CURRENCY EQUIVALENTS
(as of 31 August 2004)

Currency Unit – Nepalese rupee/s (NRe/NRs)
NRe1.00 = $0.0133
$1.00 = NRs74.64

The Nepalese rupee is pegged to the Indian rupee (Re) at NRs1.60 to Re1.00 and is fully convertible on all current account transactions.

ABBREVIATIONS

ADB – Asian Development Bank
ADF – Asian Development Fund
CAPE – country assistance program evaluation
CBO – community-based organization
CSP – country strategy and program
CSPU – country strategy and program update
DANIDA – Danish International Development Agency
DFID – United Kingdom’s Department for International Development
EU – European Union
GDP – gross domestic product
GTZ – Deutsche Gesellschaft für Technische Zusammenarbeit (German Agency for Technical Cooperation)
ICT – information and communications technology
IMF – International Monetary Fund
JBIC – Japan Bank of International Cooperation
MOF – Ministry of Finance
NEA – Nepal Electricity Authority
NGO – nongovernment organization
PRGF – Poverty Reduction and Growth Facility
SAARC – South Asian Association for Regional Cooperation
SASEC – South Asia Subregional Economic Cooperation
SDC – Swiss Agency for Development and Cooperation
SDR – special drawing rights
SOE – state-owned enterprise
TA – technical assistance

NOTES

(i) The fiscal year (FY) of the Government ends on 15 July. FY before a calendar year denotes the year in which the fiscal year ends. For example, FY2004 ended on 15 July 2004.

(ii) In this report, "$" refers to US dollars.
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EXECUTIVE SUMMARY

Nepal is facing unprecedented development challenges. Notwithstanding some important gains in economic and social conditions over the past decade, the pace of overall poverty reduction in the country has been slow. Nepal remains one of the poorest countries in the world with a per capita gross domestic product of around $270 and a poverty incidence of 38%. Poverty reduction has become more daunting due to the escalating armed insurgency that began in 1996. The conflict has adversely impacted on rural livelihoods, led to loss of life, caused out-migration, destroyed local government and the security infrastructure in certain parts, and restricted movement of people and goods.

The conflict, combined with political instability—due to the suspension of Parliament and fractious relations among the mainstream political parties—presents a complex development setting. However, the current crisis also presents Nepal with an opportunity to address fundamental problems that have long hindered development and contributed to poverty and social exclusion. The conflict has exposed deep-seated geographic, economic, social, gender, and ethnic inequalities within Nepalese society. There is a need to break the vicious cycle of social exclusion, chronic poverty, and low growth that fuels social and political tensions by making the development process more broad-based and inclusive. Addressing these inequalities and attaining high economic growth are vital to improving living conditions and to achieving a lasting solution to the conflict.

The Government recognizes the gravity of the conflict and its underlying causes. The Tenth Plan (FY2003–FY2007), which is also the Government’s poverty reduction strategy, highlights the need to address chronic poverty and social exclusion. The Tenth Plan is built on four pillars: (i) broad-based and higher economic growth, (ii) social development, (iii) targeted programs for excluded groups, and (iv) good governance. Implementation of the Tenth Plan presents a major challenge to the Government as it is predicated on the peaceful resolution of the conflict and on political stability. The Asian Development Bank (ADB) and Nepal's other development partners have an important role to play to support the Government in implementing the Tenth Plan under the present conditions—escalation of the conflict and continuing political instability.

This is ADB’s first pilot results-based country strategy and program (CSP). It identifies the “results” or “impact” sought by the Government, to which ADB will contribute, and identifies what “outcomes” are expected to be achieved during the implementation of this CSP. Preparation of this results-based CSP involved wide consultations with government officials at all levels, civil society, beneficiary communities, and Nepal’s development partners. Based on in-depth consultations, the CSP builds on a rigorous analysis of the poverty situation in the country, ADB’s operational experience in Nepal, and a comprehensive assessment of conflict and the evolving political context. The relevance of the lessons learned from ADB’s past experiences for the proposed CSP was assessed in the current development context to assure adequate measures for strengthening the development impact of the proposed assistance program.

ADB’s strategic approach in Nepal over the next 5 years will be to foster a broad-based and inclusive social and economic development process so as to achieve a steady decline in poverty. ADB’s support for a more inclusive development process will assist the Government in promoting greater balance in the development of different regions of the country; in improving access of the poor to basic services, their opportunities for economic advancement, and their participation in the development process; and in addressing the needs of disadvantaged
women, ethnic groups, and castes. Making the development process more inclusive will contribute to stronger growth and poverty reduction. By creating opportunities for more people to contribute to, and benefit from, economic growth and development, ADB’s assistance will help ease social tensions and create the foundation for sustainable poverty reduction. ADB’s strategy for development assistance to Nepal—based on the development challenges and opportunities and the Government’s strategic priorities set out in the Tenth Plan—will focus on:

(i) Promoting pro-poor and broad-based economic growth by connecting the rural poor, and those long excluded from the development process, to markets and economic opportunities through development of rural infrastructure facilities and services—road and air transport, telecommunications, rural electrification, irrigation, and rural finance;

(ii) Supporting inclusive social and human development, empowerment of the poor and disadvantaged by improving their health conditions through improved rural water supply and sanitation, and provision of basic education and vocational training needed for raising productivity and generating remunerative employment; and

(iii) Promoting good governance by helping combat corruption, improving delivery of local public services, and building professional management capacity to deliver results.

As crosscutting initiatives, the CSP will also focus on:

(i) Supporting the creation of an enabling environment for increased private sector participation and investment by fostering better policy, and more effective implementation of policies and regulatory reform in key sectors;

(ii) Addressing gender, ethnic, and caste discrimination through policy reform, targeted investments, and the mainstreaming of equal opportunity measures in key sector investments;

(iii) Improving social, environmental, and resettlement assessment policies, procedures, and practices as these relate to investment projects; and

(iv) Tapping benefits from regional cooperation initiatives in the areas of transport connections and trade facilitation, energy, tourism, and communications with neighboring countries.

Delivering development assistance effectively in a conflict setting is a major challenge. Lessons learned from past ADB experience include the need to (i) keep ADB operations simple and implementable, (ii) promote local service delivery and active participation of key stakeholders to ensure that projects are demand-driven and sustainable, and (iii) work steadily to enhance public policy and institutional performance resulting in a more enabling environment for private initiatives. To this end, (i) ADB’s future assistance will be more sharply focused and results oriented, (ii) more sector-wide and programmatic approaches will be used, and (iii) participation of a wider spectrum of stakeholders and institutions in the design and implementation of all projects will be encouraged. In addition, ADB’s assistance will be increasingly harmonized with the Government’s policies and procedures as well as with the assistance of other development partners. To respond to the special implementation challenges posed by the conflict, ADB assistance proposes more flexible modalities; greater community participation; more transparency of ADB operations; and a sharper focus on poverty reduction, regional equity, and the mainstreaming of social inclusion in ADB operations. This approach will address the underlying causes of the conflict and persistent poverty.
I. CURRENT DEVELOPMENT TRENDS AND ISSUES

1. Nepal has made steady improvements in economic and social conditions over the past four decades. There is now a far better transport and communications network, and the population has greater access to safe drinking water, schooling, and basic health care. Still, Nepal remains one of the poorest countries in the world, with two out of every five Nepalese living in absolute poverty.

2. Nepal’s development challenges are immense. Delivering services and fostering economic activity in a landlocked country with rugged topography is both difficult and costly. About 80% of Nepal's population live in rural areas, and the country is characterized by small landholdings, rapid population growth, and a fragile ecology, which make poverty chronic in many parts of the country.¹

3. Compounding these development challenges is a violent insurgency launched by the Communist Party of Nepal, Maoist (CPN/M) in 1996. The insurgency has escalated sharply in recent years, undermining Nepal’s development and poverty reduction efforts. It is clear that a lasting solution to the conflict can be found only in addressing its root causes—social exclusion (characterized by caste, gender, and ethnic discrimination), large economic and regional inequalities, lack of opportunity, poor governance, and the failure of successive political regimes to deliver expected development results. The presence of a radical communist party able to capitalize on these issues, push a populist agenda and, take advantage of Nepal's topography is also an important factor explaining the emergence and growth of the insurgency.

4. This new country strategy and program (CSP) for Nepal covers the period 2005–2009 and will be implemented in perhaps the most challenging environment in Nepal’s recent history. This is the first pilot results-based CSP of the Asian Development Bank (ADB). It identifies the development results that ADB will help the Government achieve as well as outcomes expected during implementation of the CSP. The CSP draws on important lessons from ADB’s past operations in Nepal, makes a comprehensive assessment of the present conflict and evolving political situation, and is based on wide consultations with the Government, private sector, civil society, local communities, and Nepal’s development partners.

A. Political Environment

1. Conflict

5. The insurgency, which started in the hill districts of Rukum and Rolpa in the Midwestern Development Region (Midwestern Region),² has now spread to most parts of the country with varying degrees of intensity. The economic benefits following the restoration of democracy in 1990 fell well short of meeting the aspirations of the general public, causing widespread disillusionment. In 1996, the extreme left questioned the effectiveness of the democratic order

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¹ According to the 2001 population census, Nepal’s population was 23.2 million, growing at 2.3% annually with a population density of 157 persons per square kilometer (km²). The share of the urban population is 14.2% and is growing at around 7% annually. The country’s population is relatively young, with approximately half of the population under 20 years of age and about 41% under the age of 14. Nepal is home to about 75 different ethnic groups speaking about 50 different languages.

² Nepal is divided into five development regions: Eastern Development Region, Central Development Region, Western Development Region, Midwestern Development Region, and Farwestern Development Region. For easy reference, these are referred to in a brief form in this document, e.g., Eastern Region.
established 6 years previously, opted out of the political mainstream, and declared a “people’s war” against the Nepalese state to achieve their 40-point agenda. Since 1990, persistent political instability, infighting and power struggles, corruption, inadequate social and economic benefits, and weak governance—all of which contributed to a loss of confidence in government and the political system—further contributed to widespread discontent, and CPN/M capitalized on these failings.

6. Over the past year, the conflict has spread. At present, 36 of the 75 districts are classified as Phase III districts under the United Nations’ security system. Since 1996, about 10,000 people have been killed, 300,000–400,000 rural families displaced, and infrastructure facilities estimated to cost about $400 million destroyed. Development activities have slowed significantly, especially after 2001 when Parliament was dissolved, the elected Government was dismissed, the elected local governments’ term expired and no attempt was made to hold local elections, and the insurgency took a sharp turn for the worse. The insurgents have targeted government and security installations, and bank branches, usually in sparsely populated rural areas in rugged terrain, where access for the security forces and maintenance of law and order are difficult.

7. Efforts have been made to resolve the conflict: three major, but inconclusive, rounds of peace negotiations between the Government and CPN/M have been held since 2001. The first, in July 2001, was initiated by the elected Government of Prime Minister Deuba but broke down in November 2001, leading to the imposition of a state of emergency. The second time, the Chand Government, which had been appointed by the palace, conducted two rounds of negotiations during April–May 2003. The subsequent Thapa Government, also appointed by the palace, resumed negotiations for the third time in August 2003, but it too was unsuccessful. However, after the breakdown of the latest cease-fire in August 2003, the Government took a more offensive military stance against the CPN/M insurgents, resulting in a significant containment of CPN/M’s violent activities to their traditional strongholds in the Farwestern and Midwestern regions, and parts of the Eastern Region. Nonetheless, since early 2004, taking advantage of the agitation of the “constitutional political parties” 3 against the Government and the palace, CPN/M has stepped up targeted armed attacks on security personnel and civilians. In a major act of defiance, CPN/M also imposed blockades in different parts of the country, seriously restricting the movement of people and commodities. These incidents indicate that the rebels’ military capabilities remain significant, and underscore the daunting challenge of seeking a military solution to the conflict. A lasting resolution to the conflict can only be achieved by addressing its root causes.

2. Crisis in the Constitutional Parties

8. Continued political instability and its adverse consequences have contributed to fueling the insurgency and weakened the Government’s ability to resolve the conflict. The period since the restoration of democracy in 1991 has been marked by constant inter- and intra-party fighting, and frequent changes in government—13 governments in 13 years—many of which were fragile coalitions. A complex political setting with the palace, Government, political parties, and CPN/M vying for state control and power made it more difficult for Government to focus on the country’s development challenges.

9. Infighting within the ruling Nepali Congress Party prompted the Prime Minister to dissolve Parliament in May 2002. This eventually led to an abrupt end to democratic rule in

3 Those parties that adhere to the constitution and are committed to multiparty democracy.
October 2002 when the palace dismissed the Prime Minister for failing to hold parliamentary elections as scheduled and appointed a new Prime Minister. These two crucial events sparked the constitutional crisis, which remains unresolved. The political parties refused to join a government led by a palace-appointed Prime Minister, and forced his resignation. However, the palace appointed another Prime Minister in June 2003. Since November 2002, the political parties have been protesting against the palace’s move, questioning the legitimacy of the governments appointed by it and demanding formation of an all-party government and/or reinstatement of the dissolved Parliament. In April 2004, professional groups and students joined with the political parties and escalated the political agitation sharply, forcing the second palace-appointed Prime Minister to resign in May 2004. The palace then appointed S.B. Deuba of the Nepali Congress Party (Democratic) as the new Prime Minister on 2 June 2004, with tacit support of some major agitating political parties. Notably, he was the democratically elected Prime Minister dismissed in 2002. He has won the backing of one of the major agitating political parties, and has been able to form a coalition Government with the participation of four parties. However, some other political parties, including the Nepali Congress Party, continue to question and oppose the legitimacy of the new Government. The new Government has committed to initiate Parliamentary elections by mid-April 2005 and peace negotiations with CPN/M as soon as possible.

10. There have been no elected local bodies in the country since July 2002, when their term expired and elections could not be held due to the security situation. In addition to slowing development activities, the absence of elected local officials has weakened the decentralization efforts and ceded vital political space to the insurgents, thus worsening the security situation.

B. Economic Development

11. Nepal’s economy is characterized by a low and fluctuating growth rate. Agriculture still contributes about 40% of its gross domestic product (GDP) and employs about 60% of the labor force. While progress in agriculture has contributed to food security, the subsistence orientation of highland producers limits contribution to income growth and poverty reduction. Services have evolved as a major sector in the past two decades, growing from 25% to more than 40% of GDP. They have been driven by expansion in trade, finance, tourism, and transport and communications. Tourism growth has been slowed significantly in recent years by internal security concerns and external shocks, although it has recently shown signs of recovery. The industry sector has remained stagnant, contributing only about 20% of GDP, and is constrained by the deteriorating security situation, in addition to the challenge it already faces in terms of inadequate infrastructure facilities, unfavorable investment climate, and growing global competition.4

12. The introduction of market-oriented reforms and restoration of democracy in the early 1990s raised expectations that higher economic growth would substantially benefit the poor. In response to market reform, the investment-to-GDP ratio increased significantly in the 1990s, reaching an average of 25% of GDP. Growth accelerated from 2.5% in the 1960s and 1970s to about 5% per annum in the 1990s, while poverty incidence fell by about 2%. But with the escalation of the conflict, economic performance worsened. Productivity of investment has been low both for investment as a whole, and in key industries.

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4 For more details on economic performance, see the Quarterly Economic Update on Nepal published by ADB’s Nepal Resident Mission.
13. GDP growth declined to negative 0.4% in FY2002. It then recovered moderately and grew by 2.7% in FY2003. Aided by the January–August 2003 cease-fire and a recovery in the global economy, the manufacturing, trade, and tourism sectors recovered significantly. Despite the breakdown of the cease-fire in August 2003, it is estimated that real GDP has grown by about 3.6% in FY2004 and inflation has been contained at about 4.0% in FY2004 compared with 4.8% in FY2003.

14. The fiscal position strengthened in FY2004 with a significantly low budget deficit of 1.5% of GDP. However, the low deficit was mainly due to sharply lower development spending caused by a combination of factors. The security situation, lingering political uncertainty, and absence of elected local governments have slowed the government decision-making process. Lower development spending has weakened delivery of public services in rural areas, aggravating the existing social and economic disparities. Low development spending will also have serious implications for achieving sustained and higher economic growth essential for poverty reduction. These factors could aggravate the conflict. While regular expenditure has been kept reasonably under control, security expenditures increased to 3% of GDP and development spending fell to about 6% of GDP in FY2004 compared with 1.7% and about 10% of GDP, respectively, before the conflict. Nepal's tax-to-GDP ratio is one of the lowest in South Asia, and at 10% of GDP, tax revenues are barely sufficient to finance current expenditures.

15. Despite volatile domestic economic conditions and a narrow fiscal base, Nepal's external payments position remains sound, buoyed by a sustained increase in migrant workers' remittances. The external debt service ratio increased to about 10% in FY2004 from 8.5% in FY2002, reflecting the effects of depreciation, a decline in merchandise exports, and maturity of past external loans. Given Nepal's narrow revenue base and limited room for fiscal maneuver, the economy needs prudent external debt management and a much stronger domestic resource mobilization effort.

16. The generally sound macroeconomic indicators, however, mask some important disruptions that will have long-term, lingering effects. The most serious adverse economic impact of the conflict appears to be the cumulative loss of potential output—the overall economic growth rate has been significantly lower than what it could have been since 1996. In the 1990s, for example, GDP growth averaged 5%. However, since 2001, GDP growth has dropped to an annual average of 2.6% against population growth of 2.3%. This has serious negative implications for poverty reduction. The investment climate for domestic and foreign private sectors has deteriorated. At the micro level, the adverse economic impacts are more pronounced, especially in the heavily conflict-affected areas. In these areas, labor mobility, financial services, and commodity markets have been disrupted, adversely affecting rural livelihoods. Delivery of basic public services in rural areas has deteriorated. This, together with rising rural insecurity, has led to an upsurge in rural-urban migration. An estimated 1.9 million people now live in Kathmandu Valley, putting pressure on delivery of drinking water, sanitation, and other essential services.

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5 Similarly, the ranks of the military and other security personnel nearly doubled between FY1997 and FY2004, and are expected to increase by another 20% by FY2005.
6 Remittances, including those through unofficial channels, reached $820 million in FY2003, or about 14% of GDP, contributing to national income in all sectors.
7 In percent of export of goods and nonfactor services.
C. Poverty

17. Nepal is one of the poorest countries in the world with a per capita GDP of around $270 in FY2004, an estimated overall poverty incidence of 38%, an increase in the absolute number of poor since the mid-1980s, and widening interregional and national income inequality. Poverty is more prevalent and severe in rural areas where poverty incidence (44%) is almost double that in urban areas (23%). The incidence of poverty in the Midwestern and Farwestern regions (72%) and in the mountain districts (56%) greatly exceeds the national average. There are large differences in living standards between those in Kathmandu Valley and the rest of the country. In Kathmandu Valley, poverty incidence is estimated to be approximately 4%, i.e., one tenth of the national average.9

18. While official data imply that income poverty prevalence has changed little in the past two decades, indirect poverty indicators suggest that improvements may well have been made. Between 1985 and 2002, per capita food availability in calorie terms increased by 31% while real agricultural incomes rose by 12%. In the Terai and eastern Nepal, surveys report a substantial increase in rural real wages during the 1990s. Growth in overseas employment and remittances has likely contributed the most to improved livelihoods. According to official sources, some 700,000 Nepalese work in other countries on a long-term basis, with another 2 million–2.5 million workers engaged in seasonal work abroad. This excludes several million more Nepalese who have migrated and work in India permanently. There has also been significant in-migration of Indians, especially in the southern Terai region of Nepal. The bulk of those working abroad are from rural areas, and overseas earnings, much of which goes unrecorded, help sustain consumption and augment rural investment.

19. Despite low incomes, Nepal has registered steady progress in various aspects of human development. The prevalence of underweight children (less than 5 years of age) was reduced from 57% in 1990 to 48.3% in 2000. Primary school net enrollment increased from 61% in 1990 to 80.4% in 2002. Over the same period, the adult literacy rate increased from 31% to 43%, life expectancy rose from 54 to 60 years, infant mortality fell from 102 to 66 per 1,000 live births, maternal mortality declined from 850 to 540 per 100,000 births, and the share of the population with access to drinking water increased from 66% to 72%. Since 1985, the fertility rate has been gradually declining and the proportion of the population using family planning has increased to 39%. Despite these significant improvements, Nepal still ranks 140th out of the 177 countries in the United Nations Development Programme’s human development index ranking in 2004.

20. Various factors combine to cause income poverty, namely slow overall growth in the face of a rapid increase in population, weak linkages between urban and rural growth, low rates of productivity improvement in agriculture, and limited economic and social infrastructure in rural areas. These explain why poverty remains high. In rural areas, there is inequitable access to resources: the poorest quarter of the population has average landholdings of half a hectare, little of which is irrigated or otherwise suitable for paddy cultivation.

21. Geographic isolation and development programs that failed to transfer adequate resources to rural and remote areas also contributed to poverty. Large parts of the country are effectively cut off from major markets in and around urban areas. The hilly and mountainous districts of the Midwestern and Farwestern regions, and the mountainous districts of the Central

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8 The poverty level was 42% as per the Nepal Living Standard Survey, 1996. The subsequent Tenth Plan’s estimate by the National Planning Commission showed that the poverty level had decreased to 38% by 2001. New estimates from the second Nepal Living Standard Survey will be available at around the end of 2004.

9 However, it should be noted that these official poverty statistics are not always reliable.
Region, are ranked lowest in terms of socioeconomic and infrastructure development. Road density, access to drinking water, and access to banking services are substantially lower in these areas than in the Terai and the central and eastern hill zones of Nepal. Low levels of literacy, poor access to and quality of public education and health care, a limited skills base, and high levels of maternal morbidity and mortality add to human poverty and low productivity.

22. Demographic realities also exert a powerful influence on living standards in Nepal. Nepal's population doubled from 11.6 million to 23.2 million between 1971 and 2001. This led to an increase in the average population density from 79 to 157.3 persons per square kilometer. Population densities on land suitable for farming increased to more than 600 people per square kilometer, making rural Nepal one of the most densely populated farming areas in all of Asia. Over time, as pressure on the natural resource base increased, Nepal's population shifted to the regions that had the best market connections and natural resource endowments, including the fertile Terai, Kathmandu Valley, Pokhara Valley, and the better endowed hilly regions of the Central and Eastern regions. Temporary migration to India through the long and open border has served to ease economic pressures, particularly in the poorer Farwestern, Midwestern, and Central hilly and mountainous regions.

D. Governance and Institutional Capacity

23. Political instability and weak governance have lowered the returns to government’s poverty reduction efforts. The voice of the poor and excluded groups in public decision making has been limited: politics and public institutions have been dominated by a narrowly based elite, resulting in little attention to the interests of the poor and excluded. This, together with poor service delivery, overcentralized government, weak institutional capacity, poor public participation at grassroots level, and systemic corruption, has contributed to social tension and fueled the insurgency. Political instability and the conflict have also adversely affected governance. Public service delivery has been further impeded by an increase in lawlessness and insecurity. Governance suffered a further setback with the dissolution of Parliament and de facto dissolution of elected local bodies, which seriously impeded decentralization—a major plank of good governance—as well as regulatory and legislative reform. A law can now be passed only in the form of an ordinance, which requires promulgation under royal authority. Since 2002, the number of ordinances promulgated has declined, and some political parties have opposed such promulgations.

24. While reforms have not been rapid and extensive enough to contribute significantly to poverty reduction, important reform measures have been taken to improve governance, mainly in the areas of public expenditure management, anticorruption, public enterprise reform, facilitation of local community participation, and private sector development. Over the past 2 years, the Government has made progress in prioritizing development expenditures through the medium-term expenditure framework based on the priorities of the Tenth Plan. Progress has been made in civil service reform and the broader reform of the public sector, including the elimination of about 7,200 vacant civil service positions, establishment of an automated personnel information system, and privatization or liquidation of public enterprises. Enactment of several anticorruption laws and establishment of a special tribunal to prosecute corruption cases provide new mechanisms for combating corruption. While devolution of responsibility of

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11 Amendment to the Commission for Investigation of Abuse of Authority Act, Corruption Prevention Act, Special Court Act, and Impeachment Act.
key services (primary education, primary health care, and agricultural extension) to local
governments was initiated and a Local Body Fiscal Commission was established, progress in
decentralization has been hampered by the absence of local government representatives. The
Government has taken action to streamline its role and to open up more areas for private
investment by dismantling monopolies and privatizing, liquidating, and introducing contract
management in public enterprises.

25. The Government has recognized that failure of governance is one of the underlying
causes of the conflict. It has recently refocused reforms in this area to make governance more
people centered and to enhance participation at grassroots level, particularly focusing on
women and excluded groups.

E. Gender, Ethnicity, and Caste

26. The low status of women in Nepal can be traced to sociocultural, economic, legal, and
politicore-institutional factors, which are interrelated and mutually reinforcing. The gender
dimension of poverty is reflected in women’s unequal access to food, education, and health
care; long working hours; and exclusion from productive resources and community activities.12
The social system that defines access to resources and opportunities leaves women more
disadvantaged than men.13 Poor rural women have only limited opportunities to earn incomes
and limited access to productive resources, and little effective legal protection, despite
constitutional guarantees of equal treatment. There is inconsistency between the constitution
and important laws with regard to property rights, marriage, and inheritance, which discriminates
against women. Moreover, women are further disadvantaged by their lack of awareness of their
legal rights and opportunities. The dual burden of productive and reproductive roles leaves
women not only cash poor but also time poor. In practice, women continue to be poorly
represented in public institutions including the civil service at all levels. Moreover, women’s low
self-esteem inhibits their participation, while their low social status leaves them vulnerable to
abuse within their households and communities. Households headed by women have lower
incomes than those headed by men. Women’s control over financial resources is severely
limited as indicated by the low ownership rates of land (10%) and homes (6%) for women.
About two thirds of Nepalese women are classified as illiterate, compared with one third of men.
Similarly, the number of years of schooling for females is only about half that for males. While
there has been some progress in reducing gender disparities—e.g., life expectancy, literacy
levels, and school completion rates—substantial progress is needed to overcome a long legacy
of gender bias and stereotyping.

27. Nepalese society is characterized by complex variations in ethnicity, caste, language,
and religion, which influence access to schooling, employment, and resources. Few caste and
ethnic groups dominate the power structure, and enjoy disproportionate access to resources
and opportunities. The deep-rooted structured inequalities and exclusionary practices also
impede upward mobility of disadvantaged ethnic groups and castes. For example, Dalits earn
less than half of what the upper-caste groups earn and their life expectancy is 13 years lower.
There are also ethnic and caste disparities in human development. The human development
index rankings for disadvantaged ethnic groups in rural areas are about 30–40% lower than in

13 All ethnic groups, regardless of religious practices, are classified in a caste hierarchy and accorded differential
privileges within the social system.
urban areas; those for Dalits and disadvantaged ethnic groups are only about half of those for the upper-caste groups.

F. Private Sector

28. Nepal's private sector accounts for nearly 70% of overall investment and 68% of credit outstanding in the banking sector. However, public enterprises continue to occupy a privileged position in the economy, and due to favorable fiscal treatment and regulatory preference, their activities impede competition and boost costs adversely, affecting the private sector as a whole. The Government has privatized 16 public enterprises to date, and envisages corporatizing the larger remaining public enterprises and privatizing or liquidating nine of the rest by 2005 under the Public Sector Management Program supported by ADB.

29. Despite economic liberalization and growth of trade in the 1990s, Nepal's economy is still the least competitive of all South Asian economies. Productivity levels are just 3–5% of those in the Organization for Economic Co-operation and Development countries. A mix of factors impedes private initiatives. These include the conflict, poor infrastructure, overly bureaucratic public administration, overregulation, capricious and ineffective enforcement of existing laws and regulations, corruption, inadequate consultative mechanisms for addressing labor concerns, and a perceived lack of clarity and vision in government policy and strategy. Efforts are being made to improve the environment for private sector development by restoring the health and soundness of the financial system, improving the management and financial sustainability of public utility providers, and fostering public-private partnerships to develop economic infrastructure.\textsuperscript{14} Maintaining liberal trade relations, improving strategic infrastructure links between Nepal and neighboring countries, and reforming both the regulatory environment and its implementation are central to improving the investment climate in the long run.

G. Environment

30. Population growth, together with urbanization and the spread of transport links, has contributed to deforestation, overuse of limited available land for agricultural purposes, increased congestion and urban sprawl around towns, and degradation associated with the disposal of solid waste and other forms of pollution. Air and water pollution in Kathmandu Valley is particularly severe. Much of the forested area between the Himalayas and the Terai has been cleared to provide space for crops, livestock, and human settlement. Consequently, soil erosion, landslides, and floods are becoming more serious. On the positive side, considerable success has been achieved in community forestation projects, which have restored some forests and enhanced cover. The Government has also achieved significant success in protecting natural forests in the past decade.

H. Regional Cooperation

31. As a landlocked country, situated between two of the world's most populous and most rapidly growing economies, Nepal has much to gain from regional cooperation. Nepal's total trade ratio is 50% of GDP, compared with Sri Lanka's 80%. While adoption of an outward-oriented trade policy in the early 1990s boosted regional trade and investment, Nepal's locational advantages remain untapped. The Government is making efforts to foster deeper

\textsuperscript{14} The Physical Infrastructure: Build, Operate and Transfer Policy of 2000, the Telecommunications Policy of 1999, the Hydropower Policy of 2001, and the Information Technology Policy of 2001 were designed to encourage more private sector investments in infrastructure.
regional and global economic integration. Nepal’s recent accession to the World Trade Organization; participation in the South Asia Free Trade Agreement; the commitments made under the Islamabad Declaration adopted at the 12th South Asian Association for Regional Cooperation (SAARC) summit; and its membership in the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation, all pave the way for Nepal to accelerate regional cooperation with other SAARC member countries.

32. The trade and transit treaties agreed to with India in the mid-1990s have provided Nepal with access to the vast Indian market and to Kolkata port. In recent years, efforts have been made to improve transport links to other countries, most notably the People’s Republic of China and Bangladesh. Restoration of Nepal as the traditional trade corridor between India and the People’s Republic of China has enormous potential benefits for the country. Nepal has also assumed an active role in ADB’s South Asia Subregional Economic Cooperation (SASEC) program, which is designed to foster cooperation among Bangladesh, Bhutan, India, and Nepal, initially in the areas of transport, energy, trade, industry and the private sector, environment, tourism, and information and communications technology (ICT).

II. THE GOVERNMENT’S DEVELOPMENT STRATEGY

A. Development Goals and Strategy

33. The Government’s Tenth Plan (FY2003–FY2007) was prepared through a 2-year consultative process involving a series of meetings and workshops with political parties, labor unions, nongovernment organizations (NGOs), the private sector, and other stakeholders. The Tenth Plan aims to reduce the overall poverty ratio from 38% in FY2002 to 30% by FY2007. Indicative targets for key human development variables include: raising the literacy rate from 49% to 63%; reducing the infant mortality rate from 64 to 45 per 1,000 live births; raising life expectancy from 62 to 65 years; and increasing access to drinking water from 72% to 85% of the population, access to electricity from 40% to 55%, and the number of telephones from about 1,700 to all village development committees. The Tenth Plan envisages real growth of 6.2% per annum on average. Higher overall growth, together with a substantial increase in agricultural growth to around 4.1% per annum, is forecast to result in a rapid reduction in poverty levels.

34. The Tenth Plan is built on four pillars: (i) broad-based and higher economic growth; (ii) human development; (iii) targeted programs to foster the social inclusion of the ultra-poor, vulnerable, and historically deprived groups; and (iv) good governance. To implement the strategy, the Plan includes a number of crosscutting implementation approaches, including: (i) redefining the role of the state to limit public sector intervention; (ii) enlisting the private sector, together with NGOs, international NGOs, and community-based organizations (CBOs), to provide public services; (iii) promoting community participation in the management of local development activities; and (iv) accelerating the decentralization process.

15 South Asia remains far less integrated into the global economy than either East Asia or Southeast Asia. With 1.24 billion people, South Asia accounts for 22% of the world’s population (2000). The region, however, generated just 1.7% of global GDP, only 1.1% of global trade, and received less than 1% of foreign direct investment flows and tourism revenues.

16 ADB assisted the Government with the preparation of the Tenth Plan through Technical Assistance to Nepal for Support for the Preparation of the Tenth Plan (approved in July 2001).

17 The base year statistics are from the Tenth Plan.
35. The Government’s strategy for fostering broad-based growth hinges on revival of agriculture, and a recovery in manufacturing, tourism, and exports. In agriculture, the Government aims to modernize, diversify, and commercialize crop and livestock production by expanding the use of improved technology, improving rural transport links, and increasing the access of farmers to modern agricultural inputs and credit. To stimulate investment in industry and services, the Government’s strategy calls for: (i) removing impediments to private sector development; (ii) accelerating privatization of public enterprises; (iii) streamlining regulatory processes and making them more transparent; (iv) amending labor laws to make them more flexible; and (v) introducing important legislation friendly to the private sector, including bankruptcy and foreclosure procedures, as well as judicial reforms. Infrastructure development plays an important role in facilitating private sector development, and the Tenth Plan gives priority to developing the strategic road network, maintaining major roads and highways, and expanding electricity and communications facilities.

36. In the social sectors, the Tenth Plan highlights the importance of improving service delivery through decentralization and through greater involvement of local communities in the management of social services. In education, the Tenth Plan aims at improving access to and quality of primary education and at expanding access to secondary, vocational/technical, and tertiary training to produce skilled human resources. Special scholarship programs are to be introduced to assist poor women, Dalits, and other disadvantaged minority families to have access to education. In health, the strategy focuses on implementing an essential health care package that includes preventative care, maternal and child health, and family planning. Improvements in service delivery are also expected to occur through a process of devolving management of health facilities to local communities and of working increasingly with the private sector and NGOs. The Tenth Plan also emphasizes the importance of access to safe water for improving health conditions and aims to increase access to safe drinking water, and to sewerage and sanitation services, in underserved urban and rural areas.

37. Good governance envisages improving the performance of the civil service, combating corruption, reforming the role of government, fostering decentralization, and enhancing financial management and accountability. Future actions include: (i) reforming public employment through the introduction of merit-based recruitment, better pay policies, rightsizing, and an affirmative action program; (ii) improving financial management and accountability; (iii) implementing the anticorruption strategy by strengthening key institutions charged with fighting corruption, including the National Vigilance Center and the Commission for Investigation of Abuse of Authority; and (iv) progressively decentralizing service delivery functions while building capacities of local governments.

38. The Tenth Plan is different from previous plans in that it explicitly recognizes that conflict is intimately related to poverty, discrimination, and social exclusion. It emphasizes the need to address the root causes of the conflict. To foster social inclusion, the Plan lists several areas—including agriculture, forestry, wage employment, and social sectors—where special efforts will be made to mainstream and empower women, Dalits, and the disadvantaged through a variety of means, including targeted programs. Other reforms include: (i) revising existing laws to eliminate legal discrimination against women, and (ii) implementing affirmative action programs to increase the representation of women and ethnic minorities in the public service. The Tenth Plan also recognizes the great difficulties posed by the conflict for project implementation. Decentralization, promotion of service-delivery partnerships with NGOs and CBOs, and encouragement of greater transparency in all activities are among the strategies proposed for enhancing the feasibility of implementing development activities in this difficult setting.
39. Despite the difficult security and political environment, the Government, supported by its development partners, has made efforts to put the Tenth Plan initiatives into effect. Supported by the Reform and Development Group—a joint government-development partner task force—the Government prepared the Immediate Action Plan (IAP), starting in FY2003, to prioritize and effectively implement the key reform measures outlined in the Tenth Plan, including public expenditure management, devolution of selected public services, public procurement and financial accountability measures, privatization, and development programs targeted at excluded groups. The IAP has now become an annual plan to translate the Tenth Plan’s reform agenda into effective implementation.

40. The Nepal Development Forum, held in May 2004, recognized that, notwithstanding the difficult political and conflict environment, progress had been made in the implementation of the Tenth Plan, especially in maintaining macroeconomic stability, reviving economic growth, improving revenue, managing public expenditure, devolving public services, and reforming the financial sector. While acknowledging the Government’s commitment and expressing broad support for the Tenth Plan and its reform agenda, the development partners, however, expressed concern over the deterioration of the security and political situation, which has both violated human rights and undermined effective implementation of the Tenth Plan. The development partners also felt (i) that the Tenth Plan’s targets need to be further prioritized, given the realities on the ground, and (ii) that innovative and effective implementation modalities need to be put in place to ensure effective delivery of development benefits in remote and conflict-affected areas.

41. Both the International Monetary Fund (IMF) and the World Bank are supporting the implementation of the Tenth Plan through their respective policy-based operations. In October 2003, IMF approved a 3-year Poverty Reduction and Growth Facility (PRGF) of SDR49.9 million. The key elements of the PRGF include: (i) a fiscal strategy that will lead to higher revenues, more prioritized spending, and sustainable medium-term borrowing; (ii) monetary policy that would maintain the currency peg to the Indian rupee; (iii) financial sector reforms, including strengthening of Nepal Rastra Bank, improved legislation and loan recovery, and restructuring of government-owned commercial and development banks; (iv) public sector reforms, including civil service reform, privatization/liquidation of unviable public enterprises and divestment of profitable ones; and (v) governance reforms, including anticorruption measures and support for decentralization. A review of the PRGF in August 2004 concluded that there had been a reasonably satisfactory implementation of the reform program. The World Bank also provided a Poverty Reduction Support Credit (PRSC) I for SDR51 million. The PRSC involves three phases and the World Bank plans to approve PRSC II within FY2004. The PRSC supports the implementation of the Tenth Plan through reforms to foster broad-based growth, improve public service delivery, promote social inclusion, and enhance governance.

B. Resource Mobilization and Investment

42. The Tenth Plan envisages that the share of investment in GDP will rise by over 4.6% during the plan period (from 24.4% at the end of the Ninth Plan to 29.0% at the end of the Tenth Plan), and that domestic savings will increase by 4.6% of GDP. The Tenth Plan also envisages a major change in the composition of government expenditure, with a decline in current spending by 2% of GDP and an increase in development expenditures by 4% of GDP. The fiscal deficit is to average 7.3% of GDP, to be financed by foreign aid (loans and grants) equivalent to 5.9% of GDP, and by domestic borrowing equivalent to 1.4% of GDP.
43. Given the setbacks to economic performance in FY2002 and FY2003, medium-term macroeconomic targets were revised, in accordance with the 3-year PRGF agreement reached with IMF. The revised forecasts call for gross fixed investment to increase from 19.1% of GDP in FY2003 to 22.5% in FY2007. Public investment is forecast to rise from 7% to 8.2% of GDP (and capital investment from 4.7% to 6.2% of GDP), private investment from 12.1% to 14.3% of GDP, and gross domestic savings from 10.7% to 13.4% of GDP, over this period.

44. The gap between the aggregate expenditure required to meet the Tenth Plan targets and domestic revenue mobilization (including domestic borrowing) projections is estimated to be $556 million per annum during FY2005–FY2007, compared with the average external resource inflow of $244 million per annum during FY1997–FY2002. Net transfers, after debt service, are forecast to average just under $250 million per annum during FY2005–FY2007. These estimates were presented by the Government at the 2004 Nepal Development Forum, and generally accepted by the development partners.

45. Declining development expenditures, due to conflict-related impediments, and weakening private sector investor confidence imply that aggregate investment levels are considerably less than anticipated in the Tenth Plan targets. Moreover, precautionary savings have increased as households respond to heightened political and security concerns. As a result, foreign assistance requirements to close the savings-investment gap are likely to be $556 million per annum.

C. Role of External Assistance

46. External assistance has contributed substantially to the implementation of nearly all of the major public sector development projects in Nepal. Nepal received nearly $4 billion in external assistance from 1960 to 2000. External assistance accounted for an average of 49% of development spending during the past 5 years, and was divided almost equally between grants and concessionary loans. Aid levels are high compared with those in other developing countries, with net transfers averaging $9.8 per capita per year between 1999 and 2003.

47. Nepal will continue to require substantial external assistance in the years ahead, reflecting large development needs, low levels of income, limited scope to expand the domestic tax base rapidly, narrow private sector base, and fragile security situation. Nepal will need to rely primarily on concessional external assistance to close the resource gap in the short to medium term. Mobilization of more concessional external resources will need to be matched, however, by improvements in the security situation, in the Government’s commitment to achieving a lasting peace, and by improvements in the efficiency, integrity, and effectiveness with which external assistance is utilized.

48. Important reforms have been undertaken to improve aid effectiveness. The Government adopted a Foreign Aid Policy in 2002 that sets out broad aid priorities and standardizes procedures for procurement and aid management. Sector-specific coordinating committees involving government and development partner representatives have been established. A three-tier grading system for public investment programs was developed in 2002 to help prioritize public investments. NGOs, CBOs, and local governments have been increasingly involved in the planning and implementation of aid programs to align investment priorities with local needs and to strengthen implementation.
D. ADB’s Assessment of the Government’s Development Strategy

49. The Tenth Plan has built on the lessons of past exercises and has paid more attention to fostering participation in the planning and implementation process. Establishment of the medium-term expenditure framework has enforced fiscal discipline to a degree and translated plans into action through the IAP. The Tenth Plan highlights the need to foster progress in governance. It builds on a sound diagnosis of the causes and consequence of poverty, and significantly recognizes that a legacy of exclusion, inequality, and impoverishment contributed to the conflict. It concentrates on the delivery of results, acknowledges that conflict must be addressed, and identifies many ways in which a more inclusive development process can be supported.

50. While conceptually sound, the Tenth Plan appears ambitious in several of its targets, particularly in light of the prevailing security situation and political instability. For example, average annual economic growth was forecast at 6.2% compared with the achievement of 2.7% in FY2003 and an estimated 3.6% in FY2004. Investment was forecast to reach 29% of GDP compared with 26% of GDP in 2003. Implementation of the Tenth Plan initiatives was predicated on the peaceful resolution of the insurgency and on political stability, and even in a more peaceful setting, it is unlikely that such a wide-ranging and complex reform agenda could be implemented in the plan period. Tellingly, the Plan does not describe how implementation can proceed (or be adjusted) if conflict and political instability intensify. Implementation of the Tenth Plan could therefore require adjustment of some key macroeconomic targets and the reform agenda, especially if the conflict becomes worse.

III. ADB’S DEVELOPMENT EXPERIENCE

A. Impact of Past Assistance

51. ADB began lending to Nepal in 1969. As of 31 December 2003, 104 public sector loans had been approved totaling about $2.1 billion, all from the Asian Development Fund (ADF) resources, except for one small loan ($2 million) from ordinary capital resources approved in 1970. Of these, 81 loans are closed with a total of about $1.1 billion disbursed (84% of the approved loan amount). As of 30 June 2004, 21 public sector loans were ongoing with a total net loan amount of about $615.7 million. In addition, there were five private sector loans (including one supplementary loan) totaling about $59 million, including three equity investments amounting to about $3 million, all of which have been completed.

52. The first technical assistance (TA) to Nepal was approved in 1968, and as of 30 June 2004, 238 TAs had been approved totaling about $109.5 million. Of these, 90, worth $33 million, were project preparatory TAs. The remaining 146, worth $76.5 million, were advisory and operational TAs, most of which were for capacity building and institutional strengthening of ministries implementing ADB-supported projects; others were mainly for sector reviews. As of 30 June 2004, there were 35 active TAs for a total of about $32.4 million.

53. The country operational strategy of 1999 focused on building effective institutions, in recognition of the serious constraints posed by weaknesses in institutional capacity and governance for economic and social improvement. ADB provided support to build effective institutions through assisting the Government with: (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. The 1999 country operational strategy assumed that peace and political stability would prevail.

54. ADB assistance to Nepal has been focused. Three sectors accounted for 82% of ADB’s public sector loans: social infrastructure (38.7%), energy (25.4%), and agriculture and natural resources (17.9%). There have been important shifts in the composition of ADB lending over time: in the past decade, lending for social infrastructure has doubled, and increased by about a third for energy; lending has approximately halved for two sectors, namely agriculture and natural resources, and transport and communications. Lending in other sectors, including finance, remains relatively small, although these other sectors have been accorded more emphasis in recent years.

55. Some 16 projects and seven TAs were postevaluated through project performance audit reports from 1996 to 2003. Half of the projects were rated successful or highly successful, 37.5% were rated partly successful, and 12.5% were rated unsuccessful. The agriculture and natural resources sector was the poorest performer: only two of six projects evaluated were rated successful, while three were rated only partly successful, and one was rated unsuccessful. The performance of the energy sector was mixed, with two of the three evaluated projects rated successful, and the other one rated unsuccessful. In contrast, the transport and communications sector showed good performance: of the two projects evaluated, one was rated highly successful and the other one was rated successful. The post evaluation findings suggest that significant improvements can be achieved by the following: better capacity building of key development institutions; more rigorous and in-depth project feasibility studies; more extensive sector and policy analysis; increased beneficiary participation; more careful assessment of the absorptive and financial capacity of the executing agencies to implement projects; adequate provision of operation and maintenance mechanisms; increased frequency and duration of ADB review missions; detailed midterm review mechanisms; and improved monitoring and evaluation systems.

56. At the broader sector and macro level, it is difficult to isolate the impact of ADB assistance from that of other development partners’ support; from government-funded development activities; and from the effects of Nepal’s volatile political, economic, and security environment. A recent country assistance program evaluation (CAPE) concluded that most projects have been relatively successful and some have been very successful. The CAPE found that the overall development assistance impact, in areas in which ADB’s share was high, has been positive in terms of social, environmental, economic, and direct poverty impact. The CAPE noted that ADB, besides contributing to poverty reduction and to progress in achieving the Millennium Development Goals, has helped formulate several successful and replicable development models, most notably in the water supply and sanitation sector, irrigation subsector, and livestock subsector; and that there has been notable improvement in the policy and institutional environment, especially in the agriculture and natural resources and energy sectors. The CAPE cautioned, however, that a number of factors impede effective delivery of development results, including poor implementation performance in certain subsectors (including water supply and sanitation), inadequate attention to transport and rural development,

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18 ADB’s Operations Evaluation Department undertook a CAPE mission for Nepal in May 2004 to assess the contribution of ADB’s past operations to the country’s socioeconomic development and to provide guidance for the preparation of this CSP. The evaluation involved review of the three COSs prepared, as well as all 48 project and program loans and 167 TA grants approved between January 1988 and December 2003.
inadequate time-horizons for capacity building, excessive project complexity, and numerous limitations to performance posed by the unfolding conflict.

B. Portfolio Performance and Status

57. Portfolio performance in recent years has been adversely affected by political, economic, and security uncertainties. The contract award ratio in Nepal was well below the ADB average in 2002 and 2003, and disbursements fell sharply. Nonetheless, from 1997 to 2000, portfolio performance was strong: the average disbursement ratio steadily increased from 22% to 37%. However, starting in 2001, disbursement and contract award ratios substantially deteriorated. ADB committed more than $619.4 million in ADF resources for the ongoing public sector loans to Nepal, of which $94.6 million had been disbursed as of end-June 2004 (Table 1).

Table 1: Status of Ongoing Loan Projects by Sector, June 2004

<table>
<thead>
<tr>
<th>Sector</th>
<th>Net Loan Amount ($ million)</th>
<th>Elapsed Loan Period (%)</th>
<th>Project Progress (%)</th>
<th>Project Progress as % of Elapsed Loan Period</th>
<th>Disbursements as % of Net Loan Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture and Natural Resources</td>
<td>118.6</td>
<td>83</td>
<td>59</td>
<td>71.1</td>
<td>32</td>
</tr>
<tr>
<td>Transport and Communications</td>
<td>52.3</td>
<td>42</td>
<td>14</td>
<td>33.3</td>
<td>4</td>
</tr>
<tr>
<td>Power</td>
<td>53.1</td>
<td>82</td>
<td>10</td>
<td>12.2</td>
<td>1</td>
</tr>
<tr>
<td>Finance</td>
<td>8.3</td>
<td>78</td>
<td>—</td>
<td>—</td>
<td>13</td>
</tr>
<tr>
<td>Social Infrastructure</td>
<td>304.6</td>
<td>31</td>
<td>12</td>
<td>38.7</td>
<td>3</td>
</tr>
<tr>
<td>Others</td>
<td>82.5</td>
<td>86</td>
<td>97</td>
<td>112.8</td>
<td>52</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>619.4</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

— = not available.

58. Poor portfolio performance has been the result of a combination of factors—political instability, the conflict, and the unintended effect of stronger oversight by the Commission for Investigation of Abuse of Authority. A few relatively large loans are progressing slowly and contributed to poor portfolio performance. Since the escalation of the conflict in 2001, some of the projects have been facing difficulties in (i) fielding consultants, (ii) using explosives for construction, (iii) government participation in field activities, and (iv) ensuring delivery of project inputs. Frequent staff changes in government have also adversely affected a large number of projects. Long start-up delays for projects, delays in consultant recruitment, and delays in loan effectiveness are some of the generic concerns. By 2003, an average delay of 17 months was experienced between loan approval and effectiveness. Project monitoring, accounting, and auditing have also been weak. Many projects located in remote areas are difficult to supervise and implement. In many sectors, underfunding of operation and maintenance compromises project sustainability.

59. However, projects that combine community-based approaches to delivery of basic services, simple project designs, and carefully designed participatory processes appear to perform well in this conflict setting (see Box).

60. Performance of the private sector portfolio in Nepal has been mixed. Of four projects, the two earliest, both in manufacturing, have encountered financial problems since their completion in 1992. Both have been restructured, and a loan to one has been fully repaid after an agreement to waive interest due. The third project suffered significant construction delays with cost overruns of more than 25% and has also suffered operational losses due to the downturn in
the tourism industry since 2000. Repayment of the loan for the project is currently in arrears. The fourth project, a hydropower plant approved in 1996, was completed on time and within budget, and has been operating satisfactorily since July 2000, with loan repayment as agreed.

Box: Scaling Up Access to Safe Water Supply and Sanitation in Rural Nepal

The Asian Development Bank-assisted Community-Based Water Supply and Sanitation Project is to support the Government in expanding the coverage of improved water supply and sanitation facilities to underserved populations, especially in poor and remote areas, and in improving health and hygiene practices related to waterborne and sanitation diseases. The project was designed in close consultation with a wide range of stakeholders. Socially excluded castes and disadvantaged ethnic groups are specifically targeted to benefit from these investments, which will help rectify historically inequitable access to many social services, including water supply and sanitation. The project builds on lessons learned and best practices to incorporate features such as: (i) ensuring ethnic diversity in all decision making; (ii) demand-driven and participatory delivery and management using nongovernment organizations and community-based organizations; (iii) nongovernment organization-supported community-based planning, implementation, and management; (iv) support to decentralization built into design; and (v) a program orientation. Under this project, nongovernment organizations are helping the beneficiaries form water user groups, which will be responsible for construction as well as operation and maintenance of water supply systems. Community water user and sanitation committees must have at least a proportional representation of poor, deprived castes and of ethnic minority groups. Moreover, at least 50% of the executive and general members of these committees must be women. The committees will decide on the type of technology used and will be responsible for implementing the schemes. Low-income families will receive payments for 50% of the time they spend working on the project, and receive concessionary loans and subsidies to support latrine construction. The longer-term benefits of the project will arise principally from the productive uses of time saved, fewer days lost to sickness, and reduced expenditures on medical treatment.

Source: Asian Development Bank

61. Various measures are undertaken to improve portfolio performance. Bimonthly meetings are held with all executing and implementing agencies to identify and act on impediments to implementation. Quarterly high-level meetings are held with senior government officials to seek resolution of implementation issues that require policy-level intervention. ADB has increased delegation of projects to the Nepal Resident Mission (NRM) in 2004, and NRM provides more frequent advice on improving portfolio performance to executing agencies. Senior project staff also participate in project review missions. Resource savings have been identified and are being realized by closing projects with implementation delays and loan cancellations as appropriate. The High-Level Project Review Committee, chaired by the Chief Secretary and comprising secretaries of key ministries, also meets regularly to review key policy and institutional constraints that hinder project implementation.

62. ADB actively participates in the annual portfolio performance review jointly conducted by the Government, ADB, Japan Bank for International Cooperation (JBIC), and the World Bank. This aims at improving portfolio performance for all major development partners. In 2003, the following was agreed with the Government: quality-at-entry procedures would be improved to avoid premature entry of new projects in the portfolio; a new Public Procurement Law would be passed; a policy statement about project staffing, transfers, and appointments would be issued in 2004; the National Vigilance Center would implement technical audits; and external assistance would be consistent with the Government’s Foreign Aid Policy 2002.

19 To improve quality-at-entry, the Government and the development partners will pay greater attention to project design to ensure that projects can be effectively implemented, are focused on achievable results, and will deliver the maximum benefits possible in the current development setting. The Government and the development partners will also give careful consideration, during project design, to (i) the relevance of the proposed project in Nepal’s development setting and (ii) the Government’s institutional capacity to effectively deliver results.
C. Conclusions and Lessons for the Country Strategy and Program

63. ADB’s development assistance in key sectors has contributed to steady progress, particularly in transport, agriculture and rural development, education, energy, and water supply and sanitation. However, there is room for ADB’s assistance to achieve more broad-based growth and to enhance development impact.

64. Restoring peace and security as well as resolving the political impasse are Nepal’s most important priorities. It is critically important, however, to continue development assistance even in the conflict environment, where it is feasible to do so. ADB assistance can contribute to peace by helping spread the benefits of development to less advanced regions, by addressing exclusion of women and disadvantaged groups in its assistance program, and by tackling other key impediments to poverty reduction.

65. At the start of the last country operational strategy, substantial improvements in institutional capacity and governance were anticipated, but the combination of slow overall growth, political instability, and the conflict has constrained results. However, the crisis also presents Nepal with a unique opportunity to address the conflict and accelerate reform and development. The Government must therefore seize this opportunity and emerge economically stronger, institutionally more robust, and socially more inclusive. If the root causes of the conflict and chronic poverty are to be addressed, the Government must also ensure that development assistance delivers quick and tangible benefits to those who have been excluded from economic and social progress.

66. Past experience suggests that government leadership and stakeholder participation in the design and implementation of ADB’s assistance programs is as important as the choice of sectors and project modalities. Ensuring that ADB projects are technically sound and that their covenants are realistic, focused, and sequenced is essential but not enough. Strong capacity building and an appropriate policy environment are critical, along with a strong sense of ownership and commitment to projects and reforms by the Government, civil society, and grassroots communities if sustainable progress is to be achieved.20

67. The sharp decline in disbursements, at a time when the country must continue development work, is of concern. Several steps can be taken to improve financial performance and enhance project impact, including: (i) reducing start-up delays of new projects; (ii) maintaining project staff in place during implementation; and (iii) designing fewer projects that are less complex, are more closely integrated with government sector programs, are more process oriented, have more realistic conditionalities and covenants, and reflect local knowledge in project design and implementation.

20 Having experienced government executing agencies that initiated project preparation and feasibility studies has fostered a greater sense of ownership and commitment, especially in those institutions that have a long history of cooperation with ADB.
IV. ADB’S STRATEGY

A. Summary of Key Development Challenges

68. The conflict has evolved into a serious political crisis, which makes it imperative that root causes of the conflict are addressed. ADB’s results-based strategy is designed to assist the Government to address some of the key development challenges facing the country.

69. Ensuring that the development process is more broad-based and inclusive can help break the vicious cycle of exclusion and chronic poverty. This could be addressed by mainstreaming the concerns of poor women and of disadvantaged ethnic and caste groups in development policies and programs; by fostering more balanced regional development; and by promoting community and beneficiary participation in all phases of project design and implementation.

70. Poverty reduction has been slow, primarily due to inadequate and narrowly based economic growth, high population growth, and regional imbalance in overall development. Nepal therefore needs to attain stronger and more broad-based growth. Strengthening rural-urban and regional connectivity, building market linkages, and improving the quality of and access to basic social services are critical to promote broad-based growth, enhance mobility, and improve productivity. Fostering increased private sector investment by restoring peace and stability and by improving the policy and regulatory environment is key to achieving higher growth. Promoting public-private partnerships in the development and management of infrastructure can be a major instrument for greater connectivity and higher growth, especially in the underserved parts of the country.

71. Notwithstanding Nepal’s significant progress in fostering social development over the years, the quality and efficiency of basic public services, such as education and water supply and sanitation, remain poor. In education, key priorities are to improve access to and quality of primary and secondary education, boost vocational training (aimed primarily at creating employment), and foster a suitable mix of public and private higher education. Expanding access to potable drinking water, and improving sewerage and sanitation facilities are the highest water supply and sanitation sector priorities.

72. Improving governance is a pressing issue for Nepal and has significant implications for improving delivery of economic and social services, and for effective aid utilization. Weak institutional capacity; weak enforcement of laws and regulations designed to promote private investment; corruption; and lack of vision, predictability, transparency, and participation in government policy and strategy erode investor confidence and impede private sector initiatives. All sector operations should include measures aimed at improving governance. In terms of core governance, key priorities include curbing corruption, making the civil service more efficient and effective, reforming public enterprises, promoting decentralization, tapping local knowledge, promoting greater transparency and accountability in public service delivery, and building capacity.

B. Country Strategy and Program Strategic Focus

73. Fostering an inclusive development process will be ADB’s strategic approach over the next 5 years to contribute to the long-term goal of poverty reduction in Nepal. A more inclusive development process will assist the Government to promote greater balance in development of
different regions of the country; improve access of the poor to basic services, opportunities for economic advancement, and participation in the development process; and address the needs of disadvantaged women, ethnic groups, and lower castes. Such a development process will not only contribute to social and economic progress but also to stability. ADB will support the following measures to foster a more inclusive development and results-oriented process:

(i) **Conflict assessment.** All assistance will be reviewed to (a) assess the degree to which it can be effectively implemented in the conflict setting, and (b) examine options for designing assistance to address the root causes of the conflict.

(ii) **Participatory processes.** Community and beneficiary participation will be substantially strengthened in all phases of project design and implementation to ensure the involvement and commitment of local communities.

(iii) **Mainstreaming inclusion.** Opportunities to assist poor women, disadvantaged ethnic and caste groups, and the rural population will be examined in all assistance activities, with an emphasis on steadily enhancing the benefits of ADB assistance that accrue to those previously excluded from progress.

(iv) **Transparency and accountability.** Decentralization, public participation, and measures to help reduce corruption will be assessed and supported by ADB assistance. Public audits and transparency at the local level will be encouraged.

74. The strategies and choice of sectors of the CSP are based on (i) extensive consultations with all stakeholders—private sector, academia, excluded groups, civil society, local community representatives, women activists, experts, and political parties in all five development regions; (ii) the analysis of Nepal’s development constraints and poverty conditions; (iii) the Government’s strategic priorities as set out in the Tenth Plan; (iv) ADB’s experience and sector-specific strengths; (v) opportunities to harmonize ADB’s assistance with that of other development partners; and (vi) the constraints to and opportunities for improving development results and effectiveness. ADB’s strategy will rest on three pillars: broad-based economic growth, inclusive social development, and good governance. Sector interventions have been chosen on the basis of their potential: (i) to help address the underlying causes of chronic poverty and conflict; (ii) to be effectively implemented in a challenging development context; and (iii) to contribute to the delivery of meaningful development results. The conceptual linkages between the goals, the three strategic pillars, and the priority sectors of the CSP are shown in the Figure and are described below.

1. **Broad-Based Economic Growth**

75. Providing access to economic opportunities, with a special focus on the needs of the poor and excluded in rural areas (particularly in the Midwestern and Farwestern regions) will be the approach to foster broad-based growth over the CSP period. Connecting the poor and excluded to employment and market opportunities as well as promoting their integration with the national and global economy will be crucial in this regard. ADB will assist the Government to link the poor and excluded to emerging economic growth poles. To this end, ADB will assist in developing the transport and communications network to support a more dynamic, national market economy, while fostering strong links between national, regional, and international markets. ADB will assist the rural poor by (i) strengthening farm-to-market linkages in underserved regions of Nepal thereby improving agriculture productivity; (ii) supporting prudentially sound, market-oriented rural financial intermediation to support both agriculture and off-farm investment, including the development of a functional land market; (iii) restructuring the energy sector to create a foundation for private investment and to promote rural electrification; (iv) improving access to rural communications and information facilities; (v) encouraging private
investment, including small and medium enterprises; and (vi) developing one or more transport corridors traversing the northern and southern parts of the country. The last point addresses the weakest link in regional connectivity in Nepal.

2. **Inclusive Social Development**

76. ADB will strongly support inclusive social development, particularly human resource development that aims to (i) empower the poor and excluded through social mobilization and awareness and (ii) promote the skills needed for remunerative employment and for raising
productivity. Key priorities will be to improve vocational training and the quality of secondary education. ADB will also incorporate social protection components into its rural assistance to help bolster off-season rural employment, provide incentives to poor and disadvantaged families to keep their children in school, and protect minimum consumption requirements of those ultra-poor who cannot work. ADB will continue to invest in better health conditions by supporting the Government's efforts to provide potable water supply and basic sewerage and sanitation facilities in rural areas. With rapid urbanization, the deficiency of urban and environmental infrastructure and services poses a serious threat to the health of the urban population in many urban and peri-urban areas. Investments will be made to meet the urgent need for safe water supply and sanitation services in a financially sustainable manner in these areas.

3. Good Governance

77. Good governance is central to Nepal’s development and resolution of the conflict. Decades of poor governance have contributed to the conflict. Further, the lack of representative government at all tiers for last 2 years has been a major constraint to expeditious structural reform. Greater selectivity, recognition that longer time frames may be required to achieve reform, more up-front investment in awareness and consensus building, and greater attention to local service delivery are ways in which conflict-related risks to progress in governance will be mitigated.

78. ADB assistance will aim to make governance more inclusive and results-oriented. The CSP will focus on: (i) encouraging participation of women, and disadvantaged and excluded groups both in the development process and in government; (ii) supporting the Government’s decentralization initiatives, including fiscal decentralization, by strengthening the planning and implementation capacity of local institutions; (iii) improving devolved service delivery at grassroots level by encouraging involvement of the local community, private sector, and NGOs; (vi) pursuing institutional strengthening and deregulation to minimize opportunities for corruption; and (v) supporting civil service reforms to enhance the accountability, transparency, and results orientation of public service delivery. Building effective and responsive institutions remains central to forging a more inclusive society and promoting development. A combination of affirmative actions, community and beneficiary participation, and anticorruption initiatives will help make institutions more representative and accountable. Support for devolution and decentralization will help institutions tap local knowledge and empower communities. Fostering partnerships between government, the private sector, and NGOs will help build more robust service-delivery systems and reinforce accountability. Strengthening institutional capacity to deliver results, by supporting merit-based personnel management, improved monitoring and evaluation, and better project planning and implementation will enhance the competence and credibility of public sector institutions.

79. Private Sector Development. ADB will assist the Government to promote private sector investment by fostering a more conducive policy and enabling environment, with special attention to enhancing enforcement of policies aimed at catalyzing private initiative. This will be combined with measures aimed at improving the performance of key segments of the financial sector (agricultural credit and rural financial services) and at improving government capacity to support and oversee the private provision of public services. ADB will also pay special attention to promoting public-private partnerships and to improving the policy and institutional regime for encouraging foreign direct investment. A combination of deregulation and the improvement of investment-approval procedures for foreign investors will help enhance the private sector investment environment and better integrate the national economy with the global economy.
80. **Gender and Excluded Groups.** ADB will help the Government address gender, ethnic, and caste discrimination by (i) encouraging inclusive public policies; (ii) mainstreaming antidiscrimination measures in ADB-supported rural development, education, and civil service reform initiatives; (iii) building institutional capacity to foster inclusion and promote gender equality; and (iv) providing targeted interventions to empower poor women. Mainstreaming will aim at building better linkages between the Ministry of Women, Children, and Social Welfare and core line agencies so as to (i) enhance gender responsiveness, (ii) ensure that women and excluded ethnic and caste groups benefit from ADB-assisted projects, and (iii) ensure that projects include components for empowering excluded groups and monitoring changes in their status.

81. **Environment.** Fostering economic growth that is environment-friendly and ecologically sustainable will be an important priority to ADB. ADB will assist the Government to improve social and environmental policies and procedures, especially when these relate to large public sector projects. ADB will also provide assistance to address urban and peri-urban environment issues. Community-based management systems will be encouraged as a means of protecting the environment and safeguarding fragile natural resources.

82. **Regional Cooperation.** Building on the progress of SASEC, ADB will aim to assist Nepal in realizing its growth and poverty reduction goals by deepening the process of regional cooperation between Nepal, Bangladesh, Bhutan, People’s Republic of China, and India. ADB will support the restoration of Nepal as a traditional trade corridor by supporting the establishment of better transport and border-trade connections with neighboring countries and will promote cooperation in trade and investment facilitation, energy, tourism, and communications. ADB will also provide assistance to build capacity and support the activities of the SAARC Secretariat. The recently held 12th SAARC Summit, at which the historic Islamabad Declaration was adopted, has opened a new vista of opportunities for regional cooperation in South Asia. Assistance for Nepal’s participation in the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation and the Kunming initiatives will also be considered. As security conditions permit, ADB will also assist in reviving the traditional trade and transport corridor that would connect the People’s Republic of China and India through Nepal.

83. **Improving Implementation.** Development results can only be delivered if agreed interventions are implemented in a timely, effective, and sustainable manner. Nepal's project implementation record is weak and has been exacerbated by the security situation. Specific initiatives will be launched to address generic implementation issues and improve the quality of ADB assistance, and include: (i) focusing on fewer sectors; (ii) fostering greater commitment by assisting projects that are government led and, increasingly, government designed; (iii) encouraging harmonization to reinforce the alignment of ADB assistance with government programs and those of other development partners; (iv) ensuring that effective implementation arrangements are in place when public policies are reformed; (v) involving a wider spectrum of institutions in service delivery to improve quality and responsiveness to users; and (vi) simplifying project design to focus on a manageable set of objectives. In addition, to respond to the special implementation challenges posed by the conflict, ADB assistance will (i) adopt flexible implementation modalities, (ii) promote greater community participation in project design as well as implementation, (iii) ensure transparency and accountability in flow of funds and implementation mechanisms, (iv) better target the poor and disadvantaged, and (v) mainstream social inclusion. These measures will improve portfolio performance and development results. Major investment in sustained capacity building of public institutions on the one hand and simplification of design and implementation procedures on the other are critical to achieving better development results.
C. Results Orientation

84. This document represents ADB’s first pilot results-based CSP. It is results-based because it (i) identifies the “results” sought by the Government to which ADB will contribute; (ii) identifies what “outcomes” are expected during the implementation of this CSP; (iii) provides a mechanism and indicators for monitoring progress made toward achieving those outcomes; and (iv) provides a basis for evaluating the success of this CSP, thereby providing a basis for adjusting future plans to improve results. This document, therefore, describes the main ways in which ADB will assist the Government in achieving its national goals and objectives; it does not, however, establish the “share” or quantitative measure of ADB’s contribution to national goals and objectives.

85. Focusing on the delivery of development results is particularly relevant to Nepal at this time to help build broad-based support and trust in the Government, and to contribute to reviving the peace process. Making strategic processes more results oriented involves learning from past experience; scaling up proven poverty-reducing interventions; ensuring that, once committed, external assistance is implemented effectively; and judging progress not by the expressed interest, but by the delivery of results on the ground. Over time, the results-based CSP will help build a stronger and more robust development partnership by establishing a results framework for priority setting, for monitoring progress, and for assessing the consistency and coherence of ADB-supported interventions.

86. A results framework has been prepared to serve as a management tool for focusing ADB assistance on the delivery of development results (see Matrix). The results framework provides a conceptual link between the Government’s long-term development goals, its medium-term development agenda, the development context, intermediate results, and the risks and assumptions underlining the provision of external assistance.

87. ADB’s contribution to the achievement of intermediate outcomes in the next 4–5 years will also depend on its ongoing projects and programs. Improving the implementation of ongoing operations, therefore, will be important to boosting ADB’s contribution to the achievement of development results. The Government and ADB routinely restructure and refocus ongoing operations, based on the findings of careful project monitoring and supervision, in an effort to improve the delivery of development results.

88. The results framework (the Matrix) has a number of salient features. First, it clearly identifies which of the long-term development goals and medium-term development agenda of the Government are aligned with ADB’s overarching goal and strategic focus. This alignment is important because, while both the Government and ADB are fully committed to the achievement of the Millennium Development Goals, ADB’s assistance will have to remain focused on those areas in which ADB can make a meaningful contribution and in which it can harmonize assistance provided by other development partners. Second, the results framework identifies key constraints that are barriers to the achievement of the identified goals and objectives. Addressing these constraints and removing these barriers are the combined undertaking of the Government and all of its development partners, including ADB. Third, the results framework describes the focus of ADB assistance. This is not a matter of the number of sectors or projects assisted by ADB, but the credibility and relevance of ADB’s support to a wider effort aimed at achieving national development objectives. Therefore, in the results framework, ADB (along with other development partners) commits to contribute to the achievement of intermediate outcomes that are needed to address the development constraints facing Nepal. Fourth, the results framework reproduces a set of realistic intermediate indicators that are intended to show
whether progress has been made toward achieving these intermediate outcomes. Fifth, the results framework clarifies those key assumptions used and risks identified during strategy formulation that could affect the outcomes.

89. The results framework is designed to be an operational management tool. It may need to be periodically updated to ensure its continued relevance; to identify and guide the operations to enhance development impact; and to monitor and evaluate progress in implementing the strategy and program for necessary adjustments in order to improve results.

V. ADB'S ASSISTANCE PROGRAM

A. Overall Assistance Level

90. An indicative ADF level of $350 million is programmed for 2005–2007, which corresponds to an average assistance program of $117 million per annum, including overprogramming. However, the proposed assistance level is subject to the annual performance-based allocation exercise and overall ADF resource availability. The actual level of assistance will, however, depend on the security situation. If the conflict is peacefully resolved, a higher level of external assistance will be required to (i) meet reconstruction and rehabilitation requirements, (ii) consolidate the gains of such peace by helping realize peace dividends quickly, and (iii) accelerate supporting reforms. The nonlending program focuses on institutional strengthening and capacity building to help construct more effective sector institutions and improve development impacts. The 2005–2007 nonlending program is expected to average about $4 million per annum. (The 2004 assistance program for lending and nonlending products is provided in Appendix 6.) ADB will also coordinate and harmonize with major development partners to further improve the effectiveness, efficiency, and impact of its lending and nonlending programs. ADB will continue to actively pursue cofinancing opportunities in its operations, particularly from grant and concessional sources.

B. ADB Assistance for the Strategic Priorities

91. The overarching objective of the CSP is to achieve sustained poverty reduction by fostering more inclusive processes of broad-based growth, social development, and good governance. ADB’s program during 2005–2007 will focus on helping the Government foster more inclusive development by providing assistance to develop rural areas, improve basic social services and infrastructure, empower women, promote private sector development, and improve governance in the public and private sectors. Special emphasis will be placed on project design to ensure that the projects’ primary objectives are fully in line with these priorities and are results oriented. ADB will assist the Government to scale up good practices in poverty reduction and to carry out realistic policy and institutional reforms.

92. The proposed 2005–2007 lending program consists of 11 firm projects, totaling $350 million (Appendix 1, Table A1.10). (Concept papers for the 2005 lending products are included in Appendix 4.) All lending products are poverty intervention projects. For the next 3 years, program lending assistance will constitute about a third of overall lending. The higher level of program assistance is warranted to support the Government's wide-ranging policy reform effort, and to ensure that priority sector-specific poverty reduction activities are adequately financed.
93. The 2005–2007 nonlending program comprises 26 TAs and five economic, thematic, and sector work activities (Appendix 1, Table A.1.11). The TA program includes 16 project preparatory TAs to support project preparation and 10 institutional development TAs to support institutional capacity building and managing for development results. The economic, thematic, and sector work program forms the basis of ADB’s support for policy reform, capacity building, and institutional strengthening. The five planned studies will also help guide ADB interventions in rural development, connectivity, infrastructure, and regional development. (Concept papers for the 2005 nonlending products are provided in Appendix 5.)

1. Promoting Broad-Based Economic Growth

a. Transport and Communications

94. The key focus will be on bringing excluded regions and social groups into the economic mainstream by fostering connectivity between all parts of the country and by facilitating trade between Nepal and its neighbors. ADB will assist the Government in developing connectivity by improving accessibility and reducing isolation within the country and by promoting subregional connectivity with neighboring countries through the development of roads, airports, and telecommunications infrastructure.

95. In the road sector, the sector loan modality will be used more frequently to assist in improving and completing the major road networks. This will enable ADB support to be used in distressed regions in line with evolving security conditions. The use of explosives will be avoided where possible, and labor-intensive, environment-friendly construction methods will be promoted. Better road linkages and improved customs and transshipment facilities at the principal border crossings will be supported to reduce transport costs and customs-processing delays. Implementation of a road fund and other measures to bolster road maintenance will be assisted, while the policy-making and regulatory oversight capacities of the road transport authority will be developed.

96. Civil aviation is essential for Nepal, especially in remote areas that are otherwise inaccessible by road. ADB’s reengagement in the sector will be based on a careful assessment of progress in policy, regulation, and institutions, and will take conflict-related considerations into account. Building on this knowledge base, ADB will assist in institutional capacity building and infrastructure development, mainly improvement of Tribhuvan International Airport, but also of priority regional airports and several short take-off and landing airstrips. ADB will also support the Government in improving the institutional framework for the civil aviation sector, through restructuring and reforming the Civil Aviation Authority of Nepal and Royal Nepal Airlines, and through improving the regulatory framework for private participation in the subsector.

97. Nepal has an overall low level of telephone density and many parts of the country have almost no access to modern sources of information. ICT would be an effective means to provide rural and remote areas with access to information and basic government services, especially in conflict-affected regions with increasingly limited options for physical mobility. In telecommunications, support will be provided to help broaden access to communications in underserved parts of rural Nepal and to develop more efficient links between Nepal and its neighbors. Better access to ICT will also facilitate access to basic public services by enabling use of e-government technologies.
b. Agriculture and Rural Development

98. A distinct lack of opportunities for advancement in rural areas has contributed to conflict and endemic poverty. Boosting agricultural productivity and food security and diversifying economic opportunity are central to developing rural areas of Nepal, and are highlighted as poverty-reduction priorities in the Agricultural Perspective Plan and the Tenth Plan. ADB will assist the Government to achieve its agriculture and rural development objectives by (i) strengthening infrastructure and connectivity within rural areas; (ii) providing holistic support for sustainable, market-oriented agriculture, including a functional land market and livestock development; (iii) delivering assistance that can generate visible benefits to the lives of the rural population; and (iv) mainstreaming participation, gender, and ethnic-equality considerations in all projects. Support for a carefully supervised and monitored program of rural infrastructure development will include decentralized, labor-intensive provision of community infrastructure, primarily to improve transport and rural market access. Community livestock development will assist producers boost productivity and market orientation, particularly in the poorer and more remote hilly and mountainous regions. Drawing on evolving good practices, assistance in irrigation will help the low-cost and quick-impact development of groundwater sources. Further development of commercial agriculture will be supported by institutional reforms that will include (i) the restructuring of the relevant government agencies to transform government from supplying inputs to facilitating agribusiness activity, (ii) fostering public-private partnerships to deliver agricultural support services, and (iii) linking Nepal’s rural areas with growing urban and export markets.

99. It is a challenge ensuring that agriculture and rural development projects can be effectively implemented in a rural setting affected by conflict. To mitigate conflict-related risks, ADB will support initiatives that (i) incorporate decentralized and participatory design and management, (ii) involve NGOs and CBOs in implementation, (iii) are transparent in design and implementation, (iv) deliver visible benefits as quickly as possible, and (v) are planned and formulated in a way that ensures that the bulk of project benefits are realized by excluded groups and the poor.

c. Finance and Private Enterprise Development (including small and medium enterprises)

100. Nepal’s financial sector is burdened by an overhang of nonperforming assets, weak credit discipline, and political interference. The combination of the conflict and the deteriorating financial health of the two biggest government-controlled commercial banks has resulted in a substantial reduction in access to banking services in rural areas. Commercial banks find it difficult to increase their lending operations as big borrowers usually default, and small and medium enterprises either have poor access or face high transactions costs. Moreover, large parts of rural Nepal have no effective access to formal financial service institutions. ADB will assist the Government to improve access to sound and sustainable financial services in rural areas by helping restructure the Agricultural Development Bank of Nepal and by helping strengthen community-based microfinance institutions. In light of the important role that small and medium enterprises play in generating employment for the poor, ADB will continue to help the authorities in providing financial, regulatory, and complementary business development support for such enterprises.

101. There is greater recognition in the Tenth Plan than previously that the private sector must expand its operations across the entire country, and that private investment can play a
valuable role in infrastructure and service delivery. ADB assistance will help foster the
development of public-private partnerships in infrastructure and social sector projects.

d. Energy

102. Only one in every 20 households in rural Nepal has access to electricity from the grid. ADB will help the Government expand access to rural electricity by extending the integrated grid, fostering cooperative-based development of rural electrification, strengthening the distribution network of Nepal Electricity Authority (NEA), and developing renewable energy—where economically viable and financially sustainable—for remote off-grid power supply. The high cost of extending distribution facilities in rural areas has discouraged NEA from including the rural population in the national power system. ADB assistance will help the Government continue to improve the financial viability of NEA, while establishing a power sector financing structure that makes more explicit any subsidies that arise in extending the grid and other measures to promote electrification in rural areas.

Table 2: Proposed Projects to Address Broad-Based Economic Growth

<table>
<thead>
<tr>
<th>Lending Projects</th>
<th>Proposed Projects</th>
<th>Program Year</th>
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<tbody>
<tr>
<td>Agriculture and Natural Resources</td>
<td>Commercial Agriculture Development</td>
<td>2005</td>
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<tr>
<td></td>
<td>Decentralized and Community-based Water Management Support</td>
<td>2007</td>
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<td></td>
<td>Decentralized Rural Infrastructure and Livelihood II</td>
<td>2007</td>
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<tr>
<td>Energy</td>
<td>Rural Electrification and Renewable Energy</td>
<td>2006</td>
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<tr>
<td>Finance</td>
<td>Rural Finance Sector Development Cluster Program (Subprogram 1)</td>
<td>2005</td>
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<tr>
<td></td>
<td>Rural Finance Sector Development Cluster Program (Subprogram 2)</td>
<td>2007</td>
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<tr>
<td>Transport and Communications</td>
<td>Road Connectivity Sector I</td>
<td>2005</td>
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<tr>
<td></td>
<td>ICT for Public Service Delivery</td>
<td>2006</td>
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<td></td>
<td>Civil Aviation Sector Development</td>
<td>2007</td>
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<tr>
<th>Nonlending Projects</th>
<th>Proposed Projects</th>
<th>Program Year</th>
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</thead>
<tbody>
<tr>
<td>Agriculture and Natural Resources</td>
<td>Decentralized and Community-based Water Management Support</td>
<td>2005</td>
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<tr>
<td></td>
<td>Strengthening Project Implementation and Quality Assurance II</td>
<td>2006</td>
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<tr>
<td></td>
<td>Community-based Highland Livestock Development</td>
<td>2006</td>
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<td></td>
<td>Decentralized Rural Infrastructure and Livelihoods II</td>
<td>2006</td>
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<td></td>
<td>Agribusiness</td>
<td>2007</td>
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<tr>
<td>Energy</td>
<td>Capacity Building in Renewable Energy Institutions</td>
<td>2006</td>
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<tr>
<td></td>
<td>Rural Electrification and Renewable Energy II</td>
<td>2007</td>
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<tr>
<td>Finance</td>
<td>Capacity Building in Rural Finance Institutions</td>
<td>2005</td>
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<tr>
<td></td>
<td>Financial Sector and SME Development Program</td>
<td>2007</td>
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<tr>
<td>Transport and Communications</td>
<td>Preparation of Civil Aviation Sector Strategy</td>
<td>2005</td>
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<tr>
<td></td>
<td>Civil Aviation Sector Development</td>
<td>2006</td>
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<tr>
<td></td>
<td>Road Connectivity II</td>
<td>2007</td>
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</tbody>
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ICT = information and communications technology, SME = small and medium enterprise.
e. Regional Development

103. While national development plans recognize that a disproportionately larger share of the benefits of development has accrued to Kathmandu Valley, geographic priority setting and the spatial focus of public investment efforts remain poorly defined. Nepal's five development regions have vast differences in development potential and opportunities. ADB will assist the Government to establish the institutional capacity for participatory regional planning, strategy formulation, and priority setting to facilitate decentralization and to improve the coherence of the public investment program.

2. Fostering Inclusive Social Development

104. While the Government has shown a long-standing commitment to boosting access to social services, significant disparities in access and quality of social services remain. These contribute to marked regional variations in human development and to the nonincome dimensions of poverty. Improving the skills base, and enhancing access to other social services of the rural poor in general, and of women, underemployed youth, and socially excluded groups will help improve their living standards, enhance their employment potential, and reverse perceptions of urban bias and neglect.

a. Education

105. Significant challenges remain in increasing equity in access and in improving the quality and efficiency of education at all levels. The adult literacy rate is still only about 43%, and some 20% of eligible children are not enrolled in primary school. Among out-of-school children, the largest proportions are girls and children from poor and disadvantaged families living in remote areas. ADB will provide holistic support to the sector by combining investment with assistance for improvement in policies, planning, and management. Building upon past experience and ongoing assistance in primary and secondary education, ADB proposes to support policy-based, sector-wide approaches to foster comprehensive development of the education sector. ADB will also assist the Government to improve the earnings potential of unemployed youth, women, the poor, and disadvantaged groups by improving access to and quality of the country's skills development programs. These interventions will help foster inclusive development by increasing the productivity of the poor, making the labor force more mobile, reinforcing tolerance, and directly contributing to increased youth employment.

b. Water Supply, Sanitation, and Urban Development

106. Water supply coverage is estimated at around 72%, while sanitation coverage is estimated at around 28%. Building on the lessons learned from four previous rural water supply and sanitation projects, a sector-wide assistance approach is proposed to (i) expand the coverage of improved water supply and sanitation facilities to underserved populations, especially to poor and remote areas; and (ii) improve health and hygiene practices related to waterborne and sanitation-related diseases. ADB will help strengthen the capacity of local governments and other entities to provide water and sanitation by scaling up community-based, demand-driven approaches to the provision of rural water supplies.

107. The conflict and vast differences in economic opportunity have forced large segments of the rural population to migrate to urban areas. The rapid growth of the urban population has caused severe drinking water shortages and haphazard provision of basic infrastructure in Kathmandu and secondary towns. ADB assistance in the sector will continue to focus on
integrated urban infrastructure improvement, including water supply and sanitation, solid waste management, drainage, road rehabilitation, and traffic management. Water supply improvements in Kathmandu Valley will be undertaken in tandem with the Melamchi Water Supply Project.

c. Social Protection

108. Social protection initiatives may be supported as components within existing ADB-assisted projects in agriculture and rural development and in the social sectors, with help to strengthen institutions to design effective social protection policies. Empowerment efforts, aimed at strengthening the voice of women and disadvantaged castes, will be a key thrust of ADB support for strengthening the Government’s commitment to social protection. Other options for weaving quick-impact social assistance into sector lending operations include labor-intensive public works for off-season employment in developing village infrastructure, and programs that provide incentives for ultra-poor families to improve their food security, affordability of health services, and their ability to send their children to school. Requiring a certain portion of the labor under ADB-assisted projects from the local areas, especially when projects include remote and poor regions where most of the excluded are part of the labor force, can also be an effective means of promoting inclusive development.

Table 3: Proposed Projects to Promote Inclusive Social Development

<table>
<thead>
<tr>
<th>Proposed Projects</th>
<th>Program Year</th>
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<tbody>
<tr>
<td><strong>Lending Projects</strong></td>
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<tr>
<td>Agriculture and Natural Resources</td>
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<tr>
<td>• Empowerment of Women and Excluded Groups</td>
<td>2007</td>
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<tr>
<td>Education</td>
<td></td>
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<tr>
<td>• Education Sector Development Program I</td>
<td>2006</td>
</tr>
<tr>
<td>Water Supply, Sanitation, and Waste Management</td>
<td></td>
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<tr>
<td>• Community-based Water Supply and Sanitation Sector II</td>
<td>2007</td>
</tr>
<tr>
<td><strong>Nonlending Projects</strong></td>
<td></td>
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<tr>
<td>Agriculture and Natural Resources</td>
<td></td>
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<tr>
<td>• Empowerment of Women and Excluded Groups</td>
<td>2006</td>
</tr>
<tr>
<td>Health, Nutrition, and Social Protection</td>
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</tr>
<tr>
<td>• Capacity Building in Social Protection Institutions</td>
<td>2006</td>
</tr>
<tr>
<td>Education</td>
<td></td>
</tr>
<tr>
<td>• Education Sector Development Program I</td>
<td>2005</td>
</tr>
<tr>
<td>• Skills for Employment II</td>
<td>2007</td>
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<tr>
<td>• Education Sector Development Program II</td>
<td>2007</td>
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<tr>
<td>Water Supply, Sanitation, and Waste Management</td>
<td></td>
</tr>
<tr>
<td>• Kathmandu Valley Water Distribution, Sewerage, and Urban Development</td>
<td>2005</td>
</tr>
<tr>
<td>• Community-based Water Supply and Sanitation Sector II</td>
<td>2005</td>
</tr>
<tr>
<td>• Secondary Towns Urban Environmental Improvement</td>
<td>2007</td>
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</tbody>
</table>


3. Promoting Good Governance

109. Recognizing that conflict and political instability pose serious risks to reform and development, ADB will focus its support for good governance on building the capacity of key public institutions, especially at the local level, to deliver essential services, thereby improving the quality and inclusiveness of the public service and helping combat corruption. Progress in these areas will help address those factors that cause conflict and long-standing poverty in the
first place. A clear government commitment to secure and sustain consistent staffing will underpin ADB assistance to build capacity in the public sector.

110. ADB will continue to support the Government’s civil service reform program, building on the achievements of the Governance Reform Program. Civil service reform will focus on critical institutional constraints that cut across the civil service as a whole. To promote inclusion and participation in the civil service, ADB will assist the Government to develop and implement affirmative action measures and programs for women and other disadvantaged groups. To enhance the development of a professional and efficient civil service, ADB will build on earlier assistance to establish a results-based performance management and pay system. A computerized personnel information system installed in the Ministry of General Administration will be improved to become a comprehensive human resource management system.

111. ADB will support government initiatives to strengthen the legislative and institutional framework for corruption control and capacity building in anticorruption institutions. ADB will continue to support the National Vigilance Center in fully institutionalizing technical audits of infrastructure projects so as to improve the quality of development projects and combat corruption during project implementation. ADB will work in close cooperation with the Government and development partners to support the implementation of the Government’s anticorruption strategy and action plan.

112. ADB will continue to support the development of a public service for local government and the setting up of a local government service commission. Enactment of a new Local Service Act will grant authority and autonomy to local governments to employ and develop their public service workforce, an arrangement that will ultimately bolster long-run institutional capacity. The Act, in addition to enabling the transfer of civil servants to local governments, will contribute to further rightsizing in the civil service. In all sectors, ADB will promote greater local governance and community participation in the design and implementation of projects and programs. ADB will also provide support to assess progress made in fiscal devolution. Based on this assessment, ADB will provide policy reform as well as financial and capacity-building support to enhance the fiscal management capacity of local governments, in close consultation and coordination with other development partners.

<table>
<thead>
<tr>
<th>Table 4: Proposed Projects to Improve Governance</th>
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<tbody>
<tr>
<td><strong>Lending Projects</strong></td>
</tr>
<tr>
<td>Law, Economic Management, and Public Policy</td>
</tr>
<tr>
<td>• Governance Reform and Decentralization Cluster Program (Subprogram 1) 2006</td>
</tr>
<tr>
<td><strong>Nonlending Projects</strong></td>
</tr>
<tr>
<td>Law, Economic Management, and Public Policy</td>
</tr>
<tr>
<td>• Strengthening Capacity for Managing for Development Results 2005</td>
</tr>
<tr>
<td>• Governance Reform and Decentralization Cluster Program (Subprogram 1) 2005</td>
</tr>
<tr>
<td>• Strengthening Institutional Capacity for Public Debt Management II 2006</td>
</tr>
<tr>
<td>• Decentralization Support 2006</td>
</tr>
<tr>
<td>• Strengthening Capacity for Managing for Development Results II 2007</td>
</tr>
<tr>
<td>• Strengthening Planning Capacity for Local Bodies 2007</td>
</tr>
<tr>
<td>• Capacity Building for Anticorruption Institutions 2007</td>
</tr>
</tbody>
</table>

C. External Funding Coordination and Partnership Arrangements

113. The Tenth Plan and the Foreign Aid Policy of 2002 have established a broad framework for aid coordination. The Foreign Aid Policy seeks external assistance to concentrate in areas that build on past strengths in delivering development results. Well-coordinated support from the development partners was instrumental in the successful preparation of the Government’s Tenth Plan through wide consultations with key stakeholders in Nepalese society. A national action plan for harmonization of development activities was endorsed by the 2004 Nepal Development Forum to improve aid effectiveness and better align aid with the national strategies and priorities set out in the Tenth Plan.

114. Due to the ongoing decentralization of aid management responsibilities to country offices by several development partners, including ADB, opportunities for the Government to coordinate external assistance, and for the development partners to coordinate among themselves, have substantially improved in recent years. Under the auspices of the Nepal Donor Group, there are 12 thematic subgroups and working groups, several of which are cochaired by the Government. ADB is the cochair of the agriculture and rural development group and the energy group. These groups meet regularly to exchange experience, review best practices, and coordinate ongoing and future programs. ADB also participates in the Reform and Development Group that is chaired by the Government and that comprises a select group of development partners actively supporting the Government’s reform agenda. The Reform and Development Group meets regularly to review implementation progress and to help the Government formulate its reform agenda, including the IAP.

115. ADB maintains close coordination with all major development partners, aimed at further improvement of the effectiveness, efficiency, and impact of its lending and nonlending programs in Nepal. ADB makes maximum effort to coordinate with its development partners during the preparation of CSPs and country strategy and program updates (CSPUs), and at different stages of project processing. As a result, cofinancing has been obtained for a number of ADB projects from the Danish International Development Agency (DANIDA) under the first phase of the ADB-assisted Secondary Education Support Program; consulting inputs to help prepare the ongoing Community-based Water Supply and Sanitation Project from the United Kingdom’s Department for International Development (DFID); TA support for the Governance Reform Program from the Swiss Agency for Development and Cooperation (SDC); and support for capacity-building interventions under the Governance Reform Program from the United Nations Development Programme. DFID has provided TA support for the ongoing Public Sector Management Program and an agriculture and natural resource expert in NRM. A number of ongoing projects in the energy and water supply sectors have also received assistance from JBIC and the Japan International Cooperation Agency. In the past year, formal action plans have been agreed on with DFID and the Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) to guide cooperation more effectively. NRM has also initiated a bimonthly harmonization series with the World Bank’s resident office to improve coordination and collaboration.

116. In conjunction with its lending program, ADB will continue to actively pursue cofinancing from grant and concessional loan sources. While continued efforts will be made to mobilize cofinancing, core components of large projects, and especially those relating to engineering design, will be financed directly by ADB to ensure coherence, timeliness, and technical soundness. Close coordination is being maintained through regular contact and dialogue with the major development partners, and a special effort is being made to involve development partners early on in the identification stage of new projects. For example, SDC and GTZ have
agreed, in principle, to cofinance the planned Decentralized Rural Infrastructure and Livelihood Project. NRM has also initiated quarterly meetings of key development partners to share experience on working in the conflict environment and discuss effective project implementation modalities.

D. **Indicative Internal Resource Requirements**

117. The conflict has made it difficult to plan and supervise projects. An assessment of indicative staff resources required to ensure adequate delivery of the program for the next 3 years suggests that such delivery needs greater staff resources than currently available. An analysis of ADB’s operations during 2002 and 2003 shows that staff resources devoted to supervising each project have fallen and are 20% below the ADB average. Staff intensity (i.e., days supervising projects) fell to 22 days per project in 2002 from 23 days in 2001 (the ADB average is 25.5 days). While more transfer of supervision responsibilities to NRM is desirable, commensurate expansion of staff resources is also required to ease the supervision constraint. Adequate increase in monitoring and supervision resources, including staff, is a prerequisite for success in managing for results. NRM’s added regional cooperation responsibilities following signing of the ADB-SAARC memorandum of understanding in April 2004 will also require additional staff resources.

VI. **RISKS, PERFORMANCE MONITORING, AND EVALUATION**

A. **Risks**

118. The CSP will be implemented in a very uncertain environment and carries major risks. The future trends, geographic spread, and level of intensity of the conflict are difficult to predict. The first risk is associated with the fact that, although the restoration of peace and security is the Government’s highest priority, the prospects for a peaceful resolution of the conflict in the near term remain uncertain. However, abrupt developments cannot be ruled out. In such a situation, ADB will need to respond quickly to security-related threats and opportunities. To ensure this, various steps are required. First, ADB operations will be designed prudently and flexibly to facilitate implementation in the present environment. Second, if evolving security considerations preclude effective project implementation, ADB will consider restructuring both the existing projects and the future project pipeline according to the priorities set out in the CSP. ADB’s operations will, at all times, be undertaken in accordance with the United Nations security guidelines. On a routine basis, ADB will monitor reconstruction and rehabilitation requirements, so that assets destroyed in the conflict can be rebuilt and livelihoods restored quickly once a more conducive security situation emerges.

119. The second risk is that the Government’s commitment to reforms may falter if the frequent changes in government continue. To help reduce this risk, ADB assistance will help build partnerships between core government agencies, local think tanks, the private sector, and civil society, so that the reform agenda is well rooted in local needs and requirements, and can be implemented effectively in the present environment. Timely restoration of democratic processes is necessary to enhance the legitimacy and credibility of the reform process. However, changes in government could initially slow reforms as a new government may be reluctant to ensure continuity or may require time for familiarization.

120. The third risk is that faltering economic performance and further increases in security-related expenditures could crowd out vital development expenditures. The Government is
mindful of the need to protect and sustain development spending, and the 3-year PRGF agreement signed with IMF accords priority to boosting development outlays. If the Government undertakes important and implementable institutional reforms, ADB may consider providing more assistance in the form of program loans.

121. The fourth risk is that some bilateral development partners may reduce their assistance unless the Government moves to end the political crisis and the conflict, and to deal with the allegations of human rights violations. Both the lending and TA programs envisage cofinancing in many ADB operations, which may not be forthcoming if the development partners reduce their assistance, thus constituting a risk to delivery of the CSP. ADB will encourage the Government to sustain good relations with the development partners, and will emphasize the need to remain engaged and foster inclusive development to provide the foundation for lasting improvement in internal security and good governance.

B. Results-Based Monitoring and Evaluation

122. Systematic monitoring and evaluation of the implementation of the CSP is a precondition for active management of the portfolio and learning for the future. Reliable monitoring and evaluation systems are important components in a results-based CSP. In establishing and applying these systems, ADB will harmonize its efforts with those of the Government, and of other development partners and stakeholders.

123. The monitoring and evaluation systems in the Government are closely linked with the various planning and budget processes. Project performance information flows systematically from the district through all levels of government. The National Planning Commission plays a key role in overseeing and improving monitoring and evaluation systems. Although there are weaknesses in the quality of data, the greater challenge is to make full use of available information on the delivery of results in order to foster learning and guide development decision making. (The Government’s monitoring and evaluation system is discussed more extensively in Appendix 3.)

124. A Poverty Monitoring and Analysis System has been established in the National Planning Commission to coordinate, consolidate, harmonize, and analyze data from existing and new poverty monitoring mechanisms. If implemented effectively, the system could significantly help improve understanding both of poverty conditions and of the linkage between poverty and public policy.

125. This CSP is underpinned by participatory processes aimed at revealing actual needs, and at tapping local knowledge and initiative. Such processes will continue to be supported in order to anchor and inform ADB interventions as CSP implementation unfolds. Progress will be monitored toward achievement of agreed results. CSP monitoring will assess progress made in intermediate indicators (see Matrix), with interventions adjusted accordingly, depending on progress made. These indicators are selected on the basis of the ease of collection and reliability of data, as well as their relevance to ADB’s support to Nepal. Baseline and target values for these indicators are available and will form part of the routine monitoring framework for ADB’s operations. Regular assessment of progress made in delivering development results will assist ADB and the Government to reassess priorities and to define suitable interventions.

126. ADB will continue its partnership with the Government and other stakeholders, including other development partners, to jointly monitor and evaluate progress made in the Government’s Tenth Plan through the process of an annual CSPU. In addition to tracking overall progress in
poverty reduction and in the delivery of key results, the CSPU exercise will evaluate: (i) the
security situation and its implications for delivering external assistance; (ii) the Government's
reform program and its implications for fostering poverty reduction and forging a more inclusive
society; (iii) sector portfolio performance; (iv) the lending and nonlending program in the
following 3 years to ensure the relevance and effectiveness of ADB assistance; and
(v) performance-based allocation of ADF resources.

127. ADB will assist the Government and other key stakeholders to improve their capacity to
manage for delivery of development results. The Tenth Plan recognizes that there are
weaknesses in public sector decision making, the poverty database, and the procedures for
monitoring poverty reduction and for acting on the information that exists. ADB will help the
Government build its capacity to manage for results, with particular emphasis on improving
public policy formulation processes, strengthening monitoring capacity, and building capacity in
selected ministries and line agencies to incorporate results-based planning and management
approaches. In line with the priorities outlined in the Tenth Plan, more accurate monitoring of
poverty and human development, under the coordination of the National Planning Commission,
will ensure that timely information is available on poverty reduction outcomes and on the welfare
consequences of ongoing reforms.
### MATRIX: COUNTRY STRATEGY AND PROGRAM RESULTS FRAMEWORK (FY2005–FY2009)

<table>
<thead>
<tr>
<th>Long-Term Development Goals</th>
<th>Medium-Term Development Agenda</th>
<th>Asian Development Bank Strategic Focus</th>
<th>Risks and Assumptions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Pillar I:</strong> Broad-based Economic Growth</td>
<td>• Accelerate broad-based economic growth to 8.3% per annum by FY2017.</td>
<td></td>
<td>• No further deterioration of conflict or political instability.</td>
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<tr>
<td></td>
<td>• Reduce poverty level to 10% by 2017.</td>
<td></td>
<td>• Public confidence.</td>
</tr>
<tr>
<td></td>
<td>• Achieve annual average growth rate of 6.2% during 2002–2007.</td>
<td></td>
<td>• Project designs are appropriate to country conditions.</td>
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<tr>
<td></td>
<td>• Increase overall private investment to 23.5% of GDP by 2007.</td>
<td></td>
<td>• Timely implementation of projects.</td>
</tr>
<tr>
<td></td>
<td>• Political instability and conflict.</td>
<td>• Improved connectivity of different parts of the country, particularly of the rural poor, to markets and livelihood opportunities.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Poor linkages between urban and rural areas, and to markets.</td>
<td>• Improved economic status of backward regions and rural areas.</td>
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<tr>
<td></td>
<td>• Regional, ecological, and rural–urban disparity in income and economic opportunity.</td>
<td>• Expanded national road network.</td>
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<td></td>
<td>• Weak infrastructure, particularly transport and ICT.</td>
<td>• Enhanced domestic air transport services.</td>
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<td></td>
<td>• Weak financial service delivery mechanism.</td>
<td>• Improved access of communications services to VDCs.</td>
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<tr>
<td></td>
<td>• Achieve annual average agricultural growth of 4.1% by 2007.</td>
<td>• Increased number of districts connected through road network.</td>
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<tr>
<td></td>
<td>• Low productivity and slow growth of output in agriculture sector</td>
<td>• Reduction in nonperforming assets of the Agricultural Development Bank of Nepal.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Lack of rural infrastructure to connect production pockets to markets</td>
<td>• Increased number of small loans and borrowers.</td>
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<tr>
<td></td>
<td>• Poor access to basic productive resources for agriculture (irrigation, rural credit, and electrification).</td>
<td>• Continued government commitment to restructuring and reform of financial sector.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Higher agricultural productivity to rates nearer regional average.</td>
<td>• Improved institutional capacity and financial viability of financial institutions.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Increase agricultural income and employment opportunities of rural people.</td>
<td>• Improved access to key inputs, outputs, and markets</td>
<td></td>
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<tr>
<td></td>
<td>• Increased commercialization of agriculture.</td>
<td>• Increased rural road density.</td>
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<tr>
<td></td>
<td>• APP targets supported by appropriate national budgetary allocations.</td>
<td>• Increased access to irrigation, especially shallow tubewells</td>
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<tr>
<td></td>
<td>• Presence of community and private sector organizations that can be empowered to deliver rural services</td>
<td>• Increased rural electrification ratio.</td>
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<tr>
<td></td>
<td>• Unimpeded access of projects to rural areas</td>
<td>• Increased cash crop ratio and livestock production.</td>
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<tr>
<td></td>
<td>• Increased agricultural and rural credit availability.</td>
<td>• Increased agricultural and rural credit availability.</td>
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<table>
<thead>
<tr>
<th>Long-Term Development Goals</th>
<th>Medium-Term Development Agenda (^a)</th>
<th>Asian Development Bank Strategic Focus</th>
<th>Risks and Assumptions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Pillar II:</strong> Inclusive Social Development</td>
<td></td>
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<tr>
<td>Improve livelihoods and human resource capacity.</td>
<td>• Improve the availability and quality of social infrastructure and services: - Improve access to, and quality of basic education; - Increase sustainable access to safe drinking water and sanitation in urban and rural areas.</td>
<td>• Improved quality of basic education. • Improved access to vocational training. • Improved access to clean drinking water and sanitation. • Reduced water borne diseases. • Increased women's participation in income-generating activities.</td>
<td>• Increased proportion of trained teachers. • Increased participation in vocational training. • Enhanced literacy of women. • Increased scholarships to deprived groups and women. • Improved access to clean drinking water and sanitation. • Reduced waterborne diseases.</td>
</tr>
<tr>
<td></td>
<td>• Promote social and economic inclusion of women and the disadvantaged by removing social, legal, economic, and other constraints.</td>
<td>• Social and ethnic-based exclusion. • Gender disparity.</td>
<td>• Mainstreamed participation by women and excluded groups in development and decision making roles. • Increased economic and social benefits to women and excluded groups.</td>
</tr>
<tr>
<td><strong>Pillar III:</strong> Good Governance</td>
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<tr>
<td>Make governance efficient, accountable, and transparent.</td>
<td>• Promote people-centered and inclusive governance. • Enhance efficiency of public services. • Enhance government accountability and transparency.</td>
<td>• Overcentralization. • Low participation by women and excluded groups in public service and political positions. • Absence of elected local bodies. • Weak institutional capacity of local organizations.</td>
<td>• Enhanced participation and empowerment of excluded groups in the governance process. • Increased decentralization. • Enhanced capacity of local organizations. • Improved resource management at local level.</td>
</tr>
<tr>
<td>Long-Term Development Goals</td>
<td>Medium-Term Development Agenda</td>
<td>Asian Development Bank Strategic Focus</td>
<td>Risks and Assumptions</td>
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<tr>
<td><strong>Strategic Goals</strong></td>
<td><strong>Key Constraints</strong></td>
<td><strong>Intermediate Outcomes</strong></td>
<td><strong>Intermediate Indicators</strong></td>
</tr>
<tr>
<td>Accelerate decentralization.</td>
<td>Low resource mobilization at local level.</td>
<td>Further progress on devolving responsibilities for key services in education and agriculture; Increased development resources to local bodies; Increased share of internal resources to total development budget of the districts.</td>
<td></td>
</tr>
<tr>
<td>• Control corruption.</td>
<td>Weak institutional, legal, and judicial capacity. Limited measures to prevent and control corruption.</td>
<td>Improved budget implementation. Improve access, quality, accountability and responsiveness of public service delivery. Strengthened anticorruption institutions.</td>
<td>Strengthened preventive/ punitive measures to combat corruption: Anticorruption Strategy implemented; Increased number of corruption cases prosecuted and convicted; Technical audit agencies established and made operational.</td>
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</table>

**Implementation Mechanisms To Deliver Results**


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### Matrix—Continued

<table>
<thead>
<tr>
<th>Long-Term Development Goals</th>
<th>Medium-Term Development Agenda a</th>
<th>Asian Development Bank Strategic Focus</th>
<th>Risks and Assumptions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strategic Goals b</td>
<td>Key Constraints c</td>
<td>Intermediate Outcomes d</td>
<td>Intermediate Indicators e</td>
</tr>
<tr>
<td>• Improve service delivery.</td>
<td>• Political instability and conflict.</td>
<td>• Enhanced institutional capacity of central and local bodies, users groups, NGOs, and CBOs.</td>
<td>• Increased program focus at local level.</td>
</tr>
<tr>
<td></td>
<td>• Absence of Parliament and local bodies.</td>
<td>• Increased role of private sector in service delivery.</td>
<td>• Increased number of quality district plans prepared.</td>
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<tr>
<td></td>
<td>• Weak monitoring and evaluation systems, and use of available information.</td>
<td>• Improved M&amp;E capacity.</td>
<td>• Increased partnerships with private sector, NGOs, and CBOs in service delivery.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Strengthened public audit system at local level.</td>
<td>• Public audit reports at local level published.</td>
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<td></td>
<td></td>
<td></td>
<td>• Adequate implementation capacity of government agencies, CBOs, and private sector.</td>
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<td></td>
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<td>• Emergence of local accountability mechanisms.</td>
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</tbody>
</table>

ADB = Asian Development Bank, APP = Agricultural Perspective Plan, CBO = community-based organization, GDP = gross domestic product, ICT = information and communications technology, M&E = monitoring and evaluation, NGO = nongovernment organization, VDC = village development committee.

a Selected components of national agenda that overlap with ADB’s strategic priorities in Nepal.
b Strategic goals of the Tenth Plan.
c As identified in the Tenth Plan to achieve the strategic goals.
d Achievement of these outcomes is the combined responsibility of the Government and its development partners, including ADB, the civil society, private sector, and other development aid agencies.
e Indicators to track success of implementation toward expected outcomes. Baselines, targets, and indicators for monitoring progress have been identified and will be updated regularly.