jobs under often hazardous working conditions in the formal sector. Women entrepreneurs likewise face severe problems in access to credit and marketing networks, technology, and risk-taking capacity, which lead to low income and progressive loss of proprietorship in the informal sector. The consequent problem to be noted is the declining economic activity rate among urban women, probably signaling the "domestication of women."

3. The degree of women's access to resources and services varies, depending on geographical, cultural, and ethnic settings. Women in the high mountains and remote hills and from economically disadvantaged groups face greater accessibility problems than women in the better-off households, urban areas and Terai plains in general. Socioculturally, Tibeto-Burman communities, populating mostly the midhills and mountains, are less constrained in mobility and other social or economic options. In the Indo-Aryan groups, women traditionally have fewer options. In Terai communities and the Mid-Western and Far-Western Development Regions, the social exclusion of women is more severe.

4. Women's representation in the political and administrative decision-making positions has been minimal. In the political arena, the condition has improved significantly at the grassroots level, as all contesting parties to the elections are now required to have at least one woman candidate among the five ward member contestants. At least one woman must be nominated to the village development committee and district development committee executive committees and municipality boards. Women's representation in government administration is increasing only slowly: women account for about 5 percent in the gazetted (officer)-level positions.

### **B. Key Considerations and Approaches**

5. Integration of gender issues in the country operation strategy derives from a new strategic emphasis on women's empowerment within the development process, stipulated in the Bank's policy on gender and development.<sup>1</sup> Strategic emphasis is widened to include women's rights, women's role as active participants and agents in development, and their role as actors with a specific agenda for development. A gender-focused approach seeks to redress gender inequity by facilitating strategic, broad-based, multifaceted solutions to gender inequality.

6. In line with the thrust of that Bank policy, the gender strategy for Nepal will encompass these elements: (i) assist in policy support, capacity building, and awareness raising; (ii)

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<sup>1</sup> R74-98: *Policy on Gender and Development*, 11 June 1998.

facilitate gender analysis of proposed projects; and (iii) assist to implement commitments made at the United Nations Fourth World Conference on Women. In particular, as the Government's Ninth Five-Year Plan places emphasis on mainstreaming, empowerment, and elimination of gender inequality, the strategy takes a holistic approach to address key constraints systematically at the policy, institution, sector/program, and project levels.

### **C. Bank Assistance and Operations**

7. The Government has developed a well-meant policy framework and has committed itself to the follow-up actions based on pledges made at the Beijing Conference (the National Action Plan for Women, 1997). Therefore, the primary focus of the Bank's policy support assistance is to *operationalize* and *institutionalize* these policy agenda. For instance, the Ninth Plan Approach Paper stipulates that all laws discriminatory to women will be reviewed and reformulated. However, in a new bill pending in Parliament, the age limits for women to inherit property are removed, but women's right to inherit will remain conditional on her marital status. Women's access to common property (e.g., forests) is derived through her husband, the head of the household. Marriage is the overwhelming factor in determining women's life options. The first step then is for the Bank to ensure women's property rights through policy dialogue, and promote policy and regulatory reforms (e.g., introduction of joint ownership) through appropriate investment projects.

8. Second, mainstreaming and gender sensitization need to be promoted at all levels and entities. While the Government has long established women's cells or units in relevant ministries (such as Agriculture, Education, Forest, Health, Home, Labor, and Water Resources, and National Planning Commission), gender perspectives have not been fully integrated into the mainstream operations of those ministries. Through capacity building and development of adequate monitoring systems, sectoral interventions will be more systematic and the long-term impact of these interventions on gender equality can be ensured.

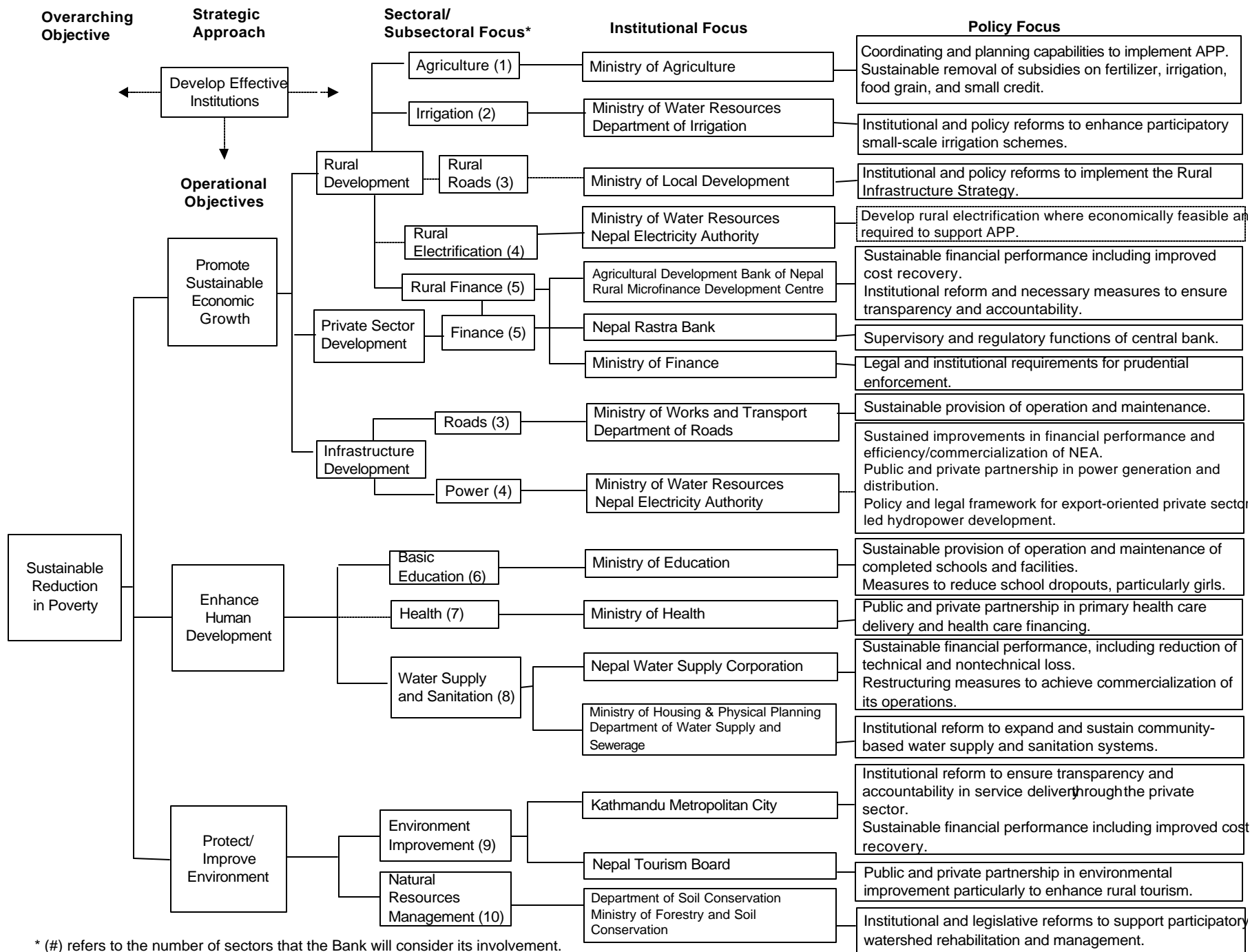
9. Third, empowerment at the stakeholder level will be promoted. It is revealed that women can be empowered when economic inputs (e.g., credit) are preceded by social mobilization/preparation, often with literacy programs. Group dynamics have been noted in a number of water supply projects where drinking water groups are formed. These projects also have a multiplier effect, on one hand directly lessening women's work burden and on the other reducing morbidity and mortality. Development assistance involving all stakeholders (both women and men) and increasing their accountability should be carefully identified, planned, implemented, and followed up to maximize its effect.

10. Fourth, increased attention will be paid to gender disparities in the cultural, ethnic, or geographic settings. There is a sharp difference in access to resources and services among the various populations. Explicit and well-conceived interventions are required. For instance, covering the remote areas and rugged terrain is one means, and targeting specific groups (e.g., low-caste women) is another. In either case, assistance in raising awareness and building capacity will be accompanied by investments. Reducing disparities and increasing equity will be the major objective of project-level intervention.

## **ECONOMIC AND SECTOR WORK PROGRAM FOR NEPAL**

1. The Bank will continue to cooperate with the World Bank and IMF in supporting sound macroeconomic management through regular public expenditure reviews and Article IV consultations. Country Economic Review/Update will be prepared at least annually to review the latest economic development and assess the short-term economic outlook in the country. This provides the macroeconomic context and assessment, which supports the Bank's operational program in the country.
2. In the past, sector work was often undertaken by the Bank through engagement of consultants on an ad-hoc and project-oriented basis. Some studies suffered from inadequate coordination and cooperation among government agencies, donors, and stakeholders, and lack of ownership by the government counterparts. Increased staff resources to undertake sector work is most crucial to the implementation of the new strategy.
3. The new strategy emphasizes that sector approach and long-term institutional development are key elements to effective Bank investments. Developing and monitoring sectoral development plans or road maps with performance standards become a core exercise in future Bank operations. Future Bank efforts in sector work will focus on the 10 indicative sectors, which the Bank will consider its involvement. Emphasis will be put on cooperation among donors and stakeholders in arriving at consistent sectoral development plans. Formulation of APP in the agriculture sector is a good example in achieving a common framework.
4. Priorities for sector work to effectively implement the new strategy include efforts towards developing effective institutions. These are:
  - (i) institutional support to decentralization
  - (ii) civil service and public administration reform
  - (iii) institutional support to corporate governance
  - (iv) assessment of progress and institutional requirements in implementing APP
  - (v) institutional and policy analysis in improving efficiency of service delivery for
    - a. road
    - b. power
    - c. basic education including lower secondary
    - d. health
    - e. water supply and sanitation
    - f. urban services
    - g. environmental management including tourism
 with emphasis in promoting private sector participation or public and private partnership.
5. Realignment of these priorities will be undertaken during the implementation of the new strategy depending on the progress and commitment of the Government in pursuing necessary sector reforms to develop effective institutions in these sectors and allow effective Bank interventions in the future.

**Figure E1: Institutional and Policy Focus of the Bank Strategy**



\* (#) refers to the number of sectors that the Bank will consider its involvement.

**Figure E2: OPERATIONAL FRAMEWORK OF THE BANK STRATEGY**  
**Overarching Objective: Sustainable Reduction in Poverty**  
**(Strategic Approach: Building Effective Institutions)**  
**Operational Objective I: Promoting Sustainable Economic Growth**

Sectoral/ Subsectoral Focus	Government Strategy	Major Aid Agencies' Related Activities	Bank Operational Focus	
			Policy and Institutional Focus	Investment Focus
Rural development	Agriculture Perspective Plan (APP), which was adopted in July 1995, identifies the essential inputs to realize the potential of agricultural productivity to 5 percent per annum growth. Policy and institutional measures to meet fertilizer demands through sustainable removal of market distortions including subsidies. Coordinated or packaged approach to investments in key areas including: (i) agricultural technology, (ii) rural credit, (iii) irrigation, (iv) rural roads, and (v) rural electrification.	<u>DFID</u> : rural access; support to APP's implementation unit (cofinanced with the Bank); and seed sector development.  <u>ILO/GTZ</u> : introduce and implement low technology and labor-intensive rural road construction  <u>USAID</u> : support for fertilizer trade liberalization; support for implementation of APP; development of high-value crop marketing pilots; technical support for formulation and training of water user groups in farmer-managed small-scale irrigation schemes  <u>World Bank</u> : area-sliced approach with the Bank in (i) implementing small-scale farmer-managed irrigation schemes, and (ii) power transmission and distribution; implementation of irrigation sector policy including formulating development strategy for deep tubewells irrigation systems; and supporting research and extension services	Removal of subsidies for fertilizers, irrigation, and small credit  Institutional reforms for ADBN and NEA to commercialize their respective operations  Institutional reforms for DOI to expand and sustain operations and maintenance of participatory small-scale surface and shallow tubewell irrigation schemes  Institutional reforms for MLD to expand and sustain participatory labor-intensive and low-technology rural road construction	<u>Agriculture</u> : Close monitoring of progress in the implementation of Loan No. 1604-NEP(SF): Second Agriculture Program Loan on subsidies removal and institutional reforms of AIC and NFC in their changing roles. Agricultural technology will help diversify production opportunities and increase productivity.  <u>Irrigation</u> : farmer-managed small-scale irrigation systems  <u>Rural roads</u> : participatory labor-intensive and low-technology road construction  <u>Rural electrification</u> : expand rural power transmission and distribution to support the APP investment requirement  <u>Rural Finance</u> : see under Finance below
Infrastructure development	Road: priority investment Plans for road links and national highways were identified to establish the necessary road transport network system.  Power: Bank-assisted Power System Master Plan (PSMP) identifies the most economical generation expansion program of hydropower projects to meet the electricity load growth for the next 15 years.	<u>DFID</u> : strategic road construction and maintenance.  <u>Japan/JICA</u> : construct major road links  <u>World Bank</u> : ongoing road rehabilitation project; proposed power development fund to support public and private power generation projects  <u>USAID</u> : TA for capacity building of Electricity Development Center for solicitation and processing of private sector power development  <u>CIDA</u> : capacity building of Water and Energy Commission Secretariat to provide necessary policy environment to support sustainable water and energy resources development including export-oriented power projects  <u>KfW</u> : proposed development of Middle Marsyangdi Hydropower Plant of 61MW (required in 2003 according to PSMP)	Sustainable provision for operation and maintenance in existing and completed roads  Develop objective/transparent criteria to prevent political interference in selection of subprojects  Develop explicit and transparent legal, institutional, and policy framework for private sector export-oriented hydropower development  Commercialization of NEA's operations	<u>Roads</u> : road improvement and rehabilitation to strengthen private sector involvement in the sector  <u>Power</u> : Public-private sector projects will be promoted.

## Operational Objective II: Enhancing Human Development

Sectoral/ Subsectoral Focus	Government Strategy	Major Aid Agencies' Related Activities	Bank Operational Focus	
			Policy and Institutional Focus	Investment Focus
Private sector development	Improve effectiveness of commercial banking and rural finance to provide financial services and resources in both urban and rural areas to support private sector development.	<p><u>DFID</u>: debt management, privatization, and financial management</p> <p><u>USAID</u>: privatization, small enterprises development</p> <p><u>World Bank/IMF</u>: prepare privatization of Rastriya Banijya Bank through ongoing technical assistance and possible program assistance.</p>	<p>Commercialization and financial viability of Rural Microfinance Development Center and ADBN.</p> <p>Supervisory and regulatory functions of Nepal Rastra Bank, the central bank.</p>	<u>Private Sector Development</u> : Improving corporate governance and legal regulatory functions of prudential agencies.
Basic education	<p>Basic and Primary Education Project II (BPEP II) supported by a consortium of aid agencies provides the framework for the development of the sector, including improvement of access and quality of service delivery.</p> <p>Secondary Education Development Strategy emphasizes the expansion of school facilities to achieve 8-year mandatory schooling.</p> <p>Establishment of National Council for Nonformal Education (NFE) and district NFE committees under respective district development committees to aim at improving adult literacy particularly women</p>	<p><u>Danida/World Bank/SNV</u>: consortium of aid agencies in implementing the second basic and primary education project (grades 1-5) including expansion of school facilities, improvement of teaching materials, and teachers' training</p> <p><u>USAID</u>: Integrated programs on adult female literacy are stressed under women's empowerment program.</p>	<p>Sustainable provision for operation and maintenance of completed facilities</p> <p>Adequate budgetary allocation for maintenance of school facilities, upgrading teaching materials, provision of teachers' salaries with sufficient training</p> <p>Development of a long-term policy and strategy framework for NFE including (i) institutional development and capacity building to strengthen national, regional, and district coordination and implementation; (ii) quality control; and (iii) aid agency coordination to mobilize financing</p>	<p><u>Lower secondary education</u> (grades 6-8): As part of basic education subsequent to completion of the primary level, investment will be made to strengthen institutional development and quality of service delivery in the sector, as well as expand and upgrade physical facilities and teachers' training.</p> <p><u>Nonformal education</u>: Investment will build on necessary institutional development to allow expansion and sustainable development of nonformal education.</p>
Health	The Second Long-Term Health Plan (1997-2017) emphasizes that priority will be given to providing a basic package of the most cost-effective, high-quality interventions, including preventive and promotive services, on a need basis. This will be done through efficient, decentralized management and community participation. A major emphasis will be given to developing an appropriate public-private mix in the provision and financing of services.	<p><u>World Bank</u>: Ongoing project assistance in health and population aims at improving both quantity and quality of service delivery.</p> <p><u>USAID</u>: support for provision of quality family planning and reproductive services; TA to strengthen Government policies and procedures to improve the delivery of child survival intervention; support for increased awareness of HIV/AIDS; TA to strengthen capacity and programs to control selected infectious diseases</p> <p><u>WHO/DFID/GTZ</u>: focus on women's health and safe motherhood, manpower training, and district health services</p>	Improve public health sector performance in areas of allocative efficiency, management, quality of care, and coverage of the most cost-effective interventions. Policy and institutional issues include (i) defining the role and responsibilities of the Government (both in the central and local level), private sector and NGOs in the sector; (ii) developing district- and village-level health service systems with increased autonomy and authority; (iii) enhancing management of district hospitals, primary health care centers and sub-health posts, personnel, and logistics; (iv) separating responsibilities for curative and preventive/promotive services; and (v) public-private mix in health sector financing.	<u>Health</u> : TA loan for institutional development can be considered; investment in project assistance is not envisaged.

### Operational Objective III: Protecting and Improving the Environment

Sectoral/ Subsectoral Focus	Government Strategy	Major Aid Agencies' Related Activities	Bank Operational Focus	
			Policy and Institutional Focus	Investment Focus
Water supply and sanitation	National Drinking Water Supply Policy aims at achieving 100 percent access to safe drinking water by the end of the Ninth Five-Year Development Plan, 2002.	<u>World Bank</u> : Urban Water Supply Project in Kathmandu aims to improve the water supply conditions through institutional restructuring of NWSC; rural water supply and sanitation project emphasizes the community-based participatory water supply schemes and the changing role of DWSS.	Commercialization of NWSC's operations including achievement of financial sustainability  Institutional development of DWSS to support expansion and sustainability of community-based participatory water supply and sanitation schemes	<u>Water supply and sanitation</u> : Melamchi Water Supply Project in Kathmandu will be prepared in line with the institutional reforms of NWSC to alleviate the acute water shortage in Kathmandu. Expansion and sustainability of rural water supply and sanitation systems
Environment improvement	Nepal Environment Policy and Action Plan (1993) and Environment Protection Act (1997) provide a comprehensive multisectoral priority framework to institutionalize and mainstream environmental protection in the development process including the urban sector	<u>GTZ</u> : urban development including waste management, restoration and rehabilitation of historical sites and tourist attractions	Institutional reforms and strengthening of Kathmandu Metropolitan City (KMC) to achieve autonomy and financial sustainability in providing urban services including environmental preservation and improvement  Operationalization of Nepal Tourism Board (NTB) in developing public and private partnership in environmental improvement to enhance rural tourism	<u>Environment improvement</u> : Investment project will be built on progress of institutional development of (i) KMC to establish effective delivery mechanisms for urban services in a sustainable manner and (ii) NTB to play an effective role in developing public and private partnership in environmental management in promoting tourism.
Natural resources management	Forestry Sector Policy (1989) emphasizes effective protection of natural resources.  The Ninth Five-Year Development Plan (FY1998-FY2002) aims at establishing soil conservation and watershed management programs in all 75 districts.	<u>World Bank</u> : proposed forestry resource management program in tarai zones including policy and institutional reforms  <u>USAID</u> : technical support to formulation and training of community forest users groups  <u>Danida/AusAid/DFID</u> : community forestry in support of watershed rehabilitation and management  <u>Danida</u> : natural resource management assistance program including watershed management in hills districts, staff training, and institutional support	Institutional development of Department of Soil Conservation to support sustainable participatory watershed management and rehabilitation including involvement of local community groups and NGOs for project planning, implementation, and evaluation	<u>Watershed rehabilitation and management</u> : strengthen and enhance sound watershed management in hill areas through sustainable land use practices, appropriate soil and water conservation measures, and support for ecologically sustainable farming systems consistent with the implementation of APP

ADBN - Agricultural Development Bank of Nepal  
 CIDA - Canadian International Development Agency  
 Danida - Danish International Development Agency  
 DFID - Department for International Development, UK  
 DOI - Department of Irrigation  
 DWSS - Department of Water Supply and Sewerage  
 GTZ - German Agency for Technical Cooperation  
 ILO - International Labour Organization  
 JICA - Japan International Cooperation Agency

KfW - Kreditanstalt für Wiederaufbau  
 NEA - Nepal Electricity Authority  
 MLD - Ministry of Local Development  
 NFC - Nepal Food Corporation  
 NGOs - nongovernment organization  
 NWSC - Nepal Water Supply Corporation  
 SNV - Netherlands Development Organisation  
 USAID - United States Agency for International Development

## NEPAL: COUNTRY PERFORMANCE INDICATORS

Item	1994	1995	1996	1997	1998
<b>A. Income and Growth</b>					
1. GDP per Capita (US dollars, current)	205	218	219	233	217
2. GDP Growth (% in constant prices)	8.2	3.5	5.3	4.0	1.9
Agriculture	7.6	(0.3)	4.4	4.1	1.1
Industry	9.0	4.0	8.3	3.5	0.2
Services	7.7	6.0	5.8	4.0	4.6
(percent of GDP)					
<b>B. Savings and Investment (current market prices)</b>					
1. Gross Domestic Investment	22.4	25.2	27.3	25.1	-
2. Gross National Saving(%of GDP)	16.6	17.0	15.4	14.6	-
(annual percent change)					
<b>C. Money and Inflation</b>					
1. Consumer Prices (annual average)	8.9	7.6	8.1	7.8	4.0
2. Money Supply (M2)	19.6	16.1	14.4	11.9	17.0
(percent of GDP)					
<b>D. Government Finance</b>					
1. Total Receipts	11.0	13.0	13.1	12.9	13.2
2. Expenditure	16.9	17.6	18.7	18.1	19.7
3. Overall Surplus/Deficit (-) including grants	(5.8)	(4.6)	(5.6)	(5.1)	(6.4)
<b>E. Balance of Payments</b>					
1. Merchandise Trade Balance (% of GDP)	(16.2)	(21.0)	(22.0)	(25.3)	(20.9)
2. Current Account Balance (% of GDP)	(5.6)	(7.8)	(11.7)	(9.4)	(8.8)
3. Export (\$) growth (annual percent change)	3.6	(9.7)	1.9	10.2	11.7
Exports (\$ million)	392	354	361	397	444
4. Import (\$) growth (annual percent change)	21.9	21.8	5.8	21.6	(12.6)
Imports (\$ million)	1,048	1,276	1,350	1,642	1,439
<b>F. External Payments Indicators</b>					
1. International Reserves (\$) (end of period)	718	702	609	651	712
- months of imports	8.2	6.6	5.4	4.8	6.0
2. External Debt Service (% of exports of goods & services)	6.8	7.9	8.4	8.2	8.4
3. External Debt (% of GDP)	53.2	53.8	53.5	49.0	57.9
<b>Memorandum Items:</b>					
GDP (current prices, NRs billion)	199	219	249	280	293
GNP (current prices, NRs billion)	203	223	252	285	-
Exchange Rate (NRs per US\$, annual average)	49.3	49.9	55.2	57.0	62.0

## NEPAL: COUNTRY PERFORMANCE INDICATORS

	1985	1990	Latest Year
<b>POPULATION INDICATORS</b>			
Total Population (millions)	16.30	18.10	23.0 (1997)
Annual Population Growth Rate (% change) <sup>a</sup>	2.10	2.10	2.6 (1997)
<b>SOCIAL INDICATORS</b>			
Total Fertility Rate (births per woman)	6.30	5.60	5.0 (1996)
Maternal Mortality Rate (per hundred thousand live births)	n.a.	n.a.	539 (1996)
Infant Mortality Rate (below 1 year; per '000 live births) <sup>d</sup>	152.00	107.00	85 (1996)
Life Expectancy at Birth (years)	45.00	54.00	56 (1995)
Female	45.00	53.00	56 (1995)
Male	48 (1981)	55.00	57 (1995)
Adult Literacy (%)	24 (1981)	40 (1991)	48 (1997)
Primary School Enrollment (% of school age population) <sup>b</sup>	75.00	103.00	110 (1995)
Female	47.00	77.00	72 (1995-96)
Secondary School Enrollment (% of school age population)	25.00	31.00	37 (1995)
Female	12.00	18.00	31 (1995-96)
Child Malnutrition (% of under age 5)	-	70 (1989-95)	47 (1990-97)
Population Below Poverty Line (%)	-	-	45 (1995-96)
Income Ratio of Highest 20% to Lowest 20%	4.3 (1984-85)	-	5.9 (1996)
Population with Access to Safe Water (%)	28 (1980-85)	-	64 (1994-95)
Population with Access to Sanitation (%) <sup>c</sup>	-	-	20 (1995)
Public Education Expenditure as % of GNP	2.60	2.00	2.6 (1997)
Public Health Expenditure as % of GDP	0.80	0.70	0.9 (1997)
Human Development Index	0.273 (1987)	0.170	0.351 (1995)
Human Development Ranking	114 (1987)	152	152 (1995)
<b>ENVIRONMENTAL INDICATORS</b>			
	1980	1990	Latest Year
<b>Environment Indicators</b>			
GDP per unit of energy use (1987 \$ per kg oil equivalent)	12.6	-	6.4 (1995)
Traditional fuel use (% of total energy use)	94.8	-	88.9 (1995)
Carbon dioxide emissions (total metric tons)	0.5	-	1.5 (1993)
(per capita metric tons)	0.04(1989)	.07(1992)	.1 (1993)
<b>Water Pollution</b>			
Emissions of organic water pollutants (kg/day)	19,000.0	-	29,000.0 (1993)
Industry share of emissions of organic water pollutants	-	-	-
Wood	-	-	1.5 (1993)
Primary Metals	-	-	1.9 (1993)
Pulp and Paper	-	-	5.5 (1993)
Chemical	-	-	3.4 (1993)
Food and Beverages	-	-	46.5 (1993)
Textiles	-	-	38.0 (1993)
<b>Land Use</b>			
Cropland (% of land area)	16.0	-	21.00
Permanent Pasture (% of land area)	13.0	-	12.0 (1994)
Forest area (thousand sq. km.)	-	-	48.00
Annual deforestation (Thousand sq. km.)	-	-	548.0 (1990-95)
Annual deforestation (Average % change)	-	-	1.1 (1990-95)
Nationally protected area (% of total land area)	6.8 (1985)	7.9	8.1 (1994)
<b>Threatened species</b>			
Mammals	-	-	23.0 (1994)
Birds	-	-	23.0 (1994)
Higher Plants	-	-	21.0 (1994)