



# Report and Recommendation of the President to the Board of Directors

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Project Number: 38349-029  
June 2020

## Proposed Policy-Based Loan and Technical Assistance Grant Nepal: Civil Aviation Sector Improvement Program

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Asian Development Bank

## **CURRENCY EQUIVALENTS**

(as of 5 May 2020)

Currency unit	–	Nepalese rupee/s (NRe/NRs)
NRe1.00	=	\$0.008255
\$1.00	=	NRs121.14

## **ABBREVIATIONS**

ADB	–	Asian Development Bank
ASAN	–	Air Service Authority of Nepal
CAAN	–	Civil Aviation Authority of Nepal
CAANepal	–	Civil Aviation Authority of Nepal
COVID-19	–	coronavirus disease
GASP	–	Global Aviation Safety Plan
GDP	–	gross domestic product
GESI	–	gender equality and social inclusion
ICAO	–	International Civil Aviation Organization
IMF	–	International Monetary Fund
NASP	–	Nepal Aviation Safety Plan
PBL	–	policy-based loan
SARPs	–	standards and recommended practices
TA	–	technical assistance
TIA	–	Tribhuvan International Airport

## **NOTES**

- (i) The fiscal year (FY) of the Government of Nepal and its agencies ends on 15 July. “FY” before a calendar year denotes the year in which the fiscal year ends, e.g., FY2020 ends on 15 July 2020.
- (ii) In this report, “\$” refers to United States dollars.

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## PROGRAM AT A GLANCE

1. Basic Data		Project Number: 38349-029	
Project Name	Civil Aviation Sector Improvement Program	Department/Division	SARD/SATC
Country	Nepal	Executing Agency	Ministry of Finance
Borrower	Government of Nepal		
Country Economic Indicators	<a href="https://www.adb.org/Documents/LinkedDocs/?id=38349-029-CEI">https://www.adb.org/Documents/LinkedDocs/?id=38349-029-CEI</a>		
Portfolio at a Glance	<a href="https://www.adb.org/Documents/LinkedDocs/?id=38349-029-PortAtaGlance">https://www.adb.org/Documents/LinkedDocs/?id=38349-029-PortAtaGlance</a>		
2. Sector	Subsector(s)	ADB Financing (\$ million)	
✓ Transport	Transport policies and institutional development		50.00
		Total	50.00
3. Operational Priorities		Climate Change Information	
✓ Accelerating progress in gender equality		GHG reductions (tons per annum)	0
✓ Strengthening governance and institutional capacity		Climate Change impact on the Project	Low
✓ Fostering regional cooperation and integration			
		ADB Financing	
		Adaptation (\$ million)	0.00
		Mitigation (\$ million)	0.00
		Cofinancing	
		Adaptation (\$ million)	0.00
		Mitigation (\$ million)	0.00
Sustainable Development Goals		Gender Equity and Mainstreaming	
SDG 9.4		Some gender elements (SGE)	✓
		Poverty Targeting	
		General Intervention on Poverty	✓
4. Risk Categorization:		Low	
5. Safeguard Categorization		Environment: C Involuntary Resettlement: C Indigenous Peoples: C	
6. Financing			
Modality and Sources		Amount (\$ million)	
ADB		50.00	
Sovereign Stand-Alone Policy-Based Lending (Concessional Loan): Ordinary capital resources		50.00	
Cofinancing		0.00	
None		0.00	
Counterpart		0.00	
None		0.00	
Total		50.00	
Note: An attached technical assistance will be financed on a grant basis by the Technical Assistance Special Fund (TASF-6) in the amount of \$500,000.			
Currency of ADB Financing: US Dollar			

## I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed policy-based loan (PBL) to Nepal for the Civil Aviation Sector Improvement Program. The report also describes proposed technical assistance (TA) for Supporting the Civil Aviation Sector Improvement Program, and if the Board approves the proposed loan, I, acting under the authority delegated to me by the Board, approve the TA.

2. The program will provide budget support for civil aviation sector reforms in the restructuring of the current Civil Aviation Authority of Nepal (CAAN) and the strengthening of its oversight functions, management accountability, and operational efficiency. The program is aligned with the Asian Development Bank (ADB) Strategy 2030 operational priorities of (i) strengthening governance and institutional capacity through civil aviation sector reforms (operational priority 6), (ii) fostering regional cooperation and integration through attracting more international flights with enhanced aviation safety (operational priority 7), and (iii) accelerating progress in gender equality by introducing gender-related initiatives (operational priority 2).<sup>1</sup>

## II. PROGRAM AND RATIONALE

### A. Background and Development Constraints

3. **Macroeconomic context.** Nepal's economic growth is robust, reaching 7.1% in fiscal year (FY) 2019, which is much higher than the 10-year average of 4.3% during FY2009–FY2018. The budget balance had been in surplus before FY2016. However, increased government expenditures and fiscal transfers to subnational governments rapidly widened the fiscal deficit to 6.7% of gross domestic product (GDP) in FY2018. The deficit for FY2019 had been projected at around 8% of GDP but was actually 4.6% mainly because of under-execution and back-loading of spending resulting from federal and subregional government capacity constraints. External sector stability is vulnerable over the medium term because of a rapidly rising trade deficit. This may only be partially offset by inflows of remittances from overseas, which declined from 29.5% of GDP in FY2016 to about 25.3% of GDP in FY2019. The current account deficit reached \$2.4 billion, or 7.7% of GDP, in FY2019—significantly higher than the \$95.7 million (0.4% of GDP) figure for FY2017.<sup>2</sup> Based on the scenario before the outbreak of the new coronavirus disease (COVID-19)—despite some balance-of-payment pressure, financial stability risk, slower growth in neighboring countries, and sluggish remittance inflows—the near-term outlook for growth is moderate (about 6%), attributed to a stable political environment, a robust tourism industry, and ongoing reconstruction from the earthquake in 2015. Public debt is estimated at 30.1% of GDP as of mid-2019, which remains lower than in other low-income countries. Debt sustainability analysis indicates that none of the debt burden indicators breach the indicative threshold values, though Nepal's public debt is projected to gradually increase over the medium term. Development spending financed by concessional inflow should be accommodated since it keeps the debt burden in check while allowing for needed development expenditures. The COVID-19 shock, however, is expected to severely impact economic activities and lower growth to 1.0% in FY2020 through a significant reduction in remittances and tourism, and broader disruptions brought by the pandemic.<sup>3</sup> Nepal continues to be assessed at *low risk* of debt distress for both external and

<sup>1</sup> ADB. 2018. [Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific](#). Manila.

<sup>2</sup> International Monetary Fund (IMF). 2020. *Nepal: Staff Report for the 2020 Article IV Consultation*, [IMF Country Report No.20/96](#). Washington, DC.

<sup>3</sup> IMF. 2020. [Nepal: Request for Disbursement Under the Rapid Credit Facility](#), *IMF Country Report 20/155*. Washington, DC.

overall public debt, but the government needs additional fiscal financing to address the COVID-19 shock.<sup>4</sup>

4. **Importance of civil aviation sector to the economy.** Nepal is a landlocked country of tremendous geographic diversity, with the northern rim of the Gangetic Plain in the south, the Himalaya Mountains in the north, and rugged and hilly terrain in between. Civil aviation is crucial to transport, trade, and tourism, and provides indispensable links to hilly and mountainous areas that are inaccessible by other transport modes. Tourism is one of the major economic activities in Nepal and a top government priority. It is estimated that tourism brought in \$651 million in foreign exchange in FY2019, equivalent to 65% of goods exports (footnote 2). Travel and tourism in Nepal generated an estimated \$1.92 billion (7.8% of GDP) in 2018, including indirect and induced contributions.<sup>5</sup> Considering that more than 80% of international tourists come to Nepal by air, improvement of the civil aviation sector is essential for tourism to support the country's economic development.

5. **Challenges in the civil aviation sector.** Nepal has a large airport network, albeit with low capacity, comprising one international airport, Tribhuvan International Airport (TIA) in Kathmandu, and 53 domestic airports.<sup>6</sup> TIA is the sole gateway airport to Nepal. It handled 4.1 million international passengers in 2019, up from 1.8 million in 2008. It also serves as the largest domestic airport, handling 3.2 million domestic passengers in 2019—accounting for about half of the country's domestic air traffic.<sup>7</sup> TIA handled 32,439 international and 91,816 domestic flights in 2019. With the tourism industry expected to continue to grow, it is expected under pre-COVID scenario that air traffic will steadily increase 3%–5% annually (para. 9).<sup>8</sup>

6. Although TIA plays a critical role as an international gateway and domestic air hub, its close proximity to Kathmandu's city center restrains expansion beyond the current airport boundary. Aircraft need to occupy the runway for 2–3 additional minutes for takeoff and landing because the inefficient taxiway caps aircraft movements, particularly during peak hours. The number of parking spots at aprons (international: 9 and domestic: 17) is not sufficient to handle peak-hour parking demand, causing unnecessary waiting time for spot allocation. It also restricts the number of domestic operating aircrafts based in TIA for nighttime parking. Combined with limited airspace in the Kathmandu Valley, the insufficient capacity of airside facilities forces airplanes to remain on hold in the sky, leading to frequent flight delays and risks. For landside facilities, the current international terminal building handled 4.1 million passengers in 2019, beyond its annual capacity of 3.2 million. Heavy congestion and lower quality of services are observed during peak hours; the international terminal building handles more than 2,200 passengers per hour, about 70% more than its per-hour capacity of 1,350. The number of international passengers is projected to further increase to 6.1 million by 2028. TIA will have to use its existing space more efficiently, while more flights must be routed through other airports.<sup>9</sup>

7. Aviation safety in Nepal is another challenge. The Universal Safety Oversight Audit Programme under the International Civil Aviation Organization (ICAO), a specialized agency of

<sup>4</sup> International Monetary Fund Assessment Letter (accessible from the list of linked documents in Appendix 2).

<sup>5</sup> World Travel & Tourism Council. 2018. *Travel & Tourism Economic Impact 2018 Nepal*. London.

<sup>6</sup> Of these 53 domestic airports, 22 have no scheduled flights. Four airports—Biratnagar, Gautam Buddha, Nepalgunj, and Pokhara—are regional hubs that receive passengers transiting to smaller domestic airports. Gautam Buddha Airport will operate as a second international airport from 2021.

<sup>7</sup> Government of Nepal; Ministry of Culture, Tourism and Civil Aviation. 2018. [Nepal Tourism Statistics 2017](#). Kathmandu.

<sup>8</sup> Government of Nepal, CAAN. 2013. *National Airports Plan Air Traffic Demand*. Kathmandu.

<sup>9</sup> An investment loan is being prepared to address physical constraints in the civil aviation sector in Nepal.

the United Nations, is responsible for conducting aviation safety oversight audits to identify deficiencies of its member states. The CAAN has achieved significant progress in improving its safety oversight capability. In its 2017 audit of the CAAN, the Universal Safety Oversight Audit Programme raised the rate of effective implementation of the CAAN from 46.96% in 2009 to 66.76% in 2017, above the Global Aviation Safety Plan (GASP) benchmark of 60%.<sup>10</sup> Nonetheless, negative safety oversight margins were still identified in (i) air navigation; and (ii) support in organization, legislation, and accident and incident investigation.<sup>11</sup> During 2009–2018, 21 accidents involving Nepalese-registered aircrafts claimed 164 lives. These accidents and fatalities were mainly because of controlled flight into terrain (74% of fatalities), loss of control in flight (24% of fatalities), and runway excursion. There were 192 incidents in 2016 and 159 incidents in 2017, in which air operation and maintenance were found to be the predominant reason.<sup>12</sup> The CAAN prepared the Nepal Aviation Safety Plan (NASP), 2018–2022 in congruence with ICAO's GASP to continually enhance aviation safety performance by reducing fatalities and the risk of fatalities through the development of a harmonized aviation safety strategy and its implementation.<sup>13</sup>

8. The global civil aviation sector is heavily regulated, particularly in maintaining high-level safety and security to be applied across the countries. ICAO is responsible for ensuring standardized global procedures and processes with respect to civil aviation. As a signatory to the Convention on International Civil Aviation, Nepal is generally bound by the requirements of the convention. There are 19 annexes to the convention, divided into specific areas of civil aviation over which ICAO has authority. These include Security (Annex 17) and Safety Management (Annex 19). The annexes provide details of the standards and procedures that ICAO member states must follow to ensure safe and efficient civil aviation operations. With regard to safety management, the standards and recommended practices (SARPs) in Annex 19 are intended to assist the states in managing aviation safety risks. The GASP is a means for ICAO member states, including Nepal, to achieve compliance with the ICAO safety-related SARPs, and the GASP assists the states in strengthening their capabilities in the management of safety through a structural process.

9. Despite the COVID-19 pandemic, the importance of the tourism industry to the Nepalese economy will remain unchanged over the medium term though its character and business models might be adjusted accordingly under the new normal. As such, directing well-targeted investments into the key airports and creating an enabling environment for the improvement of the civil aviation sector are still critical to support Nepal's long-term economic development.<sup>14</sup> The outbreak of COVID-19 has serious negative impacts on Nepalese aviation and tourism sectors. All international flights were temporarily suspended in March 2020, and the government had to cancel the Visit Nepal 2020 campaign, which was just launched in January 2020 to attract two million visitors. The depth and duration of the shock are uncertain. There could be several scenarios on how soon international connectivity will be restored, depending partly on the length of containment measures adopted by Nepal and other major economies. Nonetheless, continuous performance improvement of the civil aviation sector needs to underpin tourism to prepare for

<sup>10</sup> ICAO. 2019. [Global Aviation Safety Plan, 2020–2022](#). Montreal (Appendix A).

<sup>11</sup> Government of Nepal, CAAN. 2018. [Aviation Safety Report 2019](#). Kathmandu.

<sup>12</sup> Government of Nepal, CAAN. 2017. [Aviation Safety Report 2018](#). Kathmandu.

<sup>13</sup> Government of Nepal, CAAN. 2018. [Nepal Aviation Safety Plan, 2018–2022](#). Kathmandu.

<sup>14</sup> ADB. 2019. [Country Operations Business Plan: Nepal, 2020–2022](#). Manila. This was originally in the pipeline as the Tribhuvan International Airport Capacity Expansion Sector Development Program. The sector loan was split into this policy-based lending and an investment loan after the concept clearance because of differences in loan processing timelines. A stand-alone investment loan under the South Asia Subregional Economic Cooperation Airport Capacity Enhancement Project that will finance the improvement of airport facilities, including TIA, is being processed.



accommodating the future bounce-back of international travelers and kickstarting the economy after the pandemic.

10. **Government reform agenda in civil aviation sector.** Nepal has maintained a traditional civil aviation sector structure whereby the functions of regulation, safety oversight, and service provision are carried out by one entity: the CAAN. The roles of regulator and service provider lodged in a single organization create a conflict of interest. The regulatory function may not provide adequate oversight on service provision, may raise operating costs, and result in suboptimal performance as a service provider. There are also repercussions on aviation safety, which have been noted and highlighted by international aviation agencies. ICAO's GASP, 2020–2022 states that an independent regulatory authority should be established and maintained, which includes separation of oversight functions from service provision functions where these exist within the authority (footnote 10). The European Commission has banned Nepalese airlines from flying to the European Union because of a lack of safety oversight by the aviation authority of Nepal.<sup>15</sup> To remedy this situation, the NASP (footnote 13) has named the bifurcation of CAAN as a priority measure to comply with international standards. The change of the governance structure in the civil aviation sector is the most fundamental and imminent reform requirement. While the preparation of bills on the reforms was initially supported by the ADB-funded Air Transport Capacity Enhancement Project, the government continued working on finalizing the bills until their submission to the Parliament.<sup>16</sup> The main objective of the new bills is to reform the civil aviation sector in Nepal by bifurcating the roles of the regulator and the operator (CAAN) into separate entities.

11. **ADB assistance to the sector.** ADB is Nepal's key partner in the civil aviation sector to support various aspects of its development, including planning, physical investment, and institutional reform. ADB's involvement in Nepal's aviation sector started with a \$70 million loan and a \$10 million grant to Nepal through the 2009 Air Transport Capacity Enhancement Project (footnote 16). The project aimed to enhance safety and capacity at TIA and three regional airports.<sup>17</sup> The draft bills to bifurcate CAAN, as per ICAO's guidance materials and international best practices, were prepared under the project, based on which ADB has conducted policy dialogues with the government to strengthen aviation safety from an oversight function perspective. The Transport Project Preparatory Facility assisted CAAN in (i) preparing the TIA master plan to guide future investments for the airport, and (ii) developing the designs of required airside and landside facilities.<sup>18</sup> Through the South Asia Tourism Infrastructure Development Project, ADB is funding the upgrade of Gautam Buddha Airport, one of the four domestic hub airports in Nepal, to accommodate the increasing number of tourists to Lumbini.<sup>19</sup> Review missions of the ADB-funded projects observed that the CAAN's capacity for (i) contract management and procurement; and (ii) investment preparation needs to be strengthened to improve implementation performance. Lessons from the reviews are incorporated in the policy actions of the program. For the Air Service Authority of Nepal (ASAN), these include the

<sup>15</sup> European Commission. 2019. [Aviation: Commission updates the EU Air Safety List to maintain highest level of protection for passengers](#). News release. 16 April.

<sup>16</sup> ADB. 2009. [Report and Recommendation of the President to the Board of Directors: Proposed Loan and Asian Development Fund Grant to Nepal for the Air Transport Capacity Enhancement Project](#). Manila. The new bills comprise (i) a bill to amend and consolidate laws regarding CAAN, and (ii) a bill for the establishment and management of an Air Service Authority of Nepal (ASAN).

<sup>17</sup> The three regional airports are Lukla, Rara, and Simikot.

<sup>18</sup> ADB. 2010. [Report and Recommendation of the President to the Board of Directors: Proposed Grant to Nepal for the Transport Project Preparatory Facility](#). Manila.

<sup>19</sup> ADB. 2014. [Report and Recommendation of the President to the Board of Directors: Proposed Loan for Additional Financing and Administration of Grant for Additional Financing to Nepal for the South Asia Tourism Infrastructure Development Project](#). Manila.

(i) creation of a legal and/or procurement unit, and (ii) development of an integrated institutional management strategy.

12. **Development partner coordination.** The ADB program team has closely coordinated with other development partners and diplomatic communities in Nepal, including through the International Development Partner Group. Because of the ban on Nepalese airlines flying to the European Union, its member states theoretically have a strong interest in the proposed civil aviation sector reforms to enhance the oversight function, and they could provide various support for the reforms if called upon. ICAO provides oversight authorities and service providers in Nepal with the SARPs, relevant guidance materials, and trainings, as required.

## **B. Policy Reform and ADB's Value Addition**

13. **Policy reform.** A two-tranche stand-alone PBL is proposed. The first tranche, to be released on loan effectiveness, includes the legal framework for the reforms to bifurcate the CAAN into a regulator, which is the Civil Aviation Authority of Nepal (CAANepal), and a service provider, which is the ASAN. The draft bills include fundamental elements of the new organizations such as mandate; governance structure; roles and responsibilities of the board; executive bodies; internal and external audits; decision-making process including appointment of executive heads, staff management, remuneration and benefits; funding sources; and accounting.<sup>20</sup> The two first tranche policy actions on submission of the bills to the Parliament have been achieved. The second tranche has 11 policy actions that will support the establishment of high-quality organizations. To support this, the tranche 2 policy actions cover more advanced elements of organizational development such as preparation of an integrated institutional management strategy, development of key performance indicators, and gender equality and social inclusion (GESI) initiatives. There are three reform areas:

- (i) **Reform area 1: Legal and implementation framework of the civil aviation sector reforms approved.** A critical step to bifurcate CAAN into a regulator and a service provider is to provide the legal basis for the establishment of the two authorities. In tranche 1, the program will support the government in approving the two draft bills for the establishment of the CAANepal and the ASAN, and submitting these to the Parliament for consideration (footnote 20). The draft bills stipulate (a) duties, responsibilities, and rights of the new entities; (b) establishment, duties, responsibilities, and rights of boards; (c) appointment, duties, responsibilities, and rights of executive heads; (d) staff management, including staff numbers, gratuity fund, principles of staff transfer, remuneration, and benefits; (e) transfer of properties, assets, and liabilities; (f) separated fund sources; (g) accounting rules, including internal audit; (h) provisions on conflicts of interest; and (i) procedures to set rules to implement the acts (footnote 20). The act for the ASAN also allows the private sector, subject to government approval, to be involved in the construction, development, operation, and management of airports in Nepal. Under tranche 2, the program will support the implementation and enforcement of the laws once the bills are approved and enacted.
- (ii) **Reform area 2: Independent regulatory body for the civil aviation established and functionalized.** To establish and maintain an independent regulatory

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<sup>20</sup> The bills are (i) a bill (that will become the Nepal Civil Aviation Authority Act) to amend and consolidate laws regarding CAAN, and (ii) a bill (that will become the Nepal Air Service Authority Act) for the establishment and management of ASAN. Both bills were endorsed by the Cabinet in January 2020, and submitted to the Parliament in February 2020.

oversight authority, which should be separated from a service provision function, is an important safety enhancement initiative to avoid conflicts of interest following ICAO's GASP, 2020–2022. The program will support the establishment of the CAANepal as a regulator with appropriate oversight functions as stipulated in the bill. The CAANepal shall develop an effective system to promulgate technical guidance and tools to effectively perform the safety oversight functions, and to recruit, train, and retain qualified and sufficient technical personnel to support regulatory oversight. Under the program, key performance indicators to measure the regulatory functions will be developed following ICAO's SARPs in the areas of (a) aviation safety; (b) aviation security; (c) licensing and certification of service providers; (d) authorization and approval of aviation activities; (e) surveillance, inspection, and audits of service providers; and (f) capacity development requirements. The program will also support improvement of the CAANepal's organizational structure to comply with ICAO's SARPs.<sup>21</sup> An updated NASP will be approved based on ICAO's latest safety audit to Nepal, ICAO's GASP, and other safety standards.

- (iii) **Reform area 3: Independent service provider for the civil aviation established and functionalized.** The ASAN will be established as an independent service provider to focus its business domain on the construction, operation, and management of airports. The newly established service provider will need to improve its operational efficiency to provide better services to airport users and to promote efficient resource use through more accountable institutional management. The new service provider will remain a government authority as per the bill for the establishment and management of the ASAN, but it allows for private sector involvement, subject to government approval, in the construction, development, operation, and management of airports.<sup>22</sup> The program will support the establishment of the ASAN and its transformation into a high-quality entity with more accountable management and efficient operations. The program includes development of (a) a medium-term business plan; (b) a medium-term financial framework and forecast financial statements; and (c) a financial management improvement plan comprising the introduction of accrual-based financial statements, an enterprise resource planning system, and a management accounting system. Under the program, key performance indicators to measure the service provider functions will be developed in the areas of (a) core business and functions, (b) aviation safety, (c) aviation security, (d) service quality, (e) productivity and cost-effectiveness, (f) financial management, and (g) social and environmental performance. The program will also support GESI initiatives through a GESI audit of the ASAN and a GESI operational plan. To strengthen the capacity of the ASAN, the program will further support the (a) creation of new separate units for environmental and social, as well as legal and/or procurement services; and (b) development of an operational capacity program.

14. **ADB's value addition.** The program will (i) build on outputs of ADB's assistance and initiatives to align with international good practices and ADB's strategic objectives; (ii) add value by creating an institutional environment for enhanced civil aviation safety and sector efficiency;

<sup>21</sup> The CAANepal shall comply with Annex 19 of the Convention on International Civil Aviation (Safety Management); ICAO Doc 9859, *Safety Management Manual*; and ICAO Doc 9734, *Safety Oversight Manual*.

<sup>22</sup> Article 12 (Joint Investment) of the bill stipulates that the authority (ASAN), after obtaining approval from the Government of Nepal, can construct, operate, or manage airports under public, private, or joint partnership.

and (iii) facilitate other interventions of the government, development partners, and the private sector in improving civil aviation as well as further developing the tourism sector in the country. ADB's country partnership strategy for Nepal, 2020–2024 aims to address major development constraints by pursuing three objectives: (i) improved infrastructure for private sector-led growth, (ii) improved access to devolved services, and (iii) environmental sustainability and resilience.<sup>23</sup> The transport sector is a key area for implementing the strategy, and ADB places high value on improving the infrastructure and operational capacity of TIA and increasing air safety through the civil aviation reforms. The program is listed in ADB's country operations business plan for Nepal, 2020–2022 (footnote 14). This will be the first ADB transport sector policy-based loan for Nepal, and it will complement infrastructure investment, which is in line with recommendations made by the 2020 sector-wide evaluation of ADB support for transport.<sup>24</sup>

15. **Effect of COVID-19 on program implementation.** Since the proposed policy reform focuses specifically on the governance structure of the civil aviation sector in line with the established international safety standards and practices, the COVID-19 pandemic will not affect the policy actions under the program. The proposed program to be implemented over the next 2 years will provide more air travel opportunities with higher safety and service standards and support the quick recovery of the Nepalese economy once the pandemic is contained. The adverse impact of the pandemic on program implementation is considered limited since the program does not involve physical activities such as construction and transportation of equipment and materials. However, the progress of the reform will be closely monitored especially in terms of necessary resource allocation for implementation. From another perspective, the quick-disbursing proposed PBL, particularly with \$25 million of tranche 1 to be released upon effectiveness, will also assist the government in securing external fiscal financing to mitigate economic and social shocks caused by COVID-19 (para. 17).

### C. Impacts of the Reform

16. The program is aligned with ICAO's GASP (footnote 10) and NASP (footnote 13) to avoid potential conflicts of interest within the CAAN (which has both oversight and operation functions), and to secure the effective safety oversight of the service provider. The operational functions of the CAAN will be transformed into the ASAN with (i) clearly defined objectives and duties, and (ii) independent management and funding structures to improve the operational efficiency and accountability of airports in Nepal. The civil aviation reforms under the program will also allow the ASAN, the service provider, to involve the private sector in construction, operation, and management of airports, which could achieve efficiency gains in airport operations.<sup>25</sup> Strengthened oversight functions and airport management capacity through the civil aviation reforms will help the government address constraints on air travel to and from Nepal and improve substandard airport services, contributing to international tourism development that will ripple across the whole economy.

<sup>23</sup> ADB. 2019. [Country Partnership Strategy: Nepal, 2020–2024—Promoting Connectivity, Devolved Services, and Resilience](#). Manila.

<sup>24</sup> Independent Evaluation Department. 2020. [ADB Support for Transport, 2010–2018](#). Manila: ADB.

<sup>25</sup> Private sector involvement is subject to government approval in consideration of the following factors: security and safety of the civil aviation sector, social impacts on stakeholders, country context of possibility of private sector involvement, modalities of the participation, market conditions, and potential economic benefits.

## D. Development Financing Needs and Budget Support

17. Nepal faces a rising deficit—from 3.1% of GDP in FY2017 to 4.6% of GDP in FY2019—largely because of increasing expenditures on grants, land, buildings, and civil works.<sup>26</sup> In the original FY2020 budget, the government's total gross borrowing requirement is estimated at \$4.1 billion, of which \$2.5 billion will be from external borrowing. External borrowing will comprise mostly concessional official development assistance and export–import loans, of which program loans are about \$350 million. In addition, the outbreak of COVID-19 will negatively affect Nepal's economy through lower tourism demand and possible declines in exports as well as overseas workers' remittances. The International Monetary Fund (IMF) estimated that COVID-19 will lower growth in Nepal to 1.0% and widen the country's fiscal deficit to 7.2% of GDP in FY2020 (footnote 3). The COVID-19 shock has given rise to an urgent external financing need of 3.0% of GDP and a fiscal financing need of 2.6% of GDP in FY2020. The government is therefore seeking budget support from development partners to fill these gaps. ADB closely coordinated with the World Bank and IMF through the government to respond to public health emergencies and mitigate adverse economic and social impacts caused by COVID-19, and provided in May 2020 a loan of \$250 million for COVID-19 Active Response and Expenditure Support Program.<sup>27</sup> The proposed loan will not only secure fiscal headroom to cover additional expenses on the civil aviation reforms but also contribute to addressing the government's urgent fiscal needs.

18. For the proposed PBL to the civil aviation sector, the Government of Nepal has requested a concessional loan of \$50 million equivalent from ADB's ordinary capital resources to help finance the program. The loan will have a 24-year term, including a grace period of 8 years; an interest rate of 1.0% per year during the grace period and 1.5% per year thereafter; and such other terms and conditions set forth in the draft loan agreement. The funds will be released in two tranches—\$25 million at loan effectiveness and \$25 million about 24 months later—once the government has complied with the policy actions.

## E. Implementation Arrangements

19. The executing agency for the program will be the Ministry of Finance, and the implementing agencies will be the Ministry of Culture, Tourism, and Civil Aviation and the CAAN established under the Nepal Civil Aviation Authority Act, 2053 (1996). After the bifurcation of the CAAN, the implementation responsibility under the CAAN shall be transferred to the CAANepal, which will be established under the Nepal Civil Aviation Act, and the ASAN, which will be established under Air Service Authority of Nepal Act. The CAAN will appoint a transition team to lead the implementation of activities required for its bifurcation, and the transition team will be transferred to the CAANepal and the ASAN after they are established to assist the CAANepal's director general and the ASAN's managing director in setting up the new entities, including implementation of the policy actions in tranche 2.

20. ADB will undertake periodic review missions to (i) confirm progress and fulfillment of policy actions for tranche release; (ii) monitor continued applicability of the assumptions that might impact program success, as well as specified risks and their mitigating measures; and (iii) advise on actions to maintain effective implementation within the program period.

<sup>26</sup> ADB. 2019. [Macroeconomic Update: Nepal \(Volume 7, No. 1\)](#). Manila; and Government of Nepal, Ministry of Finance. 2019. [Budget Speech of Fiscal Year 2019/2020](#). Speech delivered to Joint Assembly of Federal Parliament by Finance Minister Yuda Raj Khatriwada. Kathmandu. 29 May.

<sup>27</sup> ADB. 2020. [Report and Recommendation of the President to the Board of Directors: Proposed Loan to Nepal for COVID-19 Active Response and Expenditure Support Program](#). Manila.

21. Procurement and advance contracting are not expected, but retroactive financing will be applied.<sup>28</sup> The program will be implemented over 30 months, from January 2020 to June 2022.<sup>29</sup> The proceeds of the PBL will be withdrawn in accordance with ADB's *Loan Disbursement Handbook* (2017, as amended from time to time).

### III. ATTACHED TECHNICAL ASSISTANCE

22. The attached transaction technical assistance (TA) will assist the implementing agencies to comply with the program's second tranche policy conditions.<sup>30</sup> The TA is estimated to cost \$550,000, of which \$500,000 will be financed on a grant basis by ADB's Technical Assistance Special Fund (TASF-6). The government will provide counterpart support in the form of counterpart staff, office accommodation, and other in-kind contributions.

23. The implementation arrangements for the TA will be aligned with those of the PBL. ADB will administer the TA. The executing agencies will be the CAAN, the CAANepal, and the ASAN. The transition teams of the executing agencies will implement the TA components. A total of 10.5 person-months of international and 23 person-months of national consultancy inputs will be required. A consulting firm and individual consultants will be recruited in accordance with the ADB Procurement Policy (2017, as amended from time to time) and its associated project administration instructions and/or staff instructions.<sup>31</sup> The TA will be implemented from October 2020 to September 2022.

### IV. DUE DILIGENCE

#### A. Technical

24. Several outputs of the program have technical components in the area of civil aviation safety. These policy actions shall comply with relevant safety requirements of ICAO's international SARPs that are stipulated in Annex 19 of the Convention on International Civil Aviation (Safety Management).<sup>32</sup> The policy actions, in principle, intend to comply with the minimum safety standards as per the SARPs; however, selected critical actions aim at satisfying a higher level of the recommended practices of the SARPs. Compliance of the technical policy actions will be monitored and confirmed with the support of individual consultants engaged under the attached TA.

#### B. Governance

25. A governance risk assessment was conducted in line with the implementation guidelines of ADB's Second Governance and Anticorruption Action Plan.<sup>33</sup> ADB's Anticorruption Policy (1998, as amended to date) was also explained to and discussed with the government and CAAN. Areas of possible governance risks that may affect program implementation include (i) political support for sensitive aspects of the reforms, and (ii) the institutional dimension of the program.

<sup>28</sup> List of Ineligible Items (accessible from the list of linked documents in Appendix 2).

<sup>29</sup> Tranche 1 policy actions will have been completed by June 2020. The tranche 2 implementation period is from July 2020 to June 2022.

<sup>30</sup> Attached Technical Assistance Report (accessible from the list of linked documents in Appendix 2).

<sup>31</sup> A consultant firm will be engaged through the quality- and cost-based selection method with a quality-cost ratio of 90:10.

<sup>32</sup> ICAO. 2016. *International Standards and Recommended Practices: Annex 19—Safety Management (Second Edition)*. Montreal.

<sup>33</sup> ADB. 2006. [Second Governance and Anticorruption Action Plan](#). Manila.

Full understanding of all stakeholders, including CAAN employees, on the objectives and procedures of the reforms is key to successful implementation. In addition, since the PBL includes the bifurcation of the implementing agency itself (CAAN, which is responsible for uninterrupted civil aviation safety and airport operations), special attention needs to be paid to the smooth transition to the two new authorities (ASAN and CAANepal) to ensure that both entities commence their respective operations having already met governance, management, staffing, financial, and business requirements. The transitions will be closely monitored through ADB's continued engagement with the government along with TA support and implementation monitoring by ADB.

### **C. Poverty, Social, and Gender**

26. Nepal derives significant income from tourism activities, and this has become one of the key sectors driving national development. Considering that an overwhelming majority of international tourists come to Nepal by air, improvement of the civil aviation sector is essential for tourism to flourish and contribute to the economic development of the country. The proposed improvements in the regulatory and policy sphere will remove concerns about Nepal's oversight functions relating to civil aviation safety and create an enabling business environment for better air connectivity with the rest of the world. Better aviation will also enhance associated commercial business activities and will have a positive ripple effect on other sectors such as agriculture, industry, energy, and transport. Overall, the economic impact of an improved civil aviation sector will have substantial impact on the country's poverty alleviation programs.

27. The proposed reforms under the PBL to bifurcate CAAN into a regulator and a service provider may have negative impacts on the working conditions of CAAN employees. The draft bills (footnote 20), however, provide relevant clauses to safeguard CAAN employees through (i) employees' submitting applications to transfer to the new entities, (ii) keeping at least the same level of remuneration and benefits after the transfer, (iii) providing a necessary retirement scheme in consideration of the previous working records in CAAN, and (iv) establishing a gratuity fund in each authority. The CAAN and its successors (CAANepal and ASAN) will communicate with stakeholders, especially employees, about the transformation and its impacts; the attached TA will help with these communication efforts.

28. There are pressing needs in the global civil aviation sector to advance gender equality and the empowerment of women. ICAO made commitments, in Resolution A39-30: ICAO Gender Equality Programme Promoting Participation of Women in the Global Aviation Sector, to enhance gender equality by 2030 at all professional and higher levels of employment in the sector. In line with global trends and requirements, the civil aviation sector in Nepal needs to transform its institutions, particularly the service provider, to be more advanced and forward-looking in terms of gender inclusion. The program will support GESI initiatives of the ASAN by (i) conducting a GESI audit of the ASAN, (ii) developing a GESI operational plan, and (iii) increasing the percentage of women and the socially excluded in the ASAN's workforce. The program is categorized *some gender elements*.

### **D. Safeguards**

29. The program is confined to policy reforms and will not involve any physical activities. None of the policy actions will result in or lead to involuntary resettlement or adversely affect indigenous peoples.<sup>34</sup> No adverse environmental impacts have been identified and, as such, the program is

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<sup>34</sup> Matrix of Potential Environmental and Social Impacts and Measures (accessible from the list of linked documents in Appendix 2).



categorized C for the environment, involuntary resettlement, and indigenous peoples. Meanwhile, the PBL will support the establishment of an environmental and social unit in the ASAN to enhance capacity in safeguard compliance and social inclusion in the implementation of investment projects. The ASAN is expected to be the executing agency for airport projects funded by development partners, including ADB.

## **E. Risks and Mitigating Measures**

30. Major risks and mitigating measures are summarized in the table and described in detail in the risk assessment and risk management plan.<sup>35</sup> The integrated benefits and impacts of the program are expected to outweigh the costs.

### **Summary of Risks and Mitigating Measures**

<b>Risk</b>	<b>Mitigation Measures</b>
Delay in the legislation in the Parliament	Strong incentives exist in the government to complete the civil aviation reforms to comply with international practices and recommendations. The Asian Development Bank will closely monitor the progress of the legislation and continue policy dialogues with the government, involving, if necessary, international organizations and development partners, including European Union member states.

Source: Asian Development Bank.

## **V. ASSURANCES**

31. The government and the CAAN have assured ADB that implementation of the program shall conform to all applicable ADB policies including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement as described in detail in the loan agreement. No disbursement shall be made unless ADB is satisfied that the government has completed the policy actions specified in the policy matrix relating to the program.

## **VI. RECOMMENDATION**

32. I am satisfied that the proposed policy-based loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the loan of \$50,000,000 to Nepal for the Civil Aviation Sector Improvement Program, from ADB's ordinary capital resources, in concessional terms, with an interest charge at the rate of 1.0% per year during the grace period and 1.5% per year thereafter; for a term of 24 years, including a grace period of 8 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan agreement presented to the Board.

Masatsugu Asakawa  
President

3 June 2020

<sup>35</sup> Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).



## DESIGN AND MONITORING FRAMEWORK

<b>Country's Overarching Development Objectives</b> (i) Safe, reliable, standard, easily available, accessible for the general public, sustainable, and effective air services developed (The Aviation Policy, 2063) <sup>a</sup> (ii) Aviation safety performance in Nepal enhanced (National Aviation Safety Plan, 2018–2022) <sup>b</sup>			
<b>Results Chain</b>	<b>Performance Indicators with Targets and Baselines</b>	<b>Data Sources and Reporting Mechanisms</b>	<b>Risks</b>
<b>Effect of the Reform</b> Nepal's aviation safety oversight capabilities and operational efficiencies strengthened	By 2023: a. Rate of effective implementation of the critical elements of the safety oversight system improved to 75% (2019 baseline: 67%) <sup>c</sup> b. Positive safety oversight margin in all categories achieved (2019 baseline: 1 out of 3 categories achieved) <sup>d</sup> c. Operating ratio of service provider improved to less than 70% (2019 baseline: 86%) <sup>e</sup>	a–b. ICAO audit report  c. ASAN annual report	Response to coronavirus disease 2019 shifts focus and resources of the government, delaying implementation of the reform program
<b>Reform Areas</b> 1. Legal framework of the civil aviation reforms approved	<b>Key Policy Actions</b> By 2020: 1a. Nepal Civil Aviation Authority Act and Nepal Air Service Authority Act approved by the Parliament and became effective	1a. National Gazette	
2. Independent regulatory body for civil aviation established and functionalized	By 2022: 2a. The CAANepal legally established in accordance with CAANepal Act and commenced its regulatory functions with (i) establishment of the board; (ii) appointment of a director general; (iii) completion of staff transfer from CAAN to the CAANepal; (iv) completion of transfer of properties, assets, and liabilities from CAAN to the CAANepal; and (v) arrangement of gratuity fund. 2b. The CAANepal has approved the KPIs as per ICAO's SARPs, in the following areas: (i) aviation safety: state safety program levels of implementation and effectiveness; (ii) aviation security: state aviation security levels of implementation and effectiveness; (iii) licensing and certification of service providers;	2a. Notice in National Gazette  2b. CAANepal compliance report	Delay in the legislation in the Parliament

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
	<ul style="list-style-type: none"> <li>(iv) authorization and approval of aviation activities under the authority of the CAANepal;</li> <li>(v) surveillance, inspection, and/or audits of service providers; and</li> <li>(vi) capacity development required for the ability to effectively and continuously meet the organization's mandate.</li> </ul>		
<p>3. Independent service provider for civil aviation established and functionalized</p>	<p>By 2022:</p> <p>3a. The ASAN has been legally established in accordance with the ASAN Act and commenced its service provider functions with the</p> <ul style="list-style-type: none"> <li>(i) establishment of the board;</li> <li>(ii) appointment of a managing director;</li> <li>(iii) completion of staff transfer from CAAN to the ASAN;</li> <li>(iv) completion of transfer of properties, assets, and liabilities from CAAN to the ASAN; and</li> <li>(v) arrangement of gratuity fund.</li> </ul> <p>3b. The ASAN has approved the integrated institutional management strategy comprising</p> <ul style="list-style-type: none"> <li>(i) a medium-term business plan;</li> <li>(ii) a medium-term financial framework, and forecasted financial statements based on projections of revenue and/or fee and expenditure and/or investment consistent with the business plan; and</li> <li>(iii) a financial management improvement plan with timelines, including introduction of (a) accrual-based financial statements; (b) an enterprise resource planning system at least in the fields of financial budget, asset management, and accounting; and (c) a management accounting system.</li> </ul> <p>3c. The ASAN approved the KPIs with a clear distinction between those for airports and those for air navigation services in the following areas:</p> <ul style="list-style-type: none"> <li>(i) core business operation and functions;</li> <li>(ii) aviation safety, consistent with ICAO's SARPs;</li> </ul>	<p>3a. Notice in National Gazette</p> <p>3b–3d. ASAN compliance report</p>	

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
	<ul style="list-style-type: none"> <li>(iii) aviation security, consistent with ICAO's SARPs;</li> <li>(iv) service quality, consistent with industry standards and guidance materials as published by the Airports Council International and the Civil Air Navigation Services Organisation;</li> <li>(v) productivity and/or cost-effectiveness;</li> <li>(vi) financial; and</li> <li>(vii) social and environmental, consistent with industry standards and guidance materials as published by ICAO, the International Air Transport Association, Airports Council International, and the Civil Air Navigation Services Organisation.</li> </ul> <p>3d. The ASAN approved GESI initiatives, including the following:</p> <ul style="list-style-type: none"> <li>(i) a GESI audit within the ASAN;</li> <li>(ii) a GESI operational plan based on the GESI audit; and</li> <li>(iii) an increased percentage of women and the socially excluded in the ASAN's workforce than the current percentage, to be set by (a) employee regulations guided by the Civil Service Act, 2049 for the ASAN's new recruitment, and (b) a GESI operational plan.</li> </ul>		
<b>Budget Support</b> Asian Development Bank: \$50,000,000 (concessional ordinary capital resources) Technical assistance: \$500,000 (Technical Assistance Special Fund [TASF-6])			

ASAN = Air Service Authority of Nepal, CAAN = Civil Aviation Authority of Nepal, CAANepal = Civil Aviation Authority of Nepal, GESI = gender equality and social inclusion, ICAO = International Civil Aviation Organization, KPI = key performance indicator, SARPs = standards and recommended practices.

Notes:

1. Linkage to Strategy 2030 operational priority indicators will be determined after program approval.
2. Outputs 3b, 3c, and 3d will be supported by the attached technical assistance.
- <sup>a</sup> Government of Nepal; Ministry of Culture, Tourism, and Civil Aviation. 2006. *The Aviation Policy, 2063*. Kathmandu. The government is preparing a new national aviation policy to achieve a secure, reliable, competitive, systematic, affordable, and credible civil aviation sector.
- <sup>b</sup> Government of Nepal, CAAN. 2018. [Nepal Aviation Safety Plan, 2018–2022](#). Kathmandu.
- <sup>c</sup> The critical elements comprise (i) primary aviation legislation, (ii) specific operating regulations, (iii) state system and functions, (iv) qualified technical personnel, (v) technical guidance, tools and provision of safety-critical information, (vi) licensing, certification, authorization and/or approval obligations, (vii) surveillance obligations, and (viii) resolution of safety issues.
- <sup>d</sup> The categories comprise operations, air navigation, and support functions.
- <sup>e</sup> Excluding Airport Development Fund collected from international passengers.

Source: Asian Development Bank.

**LIST OF LINKED DOCUMENTS**

<http://www.adb.org/Documents/RRPs/?id=38349-029-3>

1. Loan Agreement
2. Sector Assessment (Summary): Transport (Air Transport)
3. Contribution to the ADB Results Framework
4. Development Coordination
5. Country Economic Indicators
6. International Monetary Fund Assessment Letter
7. Summary Poverty Reduction and Social Strategy
8. Risk Assessment and Risk Management Plan
9. List of Ineligible Items
10. Attached Technical Assistance Report
11. Matrix of Potential Environmental and Social Impacts and Measures

**Supplementary Document**

12. List of Publications and Guidance Materials Relevant to the Policy Matrix

## DEVELOPMENT POLICY LETTER



Government of Nepal  
**MINISTRY OF FINANCE**

Ref: DECD/ADB/150/2076-77/3398

SINGHADURBAR  
KATHMANDU, NEPAL

16 April 2020

Mr. Masatsugu Asakawa  
President  
Asian Development Bank  
6 ADB Avenue, Mandalayon City  
Metro Manila, Philippines.

Dear Mr. President:

**Subject: Letter of Development Policy for Civil Aviation Sector  
Improvement Program in Nepal.**

Please allow me to thank you, on behalf of the Government of Nepal, for the high commitment and continued support of the Asian Development Bank (ADB) towards our vision of raising the living standards of the Nepali people by achieving sustainable economic growth. With the aim of graduating from the Least Developed Country Status and to emerge as an inclusive, equitable, and prosperous middle-income-country by 2030, Nepal is fully committed to the global development agenda of the Sustainable Development Goals. We value the long-term partnership with ADB, which has helped Nepal to attain development outcomes in many areas, including the transport sector that improves infrastructure for connectivity. Civil aviation sector is particularly important to develop tourism industry which is one of the major economic activities in this country. ADB has been an important catalyst in advancing transport and, more specifically, civil aviation sector development.

Civil aviation is crucial to transport, trade, and tourism, and provides indispensable links to international as well as national hilly and mountainous areas that are inaccessible by other transport modes. Tourism is one of the major economic activities in Nepal and a top government priority which contributes to export promotion and increase in foreign exchange reserves. Considering that more than 80% of international tourists come to Nepal by air, improvement of the civil aviation sector is essential for tourism to support the country's economic development. Nepal has maintained a traditional civil aviation sector structure whereby functions of regulation, safety oversight, and service provision are absorbed by one entity, Civil Aviation Authority of Nepal (CAAN). The roles of



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regulator and service provider lodged in a single organization create a source of conflict of interest. The regulatory function may not provide adequate oversight on service provision and may raise operating costs and result in suboptimal performance as a service provider. There are also repercussions on aviation safety, which have been noted and highlighted by international aviation agencies such as the International Civil Aviation Organization. The government in its Nepal Aviation Safety Plan (NASP) has placed the separation of the CAAN as a priority measure to comply with the international standards. The process of reform regarding the civil aviation governance structure is the most fundamental and imminent reform requirement.

The proposed Civil Aviation Sector Improvement Program will support the reforms to bifurcate the CAAN into a regulator (Civil Aviation Authority of Nepal [CAANepal]) and a service provider (Air Service Authority of Nepal [ASAN]). The government has endorsed and submitted to the Parliament the draft bills including fundamental elements of the new organizations such as mandate, governance structure, roles and responsibilities of the board, executive bodies, internal and external audits, decision making process, including appointment of executive heads, staff management, remuneration and benefits, funding sources, and accounting. The program will further support establishment of higher-standard entities. To ensure this, the program covers more advanced elements of organization development such as preparation for integrated institutional management strategy, development of key performance indicators, and gender- and social-inclusion initiatives. More specifically, ADB's support will be utilized to initiate key reforms in the following broad areas:

- (i) **Reform Area 1: Legal and implementation framework of the civil aviation sector reforms finalized.** A critical step to bifurcate the government authority of CAAN into a regulator and a service provider is to provide the legal basis for establishment of the two authorities. The program will support in tranche 1 the government has submitted two draft bills to the Parliament for its consideration. The draft bills stipulate (i) duties, responsibilities rights of the new entities; (ii) establishment, duties, responsibilities, and rights of Boards; (iii) appointment, duties, responsibilities, and rights of executive heads; (iv) staff management including staff numbers, gratuity fund, principles of staff transfer, remuneration, and benefits; (v) transfer of properties, assets, and liabilities; (vi) fund sources separated from the other entity; (vii) accounting





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rules including internal audit; (viii) provisions on conflict of interests; and (ix) procedures to set rules to implement the Acts. The Act for the ASAN also allows private sector, subject to the government approval, to be involved in construction, development, operation, and management of airports in Nepal. In tranche 2, the program will support approval of the legislation by the Parliament. Following the approval, the government shall ensure smooth transition to the two entities by approving necessary rules to implement the both acts.

- (ii) **Reform Area 2: Independent regulatory body for the civil aviation established and functionalized after the parliamentary approval of new act.** To establish and maintain an independent regulatory oversight authority, which should be separated from service provision function, is an important safety enhancement initiative to avoid conflict of interests in accordance with ICAO's GASP 2020–2022. The authority shall develop an effective system to promulgate technical guidance and tools to effectively perform the safety oversight functions, and to recruit, train, and retain qualified and sufficient technical personnel to support regulatory oversight. The program will support the establishment of the regulator of CAANepal with appropriate oversight functions as stipulated in the bill. Under the program, key performance indicators to measure the regulatory functions will be developed, in accordance with ICAO's SARPs, in the areas of (i) aviation safety; (ii) aviation security; (iii) licensing and certification of service providers; (iv) authorization and approval of aviation activities; (v) surveillance, inspection, and audits of service providers; and (vi) capacity development requirements. The program will also support improvement of organization structure of CAANepal to comply with ICAO's standards and recommended practices (SARPs). An updated NASP will be approved based on ICAO's latest safety audit to Nepal, ICAO GASP, and other safety standards.
- (iii) **Reform Area 3: Independent service provider for the civil aviation established and functionalized.** A service provider, which should be separated from the oversight function, will be established as an independent organization to focus its business domain on construction, operation, and management of airports. The newly established service provider needs to improve its operational efficiency to provide better services to airport users and to promote efficient resource use through more accountable institutional management. The service provider of ASAN will still remain an authority as per the bill for establishment and management of ASAN; however, it would allow for private sector involvement, subject to the government approval, in construction, development, operation, and management of airports. Given the



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above, the program will support the establishment of the ASAN and its transformation to a high-standard entity with more accountable management and efficient operations. It includes development of (i) medium-term business plan; (ii) medium-term financial framework and forecasted financial statements; and (iii) financial management improvement plan comprising introduction of (a) accrual-based financial statements; (b) an enterprise resource planning system; and (c) management accounting system. Under the program, key performance indicators to measure the service provider functions will be developed in the areas of (i) core business and functions; (ii) aviation safety; (iii) aviation security; (iv) service quality; (v) productivity and cost effectiveness; (vi) financial; and (vii) social and environmental. The program will also support gender equality and social inclusion (GESI) initiatives through GESI audit of the ASAN and GESI operational plan. The program will further support, to strengthen capacity of the ASAN, (i) creation of new departments of environment and social as well as legal and procurement; and (ii) development of an operational capacity program.

We recognize the challenges and risks entailed in this proposed program and remain committed to its implementation. We also confirm that the policy actions that accompany this program are reflective of and fully in consonance with the reform agenda of the government. The piggybacked technical assistance will make an important contribution during the implementation of the program in overcoming the capacity constraints of the implementing agencies.

We would like to thank ADB for working closely with the government in developing this program. The outbreak of coronavirus disease, COVID-19 has posed negative impact on the economy of Nepal, and the government needs to address urgent health and economic issues under the anticipated tight fiscal position. However, the importance of the civil aviation reforms remains unchanged. All the more, we would appreciate your favorable and prompt consideration of the proposed program loan and look forward to working together to achieve the targeted milestones of the reforms.

Yours sincerely,

Dr. Yuba Raj Khatiwada  
Minister of Finance



## POLICY MATRIX

Tranche 1 (By June 2020)	Tranche 2 (July 2020–June 2022)
Policy Actions	Policy Actions
<b>Reform Area 1: Legal framework of the civil aviation sector reforms approved</b>	
<p>1.1 The Cabinet shall have submitted to the Parliament a bill on the establishment of the Civil Aviation Authority of Nepal (CAANepal) as the regulatory body. The bill shall specify the following:</p> <ul style="list-style-type: none"> <li>(i) Duties, responsibilities, and rights of the CAANepal with regard to air service operation, registration of aircraft and national symbol, airworthiness, repair and maintenance of aircraft, and personal license or certificate</li> <li>(ii) Establishment, duties, responsibilities, and rights of the Board of CAANepal</li> <li>(iii) Appointment, duties, responsibilities, and rights of the Director General as an executive head</li> <li>(iv) Provisions of staff numbers, gratuity fund, and staff management including principles of staff transfer, remuneration, and benefits of the organizational change</li> <li>(v) Transfer of properties, assets and liabilities of CAAN to CAANepal</li> <li>(vi) Fund sources separated from those of the service provider;</li> <li>(vii) Accounting requirements including internal audit</li> <li>(viii) Provisions on conflict of interests</li> <li>(ix) Procedures to set rules to implement the CAANepal Act</li> </ul> <p>1.2 The Cabinet shall have submitted to the Parliament a bill for the establishment and management of the Air Service Authority of Nepal (ASAN) as the service provider. The bill shall specify the following:</p> <ul style="list-style-type: none"> <li>(i) Duties, responsibilities, and rights of the ASAN with regard to construction, operation, and management of airports, flight and landing of aircrafts, air navigation and air space, and airport safety</li> <li>(ii) Provisions to allow the private sector to be involved in construction, operation, and management of airports</li> </ul>	<p>2.1 Nepal Civil Aviation Authority Act (CAANepal Act) and Nepal Air Service Authority Act (ASAN Act) shall have been approved by the Parliament and become effective.</p> <p><b>(Document required: MOCTCA to provide copy of the notice on the acts published in the National Gazette)</b></p> <p>2.2 Following approval of the legislation by the Parliament, the government shall have approved the implementing rules of the CAANepal Act and the ASAN Act, as per Article 57 (CAANepal Act) and Article 54 (ASAN Act).</p> <p><b>(Document required: MOCTCA to provide copy of the approved rules to implement the respective acts)</b></p>

<b>Tranche 1</b> <b>(By June 2020)</b>	<b>Tranche 2</b> <b>(July 2020–June 2022)</b>
<b>Policy Actions</b>	<b>Policy Actions</b>
<ul style="list-style-type: none"> <li>(iii) Establishment, duties, responsibilities, and rights of the Board of the ASAN</li> <li>(iv) Appointment, duties, responsibilities, and rights of the Managing Director as an executive head</li> <li>(v) Provisions of staff numbers, gratuity fund, and staff management including principles of staff transfer remuneration, and benefits by the organizational change</li> <li>(vi) Transfer of properties, assets, and liabilities of CAAN to ASAN</li> <li>(vii) Fund sources separated from those of the regulator</li> <li>(viii) Accounting requirements including internal audit</li> <li>(ix) Provisions on conflict of interests</li> <li>(x) Procedures to set rules to implement the ASAN Act</li> </ul> <p><b>(Document required: MOCTCA to provide copy of the draft bills, to provide copy of the cabinet endorsement, and to certify that the draft bills have been submitted to the Parliament)</b></p>	
<b>Reform Area 2: Independent regulatory body for the civil aviation established and functionalized</b>	
	<p>2.3. The CAANepal shall have been legally established, in accordance with the CAANepal Act, to commence its regulatory functions with the (i) establishment of the board; (ii) appointment of the Director General; (iii) completion of staff transfer from CAAN to CAANepal; (iv) completion of transfer of properties, assets, and liabilities from CAAN to CAANepal; and (v) arrangement of gratuity fund.</p> <p><b>(Documents required: CAANepal to provide a copy of the notice for the establishment in the National Gazette, and to certify completion of the (i) establishment of the board; (ii) appointment of the Director General; (iii) staff transfer; (iv) transfer of properties, assets, and liabilities; and (v) arrangement of gratuity fund, in accordance with CAANepal Act)</b></p>
	<p>2.4. The CAANepal shall have approved and notified, through an internal circular, its organizational structure and key</p>

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	<p>performance indicators as per ICAO SARPs in the following areas:</p> <ul style="list-style-type: none"> <li>(i) Aviation safety: State Safety Program levels of implementation and effectiveness</li> <li>(ii) AVSEC: State AVSEC levels of implementation and effectiveness</li> <li>(iii) Licensing and certification of service providers</li> <li>(iv) Authorization and approval of aviation activities under the authority of CAA Nepal</li> <li>(v) Surveillance/inspection/audits of service providers</li> <li>(vi) Capacity development required to effectively and continuously meet the organization's mandate</li> </ul> <p><b>(Document required: CAA Nepal to provide a copy of the approval of organizational structure and key performance indicators by the Board/Director General and to certify that these indicators are notified)</b></p>
	<p>2.5. MOCTCA and CAA Nepal shall have approved the updated the Nepal Aviation Safety Plan revised from the current one (2018–2022), based on ICAO's latest safety audit, and ICAO's relevant standards and guidelines.</p> <p><b>(Document required: CAA Nepal to provide a copy of approval of the Nepal State Safety Plan)</b></p>
<b>Reform Area 3: Independent service provider for the civil aviation established and functionalized</b>	
	<p>2.6. The ASAN shall have been legally established, in accordance with the ASAN Act, to commence its service provider functions with the (i) establishment of the board; (ii) appointment of the Managing Director; (iii) completion of staff transfer from CAA Nepal to ASAN; (iv) completion of transfer of properties, assets, and liabilities from CAA Nepal to ASAN; and (v) arrangement of gratuity fund.</p>

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	<p><b>(Documents required: ASAN to provide a copy of the notice of the establishment in the National Gazette, and to certify completion of the (i) establishment of the board; (ii) appointment of the Director General; (iii) staff transfer; (iv) transfer of properties, assets, and liabilities; and (v) arrangement of gratuity fund, in accordance with ASAN Act)</b></p>
	<p>2.7. The ASAN shall have approved the creation of the following separate units:</p> <ul style="list-style-type: none"> <li>(i) Environment and social unit</li> <li>(ii) Legal/procurement unit</li> </ul> <p><b>(Document required: ASAN to provide a copy of approval of new units by the board/Managing Director)</b></p>
	<p>2.8. The ASAN shall have approved and notified, through an internal circular, the integrated institutional management strategy comprising the following:</p> <ul style="list-style-type: none"> <li>(i) Medium-term business plan</li> <li>(ii) Medium-term financial framework, and forecasted financial statements based on projections of revenue and/or fee and expenditure and/or investment consistent with the business plan</li> <li>(iii) Financial management improvement plan with timelines, including introduction of (a) accrual-based financial statements; (b) an enterprise resource planning system at least in the fields of financial budget, asset management, and accounting, and (c) management accounting system</li> </ul> <p><b>(Document required: ASAN to provide a copy of the approval of the integrated institutional management strategy by the Board/Managing Director and its notification)</b></p>
	<p>2.9. ASAN shall have approved and notified, through an internal circular, the KPIs with clear distinction between those for airports and air navigation services, in the following areas:</p> <ul style="list-style-type: none"> <li>(i) Core business operation and functions</li> </ul>

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	<ul style="list-style-type: none"> <li>(ii) Aviation safety: These KPIs shall be consistent with ICAO's SARPs.</li> <li>(iii) AVSEC: These KPIs shall be consistent with ICAO's SARPs.</li> <li>(iv) Service quality: These KPIs shall be consistent with industry standards of the ACI and guidance materials published by CANSO.</li> <li>(v) Productivity and/or cost effectiveness</li> <li>(vi) Financial</li> <li>(vii) Social and environmental: These KPIs shall be consistent with industry standards and guidance materials as published by ICAO, IATA, ACI, and CANSO.</li> </ul> <p><b>(Document required: ASAN to provide copies of the key performance indicators for both regulated service provision divisions [Airports and ANS])</b></p>
	<p>2.10. The ASAN shall have approved gender equality and social inclusion initiatives of the ASAN, including the following:</p> <ul style="list-style-type: none"> <li>(i) GESI audit within the ASAN</li> <li>(ii) GESI Operational Plan based on the GESI audit</li> <li>(iii) Increased percentage of women and socially excluded in the workforce of the ASAN than the current percentage, to be set by (a) Employees Regulation guided by Civil Service Act for the ASAN's new recruitment, and (b) GESI operational plan</li> </ul> <p><b>(Document required: ASAN to provide a copy of approval of the gender equality and social inclusion initiatives by the board/Managing Director)</b></p>
	<p>2.11. ASAN shall have approved an OCP to ensure safe, efficient, and effective aviation services. The OCP shall include the following:</p> <ul style="list-style-type: none"> <li>(i) Equipment and high technology requirements to comply with ICAO's SARPs</li> <li>(ii) Gap analysis of technical and operational human resource requirements and development of training needs</li> </ul>

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	(iii) Assessment of feasibility of use of external resources, including the private sector for specific needs  <b>(Document required: ASAN to provide copies of approval by the Board/Managing Director of the OCP)</b>

ACI = Airport Council International, ADB = Asian Development Bank, ANS = air navigation services, ASAN = Air Service Authority of Nepal, AVSEC = aviation security, CAAN = Civil Aviation Authority of Nepal, CAANepal = Civil Aviation Authority of Nepal (to be established under the Nepal Civil Aviation Authority Act), CANSO = Civil Air Services Organization, GESI = gender equality and social inclusion, IATA = International Air Transport Association, ICAO = International Civil Aviation Organization, KPI = key performance indicator, MOCTCA = Ministry of Culture, Tourism, and Civil Aviation, MOF = Ministry of Finance, OCP = Operational Capacity Program, SARPs = standards and recommended practices.

Note: Publications and guidance materials potentially relevant to the policy matrix are accessible from the list of linked documents in Appendix 2.

Source: Asian Development Bank.