



Regional Cooperation and Integration Assessment (Summary)

Asian Development Bank

REGIONAL COOPERATION AND INTEGRATION ASSESSMENT (SUMMARY)

A. Current State of Regional Cooperation and Integration

1. As a country with a unique geography and being land-locked between two of the largest and most rapidly growing economies, Nepal could potentially gain much from regional cooperation and integration (RCI) with its neighbors. Effective RCI can potentially unlock the development of Nepal by promoting its geographical transformation and by helping it overcome the disadvantage of size: small population, small markets, and inability to take advantage of agglomeration and economies scale. Effective RCI in terms of improved connectivity and elimination of border barriers to trade and services will provide Nepal broader access to regional and global markets. Effective RCI provides the benefit of economies of scale to Nepal to invest in infrastructure. In particular, the economic benefits to Nepal from enhanced power generation and its exports are immense. It is estimated that Nepal's industrial losses amount to \$24.7 million annually due to shortage of power, representing about 4.43% of the industrial sector GDP or 0.47% of overall GDP.¹ Similarly, it is estimated that hydropower-led GDP growth rate of 8% is considered achievable, with a corresponding creation of 352,000 new jobs between 2002 and 2007.² Moreover, Nepal could double its GDP if it could export hydro-based electricity to India³, an energy thirsty country. Benefits of regional cooperation on public goods would also be immense to Nepal.

2. The Government of Nepal has been pursuing RCI since its Seventh Development Plan (1985-1990). The country changed from a closed protectionist regime in the mid-1980's to a liberal, open economy. During the last two decades, Nepal has also made conscious efforts to foster deeper economic integration with its historical trading partner India, other regional partners in South and East Asia, and with the global economy since the 1990's. The trade and transit treaties agreed with India in the mid-1990's have provided Nepal with access to the vast Indian market and to the Kolkata port.⁴ Nepal and India signed Bilateral Investment Promotion and Protection Agreement (BIPPA) and Double Taxation Avoidance Agreement (DTAA) in 2011, which further strengthened economic ties between the two countries. Nepal also acceded to the World Trade Organization (WTO) in 2004. It also became the founding member of South Asian Association for Regional Cooperation (SAARC) in 1985 and had participated in the South Asian Free Trade Area (SAFTA). Nepal is a signatory to other important regional cooperation initiatives such as the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC). Similarly, the country participated in the Asia Pacific Trade Agreement (APTA) as an observer. Nepal has also assumed an active role in the ADB-supported South Asia Subregional Economic Cooperation (SASEC), which is designed to foster cooperation among Bangladesh, Bhutan, India and Nepal.

3. Over 60% of Nepal's trade occurs with India, with which Nepal also has the largest trade deficit. Nepal has a trade surplus with Bangladesh (see Table 1).

¹ South Asia Regional Initiative for Energy Cooperation and Development. 2003. "Economic Impact of Poor Power Quality on Industry: Nepal"

² United States Agency for International Development (USAID). 2005. "Impact and Benefits of Power Trading in the South Asia Growth Quadrangle." South Asia Regional Initiative for Energy Cooperation and Development.

Available at: www.sari-energy.org/Successdocs/ImpactBenefitsSAGQ.pdf

³ S. Ahmed, S. Kelegama and E. Ghani (2010). Promoting Economic Cooperation in South Asia, SAGE Publications India Pvt. Ltd, New Dehi.

⁴ The trade treaty has been renewed in 2002, 2007 and 2009.

Table 1: Nepal's merchandise trade with SASEC countries

Country	Share in total export (%)			Share in total import (%)			Trade deficit (NRs billion)		
	FY2010	FY2011	FY2012	FY2010	FY2011	FY2012	FY2010	FY2011	FY2012
India	65.47	66.40	68.75	57.04	65.19	64.51	174.36	216.29	270.41
Bangladesh	5.54	5.38	3.48	0.20	0.28	0.30	-2.61	-2.37	-1.08
Bhutan	2.55	0.66	0.73						
Total							314.66	332.97	424.07

Source: Trade and Export Promotion Center; Import data from Bhutan were not available.

B. Government's Policy Framework and Strategy

4. The Government intends to make the best use of different bilateral, subregional, regional and inter-regional cooperation initiatives, particularly SASEC, SAARC and BIMSTEC platforms, underscoring the unique value of each initiative and their complementarities. However, any regional engagement has to go beyond bilateral arrangements. The Government intends to foster a subregional approach with the active involvement of the Ministry of Foreign Affairs. The Government perceives that the advantage of SASEC lies in its pragmatic, results-oriented focus while SAARC and BIMSTEC are more political and process-oriented. Nevertheless, the Government recognizes that SAARC is extremely important for South Asia's future and is moving in the right direction. The Government strongly emphasizes that SASEC should remain as an economic cooperation initiative focusing on the specific and practical investment initiatives, outside the more political process of SAARC and BIMSTEC. However, its activities should complement those of SAARC and BIMSTEC.

5. The previous Three-Year Plan⁵ (TYP, FY2011-FY2013) and the approach paper to the new TYP (FY2014-FY2016) both recognize the need to undertake necessary policy, institutional and regulatory reforms to maximize benefits from bilateral, subregional, regional, and inter-regional cooperation initiatives. In alignment with the country's development plans, the Nepal Trade and Integration Strategy (NTIS) 2010⁶ charts out a course of action to: (i) enhance Nepal's trade competitiveness, (ii) develop country's export sector, (iii) and improve integration of Nepal's economy at subregional, regional, inter-regional and multilateral levels. The Government's priority regional cooperation projects are in the area of transport, energy and trade facilitation.

6. The Government recognizes the importance of improving regional connectivity and establishing multiple transit routes to overcome the disadvantage of being a landlocked country. This would allow Nepal to increase trade with India and indirectly with rest of the world through India and Bangladesh. The Government is of the view that implementation of the recommendations of the ADB-supported SAARC Regional Multimodal Transport Study (SRMTS) could be a key strategic intervention to improve regional transport connectivity. In particular, The Government has indicated the priority in SRMTS Road Corridor No. 4: Kathmandu (NEP) -Kakarbhitta (NEP) – Panitanki (IND) – Fulbari (IND) –Banglabandha (BAN) - Mongla/Chittagong (BAN).

⁵ National Planning Commission (2010), *Three Year Plan Approach Paper (2010/11 – 2012/13)*, Unofficial Translation (Draft).

⁶ Ministry of Commerce and Supplies (2010), *Nepal Trade Integration Strategy 2010 Executive Summary and Action Matrix*.

7. In energy sector, the Government's key priority is the development of power grid interconnectivity.⁷ This would allow Nepal to better align demand with supply by seasonally exporting excess power and importing power during the dry season (period of shortfall). The government favors developing energy trading agreements at the bilateral level with India in the short term.⁸ It is planning to expand the existing transmission links with India, and to develop new high-capacity cross-border lines, particularly to enable imports during the dry season. The Government has recently decided to construct its first 400kV cross-border electricity transmission line across Dhalkebar-Muzzafarpur to import electricity from India. In the medium term, the Government favors exporting power to India and at the subregional level, i.e., through exporting power to Bangladesh through India, over the long term.⁹

8. To improve trade facilitation, the Government recognizes the need for effective implementation of Customs Modernization Program (2009-13), improving customs valuation, developing post-clearance audit capability, developing a risk management plan, strengthening the National Trade Facilitation Committee, establishing and strengthening food testing laboratories, and harmonizing computerized systems with those of India (NTIS 2010). Likewise, the Government recognizes the need for customs harmonization, standards accreditation, electronic data interchange, a single window concept for trade (one-stop shop), and cross-border trade and transport agreements. As part of its initiatives to improve trade facilitation, the Government is establishing four integrated check points at the border with India with the financial support from Government of India.

C. ADB's RCI Experience

9. ADB has been supporting regional cooperation in South Asia at four different levels: (i) regional level through SAARC, (ii) inter-regional level through BIMSTEC, (iii) subregional level through SASEC, and (iv) national level through projects with regional dimensions. ADB assumed the role of an 'honest broker' in supporting these initiatives. SASEC has been providing strategic directions and a platform for dialogue and decisions regarding identification and implementation of cross-border investments. ADB's support for SAARC and BIMSTEC has been in the form of policy and sector studies that support the SAARC Secretariat and BIMSTEC Working Group in implementing their respective regional cooperation agenda.¹⁰

10. ADB adopted a new Regional Cooperation Strategy (RCS) for South Asia (2011-2015) on 8 December 2011 with a focus on three priority areas, namely (i) improving regional connectivity, (ii) facilitating cross-border trade (trade facilitation), and (iii) strengthening regional energy cooperation. The RCS proposes to use a flexible multi-track and multi-speed building

⁷ GON recognizes that water resources management has wide implications for the region. However, there are deep sensitivities on this subject, which will require considerable time to resolve before any regional consensus on cooperation could be reached. Over the medium term, regional cooperation could focus on energy (hydropower) and disaster risk management.

⁸ There exists a bilateral agreement between India and Nepal to exchange power. At present, the power exchange between two countries is around 50 MW through low voltage interconnections.

⁹ Nepal needs to attract investment in hydropower projects to meet its domestic requirement and maximize its comparative advantage in hydropower by power export. So far as cross-border power trade between Nepal and India is concerned, the major issues are: (i) the absence of umbrella regional energy trade agreement between Nepal and India; and (ii) barriers relating to exchange of power between two countries in terms of specific permits and taxes.

¹⁰ ADB has signed with MOU with SAARC and supported studies on transport, energy sector, food security, and economic cooperation, discussed possibilities of co-financing with SAARC Development Fund (SDF) and provided technical assistance for capacity development of the SAARC Secretariat, its centre and its officials. ADB also supported the BIMSTEC Transport Infrastructure and Logistics Study (BTILS).

block approach where countries could process projects at the speed they are comfortable with and build on the success of each step. ADB will continue to play the role of an honest broker, facilitating dialogue among policy makers and key stakeholders by supporting regular high-level policy forums, and helping to translate RCI ideas into viable regional projects through project investments and technical assistance for capacity development and support for knowledge products. ADB will also continue to facilitate organizing meetings of SAARC Finance Ministers (SAFM) and Nodal Officials of the SASEC Program on the sidelines of ADB's annual meetings.

11. As agreed and endorsed at the Second High Level Forum, a two-tier organizational framework was adopted for speedy implementation of the RCS: a national steering committee, preferably at the Finance Ministers' level, with focal points from counterpart ministers for overall coordination; and three sectoral working groups (WGs) – one each for transport, trade facilitation and energy. Accordingly, the counterpart ministries are the Ministry of Physical Infrastructure and Transport (for transport), Ministry of Commerce and Supplies (for trade facilitation), and Ministry of Energy (for energy).

12. ADB's RCI support to Nepal has brought a number of important investment projects under implementation. These include: the SASEC Information Highway¹¹ (approved in 2008, the first subregional cooperation investment project with the participation of Nepal and other SASEC countries); the South Asia Tourism Infrastructure Development Project (approved in 2009); (iii) Subregional Transport Enhancement Project (approved in 2010); and SASEC Trade Facilitation Program (approved in November 2012).

13. Following the successful meetings of its Working Groups in Bangkok (20-22 October 2011), Kolkatta (5 March 2012), and Thimpu (8-9 November, 2012), the SASEC program has made substantial progress in 2011, particularly in the areas of transport, trade facilitation, and energy. The agreements reached in the areas of transport, trade facilitation, and energy, which have direct relevance for Nepal, are discussed below.

14. In the transport sector, the SASEC program agreed to focus on investments along the Kakarbhitta (Nepal)-Panitanki (India)-Phulbari (India)-Banglabandha (Bangladesh) regional road corridor (40 km). While work in Kakarbhitta has been completed, other transport and road connectivity investments in Nepal are being discussed bilaterally.¹²

15. In energy sector, it was agreed to develop hydropower and related transmission infrastructure with increased emphasis on private sector participation and regional cooperation. This includes strengthening the in-country transmission network and cross-border transmission capacity to evacuate hydroelectricity to the load centers and to exchange power between Nepal and India. As requested by the Government, ADB has considered to provide a Partial Risk Guarantee (PRG) to the lenders to a component of the Dhalkebar-Muzaffarpur 400kV cross border electricity transmission project, given its importance for the realization of the Cross Border Project and the benefits it would bring to Nepal in terms of increased power import capability to mitigate the existing energy crisis as well as to achieve a reduced transmission tariff. The SASEC Energy Working Group Meeting in Thimpu (November 2012) also endorsed

¹¹ The long delayed bilateral interconnections agreement among the services agencies of SASEC countries was signed on 25-27 April 2012. The procurement and installation of the network is scheduled from May to July 2012.

¹² There are pipeline national projects which have RCI potential, which include: (i) Strategic Roads Improvement Project (2013); (ii) Additional Finance for Strategic Roads Improvement Project (2014); and (iii) Air Transport Capacity Enhancement Project (2015).

the following proposed investment projects of regional significance: (i) feasibility study on a large-scale power plant in Nepal and related transmission strengthening for both domestic use and export through public investments and public-private partnership (2013/14); and (ii) feasibility study of second India-Nepal 400kV cross-border transmission line (2013/14).

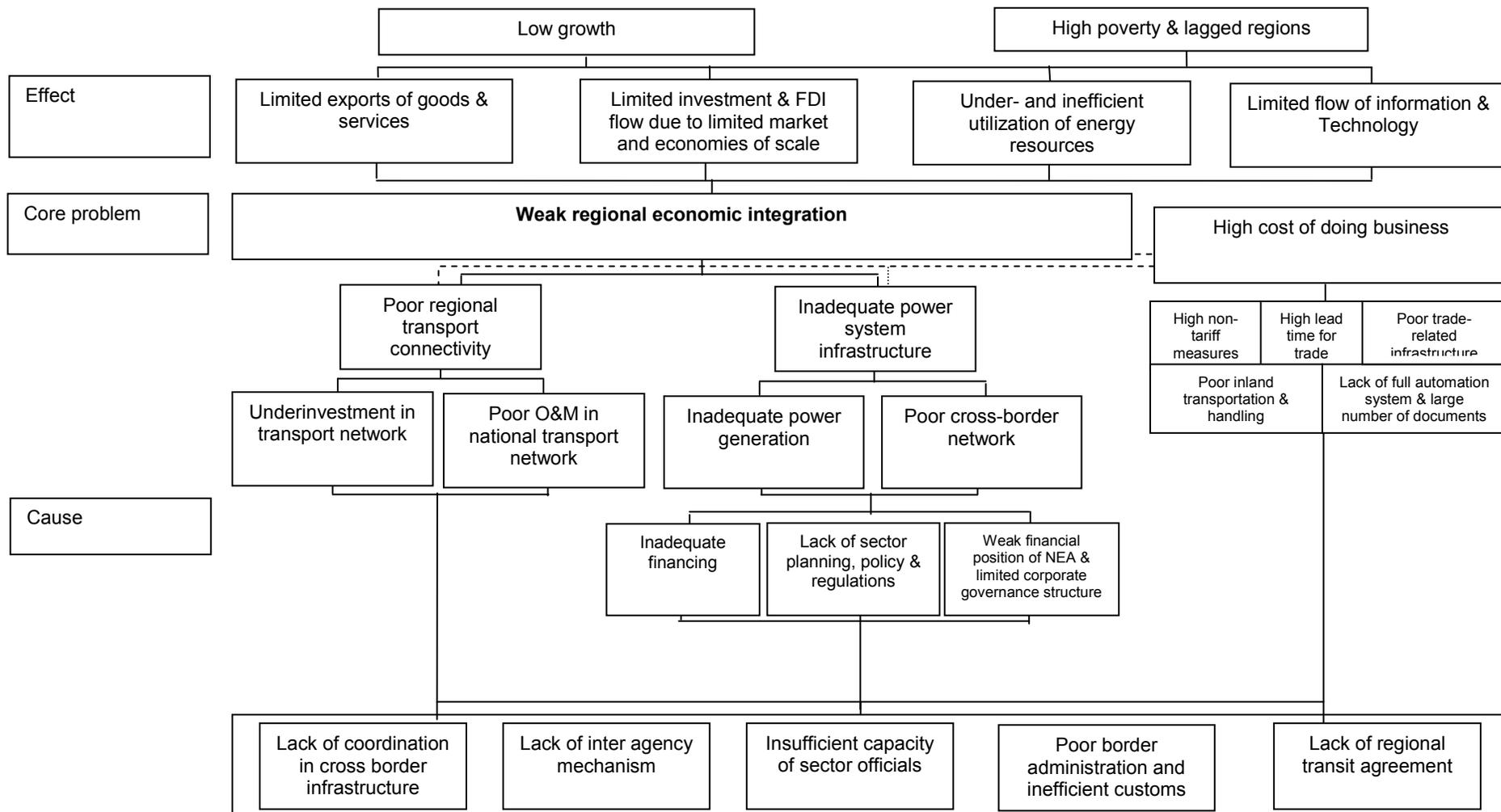
16. The SASEC program has also agreed to consider a combination of policy-based and technical assistance (TA) support to improve trade facilitation among the SASEC countries to achieve the following outcomes: (i) improved regulations and procedures, (ii) modern and efficient institutions, (iii) enhanced transparency and accountability, and (iv) improved coordination and communication among relevant agencies. To achieve the broad objectives, the SASEC Subregional Trade Facilitation Program was extended to several SASEC countries including Nepal.

17. Accordingly, on 29 November 2012, ADB approved a policy-based grant allocation of \$15 million to the Government for the SASEC Subregional Trade Facilitation Program, along with TA support to improve trade facilitation in the SASEC region. Its intended impact is to increase intra-regional trade among the SASEC countries of Bangladesh, Bhutan, India and Nepal by reducing non-tariff barriers (NTBs). This complements the objectives of the SAFTA signed in 2006 and related bilateral free trade agreements among the SASEC member countries. This program's expected outcome is efficient, effective, transparent, secure and service-oriented processing of cross-border trade in the subregion. To achieve this outcome, the Program and its associated TA will support activities under three thematic areas: (i) modern and effective customs administration, (ii) streamlined and transparent regulations and procedure, and (iii) improved information and responsiveness to the private sector.

18. ADB recognizes the need to accelerate the momentum gained so far under SASEC by advancing the pace of RCI. Reflecting the principles of SAARC and BIMSTEC, and building on the gains of the SASEC, ADB will continue to focus its RCI assistance to Nepal in the areas of transport, energy, and trade facilitation to unlock its full growth and development potentials. In particular, ADB will continue to support the establishment of better road and border-trade connections with its neighboring countries, and will promote cooperation in transport, energy, and trade facilitation. ADB will also continue its current engagement with SAARC and BIMSTEC. ADB's engagement to facilitate the Government's plans on RCI will increase further when Nepal assumes the Chairmanship of SAARC in 2013.

19. Based on the proposed program for Nepal during the new CPS period, the intended RCI outputs and outcomes will be: (i) improved connectivity between Nepal and neighboring countries, (ii) reduced travel time and reduced transaction costs of the movement of goods and services movement between Nepal and neighboring countries, (iii) increased trade of goods services between Nepal and neighboring countries, and (iv) affordable and reliable peak and off-peak electricity to Nepal and India in an economically, financially, environmentally, and socially sustainable manner.

Problem Tree



Sector Results Framework (Regional Cooperation and Integration, 2013–2017)

Regional Sector Outcome		Country Sector Outputs		ADB Sector Operations	
Outcome with ADB Contribution	Indicators with Targets and Baselines	Output with ADB Contribution	Indicators with Incremental Targets	Planned and Ongoing ADB Interventions	Main Outputs Expected from ADB Interventions
Enhanced regional cooperation and integration	<p>TIA international passenger movement (million/year) Target (2017): 7.5 Baseline (2012): 2.7</p> <p>TIA domestic passenger movement (million/year) Target (2017): 1.94 Baseline (2012): 1.58</p> <p>Cross-border land cargo volume along the east–west corridor (tons/year) Target (2022): 608,300 Baseline (2012): 553,000</p> <p>Nepal's ranking in Doing Business indicator for trading across border Baseline (2012): ranked 162</p> <p>Level of power trade Target (2017): 400 MW Baseline (2012): 150 MW</p>	<p>Strategic road network improved and airports upgraded</p> <p>Modern and effective customs administration and/or management</p> <p>Streamlined and transparent trade processes and procedures</p> <p>Energy infrastructure and system expanded and improved</p>	<p>New SRN roads added Target (2017): 3,000 km Baseline (2012): 0 km SRN roads rehabilitated/upgraded Target (2017): 2,100 km Baseline (2012): 0 km SRN maintained in good or fair condition Target (2017): 85% Baseline (2012): 80%</p> <p>Accession of Nepal to the Revised Kyoto Convention by 2015 Baseline(2012): None</p> <p>Web-based customs management system launched by 2015 Baseline(2012): None</p> <p>Pilot national single window established by 2015 Baseline(2012): None</p> <p>Installed electricity generation capacity Target (2017): 1,590 MW Baseline (2012): 705 MW</p> <p>New transmission line installed/upgraded Target (2017) : 2,000 km</p>	<p>Planned key activity areas: Air transport (airport, air navigation and security, air transport policies and reforms), (38% of funds) ; Road transport (national roads, district, and rural roads, road maintenance, road transport policies and reforms); urban transport (urban transport planning and reforms); transport management and policies (sector-wide management and reforms, PPP) (55% of funds including all road subsector interventions); ICT (cable networks) (7% of funds); Large hydropower (large dams) (62% of funds); Renewable (solar, small hydro, wind) (4% of funds) Electricity transmission and distribution (electrical power transmission) (30% of funds); Energy sector development (policy and regulation, tariffs and pricing, PPP) (4% of funds)</p> <p>Pipeline projects: South Asia Tourism Development (Additional financing) (\$30 million) SASEC Road Connectivity II (\$45 million) Air Transport Capacity Enhancement II (\$60 million) SASEC Trade Facilitation Project (\$60 million) Project Preparatory Facility (\$21 million) SASEC Power System Expansion (\$145 million) Hydropower development through PPP (\$110 million)</p>	<p>Planned key activity areas and pipeline projects: 1,800 km of SRN rehabilitated/upgraded; Road sector policies and guidelines reviewed to incorporate gender equality and social inclusion provisions; 186 km of SRN rehabilitated/upgraded; Hydropower projects with capacity up to 740 MW initiated; 5.5 MW renewable energy generation (excluding large hydro power) established; 400km transmission line and 200 km distribution line installed/upgraded</p> <p>Ongoing projects: Advanced project preparatory activities for improving or upgrading about 900 km of SRN, including subregional corridors of about 200 km rehabilitated or upgraded; SRN of about 320 km rehabilitated; New public transport branch created within Department of Transport Management by 2014; 140 MW hydropower plant constructed; 550km transmission line and 600 km distribution line installed/upgraded</p>

Regional Sector Outcome		Country Sector Outputs		ADB Sector Operations	
			<i>Baseline (2012): 0 km</i>	Ongoing projects: SASEC Road Connectivity (\$75 million) Road Connectivity Sector (\$55.2 million) Transport Project Preparatory Facility (\$12 million) Subregional Transport Enhancement (\$49 million) SASEC Trade Facilitation (\$15 million) Air Transport Capacity Enhancement (\$80 million) South Asia Tourism Infrastructure Development (\$26 million) SASEC Information Highway (\$9 million) ICT Development (\$25 million) Tanahu Hydropower (\$150 million) Energy Access & Efficiency Improvement (\$63.2 million) Electricity Transmission Expansion & Supply Improvement (\$75 million) Detailed Engineering Study for Upper Seti Hydropower (\$2.5 million)	

ICT = information and communication technology, km = kilometer; MW = megawatt, SASEC = South Asia Subregional Economic Cooperation, Regional, SRN= strategic road network, TIA = Tribhuvan International Airport

Source: Asian Development Bank and government estimates.