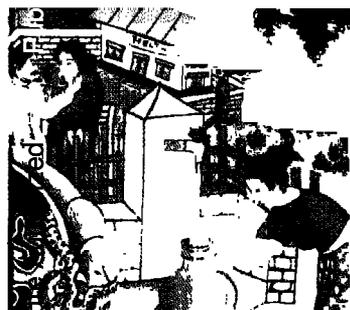


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Nepal

COUNTRY ASSISTANCE STRATEGY



2004 - 2007

THE WORLD BANK

Nepal

C O U N T R Y A S S I S T A N C E S T R A T E G Y

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A B B R E V I A T I O N S A N D A C R O N Y M S

AAA	Analytical and Advisory Activities	MDGs	Millennium Development Goals
ADB	Asian Development Bank	MFA	Multi-Fibre Arrangement
AML/CFT	Anti-Money Laundering/Combating Financing of Terrorism	MIGA	Multilateral Investment Guarantee Agency
APP	Agricultural Perspective Plan	MOF	Ministry of Finance
BPEP	Basic and Primary Education Project	MoPE	Ministry of Population and Environment
CAE	Country Assistance Evaluation	MTEF	Medium Term Expenditure Framework
CAP	Country Assistance Program	NBL	Nepal Bank Limited
CAS (PR)	Country Assistance Strategy (Progress Report)	NC	Nepali Congress (Party)
CBO(s)	Community Based Organization(s)	NDC	National Development Council
CCF	Community Carbon Fund	NDF	Nepal Development Forum
CEA	Country Environmental Analysis	NEA	Nepal Electricity Authority
CFAA	Country Financial Accountability Assessment	NGO(s)	Non-Governmental Organization(s)
CIAA	Commission for Investigation of Abuse of Authority	NIDC	Nepal Industrial Development Corporation
CITES	Convention on International Trade in Endangered Species of Wild Fauna and Flora	NLSS	Nepal Living Standards Survey
CPAR	Country Procurement Assessment Report	NPC	National Planning Commission
DDC(s)	District Development Committee(s)	NPPR(s)	Nepal Portfolio Performance Review(s)
DfID	UK Department for International Development	NTA	Nepal Telecommunications Authority
DPR	Development Policy Review	NTC	Nepal Telecommunications Corporation
EU	European Union	OED	Operations Evaluations Department
FAO	Food and Agricultural Organization	PAF	Poverty Alleviation Fund
FAP	Foreign Aid Policy	PCR	Project Completion Report
FDI	Foreign Direct Investment	PDF	Power Development Fund
FSS	Financial Sector Strategy	PER	Public Expenditure Review
FY	Fiscal Year	PERC	Public Expenditure Reform Commission
GDP	Gross Domestic Product	PIC	Public Information Center
GEF	Global Environmental Facility	PIP	Portfolio Implementation Plan
GiZ	Gesellschaft für Technische Zusammenarbeit (German Agency for Technical Cooperation)	PCF	Prototype Carbon Fund
HMGN	His Majesty's Government of Nepal	PRGF	Poverty Reduction and Growth Facility
IAP	Immediate Action Plan	PRS(C)	Poverty Reduction Support (Credit)
ICR	Implementation Completion Report	RBB	Rastriya Banijya Bank
IDA	International Development Association	RPP	Rastriya Prajatantra Party
IDF	Institutional Development Fund	SEDF	South Asia Enterprise Development Facility
IF	Integrated Framework	SMC(s)	School Management Committee(s)
IFC	International Finance Corporation	SME(s)	Small and Medium Enterprise(s)
ILO	International Labor Organization	SOE(s)	State Owned Enterprise(s)
IMF	International Monetary Fund	TA	Technical Assistance
INGO(s)	International Non-Governmental Organization(s)	UML	United Marxist Leninist (Party)
ITTA	International Tropical Timber Agreement	UNDP	United Nations Development Program
IUCN	The International Union for Conservation of Nature	UNEP	United Nations Environmental Program
JBIC	Japan Bank for International Cooperation	UNFPA	United Nations Population Fund
JICA	Japan International Cooperation Agency	UNICEF	United Nations Children's Fund
JSA	Joint Staff Assessment	VDC(s)	Village Development Committee(s)
		WHO	World Health Organization
		WTO	World Trade Organization
		WWF	World Wildlife Fund

Currency and Equivalents

Currency Unit = Nepali Rupee (NRs.)

US\$1 = NRs. 74.5 (as of October 20, 2003)

Fiscal Year

Nepal: July 15–July 14 (fiscal year starting on July 15, 2003 is designated as FY03/04)

The World Bank: July 1–June 30 (fiscal year starting on July 1, 2003 is designated as FY04)

EXECUTIVE SUMMARY

i. Today, Nepal stands at the crossroads between a brighter future that promises more sustained poverty reduction and the possibility of the country becoming mired in a more protracted internal conflict. During the past few years, the insurgency has escalated sharply, involving an open conflict with the army since November 2001. This, combined with external developments, has undermined the economy and weakened the country's fiscal position. Despite the many positive changes Nepal has seen since the advent of multi-party democracy in 1990 and the first wave of economic liberalization measures in the early-1990s, the recent developments have highlighted the stark and worsening inequities in Nepal, not only in terms of incomes, but also of the fundamental ability of the Nepali citizen to participate in social and political decision-making processes. The deepening crisis, however, has also created the space for the reform-minded political and technocratic leaders to begin a renewed drive to build an economic and social foundation for sustained peace and poverty reduction.

ii. Important reforms have emerged in several areas over the past two years. First, to prevent a possible financial sector crisis, a key initial step was taken by putting the two ailing commercial banks under external management teams. Second, facing up squarely to the fiscal pressures, His Majesty's Government of Nepal (HMGN) introduced a Medium Term Expenditure Framework (MTEF) in FY02/03 to rationalize the development budget and instill the discipline of a hard budget constraint. Third, responding to the urgent need to improve public service delivery, HMGN has started to transfer key services to community management in primary education and primary health care. Fourth, to ensure implementation of priority reforms, HMGN devised an Immediate Action Plan (IAP) in 2002, which was effectively used to hold relevant Ministries and Departments accountable for promised actions. Fifth, a highly visible

anti-corruption drive has been started by the Commission for Investigation of Abuse of Authority (CIAA), thereby giving Nepali citizens a hope that the days of rampant corruption may be coming to an end. The recently adopted Poverty Reduction Strategy (PRS)—based on the Tenth Plan (FY02/03-FY06/07)—builds on these successes, and gives the reform process much greater strategic coherence and clarity.

iii. Nepal's PRS breaks from the past, largely ineffective plans in a number of significant ways. For the first time, it explicitly identifies social exclusion as one of the fundamental development challenges. It also recognizes HMGN's constrained fiscal situation and weak implementation capacity, and places the PRS in a realistic framework of implementation abilities, both fiscal and institutional. Thus, the MTEF gives it both a medium term fiscal framework and annual budgetary translation of the strategy, while the IAP will be used as an annual implementation plan for high priority reform actions that would receive continual attention from the highest levels of HMGN. These two instruments and the track record of significant early progress give the PRS considerable credibility. With the aim of reducing poverty and improving critical public services, the PRS is built around four pillars: (i) broad-based economic growth; (ii) social sector development; (iii) social inclusion; and (iv) good governance. In implementing it, the PRS stresses decentralization, rationalization of central government functions and transparency.

iv. Despite the successes and a palpable change in the energy with which the reform leaders are pushing the agenda at the center, the benefits of the reforms have not yet been felt widely at the grassroots levels. There is clearly a need to accelerate the reform actions embodied in the PRS, including in particular greater decentralization. This would be essential not only for rebuilding the people's confidence in the state, but also for

making meaningful progress toward poverty reduction and achieving the Millennium Development Goals (MDGs).

v. Given the continuing political turmoil, the Bank no doubt faces a risky environment in which to operate in Nepal. The Bank, however, should not lose sight of the most important risk the country faces, and hence by extension the Bank also faces—i.e., the risk of Nepal spiraling into a widespread armed conflict and a breakdown of state institutions. In comparison, many of the other risks are modest if not trivial. The current wave of reforms is a determined effort by the reform leaders to mitigate this fundamental risk. Unlike in typical reform episodes, the leadership for change has come more from a growing number of reform-minded technocrats and some enlightened political leaders who stand apart in an establishment that has provided largely passive support rather than explicit leadership. Because of this, the reform efforts may seem more tenuous and less spectacular. Nevertheless, the basic contents of the reform program enjoys strong support from the population at large and at least tacit support from mainstream political parties. This is not to minimize the risks that the reform process could be stifled by myopic political interests or the implementation capacity is curtailed by hostilities. Implementation of the Bank's strategy will be cognizant of these risks.

vi. Through the lean years of slow reforms, the Bank worked consistently with reform-minded leaders and facilitated the beginnings of the current reform process. The firm linking of lending levels to actual reform implementation has challenged and inspired the reformers. And, an uncommonly strong partnership has developed between these leaders and the Bank, with a strongly shared vision for the reforms that Nepal needs. More importantly, the reformers have risen to the occasion and have begun implementing the far reaching program articulated in the PRS. Because of the fiscal pressures, accelerating its implementation will require increased external resource flows, particularly of a programmatic nature. The Bank's CAS for FY04-FY07 is designed to respond to this situation

by increasing financial support to facilitate Nepal's own reform efforts. To align the Bank's assistance program with the PRS, the CAS will be fully outcomes-focused, continuing the outcomes-based approach developed by the Nepal Country Team over the last two years.

vii. Given the risks of politics getting in the way of reforms, the Bank will continue to maintain sharply differentiated lending levels linked to progress on reform implementation. The base case envisions an average annual lending of about US\$190 million (consistent with the current IDA resource allocation for Nepal), including programmatic support to facilitate accelerated implementation of the core PRS priorities. If the reform process stalls (low case), the lending support will be curtailed sharply to a range of US\$0-50 million. In the high case—which is associated with peace and accelerated reforms—lending could increase to US\$200-250 million annually. With the prevailing uncertainties, however, there could be a need to revisit the strategy. As such, a CAS Progress Report (CAS PR) will be prepared in approximately eighteen to twenty-four months, or sooner should the situation warrant.

viii. The Executive Directors may wish to discuss:

- The appropriateness of the basic strategy of providing strong support to Nepal's PRS in the face of significant political uncertainty;
- The appropriateness of the outcomes-based approach outlined in the CAS; and
- The choice of instruments to deliver the lending program.

ix. In many respects, Nepal is truly at a critical juncture in its development process, and it is difficult to predict which path the country will follow. While the on-going reforms offer the best hope for laying the foundation for sustained peace and development, the insurgency makes their implementation more difficult. Yet, one thing is clear. With strong support of the Bank as outlined in this CAS, the chances are much greater that the reform program will succeed, and hence, lead eventually to real improvements in the lives of Nepal's poor and most vulnerable.

Introduction



1 The last Country Assistance Strategy (CAS) for Nepal—considered by the Board on December 13, 1998—identified poor governance as the fundamental constraint restricting Nepal’s development.¹ Since then, while there have been improvements, governance—broadly defined to encompass public accountability, transparency and social inclusion—remains the country’s central challenge. In part reflecting the structure of poor governance, over the last five years Nepal has gone through turbulent times. Both growth and poverty reduction have suffered from a number of factors, including: (i) successive ineffective Governments and a continuing unstable political environment; (ii) an escalation of the insurgency, interspersed with two failed attempts at peace talks (in 2001 and 2003); and (iii) harsh repercussions from the global economic slowdown that have severely affected Nepal.

2 As reported in the CAS Progress Report (CAS PR) of November 2002,² despite this instability and uncertainty—or perhaps because of it—over the last two years, Nepal has begun implementing an impressive and

far-reaching reform program. Notable progress has been made in financial sector reform, public expenditures management, changes in public service delivery modalities, the fight against corruption and the infrastructure regulatory environment. To give the reform process greater coherence, the country has recently formulated a Poverty Reduction Strategy (PRS).³ Nonetheless, the impact of the reforms have not been felt widely enough to date and Nepal remains one of the world’s poorest countries, with an annual per capita income of about US\$230 and bleak social indicators. Nepal also needs to address fundamental issues related to social exclusion and redress the widespread perception that the state has been failing to deliver basic public services. While the ongoing reforms offer the best hope for laying the foundation for sustained peace and development, the insurgency makes their implementation more difficult.

3 Thus, Nepal is at a critical juncture in its development process today. Nepal may be turning toward a brighter future, but the risk of the country becoming mired in a more

protracted internal conflict cannot be discounted. Despite this unpredictable environment, there are several good reasons for the Bank to formulate a new CAS at this time. Most fundamentally, a new CAS will allow the Bank to align its assistance program closely to the current reform process embodied in the PRS, hence providing more effective support and encouragement to the reform efforts. Moreover, contrary to the

political turmoil and uncertainties, in the last two years there has been much greater continuity and certainty in the reform process, backed by broad support from the general public. As such, there is a solid process of change that Bank assistance can and should support. This is not to minimize the risks the reform process faces, but all the more reason the Bank should have a clear strategy to deal with the various possibilities.

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¹ Report No. 18578-NEP, dated November 17, 1998.
² Report No. 24170-NEP, dated November 18, 2002, and discussed by the Board on December 19, 2002.
³ The draft PRS received cabinet endorsement in May 2003. It was finalized and officially submitted to the Bank and IMF in late-June, at which time work was initiated on a Joint Staff Assessment (JSA).

1



The CAS Context

A. Social Context

B. Political Context

C. Macroeconomic Performance
and Medium Term Prospects

D. Progress Under the Last CAS
and Lessons Learned

A. Social Context

4 Despite improving economic performance during the 1990s in which per capita income growth increased to about 2.5%, Nepal remains extremely impoverished. Although the most 'recent' poverty estimates are rather outdated⁴ and comparability among different poverty estimates is questionable, it is possible to draw some broad conclusions regarding poverty trends over the last few decades. Specifically:

- The absolute number of poor in Nepal has increased since the mid-1980s;
- The distribution of income has become more unequal throughout the country; and
- Progress towards attaining the Millennium Development Goals (MDGs) has been slow.

The country will continue to face many challenges towards achieving the MDGs in the coming decade (see Box 1 and Appendix I).

5 With approximately 85% of the total population living in rural areas, poverty is largely a rural phenomenon in Nepal—a rural poverty incidence of 44% compared to about 23% in urban areas.⁵ Of the country's ecological regions, poverty in the mountains, at about 55%, is significantly above the national average, as it is in the more remote mid- and far-western districts (many of

which are controlled by the insurgents) where poverty is as high as 70%. While there have been noticeable improvements in human development indicators in recent years, they are still quite low and show significant urban/rural and geographical variations. There has been some progress in reducing gender disparities—e.g., life expectancy, literacy levels, and school completion rates—but, great advances are still required for Nepali women to be considered truly empowered.

6 As important, there are significant ethnic and caste-based disparities in what is recognized as a largely pluralistic society with diverse ethnic, caste, linguistic and religious communities.⁶ Broad linkages have been identified between caste and poverty, and caste and human development levels, and there are some clear messages: (i) most of the Dalit population is disadvantaged; and (ii) there are striking caste and ethnicity-based disparities in education. A number of factors—including its limited natural resource endowment, land-locked and rugged terrain, and series of ineffective and unstable Governments—have contributed to Nepal's poverty problems. Adding to these, much of the economic growth has been in non-agricultural sectors, leaving behind the majority of Nepalis living in rural areas.

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NEPAL'S PROGRESS TOWARDS ACHIEVING THE MILLENNIUM DEVELOPMENT GOALS

MILLENNIUM DEVELOPMENT GOAL	NEPAL'S CURRENT POSITION
Halve, between 1990 and 2015, the proportion of people whose income is less than US\$1/day.	As of 1995, it was estimated that about 40% of Nepal's population lived on less than US\$1/day. There is little evidence that poverty has declined since the 1980s and the absolute number of poor has likely increased.
Enroll all children in primary education by 2015.	There is evidence that the net enrolment rate of primary-aged children rose in the 1990s reportedly to over 70% and the youth literacy rate increased to 63%.
Make progress towards gender equity and empowering women by eliminating gender disparities in primary/secondary education by 2005 and all levels by 2015.	There have been significant improvements in the relative access of girls to school education during the 1990s (a ratio of girls to boys in primary/secondary education of 82%); however, the ratio of young literate females to males is still less than 60%, and Nepali women are still largely without voice and influence in the public domain.
Reduce infant and child mortality rates by two-thirds between 1990 and 2015.	Within the last decade, there have been considerable reductions in infant mortality (from 100 per 1,000 live births to 66) and child mortality (from 145 per 1,000 to 91); nevertheless, large regional variations persist.
Reduce maternal mortality ratios by three-quarters between 1990 and 2015.	Maternal mortality remains high (estimated at 830 per 100,000 live births in 1995) with only about 12% of births attended by skilled health staff.
Have halted by 2015 and begin to reverse the spread of HIV/AIDs, incidence of malaria and other major diseases	It is hard to obtain an accurate assessment of the HIV/AIDS situation; however, evidence suggests that the HIV rate is rising rapidly—perhaps the early stages of a concentrated epidemic—in several vulnerable groups, notably Nepalis working abroad and sex workers.
Integrate the principles of sustainable development into country policies and programs, and reverse the loss of environmental resources.	There are issues—e.g., depletion of soil nutrients and arsenic contamination in the Terai—that show environmental sustainability remains a problem. However, other initiatives—in drinking water and forestry—indicate positive progress. A national sustainable development strategy is under preparation.
Develop a global partnership for development.	Nepal has an overall low level of telephone density and approximately two-thirds of telephones are in the Kathmandu valley.

Note: See Appendix I for the MDGs and related indicators for Nepal. Sources: Staff estimates.

B. Political Context

7 Nepal has seen extraordinary political instability in recent years—i.e., there have been twelve changes in Prime Minister in the past eight years. Peace has also eluded Nepal for more than seven years while a violent

insurgency has claimed over 8,000 lives and the remit of the state machinery shrunk largely to urban and semi-urban areas in many districts (see Box 2). An important breakthrough was made on January 29,

2003 when His Majesty's Government of Nepal (HMGN) and the insurgent leaders agreed to a cease-fire. After three rounds of peace talks, however, the insurgents unilaterally called off the cease-fire on August 27, 2003. While all sides stress the need for a peaceful resolution of the conflict, the path to peace is not obvious.

8 On the political front, the Parliament was dissolved on May 22, 2002, and Mr. Sher Bahadur Deuba remained as caretaker Prime Minister for about six months. During this time, the terms of locally elected bodies—both at the village/municipality and district

levels—were allowed to expire in July 2002. With an escalation of insurgency-related violence—in part a campaign to prevent elections—Mr. Deuba recommended deferment of elections for over a year. This led the King to dismiss the Government in September 2002, and has resulted in two successive interim Governments.

9 The first interim administration—headed by Prime Minister Lokendra Bahadur Chand of the Rastriya Prajatantra Party (RPP)—was appointed by the King on October 11, 2002 with a mandate, among other things, to restore peace, hold the suspended

2

THE INSURGENCY The insurgency—previously a low intensity and mainly rural campaign to form a 'people's republic'—has claimed more than 8,000 lives by official accounts and has resulted in Nepal's longest and bloodiest conflict since the mid-1700s. It is clearly a political movement with a firm political philosophy, but has gained strength because of certain social-economic conditions, including in particular:

- Horizontal inequality and social exclusion: specifically, economic growth has largely benefited Kathmandu valley residents, with the large impoverished and deprived rural population—for decades a target of social

exclusion—witnessing little social and economic progress; and

- Failure of governance, including lack of delivery of public services: specifically, weak institutions have failed to meet the basic needs of the population and continue to be linked with corruption, political infighting and instability.

The insurgency has increasingly challenged the fragile economy—the costs have been estimated at 8-10% of GDP, including: (i) damage to infrastructure—e.g., over 1/3 of the 3,900 Village Development Committee (VDC) buildings have been destroyed; (ii) lost economic activity due to *bandhs*—i.e., strikes—

that have been taking place with greater frequency and often lasting 2-3 days; and (iii) a generally low level of economic activity caused by decreased business confidence and low tourism. Furthermore, there have been large direct impacts on the livelihoods of millions of primarily rural-based individuals, for which killing, extortion, confiscation, forced recruitment, and infrastructure destruction have created fear and resulted in migration, decreased agricultural production, and a decline in living standards—it is estimated that approximately 300,000 people have migrated to the Kathmandu valley in recent years.

elections, fight corruption and improve service delivery. While public opinion was firmly behind the peace talks and supported the administration, the main political parties—most notably, the split Nepali Congress (NC) Party and the United Marxist Leninist Party (UML)—continually challenged the administration's legitimacy. On the basis of the standoff that developed with the political parties agitating for the restoration of Parliament and formation of an all-party Government, the Chand administration resigned in late-May 2003, and the King appointed Mr. Surya Bahadur Thapa—also of the RPP—as the new Prime Minister on June 4.

10 As head of the second interim administration, Prime Minister Thapa has been vested with full executive powers to assemble an all-party Government, but the five main political parties have so far all declined to join, claiming that the current administration is no different from its predecessor. As such, the cabinet contains only six additional members, all from the RPP. Mr. Thapa has outlined a ten-point agenda that includes: (i) resolving the insurgency problem and establishing lasting peace; (ii) creating an environment conducive to local and general elections; (iii) establishing the foundations of good governance and strengthening the administrative machinery; (iv) effectively implementing anti-corruption measures; (v) accelerating economic reforms and facilitating an enabling environment for investment; and (vi) building consensus for political, economic and social reforms. In this context, securing a lasting peace with the insurgents, reaching a political settlement with the parties and building an environment conducive to holding elections all remain high on HMGN's agenda. Strongly related to this, HMGN's recent replacement of public servants with political appointments in local bodies (see footnote 11) can be viewed as a precursor to local elections.

Nevertheless, the political situation remains tense and a speedy return to functioning democracy does not appear imminent.

C. Macroeconomic Performance and Medium Term Prospects

11 Since the last CAS, the Nepali economy has fluctuated. After growing at a rate of 5% per year during the 1990s, real GDP fell in FY01/02 primarily due to declines in manufacturing and tourism (see Table 1). A number of factors—including sluggish worldwide growth, the insurgency, market saturation, and inadequate quality control and standards—contributed to the decline, as did irregular rainfall that adversely affected agricultural production. More recently, there have been signs of a modest recovery underway, with GDP growing by 2.3% in FY02/03. Economic activity picked up noticeably after the January cease-fire with some recovery in tourism, transportation and other services, and certain manufactured exports—especially garments. Nevertheless, the economy remains weak.

12 As imports have also somewhat rebounded, the current account balance recorded a slight deficit (about 1% of GDP) in FY02/03. Remittances from Nepalese working abroad have grown tremendously (estimated at around US\$855 million in FY02/03), with this item now larger than the value of merchandise exports. Gross official reserves remained high at about US\$1.2 billion—about six ½ months of imports—at end-FY02/03. The external debt service ratio is low (about 7.5%) of exports of goods and services, because of the highly concessional nature of external borrowing.

13 In recent years fiscal management has come under stress, as the worsening

insurgency situation and fragile economy contributed to weak revenue growth and security-related spending increased. In FY01/02, revenues were below the budget target (despite serious collection efforts, including imposition of special security surtaxes) and security spending was about 1% above the budgeted amount (although still well below the level of similar spending in other countries in the region). Anticipating further fiscal pressures, HMGN embarked on a bold fiscal consolidation exercise in FY02/03 that has been implemented with a considerable degree of success.⁷ Despite low levels of development expenditures in FY02/03, pro-poor spending has been protected. Furthermore, with revenues increasing by 13% over the previous year, the deficit before grants declined to 4% of GDP in FY02/03 (compared to the 1990s average of 6%). Fiscal management will continue to be

strengthened during FY03/04 and into the second month of the fiscal year, budget implementation is strong. In the past, the deficit has largely been financed by concessional foreign financing, however, in FY00/01 and FY01/02 domestic financing rose slightly. With successful implementation of the reform program, in the future it is envisioned that foreign financing will increase.

14 Led by a recovery of manufacturing and exports, stronger agricultural performance and productivity, and higher investment, in the medium term growth in Nepal is expected to increase to the 5% rates experienced during the 1990s.⁸ There are, however, several key pre-conditions for these to occur. First and foremost, renewed economic growth will require political stability and peace. Second, Nepal will need to implement a range of growth-enhancing

Table 1: Selected Economic Indicators: FY99/00-FY05/06

Fiscal Year	99/00	00/01	01/02	02/03 ^{1/}	03/04 ^{2/}	04/05 ^{2/}	05/06 ^{2/}
Real GDP (% change)	6.1	4.8	-0.5	2.3	3.5	4.6	5.4
Agricultural GDP	4.9	5.5	2.2	2.1	2.8	3.0	3.5
Non-agricultural GDP	6.8	4.3	-2.1	2.5	3.9	5.7	6.4
Manufacturing	7.2	3.8	-10.0	0.4	2.3	6.7	7.2
Other sectors	6.8	4.4	-0.6	2.9	4.2	5.5	6.4
Fiscal indicators (% of GDP)							
Total revenue	10.7	11.4	11.5	12.3	12.4	12.8	13.4
Total expenditure	15.7	17.6	17.2	16.3	18.7	18.5	18.2
Current expenditure	9.6	11.2	11.6	11.6	13.1	12.5	12.1
Capital expenditure and net lending	6.1	6.4	5.7	4.7	5.6	6.0	6.1
Overall deficit before grants	5.0	6.2	5.7	4.0	6.3	5.7	4.8
Overall deficit after grants	3.5	4.5	4.3	1.9	3.6	2.6	2.0
Domestic financing (net)	0.9	2.7	2.9	1.2	1.7	1.3	0.6
Current Account Balance (% of GDP)	0.5	1.2	2.6	-0.9	-1.7	-1.8	-2.3
Gross official reserves (US\$ millions, end of period)	1,385	1,020	1,048	1,177	1,237	1,292	1,347
In months of imports of goods & services	5.6	7.0	6.7	6.9	6.4	6.3	6.2
External debt/GDP (%) ^{3/}	51.8	49.9	52.9	52.2	47.2	44.8	42.4
Debt service ^{4/}	4.7	6.1	7.5	7.4	7.9	8.1	8.1

Source: IMF (as of October 6, 2003)

^{1/} Estimate

^{2/} Projected

^{3/} Includes estimated private sector debt and short-term trade credits.

^{4/} In % of exports of goods, services, and private transfers, including debt service to the IMF.

structural reforms to stimulate a more pro-poor and inclusive growth process, including: (i) enhancing the development impact of public expenditures and improving tax administration; (ii) improving power, transport, banking and telecommunications services; (iii) boosting Nepal's export competitiveness by addressing some behind the border constraints; (iv) addressing sector specific reforms such as rationalizing irrigation subsidies in agriculture and improving labor market flexibility for manufacturing and services; and (v) undertaking governance reforms that enhance the impact of the structural measures.

15 The macroeconomic framework recently agreed by HMGN with the Bank and International Monetary Fund (IMF), as well as assistance from both institutions to implement the reform efforts—through Poverty Reduction Support Credits (PRSCs) and a Poverty Reduction and Growth Facility (PRGF)—will support Nepal's attempts to achieve more sustainable growth. The key elements of the framework are consistent with the PRS and include: (i) a fiscal strategy to improve revenue mobilization, prioritize spending—towards social and infrastructure sectors to help reduce poverty—and contain domestic borrowing over the medium term; (ii) a monetary policy geared to supporting the peg to the Indian rupee; (iii) continuation of the financial sector reforms; (iv) public sector reforms including civil service and public enterprise; and (v) governance reforms to strengthen the fight against corruption and accelerate decentralization to local levels to improve accountability and service delivery.

D. Progress Under the Last CAS and Lessons Learned⁹

CAS Implementation

16 Because of the limited and slow

progress in implementing the reform program, for much of the last CAS period Nepal remained in a low case lending scenario. Given the fungibility of aid resources, without substantial improvement in the use of public resources, more financial assistance from IDA would not have been a solution to Nepal's problems. HMGN clearly began recognizing poor governance—reflected most acutely in weak implementation of reforms, poor service delivery and corruption—as a central obstacle to development. Growing recognition of the gravity of the financial sector conditions and their direct link to the system of poor governance, led the Bank to attach special importance to financial sector reform (see Box 3). As the first major step in reforming the financial sector, the introduction of external management teams in the two large ailing commercial banks became the 'litmus test' for moving into a base case scenario. By the time of the December 2002 CAS PR significant progress had been achieved toward implementing the reform program, including in the financial sector, and hence the decision was made to move Nepal to the base case.

17 While in the low case (late-1998 to late-2002), the lending program focused primarily on infrastructure development, and four projects—in education, rural infrastructure, road maintenance and telecommunications—were approved for a total of US\$94.6 million. Strong emphasis was placed on helping to build the agenda and needed consensus for reform. To a great extent, the introduction of a Medium Term Expenditure Framework (MTEF) and Immediate Action Plan (IAP—see paragraphs 21-24) have been prompted by the Bank's Analytical and Advisory Activities (AAA). In addition to key formal reports (see Table 2), the Bank's follow up through technical assistance (TA) and intensive dialogue have

GOVERNANCE AND THE FINANCIAL SECTOR Poor management of financial resources at Rastriya Banijya Bank (RBB) and Nepal Bank Limited (NBL) has been a way through which powerful elite have abused public institutions. Poor management and oversight of the financial sector—in part, occasioned by heavy-handed state

involvement—has resulted in problems of growing non-performing assets and capital adequacy, and an increased scope for systemic risk within the sector. RBB and NBL—accounting for about 50% of total banking system assets—are estimated to have had losses (as of mid-1998) of as much as US\$450 million—equivalent

to about 46% of the budget or 8.6% of GDP. In late-2000, HMGN adopted a strategy that commits to reducing the role of the public sector in the sector as a direct owner of financial institutions, while strengthening its role as a supervisor and regulator of banks and financial institutions (see paragraph 32).

made significant contributions to the foundations of many of the on-going and envisioned reforms. Internally, the Bank's Nepal team has also moved to an outcomes-based work programming approach to sharpen its focus on facilitating reforms (see paragraph 49). Since the transition to the base case in December 2002, three additional projects (in the financial sector, power development and education) have been approved for a total of US\$96.9 million.

Lessons Learned

18 Today, there is a realization in Nepal that the Bank is truly concerned with the well-being of the poor and that it is not

possible to simply 'negotiate' aid out of IDA. In getting to this point, a number of valuable lessons have been learned—both from our experiences in Nepal and world-wide, including through instruments such as *The Global Poll* (May 2003). The following have taken into account in developing this new CAS:

- In an environment of poor governance, closely linking lending levels to progress in implementing reforms and achieving results on the ground—not just promises—can provide significant leverage. While such an approach by itself might not prompt reforms, when spontaneous reform initiatives emerge, it can provide

Table 2: Key Formal Reports Since FY99

Poverty Report	FY99
Public Expenditure Review	FY00
Priorities & Strategy in Education Sector Reform	FY01
Power Sector Development Strategy	FY01
Business Environment & Manufacturing Perform.	FY01
Country Procurement Assessment Report	FY01
Country Financial Accountability Assessment	FY02
Financial Sector Study	FY03
Trade & Competitiveness Study	FY03
Towards a Sustainable Approach for Poverty Reduction and Decentralization: A Note on PAF	FY03
Country Assistance Strategy Progress Report	FY03

an important and constructive discipline to the process, and can even strengthen the hands of reform leaders. In addition, this fosters peer pressure among senior officials to look at development more holistically, as they realize that sectoral funds could be blocked if the overall progress is not made toward larger country goals (i.e., governance);

- A work program grounded in an outcomes framework encourages a more holistic and multi-sectoral approach for the Bank team. Outcomes need to be realistic and focus on those areas where the Bank plays a significant role, with clear linkages to the country's stated objectives;
- To be most effective, consistent dialogue and investment in a solid relationship with key counterparts are essential. In addition to building consensus for change/reform, such an investment also builds and encourages ownership of and buy in for reform programs. Proactive outreach helps build wider understanding of the development challenges and opportunities;
- It takes time for reform to catch on; hence, there is a need to simultaneously develop 'low case appropriate' interventions—typically modest in size and often supporting community-based projects or small, sector-specific reform efforts;
- The interplay of diverse political economy realities have an important impact on reform implementation. These need to be better understood for the Bank to be more effective in identifying and supporting emerging reform opportunities. When reforms do happen, they are often spontaneous and episodic, and often fall outside conventional frameworks that donors are accustomed to. Moreover, Government officials are not generally good at showcasing reform progress, nor are they practiced at communicating successes to the public. These are important aspects to stress and take into account if the benefits of reforms are to be the best arbiter for deeper reforms in the future;
- The linkages between peace and stability, and poverty reduction are strong—possibly forming a vicious circle. Development/poverty reduction can not be delayed or postponed until there is peace and stability, as many of the root causes of conflict—i.e., failure of governance, including lack of delivery of public services, and horizontal inequality and social exclusion—are often also the major challenges of reducing poverty; and
- Donor coordination is essential, but not always easy. Ultimately, the Government must be encouraged to coordinate donor assistance by setting out its own development strategy and priorities. Clearly, donors—including the Bank—need to respect Government efforts to 'regulate' and direct foreign assistance.

⁴ The most recent estimates are based on the 1995/96 Household Survey. A Nepal Living Standards Survey (NLSS) was launched in early-2003 to update household level information on consumption, poverty and their determinants. A full Poverty Report based on this survey will be finalized in FY05. For more details on the poverty situation in Nepal, see the Poverty Reduction Strategy.

⁵ All poverty figures cited are based on the results of the 1995/96 Household Survey and can be compared to an overall poverty incidence estimated at 42% of the population.

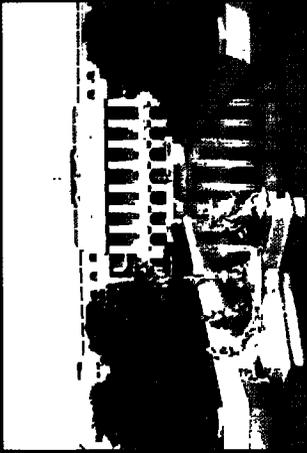
⁶ Nepal has over 100 languages and dialects, and more than 60 recorded ethnic groups, some of which are further sub-divided into distinct caste rankings. There are many indigenous ethnic ('Janajati') groups and 12-15% of the population are 'Dalits' or occupational caste groups who have been historically disadvantaged and continue to lag behind.

⁷ See paragraphs 21-23 for details on the implementation of the MTEF and fiscal adjustments.

⁸ Nevertheless, a key concern will be the removal of the Multi-Fibre Arrangement (MFA) based quota protected markets that had stimulated the growth of manufacturing and trading over the last decade.

⁹ For a more detailed discussion of the experience with implementing the last CAS, see Appendix II.

2



Nepal's Poverty Reduction Strategy

- A. The Reform Process
- B. The Poverty Reduction Strategy
- C. Assessment of the PRS

A. The Reform Process

The Context: Nepal at the Edge of Chaos

19 Nepal is struggling to emerge from a period of intense turmoil and its future hangs in balance. The acutest form of this turmoil is the insurgency that escalated into a serious armed conflict involving the army in November 2001. In the backdrop, however, had been growing disappointment with the political and development processes that have failed to meet the aspirations of the people, which had been raised after the reinstatement of a multi-party democracy in 1990. With the heightened level of hostilities, the economy slowed and fiscal pressures built. When this crisis did not seem to prompt political leaders into serious corrective action, the frustration of many turned into a sense of alarm that the nation was heading for a catastrophe. From this deep sense of crisis, a new wave of reforms was born. It is being led by a growing number of reform-minded technocrats and some enlightened political leaders.

20 An important beginning was made at the Nepal Development Forum (NDF) in

March 2000, where HMGN announced a comprehensive reform program that focused on improving governance and reducing poverty. As the severity of the financial problems of the two largest commercial banks became apparent in 2001, reformers became alarmed by the prospect of a financial sector crisis and began to use it as a focal point of the reform process. Then, with the fiscal situation deteriorating rapidly in 2002, HMGN started to use this as a driver for public expenditure reform. At the same time, to respond to the serious challenges caused by the insurgency, reformers began to design radical ways to improve public service delivery even under severe fiscal constraints. By the beginning of FY02/03, these somewhat disparate initiatives took shape as a more cogent strategy, embodied in the IAP and the financial sector reform program that would place the two ailing banks under external management as the first step. An integral part of the IAP has been the introduction of the MTEF to substantially rationalize the development budget. In parallel, after its legal framework was strengthened in 2002, the Commission for Investigation of Abuse of Authority

THE 2003 IAP The 2003 IAP contains 24 reform actions directly linked to the four PRS pillars. As such, it is more ambitious than its predecessor and covers reforms in about a dozen areas. In addition to areas previously covered—i.e., public expenditure management, civil service reform and anti-corruption—the 2003 IAP covers actions in agriculture, private sector development, public

enterprise rationalization, infrastructure development, targeted programs and decentralization. The Reform and Development Group—a joint HMGN/donor task force—has worked diligently on developing the 2003 IAP and has identified 'lead Ministries' and 'lead donor agencies' responsible for carrying out detailed assessments of each of the actions. These assessments include an explana-

tion of the impact/importance of the action, a preliminary cost estimate and timeframe for implementation, and an outline of the proposed arrangements to review implementation progress. Past experience has shown that sectoral ownership at the highest levels has contributed to achievements above and beyond the original targets established in the IAP (see Appendix III).

(CIAA) started to take some highly visible actions against senior civil servants and politicians on corruption charges.¹⁰ This has been met with enthusiastic support from the general public. As explained below, the PRS builds on these reform successes and expands the scope of reforms, with a more integrated approach within a medium term perspective.

The Immediate Action Plan

21 In June 2002, HMGN adopted the IAP that was designed to expedite reforms in three critical areas—prioritizing public expenditures, improving service delivery, and strengthening anti-corruption and accountability measures. Recognizing their weak implementation capacity, HMGN took pains to keep the plan selective. Main IAP actions included: (i) setting a realistic budget ceiling and eliminating a number of low priority projects; (ii) assuring funding for high priority projects, but tying funds release to performance; (iii) improving service delivery modalities by initiating the transfer of public primary schools and

primary health facilities to community management; (iv) public posting of budget information and tracking of expenditures; (v) implementing public procurement and financial accountability reforms; and (vi) developing and starting to implement an anti-corruption strategy. With all the Ministries and Departments relevant to the IAP galvanized into action, nearly all of the 19 actions were completed by the end of FY02/03. Inspired by this achievement, HMGN decided to turn the IAP into an annual process to define and monitor a set of critical actions necessary for the successful implementation of the PRS. After being endorsed by the cabinet, the 2003 IAP was announced in July 2003 and the measures are expected to be implemented by the first quarter of 2004 (see Box 4 and Appendix III). In this regard, reform leaders are keenly aware that these early successes have not translated into significant impacts on the lives of average citizens at the grassroots levels, especially in rural areas. To make the reform process meaningful and sustainable,

there is an urgency to accelerate the implementation, especially of the reforms that bring quick impact to the community level. The 2003 IAP is designed with this objective in mind. Lengthy delays in local elections, however, present an obstacle, as they have dampened the momentum for decentralization. In many Districts, locally elected District Development Committee (DDC) and Village Development Committee (VDC) chairs (who had executive power) tended to be strong promoters of change at the grassroots level.¹¹

Medium Term Expenditure Framework and Fiscal Adjustments

22 Based on the recommendations of the 2000 Public Expenditure Review (PER)¹² and the work of the Public Expenditure Review Commission (PERC) in 2001, and prompted by the worsening fiscal situation, HMGN decided to introduce an MTEF starting in FY02/03. Overcoming the entrenched tendency to seek increased foreign aid to cope with fiscal stress, the reform-minded National Planning Commission (NPC) and Ministry of Finance (MOF) used the fiscal pressures to motivate serious adjustments in budget allocations. This led to elimination of 160 low priority projects (out of 625 projects) in the FY02/03 budget. Further cuts in projects would have been desirable, but were politically impossible. Instead, HMGN chose to be pragmatic and opted for an unorthodox solution in which remaining projects were classified into three priorities—P1, P2, and P3. While funding for the top priority (P1) projects was assured, funding for lower priority (P2 and P3) projects would be contingent on actual availability of funds after all P1 projects are adequately funded.¹³ While seemingly vulnerable to political pressures, NPC and MOF nevertheless managed to use this system effectively to concentrate funding to the P1 projects and within a year established a clear

understanding among line ministries of the seriousness of this prioritization exercise.

23 At the same time revenue growth was slowing during the last two fiscal years, security spending was increasing sharply as the level and scale of the insurgency escalated. From a very modest level of Rs. 7 billion (1.9% of GDP) in FY00/01 to support the police and a small standing army, security spending rose to about Rs. 15 billion in FY02/03. While in principle this increase was detrimental to the development efforts, NPC/MOF turned it to its advantage. As the increase in security spending was an absolute imperative, the resulting severe fiscal pressure made it easier to impose a hard budget constraint on line ministries and politicians who had been accustomed to much softer budget constraints in the past. The majority of the cuts hit low priority, politically motivated projects. Total development spending declined from Rs. 37 billion in FY00/01 to Rs. 27 billion in FY02/03. The developmental impact of this reduction appears to have been relatively modest, as most of the dropped and P3 projects had been ill conceived to begin with and receiving only modest annual funding without any realistic hope of completion in the foreseeable future.

24 In the meantime, through reforms to decentralize service delivery modalities—not only in primary education and health care, but also in agricultural services—the quality of recurrent spending has started to improve. In FY03/04, further measures are anticipated in this regard, including: (i) the operationalization of an autonomous Roads Board that is expected to bring more rationality and transparency to the allocation of road maintenance budget; (ii) incentive grants to schools that improve enrolment of disadvantaged groups; (iii) implementation of the essential health care

package approach to focus the limited resources on priority health issues; and (iv) greater participation of the private sector in infrastructure services—e.g., establishment of the Power Development Fund (PDF) to promote private investment, introduction of a rural telecommunications operator and opening the licensing system for private cellular operators. In effect, HMGN has been able to turn the fiscal and service quality crises into an opportunity to establish a leaner and more efficient public spending program. As Nepal begins to implement its PRS in full scale and increase expenditures to support it, far greater impact from additional spending can be expected than in the past.

B. The Poverty Reduction Strategy

Background

25 Nepal's PRS is based on the reform successes and limitations it has seen over the last two years, and gives the process a broader, and longer-term vision and strategic coherence. Early on, HMGN decided that the Tenth Plan (FY02/03-FY06/07) would form the basis for its PRS. Many of the past plans, however, have suffered from a number of weaknesses, including in general an overly optimistic fiscal framework and limited focus on implementation, monitoring and evaluation. Therefore, while relying on the planning framework that was familiar to HMGN, the NPC managed to build the recent reform experience (in particular IAP and MTEF) into the PRS and make it a far more credible strategy than any recent five-year plans.

26 The PRS identifies reducing the overall poverty ratio from about 40% to 30% by the end of the Tenth Plan (FY06/07) as its key target. Other targets include: (i) raising the above 15 literacy rate from 49% to 63%; (ii) reducing the infant mortality rate from

64 to 45 per 1,000 live births; (iii) raising life expectancy from 62 to 65 years; and (iv) increasing access to drinking water to 85% of the population (from 72%), access to electricity to 55% (from 40%), and providing telephone facilities to every VDC. To meet these objectives, the PRS is formulated around four key pillars:

- Achieving sustained high and broad-based economic growth, focusing particularly on the rural economy;
- Accelerating human development through a renewed emphasis on effective delivery of basic social services and economic infrastructure;
- Ensuring social and economic inclusion of the poor, marginalized groups and less developed regions; and
- Vigorously pursuing good governance both as a means of delivering better development results, and ensuring social and economic justice.

27 In implementing these pillars, the strategy stresses four cross-cutting themes: (i) re-defining the role of the State and limiting public interventions; (ii) promoting private sector development and enlisting the involvement of the private sector, Non-Governmental Organizations (NGOs), International Non-Governmental Organizations (INGOs) and Community Based Organizations (CBOs); (iii) supporting greater social diversity in the structure of governance at all levels, and more socially and geographically inclusive access to social and economic services; and (iv) accelerating the decentralization process, including community participation in and management of activities at the local levels.

28 The PRS recognizes that the four pillars are closely inter-related and address different aspects of the same problem. Nevertheless, each pillar is described separately both in the PRS and below.

Furthermore, as a foundation for broad-based economic growth, the PRS recognizes the need for an appropriate enabling environment and macroeconomic stability. Thus, the PRS incorporates a sustainable macroeconomic framework, whose objectives include: (i) maintaining fiscal discipline; (ii) ensuring efficient use of public resources; and (iii) sustaining monetary and external stability. This is complemented by a structural reform agenda that aspires to make the public sector more diverse, efficient and effective, remove constraints to private sector competitiveness and improve the conditions of the poor. In this regard, key reforms are envisioned in: (i) public finance, including public expenditure management—i.e., implementation of the MTEF; (ii) financial sector reform; (iii) improving the competitiveness of private sector, including trade and labor market reform; (iv) governance, including civil service reform and decentralization; and (v) promoting private sector involvement in infrastructure.

Broad-Based Economic Growth

29 The PRS argues that higher growth will be achieved through greater productivity in agriculture and non-agriculture, along with recovery in manufacturing, tourism and exports. The agricultural growth strategy—the Agricultural Perspective Plan (APP)—aims to modernize, diversify and commercialize crop and livestock production by expanding the use of technology and increasing the access of farmers to modern agricultural inputs and credit. This strategy is closely linked to ground water development (i.e., irrigation strategy), increasing rural infrastructure (i.e., rural electrification and rural roads) and sustainable development of the forestry sector.

30 In the non-agriculture sector—for which manufacturing, trade (see Box 5), tourism, transport, construction, and

financial and social services are explicitly recognized as key sub-sectors—the emphasis is on reducing the role of the State in economic activities and creating an environment more conducive to private sector investment. The strategy includes: (i) removing the impediments to private sector development; (ii) accelerating privatization of state owned enterprises (SOEs)¹⁴; (iii) streamlining regulatory processes and making them more transparent; (iv) amending labor laws to make them more flexible; and (v) introducing important private-sector friendly legislation and judicial reform. In parallel, reforms will be implemented in corporate and financial governance.

31 The PRS places importance on infrastructure development in facilitating private sector development, and hence gives priority to the strategic road network, maintenance of major roads and highways, and expansion of infrastructure in electricity and communications. The intention is for the private sector to play a more prominent role in these sectors, as well as to clarify the roles and responsibilities of private and public operators. Examples of reforms initiated and/or envisioned in the near future include: (i) in roads, improving road maintenance through establishment of an autonomous Road Fund Board and transferring to DDCs the responsibility for development and maintenance of rural roads; (ii) in electricity, internal unbundling of the Nepal Electricity Authority (NEA), establishment of a PDF and creation of an independent regulatory agency; and (iii) in information and communications, conversion of the Nepal Telecommunications Corporation (NTC) into a public company under the Company Act, opening up general and rural telecommunication services to the private sector and establishment of a legal framework creating functional autonomy of the postal service. Infrastructure development is also critical for agricultural growth and

IMPROVING NEPAL'S TRADE AND COMPETI-

TIVENESS The trade to GDP ratio in Nepal is about 50%. With regard to exports, Nepal is dependent on a relatively small number of products—ready-made garments and carpets account for nearly 60% of exports—with exports to North America, Europe and India accounting for 95% of the total. Despite this narrow basis, trade was a key factor behind the acceleration of Nepal's economic growth in the 1990s.

Along with Sri Lanka, Nepal has the most liberalized

trade policy in South Asia. However, there are significant constraints—including delays in customs and transshipment, an extremely rigid formal labor market, infrastructure, and ineffective and unpredictable public sector policies and institutions—that constrain the country's trade prospects. A recently completed study—*The Nepal Trade and Competitiveness Study* led by the Bank under the auspices of the Integrated Framework (IF)—provides recommendations on key issues, such as Nepal's accession to the World

Trade Organization (WTO), improving competitiveness and productivity, and facilitating trade. Nepal faces significant challenges for realizing its export potential in the medium term, including the forthcoming phasing out of the MFA, the accession of China into the WTO and a more restrictive trade treaty with India. As improving competitiveness is an important component of the growth agenda, the Bank will continue to work closely with Nepal's other development partners supporting follow up of the key IF recommendations

productivity improvements, and as such, the strategy emphasizes the infrastructure developments needed to meet these objectives.

32 Finally, it is recognized that a strong financial system is of critical importance for private sector development. In this respect, the PRS envisions continuing implementation of Financial Sector Strategy (FSS), which includes among other things: (i) restructuring and privatizing the two large ailing state banks; (ii) strengthening the monitoring and regulatory capacity of the Central Bank; and (iii) strengthening the legislative and institutional framework for the sector.

Social Sector Development

33 The PRS outlines the importance of improving service delivery through a gradual process of decentralization and greater empowerment of local communities in the management of social services. In

education, guided by the goal of 'education for all,' the strategy aims at improving the access to and quality of primary education. In doing so, a key objective is to expand literacy programs, with special emphasis on improving educational attainment and thus, the livelihood opportunities of historically excluded groups, especially girls, Dalits and disadvantaged ethnic groups. At higher levels—i.e., secondary, vocational/technical and tertiary—the objectives are similar, with emphasis on producing manpower with higher skill levels. To achieve this, the strategy is to decentralize management of schools to local school management committees (SMCs) at the lower levels and to the governing body of the individual institutions at the tertiary level. This process at the primary level—a fundamental shift from the currently centrally-managed system—has begun over the past year with over 250 schools transferred by end-

September 2003 and an additional 500 applications pending approval. In addition, the strategy envisions implementing a program of targeted scholarship programs for girls and children from Dalit and disadvantaged ethnic minority families.

34 In health, the objective is to increase and extend essential health care services to all, with special emphasis on poor populations living in rural areas. To this end, the sector strategy focuses on implementing an essential health care package that is based on preventative care, maternal and child health, and family planning. Improvements in service delivery are also expected to occur through a process of devolving health facilities—starting with sub-health posts—to local communities and working increasingly with the private sector and NGOs. Related to this, the PRS elaborates on the importance of access to safe water for health outcomes and aims to increase access in rural areas. Key actions focus on rehabilitation and maintenance of existing projects, and developing new projects using the demand-driven user group participation and empowerment approaches supported by the Rural Water Supply and Sanitation Fund Development Board (i.e., ‘Fund Board’). In urban areas, the focus will be on improving delivery of utility services, and water supply and sanitation management in some major towns is to be contracted out to the private sector over the next few years.

Social Inclusion and Targeted Programs

35 At the core of this pillar is a specific commitment that in the implementation of all PRS pillars, efforts to reduce gender and ethnic/caste-related disparities will be mainstreamed, and in new programs emphasis will be placed on ensuring equity of access for all, with special attention to the most vulnerable. In addition, the PRS

proposes targeted programs for women and the most vulnerable poor ethnic minorities living in remote areas. The PRS reviews the weaknesses of past efforts and discusses using new mechanisms (e.g., the Poverty Alleviation Fund—PAF) and analytical tools (e.g., poverty mapping data) to improve effectiveness. The PRS also stresses the need for ‘quick results’ in order to gain the confidence of those who have thus far been left behind by development efforts.

36 The PRS lists a number of areas—including agriculture, forestry, wage employment and social sectors—where special efforts will be made to mainstream and empower women, Dalits and the disadvantaged through a variety of means, including targeted programs. Other reforms include: (i) revising existing laws to eliminate legal discrimination against women; and (ii) implementing affirmative action programs to increase the social diversity of public service. The approach to mainstreaming deprived communities and other vulnerable groups will be similar, in that emphasis will be placed on ensuring social inclusion in all programs.

37 Recognizing the limited effectiveness of targeted programs in the past, the PRS has adopted some new approaches, including, among others: (i) merging programs similar in nature; (ii) establishing PAF as an umbrella organization for targeted programs; and (iii) adopting a population and poverty-based resource allocation formula for fund transfer to the districts. To achieve its goals the PRS proposes to implement an integrated infrastructure development program (drinking water, small irrigation, schools, health posts and trails) in remote areas through local government, CBOs and NGOs.

38 In parallel, HMGN has shown serious commitment to addressing the inclusion

agenda at the political level. In the context of the last round of peace talks, while adhering to constitutional monarchy and multi-party democracy, HMGN also proposed far-reaching reforms to the parliamentary system. The proposals included, among other things: (i) proportional representation in Parliament (as opposed to the ‘first-past-the-post’ system copied from the Westminster model); (ii) reforms to ensure wider representation in the Upper House of Parliament; (iii) strengthening of the prime ministerial system (with a provision to allow non-elected technocrats to be included in the cabinet); (iv) constitutional reservations for under-served and under-represented groups; (v) consolidation of local government structures, and wider powers and responsibilities to the local level; and (vi) a constitutional provision for referenda on issues of national significance.

Good Governance

39 The PRS recognizes that improving governance is essential if the reforms are to stimulate pro-poor growth, improve service delivery and lay the foundation for lasting peace. HMGN’s strategy to improve governance covers: (i) civil service; (ii) financial management and accountability; and (iii) decentralization. While HMGN has made some progress in improving human resource management practices over the past few years—most notably through the creation of a computerized personnel information system—the PRS recognizes that additional progress is needed to make the civil service more efficient, accountable and transparent. Future actions include: (i) reforming public employment through introduction of merit-based recruitment and evaluation systems and a long-term pay policy, as well as right-sizing, improving the capacity and skills mix, and introducing an affirmative action program; (ii) improving

financial management and accountability through among other things, implementing the recommendations of the recent Country Financial Accountability Assessment; and (iii) implementing the anti-corruption strategy, in part through the enactment of an Anti-Money Laundering Act¹⁵ and strengthening key institutions charged with fighting corruption, including the National Vigilance Center and the CIAA.

C. Assessment of the PRS

40 The Tenth Plan/PRS has been developed in the context of the current political turmoil in Nepal in a relatively participatory manner (see Box 6). Although it stands on the tradition of the periodic plan process, the PRS has been able to break from the historical baggage of the established process in a number of important ways. While the implementation strategy of the PRS is not as sharply explained as one might like, the PRS relies on several strategic and cross-cutting instruments to achieve its basic objectives, including: (i) decentralization; (ii) re-defining the role of the State and reinforcing market functions; (iii) changing public service delivery modalities; (iv) strengthening accountability mechanisms; (v) maintaining macro/financial discipline and improving public expenditure management; (vi) targeted programs; and (vii) increasing investment in infrastructure and agriculture.

41 Beyond the more thoughtful structure of the poverty-focused strategy, there are several things that give the Tenth Plan/PRS considerable credibility, including:

- Acknowledging the difficulty of getting away from the tradition of an ‘all encompassing plan’ document, NPC condensed the voluminous Tenth Plan in the traditional mold into a lean summary—i.e., the PRS. This shows HMGN’s ability to be

THE PRS CONSULTATION

PROCESS The Tenth Plan/PRS adopted a participatory and relatively 'bottom up' approach. An extensive consultation process was initiated at various levels to discuss and solicit feedback on the ideas and recommendations presented in various drafts. Consultations were initiated in August 2000 with numerous public meetings held—two exclusively with women's groups—in eastern, central and western Nepal bringing together representatives from all 75 DDCs and all facets of civil society (i.e., socially excluded, minorities, academics, private sector, NGOs/CBOs).

Additional regional consultations were held in June 2001 to discuss the draft Tenth Plan Approach Paper, as well as linkages between district plans and the national plan. The Approach Paper was then finalized and discussed in the National Development Council (NDC)—composed of all Ministers, Secretaries, and representatives of all political parties, private sector, academia, ethnic minorities, labor unions, women, NGOs and CBOs—in January 2002. These efforts were complemented by consultations organized from time to time by various agencies responsible for developing key sectoral programs, thematic

chapters and background papers. Throughout this process, broad consensus and wide support have been developed for the PRS/reforms. However, the conflict likely constrained the consultation process in some parts of the country and HMGN intends to address this once it is feasible. With support from the development partners HMGN is developing a comprehensive participatory implementation, monitoring and evaluation strategy. The exercise will be completed by end-2003, with civil society to play a prominent role in monitoring efforts.

selective and strategic, indicating the seriousness attached to the PRS.

- The PRS is backed by the MTEF, giving budget prioritization a serious framework. Also, the performance-based cash release system for the high priority projects is forcing a greater focus on implementation performance.
- Through the IAP, HMGN has succeeded in being selective in reform actions and building an internal consensus on the absolute necessity for implementing the relatively few commitments made under the IAP. HMGN now intends to use the annual IAP process as the instrument to ensure implementation of a small set of key reforms to support the PRS on a priority

basis.¹⁶ By recognizing its own implementation capacity limitations and by devising a practical instrument to manage this problem, HMGN has shown a real seriousness about implementing the PRS.

- The reformers are far more serious about poverty reduction, with particular focus on inclusion. One thing the insurgency has done is to force the Kathmandu-based power elite to think about Nepal as a nation state that will survive only if glaring disparities in living standards, and access to political and economic powers are rectified. This seriousness is reflected in a frank admission in the PRS about past failures and exclusionary consequences of poor public policies and commitment to addressing them; and

- The people are demanding the kind of changes that the PRS envisions, thereby giving the PRS the political impetus, legitimacy and sustainability.

42 Thus, the PRS, combined with the MTEF and IAP, form a sound basis on which to build the Bank's CAS.¹⁷ A Joint Staff Assessment (JSA) of the PRS was carried out by staff of the Bank and the IMF in July 2003.¹⁸ In addition to highlighting the strengths of the PRSP—many of which are listed above—the JSA suggests a number of shortcomings and challenges on which HMGN will have to focus on in the coming year, including the need to:

- Identify the sources of growth, along with the key linkages to poverty reduction;
- Address gaps in costing and prioritization, and link these to the annual budget and MTEF;
- Implement a coherent monitoring and evaluation strategy, including building capacity for poverty monitoring within a clear institutional framework; and
- Further elaborate pro-poor rural strategies, especially to ensure social inclusion through changes in the way in which public services are delivered in all sectors.

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- 10 In FY02/03, the CIAA filed 154 cases in various courts. Of these, the Special Court for corruption has passed judgment on 55 cases, of which 43 have been in favor of the CIAA. The most prominent cases, however, are pending.
- 11 To fill the vacuum at the local level, recently the cabinet appointed numerous DDC and municipality officials, including some former DDC chairs, vice chairs and mayors. After experimenting with running local bodies through civil servants, HMGN concluded that local bodies were better governed by political leaders; hence, the appointments.
- 12 Nepal: Public Expenditure Review, Report No. 20211-NEP, April 11, 2000.
- 13 To deal with unexpected revenue shortfalls, the budget should include some lower priority projects. The FY01/02 budget, however, contained more projects than the most optimistic revenue projection could fund.
- 14 While budgetary transfers to SOEs averaged 1.8% of GDP over the last three years, total contingent liabilities are unknown. To estimate privatization costs, HMGN has stepped up carrying out audits in public enterprises and Bank sector work in this area is planned for FY05 (see Table 4).
- 15 Related to this, last year HMGN expressed interest in receiving assistance to begin the process of establishing a regime to protect the financial sector from money laundering and the financing of terrorism (AML/CFT). If legislation is enacted as envisioned, a number of steps—including establishing an action plan for issuing regulations and guidelines, and creating the necessary institutional structures—will be required to implement and enforce the new law. The Bank stands ready to assist in these efforts.
- 16 In a sense, IAP is the equivalent of the MTEF with regard to reform implementation resources.
- 17 These are also the basis for the IMF PRGF. For more details on the IMF program in Nepal, see footnote 41 and Appendix IV.
- 18 The complete PRS policy matrix is contained in Annex B11. This matrix—in which the outcomes and milestones supported by this CAS are highlighted—also elaborates other donor support to realizing the PRS objectives and outcomes.



The Country Assistance Strategy

A. The Context

B. The Bank's Strategy for FY04-FY07

C. Portfolio Management

A. The Context

43 The Bank finds itself in a particularly strong partnership with HMGN. More specifically:

- While many aid agencies maintained high levels of aid to Nepal in recent years, the Bank took a firm position on governance and sharply cut back new lending during FY99-FY02. Highlighting poor governance as the central obstacle to development, the Bank's stance strongly resonated with the reform-minded in Nepal. It has also convinced HMGN that the Bank is not driven by any 'lending pressure' and that it is truly concerned with poverty reduction. The Bank can, therefore, engage in policy dialogue from a position of considerable credibility;
- The Bank has been closely supporting several key reform measures taken over the last few years, including the MTEF, the IAP, financial sector and transfer of public schools to community management. This has established unusually strong collaboration between the reform leaders and the Bank. In many areas, the

Bank is relied on as a trusted advisor to the reformers, giving the Bank an important role as a 'facilitator of change'; and

- The Bank is the only donor with significant headroom for increasing lending levels just when HMGN is in serious need of additional resources, especially programmatic support. This gives the Bank not only strong influence, but also a heavy responsibility as the fiscal ability to implement the PRS may depend to a large extent on what the Bank decides to do.

44 Furthermore, in each of the PRS pillar areas, the Bank has already undertaken considerable background work, and as such, has a strong base to build on. In **broad-based economic growth**, the Bank's assistance over the last few years has focused heavily on the quality of public expenditures, the soundness of the financial system and the investment climate (see Box 7). The Bank has also supported reforms and investments in key infrastructure sectors, like the main road network, inland container terminals and customs facilities, rural roads, power generation, and telecommunications.¹⁹ In

THE BUSINESS**ENVIRONMENT IN NEPAL**

An investment climate survey—*The Business Environment and Manufacturing Performance in Nepal*—was finalized in FY01. Based on a survey of private manufacturing enterprises, the report's key findings are that poor implementation of reforms, bureaucratic burdens and continued political/policy uncertainties are the greatest obstacles to doing business in Nepal. More

specifically, although policies are often perceived as well-designed, they are often changed and implemented so inconsistently that they contribute to an unpredictable and risky business environment. In addition, firms suffer considerably from excessive bureaucratic red tape, long delays in provision of public services and having to deal with corrupt public officials. These problems are often facilitated by lack of clarity

in laws and regulations, and unpredictability and inconsistencies in policies. The implementation of the tax regime, import regime and labor laws are specific areas that significantly affect firms and need to be urgently addressed. Private sector development—including establishing a supportive business environment—will be an important theme in the Bank's work under the broad-based economic growth pillar.

agriculture, the Bank has supported transfer of small irrigation schemes to farmer management, and improvement in research and extension services.

45 In **human development**, the Bank has focused on improving the quality of education and health care, through a HMGN-led, sector-wide approach. Supported by the analytical work completed in FY01 (i.e., *Priorities and Strategy in Education Sector Reform*) there has been considerable progress in basic and primary education, with a number of donors participating in a basket funding approach to a common program. The Bank has also played a pivotal role in supporting the transfer of public schools to community management. In health, the Bank is actively supporting an important shift to a sector-wide approach, as well as the devolution of sub-health posts to local communities. Furthermore, the Bank has been instrumental in expanding demand-

driven, community-based rural water and sanitation schemes.

46 In the area of **inclusion**, aided by a policy note—*Towards a Sustainable Approach for Poverty Reduction and Decentralization*—the Bank has led the dialogue on the PAF and encouraged HMGN to use this as the main instrument to reach out to marginalized groups that tend to be overlooked by existing institutions. In specific community-based projects—e.g., Rural Water and Sanitation—the Bank has begun to address social exclusion issues more vigorously. In promoting universal primary education, the Bank has also been engaging HMGN to design ways to improve access by disadvantaged groups.

47 In **governance**, the Bank has taken a very clear and strong stance since the last CAS. The reforms in public expenditure management and banking are as much about governance as efficiency. Decentralization

has also been a key focus area, both through specific projects that have tried to give local governments greater roles—e.g., Rural Infrastructure LIL—and through analytical work—focusing especially on the fiscal decentralization framework. The Bank, in close coordination with committed HMGN teams, has conducted a *Country Procurement Assessment Review* (CPAR, FY01) and *Country Financial Accountability Assessment* (CFAA, FY02), and in each case is following up with Institutional Development Fund (IDF) grants to strengthen relevant institutions and implement main policy recommendations (see Appendix V). Finally, anti-corruption actions have been a continual theme in the Bank's policy dialogue.

B. The Bank's Strategy for FY04-FY07

The Strategy: PRS-Based and Outcomes-Focused

48 The Bank's strategy will build on the achievements under the 1998 CAS—which in short were to facilitate the beginnings of determined reform efforts—and support the Nepali-led reform process in a significant span and depth. Thus, in operational terms, it may seem to be simply supporting key elements under each of the PRS pillars. It is, however, backed by a successful process of supporting the reform dynamics that have been gaining strength. This strategy was presaged in the CAS PR which articulated continuation of focus on improving governance—by bringing resources to grassroots levels and improving development effectiveness—but with increased emphasis on growth and inclusion. The seven broad strategic instruments associated with the PRS (see paragraph 40) are equally important in the approach the Bank has emphasized. Furthermore, the spirit of focus on selective outcomes embodied in the IAP is consistent with the outcomes-

based approach that has been pursued in the Bank's work program in Nepal for the last two years.

49 While it is easy to agree that the focus should be on development outcomes, it is not so easy to define the Bank's accountability for such outcomes, for in the end the Bank's role is only to facilitate or support the changes in a country. Thus, there is a danger that an attempt to hold staff 'accountable' for outcomes will lead the Bank to select only outcomes that are nearly certain. Clearly, failing to support riskier but more important outcomes would be a mistake. To resolve this tension, a structure has been developed over the last two years and the same approach is envisioned for the future. Specifically,

- An 'outcome' is a significant change that would be highly desirable and possible within the four-year CAS horizon. For the immediate year ahead, a specific 'milestone'—i.e., key step toward achieving the four-year outcome—is defined;
- Each outcome is expected to have less than 100% probability of happening, even with best efforts on the part of the Bank;²⁰
- The matrix of outcomes is seen as a 'portfolio' in its entirety—i.e., consisting of some high-probability, but relatively low-impact outcomes and some low-probability, but high-impact outcomes. To avoid extremes, the portfolio of outcomes is constructed with an expected overall success rate of around 65–70%;²¹
- The matrix and annual milestones are updated each year, with some outcomes replaced—either through achievement or a change in strategic priorities—and new milestones defined;
- Rather than holding staff accountable for achievement of specific outcomes, the Country Team is collectively held accountable for the overall outcome of the portfolio;²² and

Table 3: CAS Outcomes

Development Results*	CAS Outcome
Broad-Based Economic Growth	
Improved public expenditure management	<ul style="list-style-type: none"> ■ Outcome focused budgeting and monitoring in place ■ Magnitude of SOE financial problems recognized by HMGN and strategy/ action plan developed ■ Reform labor laws to allow greater flexibility in employment ■ Lowered costs of doing business by liberalizing business support services ■ Increased institutional capacity for trade policy formulation/implementation
Expanded private investment trade and employment opportunities	
Strengthened financial sector	<ul style="list-style-type: none"> ■ NRB performing regulatory and supervision functions effectively ■ RBB/NBL privatized or liquidated
Increased agricultural growth and broad-based rural development	<ul style="list-style-type: none"> ■ Improved enabling environment for factor and output markets ■ Increased agricultural productivity and farm incomes
Well-developed road network	<ul style="list-style-type: none"> ■ Percentage of main road network in poor condition reduced to 10% ■ Share of population with close access to roads increased by 4%
Improved telecommunication	<ul style="list-style-type: none"> ■ Private operator introduced for rural telephone service in Eastern Region
Expanded coverage and improved quality of electricity	<ul style="list-style-type: none"> ■ Improved efficiency of NEA (as measured by a reduction in system losses to 20%), combined with greater private sector participation ■ 30,000 additional households in remote areas served by micro-hydropower
Social Sector Development	
Improved quality of and access to primary, secondary and tertiary education	<ul style="list-style-type: none"> ■ 25% of public schools under community management, and providing socially inclusive and higher quality education ■ Efficient and timely textbook distribution system in place, as measured by all primary school children having books at the beginning of the school year ■ Progress towards financial sustainability of public universities
Improved basic health care services, with emphasis on poor/underserved populations	<ul style="list-style-type: none"> ■ Essential health care services implemented in 25 districts, at least half with low health indicators ■ Extend rural water supply to an additional 10% of the onpopulation ■ Extend coverage of sanitation services to an additional 5% of the rural population
Improved quality of and access to sustainable rural drinking water and sanitati	
Social Inclusion and Targeted Programs	
Social inclusion promoted through equitable education	<ul style="list-style-type: none"> ■ Reduced out of school primary aged children (primarily girls, Dalits and disadvantaged Janajati groups) by 50%
Improved fiscal transfers to disadvantaged groups	<ul style="list-style-type: none"> ■ Increased public funds used by disadvantaged rural groups for services
A civil service that better reflects the gender, caste and ethnic diversity of Nepal	<ul style="list-style-type: none"> ■ Affirmative action policy and implementation system for improving the diversity of the civil service in place and functioning
Good Governance	
Enhanced development through stronger locally elected governments	<ul style="list-style-type: none"> ■ Decentralization (as designed in the Local Self Governance Act) advanced substantially, with good monitoring systems in place
Improved incentives and mechanisms to ensure a more performance oriented and accountable public serviceservice.	<ul style="list-style-type: none"> ■ Clear delineation of responsibilities between Ministers and civil service to ensure autonomy and accountability of civil Improved accountability and transparency

* Items in **BOLD** are objectives associated with actions in the Immediate Action Plan (IAP); see Annex B11 and Appendix III.

- The same approach is applied to a set of annual milestones as well, so that annual performance can be monitored against some expected overall achievement rate.

50 Based on this framework for work programming, this CAS has identified 15 PRS areas—out of the 34 PRS areas—that are central to poverty reduction and are consistent with the Bank’s relative strengths vis-à-vis Nepal’s other development partners. They spell out the broad ‘development results’ or outcomes that the CAS will focus on. While the importance of these results are obvious, the CAS timeframe is too short to set direct and measureable targets for them. Therefore, these 15 higher level outcomes are translated into 26 intermediate outcomes—corresponding to the base case scenario described in paragraph 64—that are specific and meaningful for the FY04-FY07 period. In a high case scenario—with acceleration of reforms—the matrix would likely be updated to include more outcomes. These outcomes were selected based on four key criteria:

- In each priority area, the outcome is representative of the broader change envisioned by the PRS. Thus, it is not the only change expected. If this particular change is happening, many associated changes are likely happening, thereby contributing to the larger PRS goals;
- As much as possible, the outcomes should be linked to an action in the IAP to ensure high priority accorded by HMGN;
- In general, the outcome is clearly defined, measurable and feasible;²³ and
- In applying the selectivity principle, the Bank has a comparative advantage in facilitating the outcome and has a well-developed strategy to contribute materially to its realization.

51 The outcomes matrix is organized around the four PRS pillars and presented in

two parts. The 15 areas and 26 specific outcomes for the CAS period are displayed in Table 3. A more detailed matrix (see Annex B10) describes briefly, for each outcome, the Bank’s strategy for achieving it, annual milestones, Bank instruments and key partners. Specific annual milestones for FY04 are provided for each outcome with some additional milestones for subsequent years. As noted, these annual milestones are updated each year, and as such, milestones for FY05, FY06 and FY07 should be seen more as indicative. The more detailed matrix also links the CAS outcomes to specific country outcomes identified in the PRS, showing the strong linkage between the Bank’s contributions and the country’s goals as established in the PRS.²⁴

Cross Cutting Themes

52 Gender and Social Inclusion. For the successful implementation of this CAS, there are a number of cross cutting themes—specifically, gender and social inclusion, fiduciary and environmental policies, and capacity building—that deserve special mention. In rural areas, the women’s critical role as economic providers—either through unpaid labor on the family farm or as wage workers for others—is widely recognized. Indeed, the poorer the family, the greater its reliance on the skills and labor of female family members for economic survival. While there is great variation in the gender systems of different ethnic and caste groups in Nepal, all of them to some extent discriminate against women in terms of access to property, investments in health and especially education, and in the degree to which women’s voices are heard in community decision-making or national governance.

53 Gender is clearly one important dimension of social exclusion in Nepal, however, more recently—especially in the

THE RESPONSE TO ENVIRONMENTAL CHALLENGES

HMGN has responded to the environmental challenges by incorporating conservation activities in sectoral plans and programs. Furthermore, environment-related provisions have been incorporated in various acts such as: (i) the Local Self-Governance Act (1998) that specifies the role of DDCs and VDCs in environmental planning, forest and biodiversity conservation, land-use management, and public sanitation; (ii) the Forest Act (1992), and the National Parks and Wildlife Conservation Act (1973 and amended in 1993) that provide for community involvement in forest

management and species conservation; and (iii) the Environment Protection Act (1996) and the Environment Protection Rules (1997) that contain provisions for institutionalizing environmental impact assessment and expanding pollution control activities. In addition, a National Environmental Policy and Action Plan was prepared (1993) to help implement Agenda 21 of the Rio Earth Summit; an Environment Protection Council was constituted as a policy advisory body (1992); and a Ministry of Population and Environment (MoPE) was established (1995). Nepal is a party to 16 environment-related international Conventions and Agreements, including CITES and ITTA.

Despite these efforts to address environmental management, weak institutional capacity and poor coordination between MoPE and sectoral agencies has constrained the implementation of environmental policies and programs. There is also a significant gap between the content of the international environmental conventions and their implementation at the national level. There are many donors (e.g., Denmark, Germany, UNDP, UNEP) and international (e.g., WWF, IUCN) and national (e.g., King Mahendra Trust for Conservation of Nature) NGOs active in the environmental arena and funding is not a constraint.

years following the reinstatement of democracy—other dimensions of social exclusion—namely caste and ethnicity—have come into greater prominence as indigenous groups (Janajati) and formerly ‘low caste’ (Dalit) groups have been able to organize and speak out. In response to this—and to the insurgents’ criticism that the Nepali state has largely been in the hands of males from the dominant caste and ethnic groups—the PRS has recognized the disparities resulting from gender, ethnicity and caste. To better understand the institutional underpinnings of caste, ethnic and gender-based social and economic exclusion in Nepal and how these affect

poverty outcomes—as well as the options for policy and institutional reforms—a Social and Gender Analysis is currently being carried out and will be completed in FY04. Furthermore, in all interventions—especially in the sector-wide approaches to be employed in education, rural water supply and health—efforts will be made to ensure that social and gender inclusion issues are explicitly recognized and receive close attention. To ensure that gender and social aspects are fully integrated at both the project and policy level work of the Nepal program, in the last year a Lead Social Scientist was posted in Kathmandu.²⁵

54 Fiduciary and Environmental Policies. Similarly, in implementing the CAS, ensuring adherence to sound fiduciary and environmental policies will be crucial. As mentioned, a CPAR was finalized in FY01 and a CFAA was completed in FY02 (see Appendix V), with IDF grants supporting implementation of the key recommendations.²⁶ While the legal and regulatory framework for ensuring public sector financial accountability is impressive, implementation—including compliance with the framework—is generally weak. In the area of procurement, very few countries today still follow the system used by Nepal—under which public procurement is governed by a set of financial rules issued by the Government—and hence, the major need is to enact a modern, transparent, and competitive public procurement law.

55 Despite a rather comprehensive framework for environmental protection, in addition to weak capacity and poor coordination, the main environmental challenges in Nepal pertain to the sustainable use of natural resources and adequate integration of environmental planning in development programs and their implementation. In response, HMGN has incorporated conservation activities in selected sectoral plans and programs, while environment-related provisions have been incorporated in various acts (see Box 8). Among the accomplishments: (i) the donor-supported Community Forest Program has been successful in helping to reverse deforestation in the hill regions; (ii) endangered mammal species have been recovered in the Terai; and (iii) careful attention to designated conservation areas supported by eco-tourism have had important impacts on poor and remote rural communities. Beyond the five key environmental issues—forest depletion, soil degradation, solid waste management, water

quality and air pollution—a number of new challenges have emerged, such as rapid but uncontrolled and haphazard urbanization (resulting partially from insecurity and violence in rural areas), glacial lake outburst floods, arsenic contamination of groundwater, indoor air pollution from biomass burning and food contamination. With the large donor and NGO presence, Bank involvement in the environmental agenda will be selective and focus on helping HMGN articulate an effective strategy for environmental conservation and management and capacity building. Accordingly, a Country Environmental Analysis (CEA) is planned for FY05. Using this as a basis, we would focus on possible outcomes for Bank support and then determine appropriate instruments. Given Nepal's biological diversity, however, there are possibilities for use of funds from the Global Environmental Facility (GEF)—e.g., support to sustainable gathering, processing and marketing of high value plants and herbs, micro-hydropower, or remediation of glacial lake outburst floods. There are also good prospects for implementation of programs supported by the Prototype Carbon Fund (PCF) and the Community Carbon Fund (CCF)

56 Capacity Building. As institutional weaknesses and lack of capacity are well-recognized constraints, an important cross cutting theme of the CAS is capacity building. According to some estimates, over US\$100 million per year is spent by donor agencies and INGOs in Nepal on what can be broadly termed 'capacity building' activities. The outcome is clearly very disappointing, and both HMGN and donors agree that a serious rethinking is in order. There is, however, an entrenched thinking to equate provision of consultants and training with capacity building, which in part explains the continued attempt to

‘throw money’ at the capacity building challenge.

57 A strong public sector institution requires: (i) sound institutional set-up; (ii) ‘enabling environment’ for the institution—especially a system that shields the institution from undue political interference and rewards professional performance; (iii) good people—which requires a performance-oriented and financially decent incentive system as well as training; and (iv) experience. In Nepal, development partners have tended mainly to focus on institutional set-up and training people, without paying sufficient attention to the other aspects or finding effective ways to get at them. Improving the ‘enabling environment’ and creating a performance-oriented incentive system are inherently political processes, and donors can only encourage indigenous efforts. Thus, donor support needs to be somewhat opportunistic. An important dimension that has tended to be neglected by donors is helping the institutions to build experience. If anything, by substituting for HMGN’s own work, development partners may have tended to hamper the ability of Nepali institutions to strengthen through experience. The Bank’s knowledge in supporting key reform initiatives indicates that capacity building is more about creating space for the Nepalis to think for themselves and act on their own, and providing knowledge only where it is specifically demanded.²⁷ Money is seldom the real constraint to capacity building in Nepal. Based on this perspective, the Bank’s efforts will focus on:

- Facilitating country-led changes, as in the end this is what capacity building is about. The primary concentration will be on helping HMGN build its own policy formulation and implementation capacity at the central level through experience. This effort depends critically on the ability of the country-based staff—especially

Nepali staff—to engage and motivate HMGN counterparts in reform thinking, backed by the ability to bring in global knowledge from the rest of the Bank and/or internationally as needed. While this concept of decentralization is already working well, further efforts will be made, especially to strengthen the capacity of the country-based staff; and

- Where there are legitimate needs for more traditional TA and training that arise from the Nepal-led and Bank-supported reform efforts, the Bank will continue to be prepared to provide such assistance through a variety of means. Since all IDA-funded projects involve important reform elements, almost all include TA and/or training components. To maximize their impact, however, the Bank relies heavily on identification of needs by the reform leaders themselves. In some areas—such as public expenditure management, monitoring and evaluation in conjunction with PRS implementation, and improving financial accountability systems—TA and training of central importance will be supported by IDF grants and direct TA.

Instruments to Achieve the CAS Outcomes

58 A critical element for achieving the CAS outcomes is an internal alignment of the work program with the outcomes. The formulation of the annual work program is used as an important process to develop a consensus on the annual milestones toward achieving the longer term CAS outcomes, and the broad strategy and specific instruments to reach those milestones. This has helped to develop organic integration of a range of AAA instruments (e.g., formal reports, informal policy notes, TA, seminars, policy dialogue, strategic communication) and lending instruments. It has also enabled much more effective cross-sectoral efforts directed toward the shared outcomes. This process, combined with regular monitoring

of progress from the outcomes perspective, is the cornerstone of the outcomes-based approach.

59 In relation to many outcomes, AAA will continue to play an important role and will be used more consciously to overcome specific obstacles to reforms. During the past four years, while the lending program remained in the low case and the work program focused on motivating reforms, the Bank learned to use AAA more strategically for engaging Nepali authorities in policy dialogue and has been effective in evoking change. The shift by the Bank toward an outcomes-focused approach also changed the nature of AAA. From the outset, each AAA piece is conceived as part of a strategy to help facilitate some specific development outcome. This has led to two important changes: (i) unlike in the past, dissemination of AAA outputs is no longer an afterthought, but is an integral part of the motivation for the AAA task itself; and (ii) there is much greater use of small, informal, and targeted reports that are designed to help the reform leaders in Nepal themselves rather than bulky reports whose target audience is often unclear. Under this CAS, these trends will continue. In addition to supporting the MTEF, IAP and overall structural reform efforts, dialogue and TA will continue to be used widely to help achieve the CAS outcomes, including in power, higher education, fiscal decentralization, civil service reform and special interest issues such as child labor and trafficking.

60 Going forward, formal AAA will continue to help lay a foundation for building the agenda and needed consensus for reform (see Table 4). Contributing to the completion of all core diagnostic pieces²⁸ and helping to prioritize future policy reform areas, a *Development Policy Review* (DPR) is envisioned for FY04, along with key studies on agriculture, labor remittances, and a

Table 4: Formal AAA, FY04-FY07

FY04
Development Policy Review
Note on Rural Sector Issues
Social and Gender Assessment
Study on Labor Remittances
FY05
Poverty Report
Public Expenditure Analysis—Evaluating the MTEF
Public Expenditure Analysis—The SOE Sector
Country Environmental Analysis
Rural Factor Market Study
FY06
Country Economic Report
Financial Sector Reform: Lessons and Next Steps
Update on Child Labor
FY07
An Evaluation of Community Managed Schools
Re-evaluating Social and Gender Issues
Update on Fiduciary Assessments

social and gender assessment. Also during the CAS period, important work will be undertaken analyzing the impacts of the financial sector reforms and providing an update of the child labor situation,²⁹ as well as continuous public expenditure analysis.

61 The **International Finance Corporation (IFC)** and **Multilateral Investment Guarantee Agency (MIGA)** will both play important—albeit relatively limited—roles in the implementation of the strategy. **IFC** will continue to support export-oriented manufacturing, private investment in telecommunications and power generation and distribution, financial market development, and the growth of small and medium enterprises (SMEs). Due to the still weak security situation and political uncertainties, currently there are few investment opportunities in Nepal large enough for direct financing, so IFC does not expect to make many new investments during the CAS period. Instead, IFC will focus on technical assistance for SMEs through the South Asia Enterprise

Development Facility (SEDF) based in Dhaka. This facility—funded by IFC in partnership with Canada, Netherlands, Norway, the UK, Asian Development Bank (ADB) and the European Union (EU)—will deliver programs in Nepal to increase access for SMEs to financing and business development services, improve the business environment for SMEs and develop linkages with larger enterprises. SEDF will closely coordinate with the Bank’s efforts in the financial sector to provide TA and training to banks, including introducing best practices and new products for SME lending. SEDF will also work with selected business associations in the agribusiness and tourism sectors. SEDF intends to locate a staff member within the Kathmandu office to manage these programs. Over the upcoming CAS period, **MIGA** will continue to support suitable foreign direct investments into Nepal as they present themselves.

Bank Group Scenarios

62 Given the current rather significant political uncertainties, the CAS must be able to respond constructively to a wide range of possible eventualities. Without a doubt, the greatest source of uncertainty is the insurgency. If a peace settlement is reached, there will likely be a need for a large scale ‘nation re-building’ program and the Bank would be expected to be part of it.³⁰ On the other hand, renewed hostilities could turn more intense and severely curtail the ability of HMGN to implement the PRS. In either of these extremes or in between, the nature of the reforms envisioned in the PRS will remain relevant. Therefore, it is useful to think of the following three scenarios that naturally correspond to the standard CAS scenarios:

- **Base (‘central’) case**—in which the hostilities are limited or not severe enough to interfere seriously with development work and the current reforms continue to move forward;

- **Low case**—in which renewed hostilities hamper implementation of the PRS—thus, reducing the external funding needs—or the reform efforts themselves become stalled—thus, making it difficult to justify high levels of IDA funding; and
- **High case**—in which it is assumed that a peace agreement is reached and/or the reforms accelerate, thereby creating both a need and environment for larger aid flows.

63 In all scenarios the scope and nature of the reforms identified in the PRS remain valid and as such, the CAS outcomes remain relevant.³¹ The main difference between the various scenarios would be the speed at which Nepal can be expected to achieve each of the specific outcomes. Therefore, the broad work program that flows from the PRS matrix is expected to be fairly resistant to these very different possible circumstances. Besides the peace dimension, from the reform perspective there are also important uncertainties arising from possible changes in the cabinet before or after national elections. Although the PRS agenda is broadly supported by most political leaders, if only tacitly, short term political dynamics could cause slowing or even backsliding in the reform process (as discussed below in the risk section). To maximize the chance of the reform process being sustained, the lending levels for the three scenarios are significantly different, thereby reconfirming the message that the Bank’s financial support will be tightly linked to the speed of reforms. These lending levels, along with the key triggers, are highlighted in Table 5.

64 A notional **base case lending scenario** is presented in Table 6 in which the IDA lending program would average about US\$190 million per year, consistent with Nepal’s current IDA allocation.³² In each year, the lending program would be anchored in a PRSC providing programmatic support to the implementation of the PRS/

Table 5: Key Triggers for CAS Scenarios

Scenario (average annual lending range)	Key Triggers
Low Case (US\$0-50 million)	<ul style="list-style-type: none"> ■ Implementation of annual IAP falls significantly short of targets (less than half attained). ■ Decentralization of basic service delivery—especially in education and health—stalls. ■ Banking reform stalls—i.e., restructuring by FY05 not in sight. ■ Management of public expenditures weakens—i.e., weakened application of MTEF/project prioritization system/similar mechanisms. ■ Anti-corruption drive loses momentum.
Base Case (US\$120-200 million)	
High Case (US\$200-250 million)	<ul style="list-style-type: none"> ■ Annual IAP implementation is complete and the process is deepened. ■ Decentralization of basic services accelerates. ■ Fiscal decentralization accelerate, with full decentralization implemented in some districts. ■ Strong measures implemented to improve access to basic education for disadvantaged children. ■ NBL/RBB restructuring plans agreed and implementation initiated. ■ Continued satisfactory portfolio performance to confirm absorptive capacity.

IAP (see Box 9). The first PRSC aims to: (i) support Nepal's reform champions in implementing far-reaching reforms that revive growth, improve service delivery, promote social inclusion and improve governance; and (ii) contribute to maintaining a sound macro framework and in protecting high priority anti-poverty programs by filling part of Nepal's financing gap. Future PRSCs will focus on key elements that are critical to achieve the CAS outcomes. In the broad-based growth pillar, these include: (i) public expenditure management; (ii) labor market; (iii) infrastructure (e.g., the main road network and rural roads); and (iv) financial sector reform. In social sector development and inclusion, the focus will be on improving service delivery—in education, health and water/sanitation—in addition to implementing targeted programs for excluded groups. Finally, in governance the focus will be on public/civil service reform as well as re-activating and strengthening the decentralization process.

65 In each year, the PRSC would be complemented by three or four investment or sectoral operations to support key programs in the focus areas. With increasing emphasis on growth, the lending program will continue to focus on infrastructure investment. Since the existing portfolio already has a strong tilt toward infrastructure, the base case lending program does not show large new infrastructure projects. In part, this also recognizes the difficulty of implementing large-scale projects during a conflict. Nevertheless, if the opportunities arise, financial support for infrastructure can be readily increased through both the PRSC and, in case of peace, additional investment operations. The necessary technical work has been built into the base case program.

66 Given its low income level, it is assumed that Nepal will continue to receive a portion of its IDA allocation in the form of grants at least for a part of the CAS period.³³ HMGN has expressed a preference to use IDA

Table 6: IDA Base Case Lending Program: FY04-FY07 (values in US\$ millions)

FY04	235.0
Poverty Reduction Support Credit I	70.0
Basic and Primary Education Project, Phase II	50.0
Poverty Alleviation Fund	15.0
Rural Water Supply and Sanitation II	30.0
Financial Sector Restructuring, Phase II	70.0
FY05	185.0
Health Sector Operation	50.0
Poverty Reduction Support Credit II	70.0
Rural Access Improvement	30.0
Reform Technical Assistance/Capacity Building	10.0
Higher Education	25.0
FY06	205.0
Agriculture Sector Operation	30.0
Poverty Reduction Support Credit III	70.0
Poverty Alleviation Fund II	30.0
Financial Sector Restructuring, Phase III	75.0
FY07	140.0
Poverty Reduction Support Credit IV	70.0
Infrastructure Development	40.0
Decentralization Support	30.0

grant financing for: (i) key priorities in the social sectors (including for PAF), and (ii) for technical assistance.³⁴ Although the base case lending program represents a significant increase in the level of IDA lending to Nepal (the base case was US\$70-120 million under the 1998 CAS), this should not pose any debt service difficulties. With a highly concessional debt structure, the public debt service to GDP ratio stands at a modest 1.6% and external debt servicing is only about 7.5% of exports of goods and non-factor services.³⁵

67 In a **low case scenario**, the lending volume would be significantly less than in a base case—i.e., averaging US\$0-50 million per year. The nature of IDA assistance in the low case would depend on its circumstance. If the cause is renewed hostilities—and the consequent narrowing of the reach of HMGN—then it would be appropriate to cut

back on investment operations to account for the reduced physical scope of reform implementation. On the other hand, if the cause is slow implementation of the reforms, then the focus of lending activities would revert back to supporting decentralization and community-based projects (which would likely lay the foundation for better governance dynamics in the future) and whatever specific reforms that nonetheless managed to proceed at the central level.

68 A **high case scenario**—associated with peace and/or an acceleration of the reform program—envisions annual lending levels averaging US\$200-250 million. Related to reform acceleration, the high case would be triggered by stepping up fiscal decentralization efforts, as well as accelerating decentralization of basic services, initiating the restructuring of the two large commercial banks, and deepening implementation of the IAP (see Table 5). The nature of the additional support in a high case would likely include some additional interventions related to ‘nation re-building’ activities, but it is difficult to be very specific about such interventions at this time, as they must emerge from the peace process itself. With the prevailing uncertainties, there may be a need to revisit the assistance strategy in eighteen to twenty-four months or even sooner. As such, a CAS PR will be prepared at least by early-FY06 or as the situation warrants.

C. Portfolio Management

IDA
69 The operating environment in Nepal has been characterized by weak public management, a low skills base, political instability and the aftermath of an armed insurgency that has affected a majority of the country’s 75 districts. Despite these heavy

FINANCIAL MANAGEMENT BROADLY DEFINED

When evaluating whether a country is considered 'ready' for programmatic support, it is common to evaluate its financial management capacity. Financial management, however, should not be equated with narrow matters of financial rules and regulations. But, it is fundamentally concerned with effective use of financial resources. First, therefore, financial management is about good resource allocation. Through the MTEF, HMGN's resource allocations have improved considerably over the last two years, eliminating much of the fat,

imposing a firm budget ceiling and prioritizing development expenditures. Second, financial management is about improving service delivery modalities. Through many programs initiated during the last two years-e.g., transferring management of schools and sub-health posts to local communities-HMGN has demonstrated commitment to improving service delivery. Finally, at the next level, financial management is about providing decision-makers with sufficient, accurate and timely financial information to evaluate: (i) overall public sector financial management performance; (ii) steward-

ship of resources placed under public sector control; and (iii) the extent to which resources are used in accordance with prescribed budgets and mandates. Although admittedly further strengthening is required, there are serious programs under way-e.g., implementing the CFAA recommendations, capacity building for accounting and auditing staff, and increased monitoring of financial and physical progress. Therefore, when looking more broadly at financial management, Nepal has come a long way and has fully demonstrated its seriousness to tackle the right issues.

odds, project implementation performance and outcomes have improved in the last five years. On many accounts—satisfactory outcomes, project sustainability and institutional development—performance of the Nepal portfolio substantially improved and compares favorably to both the region and Bank (see Table 7). As such, overall the Bank's contribution to development in Nepal in the last five years can no longer be considered as "*unsatisfactory* in outcomes, *modest* with respect to institutional development impact and highly *uncertain* in terms of sustainability" as summarized in the Country Assistance Evaluation (CAE) by the Operations Evaluation Department (OED).³⁶ Furthermore, more recently there has been greater borrower commitment as shown by adequate levels of counterpart funding and

efforts to improve project staffing and management. While in the past project implementation has suffered from political interference—in part seen through frequent staff transfers—the dedication and commitment of reform-minded senior civil servants and project staff have helped to achieve the improved outcomes. Perceived or real corruption and lack of accountability in public institutions remain a drag on project performance, but recent actions by the public sector to rectify these ills should help to improve accountability and strengthen governance.

70 Following the implementation of Portfolio Implementation Plans (PIPs) in FY99 and FY00³⁷—which included actions to improve the performance of individual

Table 7: Project Performance at Exit

	Nepal		Regional	Bank
	FY77-89	FY90-97	Average	Average
Number of projects	27	26	140	1,236
Satisfactory outcome	63%	64%	77%	74%
Likely sustainable	44%	16%	64%	64%
Sustainable institutional development	23%	28%	42%	44%
Bank performance (supervision)			83%	81%
Borrower performance (implementation)			66%	67%

Note: Regional and Bank averages are for the period FY98-02.

Source: OED audits of Implementation Completion Reports (ICRs) and Project Completion Reports (PCRs).

projects, as well as specific measures to address generic issues—there was a remarkable improvement in the status of the Nepal portfolio, with projects at risk dropping to 13% of the portfolio. This was not to last, however, as the declaration of a national emergency in November 2001 resulted in an escalation of violence and impaired security. This affected much of the portfolio—especially in the remote and less developed mid- and far-western regions—with IDA unable to carry out adequate supervision and project activities slowing or even coming to a halt in some instances under force majeure. By January 2003, 43% of the projects and over 70% of IDA commitments were considered at risk, but following the cessation of hostilities, there had been a steady improvement and by end-FY03, the

portfolio risks have been reduced to more manageable levels (see Annex B2). The Bank shares the experience with other donors that truly community-owned projects tend to be largely unaffected by the insurgency.

71 The current IDA portfolio in Nepal consists of nine active projects, of which five are due to close in the next eighteen months (see Table 8). Active operations as of September 15, 2003 represented an aggregate IDA commitment of about US\$298 million (net of cancellations), of which US\$167 million remains undisbursed. The portfolio declined from fourteen projects in FY98 to eight projects in FY01/FY02 as a result of the low lending levels since FY99, closing of aging projects and a deliberate policy to ensure adequate quality at entry.

Table 8: IDA Portfolio Trends and Performance: FY99-FY04 (As of September 15, 2003)

	FY99	FY00	FY01	FY02	FY03	FY04
Number of projects under implementation ^{1/}	10	9	8	8	10	9
Average implementation period (years) ^{2/}	3.6	3.1	3.7	3.7	3.2	3.3
Commitments (US\$ million)	17.5	54.5	0.0	22.6	96.6	0.0
Disbursements (US\$ million)	59.9	46.1	47.3	38.0	27.2	6.2
Number (%) actual problem projects ^{3/}	2 (20.0)	2 (22.2)	1 (12.5)	1 (12.5)	2 (20.0)	2 (22.2)
Number (%) projects at risk ^{4/}	6 (60.0)	5 (55.6)	1 (12.5)	2 (25.0)	2 (20.0)	2 (22.2)
Proactivity index	100	100	100	100	100	100
Realism index	33	40	100	100	100	100

^{1/} As shown in the Annual Report on Portfolio Performance, including GEF.

^{2/} Average age of projects in the portfolio as of the end of each FY.

^{3/} Projects rated U or HU (unsatisfactory or highly unsatisfactory) on Development Objective (DO) or Implementation Progress (IP).

^{4/} Number of actual and potential problem projects.

With the move to the base case in December 2002, the portfolio has increased slightly.

72 Despite the noted improvements, the portfolio remains at risk and could be adversely affected by a resumption of insurgent activities or a period of protracted political instability. To mitigate the risks, the Bank—primarily through the staff in the country office—has been proactively supporting and monitoring project implementation. In this effort, the Bank, together with HMGÑ, ADB and the Japan Bank for International Cooperation (JBIC) have been carrying out joint Nepal Portfolio Performance Reviews (NPPRs) since 2000. The main objective of these reviews is to discuss generic issues affecting portfolio management—such as security, passage of laws and regulations, procurement, financial management and safeguards—and agree on time-bound action plans to resolve the identified issues. A memorandum of understanding is signed by all parties and the actions are closely monitored and reviewed semi-annually. The most recent review was conducted in October 2002, with a mid-term review taking place in May 2003.³⁸ These joint reviews are complemented by quarterly reviews of the implementation progress of IDA projects, along with close supervision and monitoring with frequent site visits. In addition to placing emphasis on quality at entry and quality of supervision, Bank staff are active in identifying and resolving potential issues before they become problems.

73 A number of initiatives—i.e., the preparation of the CPAR, the CFAA and Public Works Directives with ADB assistance—have provided a sound framework for addressing generic implementation issues and improving the general operating environment. Special committees have been established to

implement the CPAR and CFAA recommendations, and are expected to modernize, as well as simplify and streamline, the public procurement and financial accountability regimes, resulting in a higher level of transparency in public procurement and enhanced accountability in financial transactions. Portfolio performance is expected to improve further with the implementation of performance-based budget allocations and fund releases under the MTEF, and systematic project and program monitoring by sector agencies and the NPC. There is an increasing awareness to strengthen environmental and social safeguards in all public investments, but as indicated, implementation remains weak and will require continued support.

IFC

74 IFC's current held exposure in Nepal is US\$79.9 million—US\$53.0 million from IFC's own account and US\$26.9 million in B loans—in four projects, of which two are in private power generation, one in tourism and one in leasing. The investment in the tourism sector was restructured as the performance of the company suffered due to the political instability and insurgency. The remaining portfolio is in good condition, with a loss reserve ratio of only 4% of total exposure.

MIGA

75 To date, MIGA has facilitated estimated foreign direct investment into Nepal in the amount of US\$122.4 million. MIGA's outstanding portfolio in the country consists of four contracts of guarantee for the Himal Power Limited project—a 60 MW run-of-the river project located on a tributary of the Tama Khosi River—which was the first foreign direct investment in the energy sector in Nepal.

- 19 Formal reports include *The Public Expenditure Review* (FY00), *Power Sector Development Strategy* (FY01), *The Business Environment and Manufacturing Performance* (FY01), *The Financial Sector Study* (FY03), and *The Trade and Competitiveness Study* (FY03).
- 20 In practice, the probabilities of 20, 40, 60 or 80% are assigned, recognizing the relatively crude nature of the probability assessments.
- 21 This does not imply that for outcomes that are not fully achieved, there will be no progress. In many cases, it is likely that some progress toward the ultimate outcome will have been made.
- 22 Unless an entirely unforeseen event changes the country setting profoundly, a significant shortfall in reaching the expected rate of achievement would mean either: (i) the initial assessment or strategy was unrealistic; or (ii) the Bank's efforts were inadequate.
- 23 Certain outcomes are stated rather generally for lack of a better definition. In such cases, however, annual milestones tend to be quite specific to help clarify the kind of change the CAS hopes to support.
- 24 In the PRS matrix in Annex B11, in addition to linking the CAS outcomes to the PRS outcomes, the specific intermediate indicators/activities corresponding to each of the milestones are also highlighted.
- 25 This has been made possible in part through the generous support of the United Kingdom's Department for International Development (DfID).
- 26 It is important to note, however, that the team looks at fiduciary issues in a much broader context than that covered by the CFAA. See Box 9 for details.
- 27 Good examples of this are the experience with the introduction of MTEF and development of IAP as noted in paragraph 43.
- 28 As mentioned (see paragraph 47), the CPAR and CFAA have been completed. With regard to other core diagnostic AAA: (i) a PER was completed in FY02 and a number of follow up pieces—evaluating the MTEF and analyzing SOEs—are envisioned for FY05; (ii) a Poverty Assessment was completed in FY99, with an update planned for FY05; and (iii) a CEA is planned for FY05.
- 29 This will follow up on *Understanding Children's Work in Nepal* (March 2003). This study—carried out jointly with ILO and UNICEF—includes a set of recommendations and proposed policy actions that will help formulate a more comprehensive framework for handling issues associated with child labor.
- 30 Purposely, the word 'reconstruction' is avoided, as the reconstruction needs are likely to be modest given that conflict-affected areas tend to suffer from under-investment. Instead, what is required is a major effort to upgrade infrastructure and social services in these regions that have long been under-served.
- 31 As indicated, the outcomes in Table 3 are those explicitly linked to the base case scenario and in a high case scenario there would likely be more outcomes.
- 32 While the base case envisages an average annual lending program of about US\$190 million, there is some uncertainty associated with the ability of HMGN to implement projects under different security and political situations. As such, a realistic range—US\$120-200 million—has been established.
- 33 Availability of IDA grants in FY06-FY07 will depend on the outcome of the IDA14 replenishment deliberations.
- 34 This is consistent with HMGN's Foreign Aid Policy (FAP) that states "technical assistance for project design, institutional and capacity building, technical backstopping, and project monitoring and review are more suitable for grant financing than for concessional loans."
- 35 Nepal is a 'less indebted low-income' country with a ratio of external debt to GDP of 53% and a total public debt to GDP ratio of 70% (end FY01/02). IMF simulations suggest that if key variables remained at their average value of the last ten years, the total debt to GDP ratio would decline to 53% in FY06/07.
- 36 Report No. 19850-NEP, dated November 1, 1999.
- 37 The FY98 Annual Report on Portfolio Performance identified Nepal as a priority PIP country—i.e., a country with more than 50% of the portfolio and/or more than 33% of commitments at risk, with more than eight active projects and/or US\$250 million in commitments.
- 38 The mid-term review acknowledged progress and achievements since the NPPR, noting that the reforms have had a positive impact on portfolio performance. However, a number of generic issues—including effectiveness delays, poor quality of civil works, financial management, and cost and time over-runs—were noted as requiring priority action. The 2003 NPPR will be carried out in November.

4



Implementing the CAS

A. Partnerships

B. Monitoring Outcomes

C. Risks

THE CAS CONSULTATION

PROCESS As noted (see Box 6), Nepal's PRS was prepared through a very consultative process. As such, the overwhelming focus of the CAS consultations has been on aligning donor support around the PRS with emphasis on: (i) discussing the Bank's proposed strategy and its relationship to the PRS to ensure that in the aggregate, donor support is adequate to cover implementation of key PRS

programs; and (ii) identifying specific areas of collaboration. The Bank has worked closely with DfID—which is preparing an outcomes-focused Country Assistance Plan (CAP)—including holding a one-day joint workshop in Kathmandu to discuss ways to support PRS implementation effectively. Taking the collaboration with DfID to a new level of closeness, DfID and the Bank have agreed on a set of PRS-based outcomes as the

common goals for DfID's new CAP and the Bank's new CAS. In addition, small focus groups—with representatives of HMGN, NGOs and civil society—have been convened along the way to discuss various CAS drafts. To be most effective in assisting HMGN implement the PRS, consultation with Nepal's other development partners will be a continuous process throughout the CAS lifetime.

time, Bank assistance and the deployment of programmatic support instruments in particular will provide leverage to Nepali reformers to expand and accelerate this process. Where cross-cutting interventions are critical (e.g., in HIV/AIDS) the Bank will work with other development partners to improve the framework for inter-agency collaboration and coordination. An important part of the coordination effort revolves around selectivity in implementing the PRS and ensuring that the key PRS programs can be implemented. The multi-lateral and bi-lateral partnerships for implementing the PRS are summarized in Table 9.

78 Through two participatory NDFs (2000 and 2002) and the PRS, HMGN has come to engage civil society and the private sector more effectively in policy dialogue. Also, in Bank-financed projects, HMGN has shown greater willingness to benefit from partnerships with NGOs and CBOs, in particular those that involve community mobilization, service delivery and monitoring in remote rural areas. The Bank

will continue to encouraged these efforts. In addition to policy dialogue, partnerships among HMGN, the private sector and the Bank will remain central to the efficient provision and expansion of basic infrastructure services, particularly in power and telecommunications. The Bank Group's capacity to work with the private sector will be enhanced with the introduction of the SEDF (see paragraph 61). Partnerships in capacity building will also be strengthened with institutions key to development effectiveness, such as local bodies and media. As with official partnerships, the Bank's dialogue and coordination with the private sector and civil society will be guided by principles established in the PRS with a view towards strengthening national ownership of the development agenda.

79 Helping to reinforce these partnerships, the Bank will continue to communicate its development support to Nepal through outreach mechanisms already in place—e.g., the Nepal website, and regular consultative and dissemination

Table 9: Partnerships in Implementing the Poverty Reduction Strategy

PRS Area	Bank	Multi-laterals	Bi-laterals
Broad-Based			
Economic Growth			
Macroeconomic stability	✓	ADB, IMF	Denmark, Germany, UK
Agriculture	✓	ADB, IFAD, OPEC Fund, UN Agencies	Australia, Canada, Denmark, Finland, Germany, India, Japan, Kuwait Fund, Norway, Saudi Fund, Sweden, Switzerland, UK, US
Irrigation	✓	ADB, EU, OPEC Fund, UN Agencies	Canada, Japan, Kuwait Fund, Saudi Fund, US
Trade	✓	IMF, UN Agencies, WTO	Norway
Labor	✓	ILO, IMF, UN Agencies	Germany
Roads	✓	ADB	China, Germany, India, Japan, Switzerland, UK, US
Power	✓	ADB, UN Agencies	Canada, Denmark, Finland, Germany, Japan, Norway, Sweden, US
Information/communication	✓	ADB	Denmark, Finland, Japan
Tourism		ADB, UN Agencies	Japan, Netherlands, UK
Industry		UN Agencies	Japan, US
Food security		UN Agencies	Canada, France, Germany, Japan, UK
Social Sector Development			
Education	✓	ADB, EU, UN Agencies	Canada, Denmark, Finland, Germany, Japan, Norway, Switzerland, UK
Health	✓	EU, UN Agencies	Australia, Canada, China, Germany, India, Japan, Norway, Switzerland, UK, US
Drinking water/sanitation	✓	ADB, UN Agencies	Canada, Germany, Japan, Norway, Sweden, UK
Social Inclusion	✓	ADB, EU, UN Agencies	Canada, Denmark, Germany, Netherlands, Norway, Switzerland, UK
Good Governance			
Civil service reform	✓	ADB, UN Agencies	UK, Switzerland
Anti-corruption		ADB	Denmark, Norway, Switzerland, UK
Decentralization	✓	ADB, UN Agencies	Canada, Denmark, Germany, Netherlands, Norway, Switzerland, UK, US
Human rights			Canada, Denmark, Norway, Switzerland, UK
Integrated security development plan			US

events—as well as partnerships with the media. A Public Information Center (PIC)—currently located in the country office—will be built up and moved to a publicly accessible location and managed in collaboration with an external partner. The Bank will also work closely with other donors to support HMGN in the delivery of a strategic communication program built around the Tenth Plan/PRS.

B. Monitoring Outcomes

80 Given that the CAS supports implementation of the PRS and CAS outcomes are closely aligned with PRS outcomes, effective monitoring will only be possible if HMGN's monitoring and evaluation capacity is enhanced. Therefore, much of the Bank's efforts will be through capacity building to help establish an in-country monitoring and evaluation capacity. HMGN's past efforts have been limited largely to expenditure monitoring, with few linkages to outputs and service delivery. Although reviews were held every two months within the Ministerial Development Action Committee and quarterly at the National Development Committee (NDC—chaired by the Prime Minister), a fundamental focus on achieving development outcomes was lacking. To redress these weaknesses, since the beginning of FY02/03 several initiatives have been started by HMGN to monitor both financial and physical progress, including: (i) publishing on the internet detailed work programs with monitorable output indicators for all P1 projects; (ii) releasing funds based on satisfactory implementation performance, as certified by the line ministries;⁴³ and (iii) regular reporting—through the mid-term budget review and other means—of expenditure performance of P1 projects to the NPC and MOF. Though there have been some delays, the system has proven effective, especially in the scarce cash budget

management environment. Another new initiative has been the monitoring of IAP activities that has led to satisfactory completion of the IAP activities and has embedded a culture of joint monitoring/partnership among core ministries.

81 Cognizant of the need to align and strengthen HMGN's integrated financial management system with public sector monitoring and evaluation to effectively implement and assess the country's progress in achieving the annual PRS targets towards the MDGs: (i) a Central Monitoring Division has been established within the Poverty Monitoring Unit at the NPC; and (ii) the Central Bureau of Statistics has been entrusted with gathering survey data for poverty monitoring. HMGN has prepared a poverty-monitoring framework, initiated streamlining of the existing surveys to be linked to PRS monitoring and identified preliminary indicators under each of the four PRS pillars. Though these indicators are by no means complete, efforts are under way to: (i) develop intermediate indicators; (ii) identify appropriate surveys and frequencies to monitor these indicators; (iii) institutionalize IAP reporting; (iv) strengthen the link between the fund release mechanism and measurable outcomes; (v) initiate a poverty mapping exercise to direct basic social sector infrastructure to the poor and marginalized groups; and (vi) extend expenditure tracking and client surveys through participatory monitoring exercises on specific areas and sectors. Under the direction of the Vice Chairman of the NPC, the Poverty Monitoring Unit will prepare annual poverty reports—the country report on progress towards the MDGs—to be reviewed by NDC.⁴⁴ The Bank is working closely with HMGN to develop this capacity and at the same time, will take advantage of these efforts to ensure that all CAS outcomes can be measured and regularly evaluated.

C. Risks

82 The most important risk that Nepal faces today is one of the country spiraling into a widespread armed conflict and a breakdown of state institutions. By extension, this is the gravest risk the Bank should be concerned with. The current reform process has in fact emerged as an antidote against the risk of widespread internal conflict and the breakdown of the development process. Hence, supporting it must be at the core of the Bank's own risk management strategy. Nevertheless, at the next tier of the risk structure, it is useful to consider various risks to the reform process itself, so that the Bank is well-prepared to support the reform process under different circumstances. The fragile security situation and political turmoil present obvious uncertainties. At a deeper level, however, there are two types of blockages that may arise: (i) the possibility that the reform process itself is stymied or reversed; and (ii) the possibility that capacity to implement the reforms—even if commitment is sustained—becomes seriously curtailed.

83 While the major political parties and political leaders have tacitly supported the current reform process, the risk of their undermining the reform efforts out of short term political considerations cannot be discounted and would be consistent with the politics of Nepal in the past. If the peace process advances, there is also a risk that some of the more control-oriented economic policy agenda and unrealistic elements of welfare state agenda of the insurgents (e.g., restrictive trade policies, stopping privatization of SOEs, ban on private schools, free social services) may influence the reform program. When the more technocratic interim Governments make way for an elected Government, there is a

risk of old-style patronage politics returning and with it tendencies for rent-seeking, slowing of reforms and crowding out of the reform-minded senior civil service leaders.

84 The reform leaders are acutely aware of these risks and believe that the best safeguard is the broad popular support for the reforms. By giving the people and communities more power and immediate benefits, they can expand the political constituency for reforms. This thinking is clearly reflected in the 2003 IAP which places a strong emphasis on service delivery. In the medium term, as the broader PRS is implemented, the Nepali people at large should begin to expect good public service delivery and public policies, rather than more personal gains, from the political process. Such a change could eventually transform the patronage-based politics of the past into a democracy that focuses on public interests. In this regard, the basic strategy of the Bank is to support the reformers to accelerate the reform process. Close coordination among the development partners to send consistent messages is a key element of the Bank's strategy. An added risk mitigation measure is the starkly differential lending scenarios—i.e., the difference between the low and the high case is potentially US\$250 million per year—that continue to send a strong message that the Bank's financial support is linked to continued reform implementation.

85 The second risk is mainly associated with renewed and escalated hostilities that would sharply reduce HMGN's ability to implement the programs envisioned by the PRS. While it would make the reform process more difficult in the conflict-affected areas, it may well stiffen the resolve of the reform leaders to accelerate reform implementation in the rest of the country. In such a situation, continued support by the Bank

would no doubt give considerable encouragement to HMGN to carry forward the reform process. Renewed and severe hostilities would also pose a fiscal challenge. Security spending would rise and revenues would suffer from further slowing in economic activities. Although the rise in security spending would be in part offset by slowing development activities, the net impact on HMGN's fiscal position would likely be significantly negative. HMGN has already positioned itself to cope with such a situation in an orderly manner based on its prioritized development program. Aware that this is the only way to counter the fiscal problems, the reformers—as in the last two years or so—may also use the fiscal pressure and the need to obtain budget support from the Bank and other development partners as a tool to further rationalize spending and accelerate reforms.

86 A political impasse has developed between the major political parties and the interim Governments (and by association, the King who appointed them). Although the increasingly belligerent attitude of the major political parties has dismayed many Nepalis, there is a risk that this will lead to wide-spread civil disorder and distract the administration. In such a situation, even the reform-minded technocrats would find it difficult to get cabinet decisions on further reforms and to keep the civil service focused on improving public services. The Bank can

do little to mitigate such a risk, but it will monitor the situation closely.

87 Lastly, an additional risk is that the economic situation will continue to deteriorate and Nepal will be even more vulnerable to the external environment. Given Nepal's dependence on tourism and exports, unless there is a recovery in the global and domestic economic situations, Nepal's medium term prospects remain bleak. Again, implementing the reform agenda—specifically maintaining fiscal and macroeconomic stability, and increasing economic productivity and competitiveness—provides the best chances for mitigating this risk.

88 The challenges Nepal faces in taking the reform process forward are formidable. The cost of a failure, however, is nothing short of widespread internal conflict, likely resulting in the breakdown of the development process. The current reform leaders are very conscious of the risks and the high stakes. In essence, implementing reforms with more speed and vigor is their strategy to reduce the risk of reversal, and ultimately achieve peace and poverty reduction. Supporting this process is the core of the Bank's own strategy and risk mitigation. This is consistent with the basic strategy that the Bank has followed over the last several years—support reform actions consistently and forcefully.

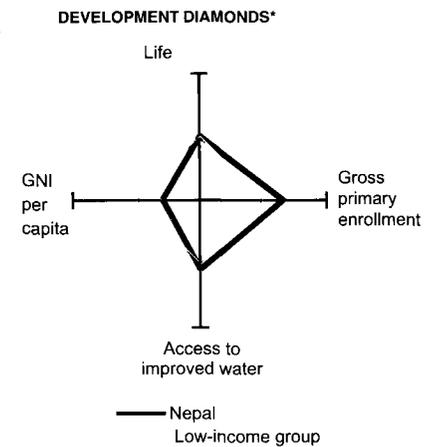
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- 39 In May 2003, the local donor coordination group agreed to break from the tradition of having the United Nations Development Programme (UNDP) and the Bank as co-chairs and invited HMGN to chair the group.
- 40 HMGN has made impressive efforts in the preparation and initial implementation of the FAP that outlines objectives, guidelines, strategies and policies aimed at guiding the flow and composition of foreign aid to ensure better aid utilization.
- 41 Board presentation of the IMF PRGF is anticipated for mid-November. Overall, IMF-Bank collaboration has been excellent. The proposed PRSC I has been prepared in parallel with the PRGF and the two institutions are working closely to ensure that the programs reinforce each other. For more information on the IMF program in Nepal, see Appendix IV.
- 42 Similar joint support is being developed to assist implementation of the Health Sector Strategy. The Ministry of Health has established a Health Sector Reform Committee to lead the reform process, including key donors (Germany, IDA, Japan, UNFPA, UNICEF, UK, US and WHO), NGOs, and the private sector.
- 43 Performance is assessed every three months. Upon announcement of the cease-fire, this rule was relaxed to expedite resource flow to insurgency-affected areas where project activities had been severely affected.
- 44 Utilizing available information, the first such report has already been issued.

Annexes



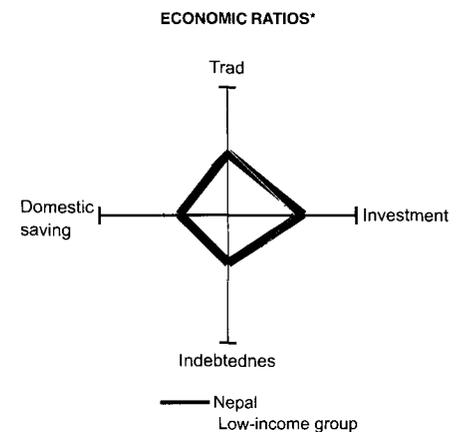
Annex A2: At a Glance

POVERTY and SOCIAL	Nepal	South Asia	Low-income
2001			
Population, mid-year (million)	24.2	1,401	2,495
GNI per capita (Atlas method, US\$)	240	460	430
GDP per capita (US\$)	238	..	..
GNI (Atlas method, US\$ billion)	5.7	640	1,072
Average annual growth, 1997-03			
Population (%)	2.2	1.8	1.9
Labor force (%)	2.6	2.3	2.3
Most recent estimate (latest year available, 1997-03)			
Poverty (% of population below national poverty line, 1996)	42	..	..
Urban population (% of total population)	13	28	30
Life expectancy at birth (years)	60	63	59
Infant mortality (per 1,000 live births)	66	71	81
Child malnutrition (% of children under 5)	48	..	..
Access to an improved water source (% of population)	88	84	76
Illiteracy (% of population age 15+)	55	44	37
Gross primary enrollment (% of school-age population)	118	97	95
Male	128	108	103
Female	103	98	87



Key Economic Ratios and Long-Term Trends

	1983	1993	2002	2003
GDP (US\$ billions)	2.4	3.7	5.5	5.7
(in percent)				
Gross domestic investment/GDP	19.6	22.6	24.6	26.1
Exports of goods and services/GDP	10.2	18.4	16.1	14.6
Gross domestic savings/GDP	8.5	12.2	11.8	11.3
Gross national savings/GDP	10.7	14.5	25.7	25.6
Current account balance/GDP	-7.4	-8.1	2.6	-0.9
Interest payments on external debt/GDP	0.2	0.8	0.4	0.4
Total external debt/GDP	18.5	54.9	52.9	51.8
Total debt service/exports	6.5	8.8	4.6	5.2
Present value of debt/GDP (2001)	..	..	28.1	..
Present value of debt/exports (2001)	..	..	71.0	..

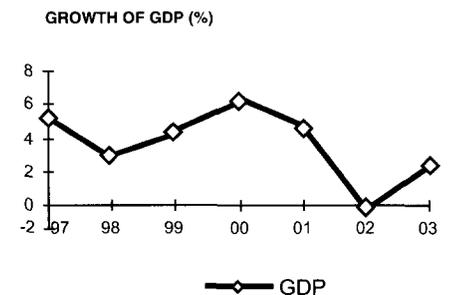


	1983-93	1993-03	2002	2003	2003-07
(average annual growth)					
GDP	5.1	4.3	-0.5	2.3	4.8
GDP per capita	2.7	2.0	-2.7	0.1	2.2

Structure of the Economy

	1983	1993	2002	2003
(% of GDP)				
Agriculture	60.3	41.3	39.6	39.6
Industry	12.8	20.2	20.9	20.7
Manufacturing	4.6	8.6	8.1	7.9
Services	26.9	38.4	39.5	39.7
Private consumption	81.3	79.3	78.1	78.2
General government consumption	10.1	8.5	10.0	10.5
Imports of goods and services	21.3	28.8	28.8	29.3

	1983-93	1993-03	2002	2003
(average annual growth)				
Agriculture	3.4	3.3	2.2	2.1
Industry	9.2	4.9	-3.3	2.3
Manufacturing	10.1	4.2	-10.0	0.4
Services	4.7	5.5	-1.4	2.7

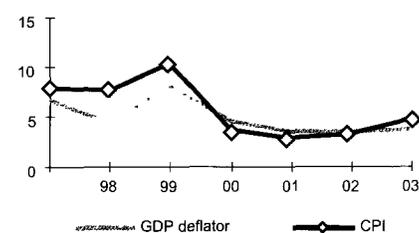


Note: 2003=2002/03.

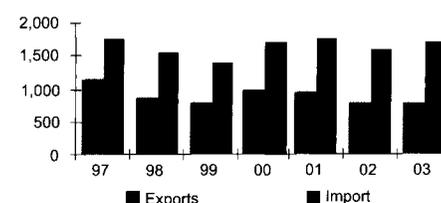
* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

Prices and Government Finance	1983	1993	2002	2003
Domestic prices				
<i>(% change)</i>				
Consumer prices	14.0	9.9	2.9	4.7
Implicit GDP deflator	12.3	11.2	3.2	3.5
Government finance				
<i>(% of GDP, includes current grants)</i>				
Current revenue	..	..	11.5	12.3
Current budget balance	..	..	-0.1	-4.0
Overall surplus/deficit	..	..	-5.7	-4.0
TRADE				
<i>(US\$ millions)</i>				
Total exports (fob)	82	379	942	782
Food	..	..	65	..
Pulses	..	..	56	..
Manufactures	..	..	256	..
Total imports (cif)	457	860	1,773	1,707
Food	..	101	81	..
Fuel and energy	..	84	338	..
Capital goods	..	169	312	..
BALANCE of PAYMENTS				
<i>(US\$ millions)</i>				
Exports of goods and services	249	675	1,060	949
Imports of goods and services	483	1,053	1,687	1,821
Resource balance	-233	-378	-626	-872
Net income	12	8	-7	-6
Net current transfers	36	75	777	825
Current account balance	-185	-295	-143	-53
Official transfers	4	77	143	161
Financing items (net)	137	380	-323	-143
Changes in net reserves (-=increase)	44	-162	36	-123
Memo				
Reserves including gold <i>(US\$ millions)</i>	..	571	1,055	1,184
Conversion rate <i>(DEC, local/US\$)</i>	13.8	48.0	75.9	77.8
EXTERNAL DEBT and RESOURCE FLOWS				
<i>(US\$ millions)</i>				
Total debt outstanding and disbursed	453	2,010	2,933	2,975
IBRD	0	0	0	0
IDA	172	832	1,156	1,185
Total debt service	20	69	88	96
IBRD	0	0	0	0
IDA	2	10	26	30
Composition of net resource flows				
Official grants	94	77	143	161
Official creditors	68	156	4	..
Private creditors	1	-10	0	0
Foreign direct investment	-1	6	-4	-2
Portfolio equity	0	0	0	0
World Bank program				
Commitments	45	0	23	97
Disbursements	31	69	38	27
Principal repayments	0	4	18	21
Net flows	31	66	20	6
Interest payments	1	6	8	9
Net transfers	29	60	12	-3

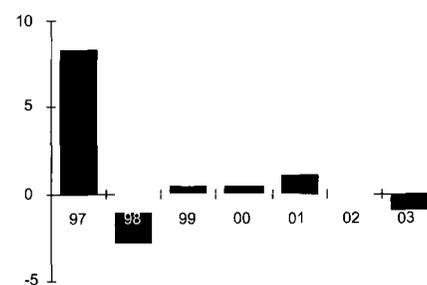
INFLATION (%)



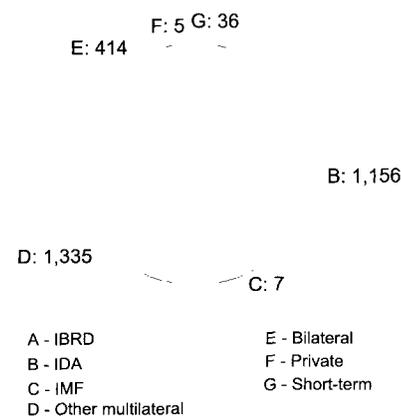
EXPORT AND IMPORT LEVELS (US\$ MILL.)



CURRENT ACCOUNT BALANCE TO GDP (%)



COMPOSITION OF 2002 DEBT (US\$ MILL.)



Annex B2: Selected Indicators of Bank Portfolio Performance and Management (As of 9/15/2003)

Indicator *	FY98	FY99	FY00	FY01	FY02	FY03	FY04
Portfolio Assessment							
Number of Projects Under Implementation ^a	14	10	9	8	8	10	9
Average Implementation Period (years) ^b	4.9	3.6	3.1	3.7	3.7	3.2	3.3
Percent of Problem Projects by Number ^{a, c}	14.3	20.0	22.2	12.5	12.5	20.0	22.2
Percent of Problem Projects by Amount ^{a, c}	10.9	16.9	18.3	2.3	24.2	25.7	26.2
Percent of Projects at Risk by Number ^{a, d}	50	60.0	55.6	12.5	25.0	20.0	22.2
Percent of Projects at Risk by Amount ^{a, d}	38.6	71.6	60.6	2.3	56.0	25.7	26.2
Disbursement Ratio (%) ^e	22.4	22.4	20.8	27.3	33.3	26.2	3.9
Portfolio Management							
CPPR during the year (Yes/No)	No	Yes	Yes	Yes	Yes	Yes	Yes ^g
Supervision Resources (total US\$ thousand) ^f	990.4	1,059.4	1,078.8	436.5	447.3	595.2	624.8 ^g
Average Supervision (US\$ thousands/project)	61.9	66.2	98.1	48.5	49.7	54.1	69.4 ^g

Memorandum Item	Since FY 80	Last Five FYs
Project Evaluations by OED by Number	62	5
Project Evaluations by OED by Amount (US\$ millions)	1,207.0	101.0
% of OED Projects Rated U or HU by Number	36.1	20.0
% of OED Projects Rated U or HU by Amount	22.5	17.4

- * All indicators are for projects active in the Portfolio, with the exception of Disbursement Ratio, which includes all active projects as well as projects which exited during the fiscal year.
- a. As shown in the Annual Report on Portfolio Performance.
- b. Average age of projects in the Bank's portfolio.
- c. Share of projects rated U (Unsatisfactory) or HU (Highly Unsatisfactory) on Development Objectives (DO) and/or Implementation Progress (IP).
- d. As defined under the Portfolio Improvement Program.
- e. Ratio of disbursements of investment projects during the year to the undisbursed balance of the Bank's portfolio at the beginning of the year.
- f. Direct costs (source: Business Warehouse Resource Management Table 5.2 as of 7/15/2003)
- g. Full year business plan projections.

Annex B3: Bank Group Program Summary ^{a/} (As of 10/15/2003)

Fiscal Year	Project Name	US\$ (millions)	Strategic Rewards ^{b/} (H/M/L)	Implementation ^{b/} Risks (H/M/L)
2004	Poverty Reduction Support Credit I	70.0	H	H
	Basic & Primary Education II (2nd Phase)	50.0	H	L
	Poverty Alleviation Fund LIL	15.0	H	H
	Rural Water Supply and Sanitation II	30.0	M	L
	Financial Sector Restructuring, Phase II	70.0	H	H
	Subtotal	235.0		
2005	Health Sector Operation	50.0	M	M
	Poverty Reduction Support Credit II	70.0	H	H
	Rural Access Improvement	30.0	H	M
	Reform Technical Assistance/Capacity Building	10.0	H	M
	Higher Education	25.0	H	M
	Subtotal	185.0		
2006	Agriculture Sector Operation	30.0	H	M
	Poverty Reduction Support Credit III	70.0	H	H
	Poverty Alleviation Fund II	30.0	H	M
	Financial Sector Restructuring, Phase III	75.0	H	H
	Subtotal	205.0		
2007	Poverty Reduction Support Credit IV	70.0	H	H
	Infrastructure Development	40.0	H	M
	Decentralization Support	30.0	H	H
	Subtotal	140.0		
	Total FY04 - FY07	765.0		

a/ This table presents a notional Base Case lending program for the next four fiscal years.

b/ For each project, indicated whether the strategic rewards and the implementation risks are expected to be High (H), Moderate (M), or Low (L).

IFC and MIGA Programs, FY 1999-2004 (As of 9/15/2003)

	1999	2000	2001	2002	2003	2004
IFC Approvals (US\$ millions)	0.0	0.0	0.3	0.0	0.0	0.0
Sector (%)						
Finance and insurance			100.0			
Total	0.0	0.0	100.0	0.0	0.0	0.0
Investment instrument (%)						
Loans						
Equity			100.0			
Quasi-Equity						
Other						
Total	0.0	0.0	100.0	0.0	0.0	0.0
MIGA Guarantees (US\$ millions)^{a/}	32.8	32.8	19.1	30.1	30.1	30.1

a. MIGA gross exposure at end of FY.

Annex B4: Summary of Non-Lending Services (As of 10/15/2003)

Product	FY of Completion	Cost (US\$ Thousand)	Audience ^{a/}	Objective ^{b/}
Recent completions				
Terai Options Study	FY01	275	G/D/B/PD	KG/PS
Priority and Strategy in Education Sector Reform	FY01	145	G/D/B	KG/PD/PS
Proposed Power Sector Development Strategy	FY01	260	G/D	KG/PD
Business Environment and Manufacturing Performance	FY01	140	G/D/B	KG/PD/PS
Country Procurement Assessment Report (CPAR)	FY01	56	G/D/B	PS
Country Financial Accountability Assessment (CFAA)	FY02	130	G/D/B	KG/PD/PS
Economic Update	FY02	30	G/D/B	KG/PD/PS
Financial Sector Study	FY03	65	G/D	KG/PS
Trade and Competitiveness Study	FY03	100	G/B/PD	KG/PS
A Note on the Poverty Alleviation Fund	FY03	85	G/D/B	KG/PS
Country Assistance Strategy Progress Report	FY03	95	G/B/PD	PD/PS
On-going/Planned				
Study on Labor Remittances	FY03/04	50	G/D/B/PD	PD/PS
Reform Episodes	FY03/04	50	G/D/B/PD	KG/PS
Social and Gender Assessment	FY04	230	G/D/B/PD	KG/PD/PS
Development Policy Review	FY04	150	G/D/B/PD	KG/PS/PD
Rural Sector Issues Note	FY04	75	G/D/B/PD	KG/PS/PD
Poverty Report	FY05	200	G/D/B/PD	KG/PD/PS
Public Expenditure Analysis-Evaluating the MTEF	FY05	100	G/B/PD	KG/PD/PS
Public Expenditure Analysis-The SOE Sector	FY05	100	G/D/B/PD	KG/PD/PS
Rural Factor Market Study	FY05	150	G/D/B/PD	KG/PD/PS
Country Environmental Analysis	FY05	125	G/D/B/PD	KG/PD/PS
Country Economic Update	FY06	75	G/D	KG/PD
Financial Sector Reform: Lessons and Next Steps	FY06	100	G/D/B/PD	KG/PD/PS
Update on Child Labor	FY06	100	G/D/B/PD	KG/PD/PS
Evaluation of Community Managed Schools	FY07	150	G/D/B	KG/PD/PS
Re-evaluating Social and Gender Issues	FY07	100	G/D/B/PD	KG/PD/PS
Update on Fiduciary Assessments	FY07	100	G/D/B	KG/PD
Technical Assistance/Other				
Medium-Term Expenditure Framework	FY03/05	100	G/B/D	KG/PD/PS
Decentralized Organizations	FY03/04	130	G/D/B/PD	KG/PD
Fiscal Decentralization	FY03/05	60	G/B/PD	PD/PS
Living Standards Survey	FY03/04	200	G/B	KG/PS
Joint IDA-IMF Staff Assessment of the PRSP	FY03/04	150	G/B/PD	KG/PD/PS
Country Assistance Strategy	FY04	125	G/B/PD	PD/PS
Country Assistance Strategy Progress Report	FY06	75	G/B/PD	PD/PS

a/ Government (G), Donor (D), Bank (B), Public Dissemination (PD).

b/ Knowledge Generation (KG), Public Debate (PD), Problem Solving (PS).

Annex B5: Social Indicators (As of 10/6/2003)

	Latest single year			Same region/income group	
	1970-75	1980-85	1995-2001	South Asia	Low-income
POPULATION					
Total population, mid-year (millions)	13.1	16.2	23.6	1,377.8	2,505.9
Growth rate (% annual average for period)	2.0	2.1	2.4	1.8	1.9
Urban population (% of population)	5.0	7.8	12.2	27.8	30.8
Total fertility rate (births per woman)	6.2	5.9	4.2	3.2	3.5
POVERTY					
<i>(% of population)</i>					
National headcount index	..	..	42.0	..	..
Urban headcount index	..	..	23.0	..	..
Rural headcount index	..	..	44.0	..	..
INCOME					
GNI per capita (US\$)	120	170	250	450	430
Consumer price index (1995=100)	17	35	141	..	..
Food price index (1995=100)	..	33	143	..	..
INCOME/CONSUMPTION DISTRIBUTION					
Gini index	..	..	36.7	..	..
Lowest quintile (% of income or consumption)	..	..	7.6	..	..
Highest quintile (% of income or consumption)	..	..	44.8	..	..
SOCIAL INDICATORS					
Public expenditure					
Health (% of GDP)	..	..	0.9	1.0	1.1
Education (% of GDP)	1.5	2.7	3.7	2.5	2.8
Social security and welfare (% of GDP)	0.1	0.1	0.4	..	..
Net primary school enrollment rate					
<i>(% of age group)</i>					
Total	..	..	72	..	..
Male	..	..	77	..	..
Female	..	..	67	..	..
Access to an improved water source					
<i>(% of population)</i>					
Total	..	..	88	84	76
Urban	..	..	94	94	90
Rural	..	..	87	80	70
Immunization rate					
<i>(% under 12 months)</i>					
Measles	..	34	71	58	60
DPT	..	32	72	65	61
Child malnutrition (% under 5 years)	69	..	48	..	..
Life expectancy at birth					
<i>(years)</i>					
Total	45	51	59	63	59
Male	46	52	60	62	58
Female	44	50	59	63	60
Mortality					
Infant (per 1,000 live births)	149	117	66	71	80
Under 5 (per 1,000 live births)	223	170	91	99	121
Adult (15-59)					
Male (per 1,000 population)	482	376	314	252	312
Female (per 1,000 population)	476	395	314	202	256
Maternal (modeled, per 100,000 live births)	..	..	830	..	..
Births attended by skilled health staff (%)	..	10	12	12	..

Notes: 0 or 0.0 means zero or less than half the unit shown. Net enrollment rate: break in series between 1997 and 1998 due to change from ISCED76 to ISCED97; ratios exceeding 100 indicate discrepancies between the estimates of school-age population and reported enrolment data.
2003 World Development Indicators CD-ROM, World Bank

Annex B6: Key Economic Indicators (As of 10/8/2003)

Indicator	Actual			Estimate		Projected		
	98/99	99/00	00/01	01/02	02/03	03/04	04/05	05/06
National accounts (as % of GDP)								
Gross domestic product ^a	100	100	100	100	100	100	100	100
Agriculture	40.1	39.6	38.4	39.6	39.6	38.7	38.1	37.4
Industry	21.2	21.5	21.3	20.9	20.7	22.7	23.0	23.3
Services	38.7	38.9	40.3	39.5	39.7	38.6	38.9	39.3
Total consumption	86.4	84.8	85.1	88.2	88.7	88.4	87.6	87.1
Gross domestic fixed investment	19.1	19.3	19.0	19.3	19.2	20.0	20.5	21.5
Government investment	7.0	7.0	7.6	7.6	7.0	7.5	7.9	8.1
Private investment	12.1	12.4	11.4	11.7	12.1	12.5	12.6	13.4
Exports (GNFS) ^b	22.8	23.3	22.4	16.1	14.6	16.0	18.3	18.1
Imports (GNFS)	29.7	32.4	31.5	28.8	29.3	30.9	32.9	32.7
Gross domestic savings	13.6	15.2	14.9	11.8	11.3	11.6	12.4	12.9
Gross national savings ^c	20.6	24.6	27.2	25.7	25.6	24.9	25.2	25.2
Memorandum items								
Gross domestic product (US\$ million at current prices)	5034	5494	5582	5549	5739	6408	6812	7311
GNI per capita (US\$, Atlas method)	230	240	240	230	240	250	260	280
GDP per capita (US\$)	228	243	242	235	238	259	270	283
Real annual growth rates (% calculated from 1985 prices)								
Gross domestic product at market prices	4.5	6.1	4.8	-0.5	2.3	3.5	4.6	5.4
Real annual per capita growth rates (% calculated from 1985 prices)								
Gross domestic product at market prices	2.2	3.8	2.4	-2.7	0.1	1.2	2.3	3.0
Balance of Payments (US\$ millions)								
Exports (GNFS) ^b	1270	1433	1359	1060	949	1022	1246	1322
Merchandise FOB	763	971	942	754	633	680	883	935
Imports (GNFS) ^b	1595	1922	1984	1687	1821	1982	2243	2389
Merchandise FOB	1390	1713	1773	1496	1630	1777	2024	2155
Resource balance	-325	-489	-625	-626	-872	-960	-997	-1067
Net private transfers	338	497	680	777	825	867	891	912
Current account balance	25	28	64	143	-53	-107	-121	-169
Official transfers	137	133	108	143	161	243	252	248

Key Economic Indicators (As of 10/8/2003) cont...

Indicator	Actual			Estimate		Projected		
	98/99	99/00	00/01	01/02	02/03	03/04	04/05		05/06
Long-term loans (net)	157	148	96	38	45	13	16	27
Official	89	97	60	58	74	47	37	-41
Private	68	52	36	-20	-29	-34	-22	68
Other capital (net, incl. errors & omissions)	-7	61	-86	-213	133	166	166	193
Change in reserves ^d	-183	-240	-80	36	-123	-77	-70	-65
<i>Memorandum items</i>								
Resource balance (% of GDP)	-6.5	-8.9	-11.2	-11.3	-15.2	-15.0	-14.6	-14.6
Annual growth rates (in US\$ terms)								
Merchandise exports (FOB) (excluding re-exports)	18.0	37.3	4.6	-18.1	2.4	7.4	5.9	6.0
Merchandise imports (CIF)	-10.4	23.3	3.5	-15.6	9.0	9.0	13.9	6.5
Public finance (as % of GDP at market prices)^e								
Total revenues	10.2	10.7	11.4	11.5	12.3	12.4	12.8	13.4
Total expenditure	15.4	15.7	17.6	17.2	16.3	18.7	18.5	18.2
Current expenditures	9.4	9.6	11.2	11.6	11.6	13.1	12.5	12.1
Capital expenditure and net lending	6.1	6.1	6.4	5.7	4.7	5.6	6.0	6.1
Overall deficit before grants	5.2	5.0	6.2	5.7	4.0	6.3	5.7	4.8
Overall deficit after grants	3.9	3.5	4.5	4.3	1.9	3.6	2.6	2.0
Domestic financing (net)	1.4	0.9	2.7	2.9	1.2	1.7	1.3	0.6
Foreign financing (net)	2.5	2.6	1.8	1.4	0.7	1.4	1.3	1.4
Monetary indicators								
M2/GDP	44.7	49.0	52.3	53.2	55.3	55.6	..	..
Growth of M2 (%)	20.8	21.8	15.2	4.4	8.3	11.1	..	..
Private sector credit growth/total credit growth (%)	90.9	109.6	88.0	59.2	132.1	107.4	..	..
Price indices								
Real exchange rate (eop; percentage change = depreciation)	7.3	-2.2	3.8	-9.2	-7.3	..	..	..
Consumer price index (% change) (FY85=100)	11.4	3.4	2.4	2.9	4.7	5.4	4.6	4.2
GDP deflator (% change) (FY85=100)	8.8	4.6	3.2	3.2	3.5	4.9	4.6	4.6

a. GDP at factor cost.

b. "GNFS" denotes "goods and nonfactor services."

c. Includes net unrequited transfers excluding official capital grants.

d. Includes use of IMF resources.

e. Consolidated central government.

Annex B7: Key Exposure Indicators (As of 10/6/2003)

Indicator	Actual				Estimate		Projected	
	98/99	99/00	00/01	01/02	02/03	03/04	04/05	05/06
Total debt outstanding and disbursed (TDO) (US\$m) ^a	2,702.0	2,848.0	2,786.0	2,933.0	2,993.0	3,022.0	3,054.0	3,097.0
Net disbursements (US\$m) ^a	141.0	146.0	-62.0	147.0	60.0	29.0	32.0	43.0
Total debt service (TDS) (US\$m) ^a	84.0	83.0	84.0	88.0	96.0	114.0	120.0	125.0
Debt and debt service indicators (%)								
TDO/XGS ^b	162.6	141.8	131.5	152.9	160.9	152.5	136.7	132.6
TDO/GDP	53.7	51.8	49.9	52.9	52.2	47.2	44.8	42.4
TDS/XGS	5.1	4.1	4.0	4.6	5.2	5.8	5.4	5.4
Concessional TDO	97.5	98.4	97.7	..	..	..	..	..
IBRD exposure indicators (%)								
IBRD DS/public DS	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Preferred creditor DS/public DS (%)	61.5	64.9	72.3	73.1	74.1	74.8	75.9	75.9
IBRD DS/XGS	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
IBRD TDO (US\$m) ^d	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Share of IBRD portfolio (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
IDA TDO (US\$m) ^d	1,107.0	1,123.0	1,102.0	1,156.0	1,185.0	1,193.0	1,204.0	1,217.0
IFC								
Loans (US\$m)	56.8	57.3	56.0	54.0	..	..	..	..
Equity and quasi-equity (US\$m) ^e	3.4	3.4	3.7	3.2	..	..	..	..
MIGA								
MIGA guarantees (US\$m)	33.0	33.0	19.1	30.1	..	..	..	..

a. Includes public and publicly guaranteed debt, private non-guaranteed, use of IMF credits and net short-term capital.

b. "XGS" denotes exports of goods and services, including workers' remittances.

c. Preferred creditors are defined as IBRD, IDA, the regional multilateral development banks, the IMF, and the Bank for International Settlements.

d. Includes present value of guarantees.

e. Includes equity and quasi-equity types of both loan and equity instruments.

Annex B8: Status of Bank Group Operations

(IBRD/IDA) (As of 9/15/2003)

Closed Projects (In US\$ Millions) 66

IBRD/IDA *

Total Disbursed (Active)	129.7
of which has been repaid	0.0
Total Disbursed (Closed)	1,218.5
of which has been repaid	136.1
Total Disbursed (Active + Closed)	1,348.2
of which has been repaid	136.1
Total Undisbursed (Active)	166.8
Total Undisbursed (Closed)	0.5
Total Undisbursed (Active + Closed)	167.3

Status of Bank Group Operations (IBRD/IDA) (As of 9/15/2003)

Active Projects

Project ID	Project Name Objectives	Last PSR Supervision Rating		Fiscal Year	Original Amount in US\$ Millions				Difference Between Expected and Actual Disbursements ^{a/}		
		Development Progress	Implementation		IBRD	IDA	GRANT	Cancel.	Undisb.	Orig.	FrmRev'd
P010516	Rural Water Supply and Sanitation	S	S	1997		18.3		1.5	0.6	3.4	1.7
P010530	Irrigation Sector Development	S	S	1998		79.8		8.0	6.0	15.6	2.1
P010509	Multimodal Trade and Transit	U	S	1998		23.5			3.9	4.6	11.4
P040612	Basic and Primary Education II	S	S	1999		12.5			3.7	4.2	4.2
P045052	Road Maintenance and Development	S	U	2000		54.5			33.1	50.7	9.6
P050671	Telecommunications Sector Reform	S	S	2002		22.6			23.2	11.0	0.0
P071291	Financial Sector Technical Assistance	S	S	2003		16.0			14.9	-2.4	0.0
P043311	Power Development Project	S	S	2003		75.6			76.5	1.5	0.0
P082646	Community School Support Project LIL*	N/A	N/A	2003		5.0			5.0	0.0	0.0
				Total	0.0	307.7	0.0	9.6	166.8	88.5	29.0

a. Intended disbursements to date minus actual disbursements to date as projected at appraisal.

* The project was approved on June 30, 2003 and effective on August 28, 2003.

Statement of IFC's Held and Disbursed Portfolio (As of 8/31/2003)

(In US\$ Millions)

FY Approval	Company	Held				Disbursed			
		Loan	Equity	Quasi	Partic	Loan	Equity	Quasi	Partic
1994	Himal Power	23.4	0.0	3.4	0.0	23.4	0.0	3.4	0.0
1996	Bhote Koshi	18.0	3.0	0.0	26.9	18.0	3.0	0.0	26.9
1998	Jomsom Resort	4.0	0.0	0.0	0.0	4.0	0.0	0.0	0.0
2001	ILFC - Nepal	0.0	0.3	0.0	0.0	0.0	0.3	0.0	0.0
	Total Portfolio	45.4	3.2	3.4	26.9	45.4	3.3	3.4	26.9

Annex B9: Summary of Development Priorities (As of 10/15/2003)

Network Area	Country Performance	Major Issue	Country Priority	Bank Priority	Reconciliation of Country and Bank Priorities
Poverty Reduction & Economic Management					
Poverty reduction	Poor	High regional and rural/urban disparities; slow progress since mid-1970s	High	High	
Economic policy	Good	Overall prudent macroeconomic policies	High	High	
Public sector	Fair	Weak institutional capacity; notable recent progress with MTEF/budget management	High	High	
Gender	Fair	Notable progress in recent years; variation across ethnic & caste groups	Moderate	Moderate	
Human Development Department					
Education	Fair	Progress in handing over schools to communities; quality remains an issue	High	High	
Health, nutrition & population	Fair	Comprehensive strategy/ implementation plan developed; financing and quality remain issues	High	High	
Social protection	Poor	Ineffective and poorly targeted programs; lack of safety nets	Moderate	Moderate	
Environmentally & Socially Sustainable Development					
Rural development	Fair	Low agricultural productivity; high rural poverty	High	High	
Environment	Fair	Efforts to address environmental management; weak institutional capacity	Moderate	Moderate	
Social development	Poor	Repercussions of the insurgency & its root causes	High	High	
Finance, Private Sector & Infrastructure					
Financial sector	Good	Management teams in place in major banks; weak Central Bank	High	High	
Private sector	Poor	Failure to privatize/liquidate identified SOEs; difficulties attracting investment in uncertain environment	High	Moderate	On-going dialogue/other donors
Energy & mining	Fair	Attracting private investment	High	Moderate	On-going dialogue/other donors
Infrastructure	Fair	Operationalization of Road Fund (funding of maintenance)	High	High	

Annex: B10

CAS Outcomes, Milestones and Indicators, and PRS Outcomes

PRS/IAP AREAS ¹	PRS OUTCOMES	CAS OUTCOMES	BANK STRATEGY	MILESTONES	IDA INSTRUMENTS/PARTNERS ²
BROAD-BASED ECONOMIC GROWTH					
A2(P1-A)	<ul style="list-style-type: none"> Improved pro-poor budget allocation Improved efficiency of public spending 	<ul style="list-style-type: none"> Outcome focused budgeting and monitoring in place 	<ul style="list-style-type: none"> Link IDA lending level to improvement in expenditure quality Continue TA for MTEF Support central and sectoral efforts to establish performance-based monitoring systems 	<ul style="list-style-type: none"> MTEF applied to all expenditures (FY04) Recurrent/capital classification implemented (FY05) Sectoral output and indicators monitoring systems in place (FY05) Poverty monitoring unit fully functional (FY05) 	<p><i>On-going</i> TA/dialogue on MTEF</p> <p><i>Proposed</i> Evaluating the MTEF (FY05) PRSC I (FY04) PRSCs (FY05, FY06, FY07) Public Expenditure Analysis (FY05) <i>Key partners</i> IMF, UK</p>
A2, A6 (P1-D)	<ul style="list-style-type: none"> Improved pro-poor budget allocation Improved efficiency of public spending Foreign direct investment increased 	<ul style="list-style-type: none"> Magnitude of SOE financial problems recognized by HMGN and strategy/action plan developed 	<ul style="list-style-type: none"> Analytical work, policy dialogue and TA on SOE issues 	<ul style="list-style-type: none"> Completion of audits of all SOEs (FY04) Completion of SOE Review AAA (FY05) 	<p><i>On-going</i> Dialogue on MTEF</p> <p><i>Proposed</i> The SOE Sector (FY05) <i>Key partners</i> ADB, IMF, UK</p>
E	<ul style="list-style-type: none"> Labor productivity enhanced Rights of labor protected 	<ul style="list-style-type: none"> Reform labor laws to allow greater flexibility in employment 	<ul style="list-style-type: none"> Help Ministry of Labor facilitate an agreement between labor and businesses on flexible contracts 	<ul style="list-style-type: none"> Flexible contracts allowed on a pilot basis (FY05) Insolvency Act enacted to allow easy 'exit' (FY05) 	<p><i>On-going</i> Trade and Competitiveness Study (FY03) follow-up <i>Key partners</i> ILO</p>
J	<ul style="list-style-type: none"> Increased private sector investment 	<ul style="list-style-type: none"> Lowered costs of doing business by liberalizing business support services 	<ul style="list-style-type: none"> Analytical work, policy dialogue and TA on investment climate and trade facilitation IFC investments and TA for SME development 	<ul style="list-style-type: none"> Amend investment and trade policy to liberalize the business support services market by allowing Foreign Direct Investment in these sectors 	<p><i>Proposed</i> Policy dialogue/follow up on investment climate/trade work <i>Key partners</i> IFC, Integrated Framework partners, IMF, UK, UNCTAD, UNDP</p>
D	<ul style="list-style-type: none"> Increased export/GDP ratio 	<ul style="list-style-type: none"> Increased institutional capacity for trade policy formulation and implementation 	<ul style="list-style-type: none"> Analytical work, policy dialogue and TA on investment climate and trade facilitation 	<ul style="list-style-type: none"> HMGN adoption of Nepal Trade and Competitiveness Study as HMGN policy (FY04) HMGN to establish apex foreign trade policy body responsible for policy evaluation, facilitation and negotiations(FY05) 	<p><i>Proposed</i> Policy dialogue/follow up on trade work <i>Key partners</i> Integrated Framework partners, UK</p>

¹ The PRS area is given first, while the IAP area is given second in parentheses. See Annex B11 for PRS areas and Appendix III, table 1 for IAP areas.

² Given the flexibility of the Poverty Reduction Support Credit (PRSC) Instrument, in all likelihood the envisioned series of PRSCs (FY04, FY05, FY06 and FY07) will support achievement of most of the CAS outcomes. As such, the PRSCs are not repeated for each of the outcomes, but likely apply.

Annex B10

CAS Outcomes, Milestones and Indicators, and PRS Outcomes Cont...

PRS/IAP AREAS ¹	PRS OUTCOMES	CAS OUTCOMES	BANK STRATEGY	MILESTONES	IDA INSTRUMENTS/PARTNERS ²
A5	<ul style="list-style-type: none"> ■ Central Bank's supervisory and regulatory capacity improved ■ Efficiency of the financial system service delivery improved 	<ul style="list-style-type: none"> ■ NRB performing regulatory and supervision functions effectively 	<ul style="list-style-type: none"> ■ With IMF, focus on banking issues in macro dialogue ■ Continued TA to improve the quality of NRB operations 	<ul style="list-style-type: none"> ■ Comprehensive Bank and Financial Institutions Act (FY04) ■ Annual cycle of on-site inspection for minimum of 6 banks (FY05) 	<p><i>On-going</i> Financial Sector TA</p> <p><i>Proposed</i> Banking Reform I (FY04), Banking Reform II (FY06)</p> <p><i>Key partners</i> IMF, UK</p>
A5	<ul style="list-style-type: none"> ■ Confidence in the financial system augmented ■ Efficiency of the financial system service delivery improved 	<ul style="list-style-type: none"> ■ RBB/NBL privatized or liquidated 	<ul style="list-style-type: none"> ■ Work closely with NRB, management teams, and IMF ■ Provide financing for restructuring ■ Link to overall lending level 	<ul style="list-style-type: none"> ■ Restructuring plans agreed (FY04) ■ Work force right-sized (FY05) 	<p><i>On-going</i> Financial Sector TA</p> <p><i>Proposed</i> Banking Reform I (FY04), Banking Reform II (FY06)</p> <p><i>Key partners</i> IMF, UK</p>
B, C	<ul style="list-style-type: none"> ■ Enhanced agricultural productivity ■ Overall agricultural growth by 4.1%; crops production increased by 4.1% 	<ul style="list-style-type: none"> ■ Improved enabling environment for factor and output markets ■ Increased agricultural productivity and farm incomes 	<ul style="list-style-type: none"> ■ Help HMG refocus its agriculture and rural development strategy, especially policies related to factor markets (land, credit, labor and water) ■ Provide support for irrigation reforms, agricultural diversification and market development 	<ul style="list-style-type: none"> ■ Improved efficiency of surface irrigation and transfer full O&M responsibility (up to the tertiary level) to farmers (FY06) ■ Agreed framework for promoting agricultural diversification (FY05) ■ Completion of joint assessment of constraints to factor market development (FY05) 	<p><i>On-going</i> Irrigation Sector, Policy Note on Agriculture</p> <p><i>Proposed</i> Improving Agricultural Performance (FY04), Factor Market Study (FY05), Agriculture Operation (FY06),</p> <p><i>Key partners</i> ADB, Australia, Denmark, EU, Germany, Japan, Kuwait Fund, Norway, OPEC Fund, Saudi Fund, Sweden, Switzerland, UK, UN Agencies, US</p>
F (P1-F)	<ul style="list-style-type: none"> ■ Sustainable road maintenance fund available in accordance with annual maintenance plan 	<ul style="list-style-type: none"> ■ Percentage of main road network in poor condition reduced to 10% 	<ul style="list-style-type: none"> ■ Work with key donors to ensure Roads Board is properly funded from fuel levies 	<ul style="list-style-type: none"> ■ Roads Board operational (FY04) ■ Adequate maintenance budget (FY06) 	<p><i>On-going</i> Road Maintenance and Development Project (RMDP)</p> <p><i>Proposed</i> Infrastructure Develop (FY07)</p> <p><i>Key partners</i> ADB, China, Germany, India, Japan, Switzerland, UK, US</p>
F, B (P1-F)	<ul style="list-style-type: none"> ■ Road access increased to 70 District headquarters 	<ul style="list-style-type: none"> ■ Share of population with close access to roads (i.e., ½ day walk) increased by 4% 	<ul style="list-style-type: none"> ■ Encourage HMG to focus on accessibility and decentralized rural roads management 	<ul style="list-style-type: none"> ■ Nation-wide accessibility mapping (FY05) 	<p><i>On-going</i> RMDP, Decentralization dialogue</p>

Annex B10

CAS Outcomes, Milestones and Indicators, and PRS Outcomes Cont...

PRS/IAP AREAS ¹	PRS OUTCOMES	CAS OUTCOMES	BANK STRATEGY	MILESTONES	IDA INSTRUMENTS/PARTNERS ²
	<ul style="list-style-type: none"> Increased investment in agricultural road and electrification 			<ul style="list-style-type: none"> Decentralize responsibility for rural roads in 10 competent Districts (FY05) 	<p><i>Proposed</i></p> <p>Improving Rural Access (FY05), Infrastructure Develop (FY07)</p> <p><i>Key partners</i></p> <p>ADB, China, Germany, India, Japan, Sweden, Switzerland, UK, US</p>
H	<ul style="list-style-type: none"> Access of telecom services to all VDCs- At least two telephone lines in all VDCs 	<ul style="list-style-type: none"> Private operator introduced for rural telephone service in Eastern Region 	<ul style="list-style-type: none"> Continue support for on-going reform IFC investments 	<ul style="list-style-type: none"> Private rural operator contracted (FY04) All VDCs in Eastern Region provided telephone connection (FY05) 	<p><i>On-going</i></p> <p>Telecom Project</p> <p><i>Key partners</i></p> <p>IFC, ADB, Denmark, Finland, Japan</p>
G (P1-G)	<ul style="list-style-type: none"> Increase in percentage of population with access to electricity from 40 to 55% 	<ul style="list-style-type: none"> Improved efficiency of NEA (as measured by a reduction in system losses to 20%), combined with greater private sector participation 	<ul style="list-style-type: none"> Provide financial support and TA to NEA's reforms and Power Development Fund IFC investments 	<ul style="list-style-type: none"> Internal unbundling of NEA (FY04) Power Development Fund (PDF) supporting private investment (FY05) Transform Tariff Fixation Commission into a full fledged regulatory body (FY05). Adopt subsidy policy for rural electrification (FY04) 	<p><i>On-going</i></p> <p>Power Development Project, TA to NEA</p> <p><i>Key partners</i></p> <p>IFC, ADB, Denmark, Germany, Japan, Norway, US</p>
G (P1-G)	<ul style="list-style-type: none"> Increase in percentage of population with access to electricity from 40 to 55% 	<ul style="list-style-type: none"> 30,000 additional households in remote areas served by micro-hydropower 	<ul style="list-style-type: none"> Continue financial and technical support to create a strong system to provide community-based micro-hydro projects 	<ul style="list-style-type: none"> Increased number of sustainable community-based micro-hydro schemes 	<p><i>On-going</i></p> <p>Power Development Project</p> <p><i>Key partners</i></p> <p>Denmark, UNDP</p>
SOCIAL SECTOR DEVELOPMENT					
L1, R	<ul style="list-style-type: none"> Net primary enrolment increased from 82% to 90% Increased percentage of pupils completing primary level Decline in percentage of primary school repeaters Decline in drop out rates at the primary level 	<ul style="list-style-type: none"> 25% of public schools under community management providing socially inclusive and higher quality education Efficient and timely textbook distribution system in place, as measured by all primary school children having books at the beginning of the school year 	<ul style="list-style-type: none"> Move toward HMG-led, sector-wide support by donors Support school transfer initiative. 	<ul style="list-style-type: none"> 1,000 primary schools transferred to community management (FY04) Integration of higher secondary education into school system (FY05) Free textbook policy effectively implemented (FY04) All community funded primary schools receiving block grants (FY04) 	<p><i>On-going</i></p> <p>BPEP II (Phase 1), Community Schools LIL</p> <p><i>Proposed</i></p> <p>BPEP II Phase 2 (FY04), An Evaluation of Community Managed Schools (FY07)</p> <p><i>Key partners</i></p> <p>ADB, Denmark, EU, Finland, Japan, Norway, UN Agencies</p>

Annex B10 CAS Outcomes, Milestones and Indicators, and PRS Outcomes Cont...

PRS/IAP AREAS ¹	PRS OUTCOMES	CAS OUTCOMES	BANK STRATEGY	MILESTONES	IDA INSTRUMENTS/PARTNERS ²
		<ul style="list-style-type: none"> Progress towards financial sustainability of public universities 	<ul style="list-style-type: none"> Build on achievements of past projects to enhance cost sharing <ul style="list-style-type: none"> Support separation of 10+ grades from universities to improve efficiency Support decentralization of university management 	<ul style="list-style-type: none"> Promulgation of Deemed University Act (FY05) University accreditation system in place (FY05) Agreement on policy framework for higher education, including plans for cost sharing and separation of 10+ grades from universities (FY04) 	<p><i>On-going</i> Policy dialogue <i>Proposed</i> Higher Education (FY05)</p>
M,R (P2-A)	<ul style="list-style-type: none"> Reduction in infant morality rate from 64 to 45% Reduction in child mortality rate from 91 to 72% Reduction in maternal mortality from 415 to 300 (per 100,000) 	<ul style="list-style-type: none"> Essential health care services implemented in 25 districts, at least half with low health indicators 	<ul style="list-style-type: none"> Work with other donors to support develop essential health packages and coherent service delivery mechanisms with special attention to reaching underserved populations <ul style="list-style-type: none"> Develop guidance (and provide NGO support/facilitation) to ensure that the governance of the decentralized health facilities is inclusive, accountable and transparent Work with other donors to support establishment of HIV/AIDS Trust Fund 	<ul style="list-style-type: none"> Implementation of essential health care packages started (FY04) Health facilities at DDC/VDC levels handed over to community or private/NGO management in 1/3 of Districts Autonomous HIV/AIDS Trust Fund operational (FY05) 	<p><i>On-going</i> Sector policy dialogue <i>Proposed</i> Health Sector Operation (FY05) <i>Key partners</i> China, EU, Germany, India, Japan, Norway, Switzerland, UK, UN Agencies, US</p>
N1, N2	<ul style="list-style-type: none"> Consistent community driven approach operational sector wide Health and hygiene improved About 3.8 million people have access to safe and sustainable drinking water services 	<ul style="list-style-type: none"> Extend rural water supply to an additional 10% of the population Extend coverage of sanitation services to an additional 5% of the rural population 	<ul style="list-style-type: none"> Leverage the success of the "Fund Board" approach to introduce more sustainable community-based approaches sector wide <ul style="list-style-type: none"> Improve M&E at the sector level and develop indicators of cost effectiveness, sustainability and inclusiveness of systems delivered by different projects and institutions to permit HMG to channel sectoral allocations funds to the best performing institutions/projects 	<ul style="list-style-type: none"> Rural Water Fund Board made independent (FY04) Performance based resource allocation for sector established (FY05) Rural water schemes under the Fund Board achieve equitable coverage of disadvantaged groups (FY06) 	<p><i>On-going</i> Rural Water Supply & Sanitation Project (RWSSP I) <i>Proposed</i> RWSSP II (FY04) <i>Key partners</i> ADB, UK, Water Aid</p>

Annex B10

CAS Outcomes, Milestones and Indicators, and PRS Outcomes Cont...

PRS/IAP AREAS ¹	PRS OUTCOMES	CAS OUTCOMES	BANK STRATEGY	MILESTONES	IDA INSTRUMENTS/PARTNERS ²
SOCIAL INCLUSION AND TARGETTED PROGRAMS					
L3	<ul style="list-style-type: none"> ■ Enrolment rate of girls and disadvantages children increase ■ Improvement in the ratio of girls enrolment rate to that of boys 	<ul style="list-style-type: none"> · Reduce out of school primary aged children (primarily Dalits, girls and disadvantaged Janajati groups) by 50% 	<ul style="list-style-type: none"> ■ Encourage social inclusion in the next phase of BPEP ■ Provide a LIL to help refine the program design ■ Support primary education in mother tongue ■ Develop indicators to track gender, caste and ethnic inclusion over time at the school level 	<ul style="list-style-type: none"> ■ Establish scholarship programs to support the target population (FY04) ■ Establish systems for monitoring the educational attainments, including the inclusion of girls and Dalits, at community managed schools (FY04) 	<p><i>On-going</i> Social & Gender Analysis (FY04), BPEP II (Phase 1), Community Schools LIL</p> <p><i>Proposed</i> BPEP II Phase 2 (FY04)</p> <p><i>Key partners</i> ADB, Denmark, EU, Japan, Norway, UN Agencies</p>
O1, O3	<ul style="list-style-type: none"> ■ HDI index of far-western and mid-western provinces to increase by 8% per year ■ Proportion of deprived communities below poverty line declines significantly 	<ul style="list-style-type: none"> ■ Increased public funds used by disadvantaged rural groups for services 	<ul style="list-style-type: none"> ■ Help HMG with the design of a PAF, as an instrument for PRSP ■ Link financial support for PAF to its autonomy effective poverty focus ■ Help HMG design poverty-based block grant formula and consider using PAF to give incentive grants to VDCs/DDCs that perform well in reducing poverty so there is not a negative incentive for maintaining high poverty levels 	<ul style="list-style-type: none"> ■ Autonomous PAF established and operational (FY04) ■ Increased funds available to the poorest VDCs through poverty based block grants (FY05) ■ VDCs that do well in improving poverty and social inclusion outcomes are rewarded with additional funding from PAF. 	<p><i>On-going</i> Policy dialogue on PAF</p> <p><i>Proposed</i> PAF I (FY04), PAF II (FY06)</p> <p><i>Key partners</i> Denmark, UK</p>
O	<ul style="list-style-type: none"> ■ Success rates of female, ethnic and disadvantaged groups in civil service increased 	<ul style="list-style-type: none"> ■ Affirmative action policy and implementation system for improving the diversity of the civil service in place and working 	<ul style="list-style-type: none"> ■ Carry out AAA to build HMG and civil society awareness of various approaches to overcoming historical discrimination ■ Help efforts to develop affirmative action programs in civil service while retaining principle of merit based selection/promotion 	<ul style="list-style-type: none"> ■ Workshop in collaboration with Ministry of General Administration (MOGA) and other donors on various approaches to affirmative action to help develop Nepal's policy (FY04) ■ Establish tertiary scholarship and internship program to support the target population (FY05) 	<p><i>On-going</i> Policy dialogue on PRSP</p> <p><i>Proposed</i> TA to provide best practice information</p> <p><i>Key partners</i> Canada, Denmark, Germany, Netherlands, Norway, Switzerland, UK, UN Agencies</p>

Annex B10

CAS Outcomes, Milestones and Indicators, and PRS Outcomes

PRS/IAP AREAS ¹	PRS OUTCOMES	CAS OUTCOMES	BANK STRATEGY	MILESTONES	IDA INSTRUMENTS/PARTNERS ²
GOOD GOVERNANCE					
R (P4-B)	<ul style="list-style-type: none"> ■ Central grants allocated to local bodies on poverty based formula ■ Functioning of fiscal decentralization based on road map drawn by fiscal commission 	<ul style="list-style-type: none"> ■ Decentralization (as designed in the Local Self Governance Act-LSGA) advanced substantially, with good monitoring systems in place 	<ul style="list-style-type: none"> ■ Assist HMG to develop a consistent legal framework for decentralization, including fiscal aspects ■ Provide financial support to test full decentralization in pilot DDCs and municipalities 	<ul style="list-style-type: none"> ■ Fiscal decentralization framework designed (FY04) ■ Inconsistencies in legal framework resolved (FY05) ■ Implementation of full fiscal decentralization piloted in 2-3 DDCs and 2-3 municipalities (FY05) 	<p><i>On-going</i> TA for developing a fiscal decentralization formula</p> <p><i>Proposed</i> Decentralization Support (FY07)</p> <p><i>Key partners</i> Denmark, UK, UN Agencies</p>
P	<ul style="list-style-type: none"> ■ Enhance civil service efficiency and accountability 	<ul style="list-style-type: none"> ■ Clear delineation of responsibilities between Ministers and civil service to ensure autonomy and accountability of civil service 	<ul style="list-style-type: none"> ■ Work with change agents in HMG to build consensus on the need for reform ■ Provide best practice knowledge 	<ul style="list-style-type: none"> ■ Legislation passed establishing clear roles and responsibilities of civil servants (FY05) 	<p><i>On-going</i> Policy dialogue</p> <p><i>Proposed</i> Reform TA/Capacity Building (FY05)</p> <p><i>Key partners</i> ADB, EU, Switzerland, UNDP</p>
R, A2	<ul style="list-style-type: none"> ■ Transparency and accountability improved ■ Citizen's charter in all DDCs and municipalities prepared 	<ul style="list-style-type: none"> ■ Improved accountability and transparency 	<ul style="list-style-type: none"> ■ Provide TA for implementation of CFAA and CPAR action plans ■ Provide TA for better performance monitoring in the public expenditure system ■ Support capacity building at the central and local level ■ Link overall lending level (PRSC support in particular) to progress on accountability systems 	<ul style="list-style-type: none"> ■ Implementation of key CPAR recommendation ■ Implementation of key CFAA recommendation ■ Institutionalization of expenditure tracking survey in the public sector (FY04) ■ Institutionalization of citizen charters and client surveys in 2-3 pilot DDCs and 2-3 pilot municipalities (FY05) 	<p><i>On-going</i> TA for expenditure tracking, TA/IDF grants to support CFAA and CPAR follow-up actions</p> <p><i>Proposed</i> Decentralization Support (FY07)</p> <p><i>Key partners</i> Denmark, UK, US</p>

Annex B11

HMGN's Policy Matrix for the Poverty Reduction Strategy Reform (PRS) Agenda and World Bank/Partner Programs of Support¹

OBJECTIVE ²	STRATEGIES	ACTIVITIES	INTERMEDIATE INDICATORS	OUTCOME	BANK GROUP INTERVENTIONS		
					NON-LENDING	LENDING	OTHER DONORS
A. Macroeconomic Stability							
A.1 Maintain fiscal discipline (P1-A)	<ul style="list-style-type: none"> ■ Pursue prudent expenditure management. ■ Improve domestic resource mobilization. 	<ul style="list-style-type: none"> ■ Medium Term Expenditure Framework (MTEF) strengthened by consolidating regular and development expenditure and classifying into recurrent and capital expenditures (on-going). ■ Development expenditure in all sectors widened and deepened through MTEF (on-going). ■ Actions taken to clear government arrears to/from the public utilities (2003/04). ■ Settle tax arrears (on-going). ■ Recommendations of the fiscal taskforce for tax reform implemented. ■ Tax exemptions and tax rebates narrowed downed and tax net widened (on-going). ■ Tax administration strengthened through a move towards an autonomous tax administration (on-going). ■ Customs valuations revised every six months based on ASYCUDA and product (on-going). 	<ul style="list-style-type: none"> ■ Fiscal deficit remaining around 5% of GDP. ■ Regular expenditure as percent of GDP declining. ■ Revenue surplus to finance development spending improves over years. ■ Annual revenue to grow by 0.4% of GDP. ■ Number of tax payers with PAN increased to 300,000 by 2007. 	<ul style="list-style-type: none"> ■ Revenue GDP ratio increased to 14% by 2007. ■ Decrease tax arrears by 50% by 2007. ■ Revenue surplus to contribute 18% of development expenditure by 2007. 	MTEF/ policy dialogue/ IAP support; Public Expenditure Analysis	PRSC I (FY04), PRSCs (FY05, FY06, FY07)	ADB, Denmark, Germany, IMF, UK
A.2 Ensure efficiency of public resources (P1-A)	<ul style="list-style-type: none"> ■ Widen and deepen MTEF to cover all sectors. ■ Increase the share of priority projects (P1) in the budget. 	<ul style="list-style-type: none"> ■ MTEF extended to all ministries (2003). ■ Performance based fund release institutionalized (2003). ■ Monitoring and evaluation unit strengthened (2003). 	<ul style="list-style-type: none"> ■ All priority projects/ programs published in the Red Book. ■ Project completion period reduced. 	<ul style="list-style-type: none"> ■ Improved pro-poor budget allocation. ■ Improved efficiency of public spending. 	MTEF/ policy dialogue/IAP support; Public Expenditure Analysis	PRSC I (FY04), PRSCs (FY05, FY06, FY07)	ADB, IMF, UK

1 This is the policy reform matrix contained in Nepal's Poverty Reduction Strategy (PRS). The final three columns have been added to highlight the assistance of the Bank and other development partners in implementing the PRS. Those items in **bold** in the outcome column correspond directly to CAS outcomes, whereas items in **bold** in the activities and intermediate indicators columns correspond directly to current Bank milestones. Finally, given the flexibility of the Poverty Reduction Support Credit (PRSC) instrument, in all likelihood the envisioned series of projects (FY04, FY05, FY06 and FY07) will support achievement of many of the CAS outcomes. As such, the PRSCs are not repeated under each of the areas of Bank involvement, but might likely apply.

2 IAP areas are provide in parentheses. See Appendix III, table 1 for IAP areas.

Annex B11

HMGN's Policy Matrix for the Poverty Reduction Strategy Reform (PRS) Agenda and World Bank/Partner Programs of Support¹ cont....

OBJECTIVE ²	STRATEGIES	ACTIVITIES	INTERMEDIATE INDICATORS	OUTCOME	BANK GROUP INTERVENTIONS		OTHER DONORS
					NON-LENDING	LENDING	
		<ul style="list-style-type: none"> ■ Performance of all projects programs made available in the web site (2003). ■ The new procurement law implemented (2004). 	<ul style="list-style-type: none"> ■ Time and cost over run reduced. ■ Total share of P1 project budget in sector ceiling increased. 				
A.3 Maintenance of monetary stability	<ul style="list-style-type: none"> ■ Pursue prudent monetary policy to (i) contain inflation and (ii) attain favorable balance of payments position. 	<ul style="list-style-type: none"> ■ Money supply (M2) contained to a desirable level (on-going). ■ Limit central bank borrowing as per financial regulation (2003/04). ■ Limit the growth of bank finance to the government (on-going). ■ Widen the instruments of open market operations (on-going). 	<ul style="list-style-type: none"> ■ Money supply (M2) growing at the rate of 14.5%. ■ Share of private sector credit as at 76% of the total. 	<ul style="list-style-type: none"> ■ Average inflation rate contained at 5% per annum. ■ Favorable balance of payments. 			IMF
A.4 Ensure external sector stability	<ul style="list-style-type: none"> ■ Diversification of exports. ■ Promotion of foreign direct investment. ■ Implementation of prudent foreign exchange rate policy. 	<ul style="list-style-type: none"> ■ Promote and diversify exportable commodities (commodity-wise and country-wise (on-going). ■ Alignment of real exchange rate. ■ Act, regulation, tariff structure amended/ revised and procedural simplification initiated. ■ Increase remittance (from Nepalese working abroad) by increasing access into foreign labor markets (on-going). ■ Foreign exchange regime rationalized (on-going). 	<ul style="list-style-type: none"> ■ Current account deficit contained at less than 4 % of GDP. ■ Foreign exchange reserve to cover minimum of 6 months of imports. 	<ul style="list-style-type: none"> ■ Balance of payment favorable. ■ International reserves remains to a comfortable position. 			IMF

Annex B11

HMGN's Policy Matrix for the Poverty Reduction Strategy Reform (PRS) Agenda and World Bank/Partner Programs of Support¹ cont....

OBJECTIVE ²	STRATEGIES	ACTIVITIES	INTERMEDIATE INDICATORS	OUTCOME	BANK GROUP INTERVENTIONS		OTHER DONORS
					NON-LENDING	LENDING	
A.5 Strengthen financial system (P1-E)	<ul style="list-style-type: none"> ■ Strengthen Central Bank's regulatory and supervisory capability. ■ Reform state owned commercial bank. ■ Strengthen banking and non-banking financial institutions. ■ Widen and deepen the activities of the stock market. 	<ul style="list-style-type: none"> ■ Implement re-engineering plan of Nepal Rastra Bank (2005). ■ Initiate privatization process of Rastriya Banijya Bank and Nepal Bank Limited (2005). ■ Establish asset Reconstruction Company (2003/04). ■ Strengthen legislative and institutional framework for effective loan recovery (2003/04). ■ Enact necessary acts for regulation of local co-operatives (2004). ■ Complete audits of two main development banks (ADB/N and NIDC) and develop restructuring strategy for them (2004). ■ Reform rural development banks (2004). ■ Strengthen rural financing system (on-going). ■ Improve the regulatory framework and operational efficiency of the stock market (on-going). 	<ul style="list-style-type: none"> ■ Reduced NPL of the banking system. ■ Improved capital adequacy ratio. ■ Interest rate spread between deposit and lending narrowed. ■ Number of listed companies and transaction volume in the stock exchange increased. 	<ul style="list-style-type: none"> ■ Central Bank's supervisory and regulatory capacity improved. ■ Confidence in the financial system augmented. ■ Efficiency of the financial system service delivery improved. 	Financial Sector Reforms: Lessons and Next Steps (FY06)	Financial Sector Technical Assistance, Banking Reform I (FY04), Banking Reform II (FY06)	ADB, Germany, IMF, UK
A.6 Enhanced role of private sector in economic activities (P1-D)	<ul style="list-style-type: none"> ■ Create conducive and competitive environment for private sector investment. 	<ul style="list-style-type: none"> ■ Review labor act and enact necessary laws for easy entry and exit (2004). ■ Mechanism for improving accounting, auditing and reporting system strengthened. ■ Procedural simplification especially for investment and exports. 	<ul style="list-style-type: none"> ■ Increased share of private sector in total investment. ■ Privatize at least three SOEs annually. ■ Unbundling of NEA and corporatization of NTC. 	<ul style="list-style-type: none"> ■ Private sector investment reached 16.7% of GDP. ■ Foreign Direct Investment increased. 		Telecommunications Sector Reform, PRSCs (FY05, FY06, FY07) IFC Investments	ADB, EU, Germany, IMF, UK

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HMGN's Policy Matrix for the Poverty Reduction Strategy Reform (PRS) Agenda and World Bank/Partner Programs of Support¹ cont....

OBJECTIVE ²	STRATEGIES	ACTIVITIES	INTERMEDIATE INDICATORS	OUTCOME	BANK GROUP INTERVENTIONS		OTHER DONORS
					NON-LENDING	LENDING	
	<ul style="list-style-type: none"> ■ Continue economic reform to ensure macroeconomic stability to increase private sector investment. ■ Restructure/ privatize state owned enterprises. 	<ul style="list-style-type: none"> ■ Continue reform in fiscal monetary and financial sectors (on-going). ■ Privatize/corporative Nepal Electricity Authority, Nepal Telecommunication Corporation, Royal Nepal Airlines. ■ Accelerate the privatization of state owned enterprises and complete audits of all state owned enterprises (2004). ■ Enact liquidation, merger, bankruptcy acts (2004). 			MTEF, Development Policy Review (FY04) Provision by MIGA of non-commercial (political risk) guarantees for foreign investors investing in privatization projects; Show-casing privatization profiles on MIGA's online investor services (FDI Xchange, Privatization Link)		
PILLAR 1: BROAD BASED ECONOMIC GROWTH							
B. Agriculture							
Increase agricultural production productivity and income for food security and poverty reduction (P1-B, P1-C)	<ul style="list-style-type: none"> ■ Expand the use of available modern technology. 	<ul style="list-style-type: none"> ■ Enhanced farmer's group based technology dissemination system and capability enhancement of staff and farmers groups (continued). ■ Promote research, development and extension for food security in severely food deficit districts (continued). ■ Enhance balanced use of agro-chemicals (continued). 	<ul style="list-style-type: none"> ■ Increased number of effective farmers groups. ■ Coordinated need based research and extension programs for severely food deficit areas (specially remote) in operation. ■ Increase number of Integrated Pest Management (IPM) and other farmer field schools. 	<ul style="list-style-type: none"> ■ Need based location specific technology recommendations available and dissemination system in place. ■ More diversified production system and enhanced commercialisation. ■ Overall agricultural growth of 4.1%. 	Improving Agricultural Performance (FY04), Rural Factor Market Study (FY05)	Irrigation Sector Development, Agriculture Sector Operation (FY06)	ADB, Australia, Canada, Denmark, EU, FAO, Finland, Germany, IFAD, IMF, India, Japan, Kuwait Fund, Norway, OPEC Fund, Saudi Fund, Sweden, Switzerland, UK, UNDP, US

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HMGN's Policy Matrix for the Poverty Reduction Strategy Reform (PRS) Agenda and World Bank/Partner Programs of Support¹ cont....

OBJECTIVE ²	STRATEGIES	ACTIVITIES	INTERMEDIATE INDICATORS	OUTCOME	BANK GROUP INTERVENTIONS		OTHER DONORS
					NON-LENDING	LENDING	
	<ul style="list-style-type: none"> ■ Increase farmers access to modern agricultural input and credit. ■ Promote diversification and commercialization in crops/livestock production system. ■ Include NGOs/private sector involvement in partnership and contract in agricultural service delivery system. ■ Improve effectiveness of Planning, Monitoring and Evaluation (PME). 	<ul style="list-style-type: none"> ■ Enhance market based environment for increasing fertilizer supply and uses (continued). ■ Enhance rural banking activities (ADBN/ Rural Banks) for effective credit delivery (continued). ■ Strengthen regional research farms stations and private sectors resources for ensured quality seeds/ breeds/ planting materials production and supply to the local multipliers/nurseries (continued). ■ Implement intensive agriculture program in year round irrigated areas (continued). ■ Provide incentive and appropriate support package for expansion of ground water irrigation and on farm water management (continued). ■ Intensify production of high value crops /livestock commodities in potential pockets (continued). ■ Ensure involvement of private sector/ NGOs/CBOs and local bodies in extension service delivery (continued). ■ Enhance PME capabilities at all levels (continued). ■ Ensure effective, transparent and timely reporting and review system (continued). 	<ul style="list-style-type: none"> ■ Increased supply and uses of fertilizer. ■ Increased flow of credits. ■ Increased supply of quality seeds/ breeds/ planting materials to local multipliers. ■ Increased number and coverage of intensive pockets in year round irrigated areas. ■ Increased no. of shallow tubwells and improved efficiency of on-farm water uses. ■ Increased areas and coverage of high value crops/ commodities. ■ Increased involvement of NGOs/CBOs/private sector in service delivery. ■ Improved database and regularized reporting and review system in place. ■ Printed monitoring reports in regular basis. 	<ul style="list-style-type: none"> ■ Crops production increased by 4.1%. ■ Livestock production increased by 4.9%. ■ Enhanced agricultural productivity. ■ Reduced food insecurity and significant contribution to income increases and reduction in malnutrition and poverty in rural areas. ■ Increased marketed volumes of agricultural products and diversified agricultural export. 			

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HMGN's Policy Matrix for the Poverty Reduction Strategy Reform (PRS) Agenda and World Bank/Partner Programs of Support¹ cont....

OBJECTIVE ²	STRATEGIES	ACTIVITIES	INTERMEDIATE INDICATORS	OUTCOME	BANK GROUP INTERVENTIONS		
					NON-LENDING	LENDING	OTHER DONORS
Develop and adapt need-based technology ensuring agro-biodiversity conservation environmental protection and sustainable development (P1-B)	<ul style="list-style-type: none"> ■ Emphasize for need-based adaptive and low cost technology development ensuring agro-biodiversity conservation and environmental protection. ■ Decentralize research and extension. 	<ul style="list-style-type: none"> ■ Make NARC's vision and strategy operational (continued). ■ Devolve DOA DLS extension activities to local bodies and ensure operational effectiveness and technical backstopping to them (continued). ■ Decentralize NARC's adaptive and on farms research activities to Regional Agricultural Research Centers (RARCS) (2005). 	<ul style="list-style-type: none"> ■ NARC's vision and strategy in operation from 2003. ■ Regular reporting of the progress. ■ Decentralized extensions are fully functional by 2004. ■ Decentralized NARC's research to RARCS in place by 2004. 				
Develop local and export market opportunities	<ul style="list-style-type: none"> ■ Encourage private and co-operative sectors involvement for market promotion and infrastructure development. ■ Promote co-operative and contractual farming. 	<ul style="list-style-type: none"> ■ Co-ordinate the expansion of agricultural roads and rural electrification (continued). ■ Develop commodity policies for congenial environment for private sector investment. (continued). ■ Emphasize on marketing research, flow of market information and development of market infrastructure (Agro industry, collection center, wholesale and retail outlets) (continued). ■ Promote conducive tariff rate for agricultural export and import (continued). ■ Regulate/facilitate agro-processing and standardization (on-going). ■ Facilitate legal arrangements for cooperative and contractual farming (2004/05). 	<ul style="list-style-type: none"> ■ Increased investment in agricultural road and electrification. ■ Commodity policies developed for major commodities by 2004. ■ Increased number of market infrastructures and continuity in market research and information flow. ■ Conducive tariff policies in place. ■ Regulatory services in place. ■ Legal arrangement for contractual farming in place by 2004. ■ Cases of cooperative and contractual farming in place after 2004. 				

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HMGN's Policy Matrix for the Poverty Reduction Strategy Reform (PRS) Agenda and World Bank/Partner Programs of Support¹ cont....

OBJECTIVE ²	STRATEGIES	ACTIVITIES	INTERMEDIATE INDICATORS	OUTCOME	BANK GROUP INTERVENTIONS		
					NON-LENDING	LENDING	OTHER DONORS
C. Irrigation							
Promote year round irrigation in the irrigable land	<ul style="list-style-type: none"> ■ Strengthen public and community based irrigation system. ■ Expand new irrigation facilities with focus on APP. ■ Establish coordination in intensive agriculture program formulation and implementation in year round irrigated areas at all level. 	<ul style="list-style-type: none"> ■ Enhance maintenance and rehabilitation of existing farmer managed and public irrigation systems (continued). ■ Revise irrigation policy and regulations to give WUAs legal power to collect irrigation charges (2004/05). ■ Initiate private sector management of large/medium scale of HMG managed irrigation system (2004/05). ■ Develop and implement small surface irrigation facilities in the hill and surface and ground water irrigation facilities in the Terai (continued). ■ Increase involvement of NGO's and private sector in the irrigation development and management (2004/05). ■ Adopt co-ordinate approach for timely supply of irrigation water in intensive packet areas (continued). ■ Scale up On Farm Water Management Program (continued). ■ Ensure irrigation support component in intensive agriculture program of MOA (continued). 	<ul style="list-style-type: none"> ■ Increased number of rehabilitated and handed over schemes. ■ Increased and strengthened water users' committees (WUAS) in place. ■ Revised irrigation policy and regulation in place by 2004. ■ Increase number and hecterage of private sector managed government owned large/medium schemes. ■ Increased number of STW, DTW and other irrigation schemes. ■ Increased number and hecterage of new schemes developed and managed by NGOs and private sector. ■ Timely supply of irrigation water in pocket areas. ■ Strengthen technical support to farmers. ■ Coordinated intensive agriculture pocket program in place. 	<ul style="list-style-type: none"> ■ Year round irrigation increased to 50% of the irrigated land by 2005. ■ Additional irrigation facilities developed in 177,600 ha. from new schemes and rehabilitation of 64,000 ha. ■ Management transfer to WUAs in 37,000 ha. ■ Farmers/WUAs become capable to own and manage irrigation systems up to the size of 500 ha by 2005. ■ Increased irrigation charge collection by WUAs significantly. ■ Private sector and NGO participation in irrigation management increased. 	<p>Irrigation Sector Development, Agricultural Sector Operation (FY06)</p>	<p>ADB, Canada, EU, FAO, Japan, Kuwait Fund, OPEC Fund, Saudi Fund, UNDP, US</p>	

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HMGN's Policy Matrix for the Poverty Reduction Strategy Reform (PRS) Agenda and World Bank/Partner Programs of Support¹ cont....

OBJECTIVE ²	STRATEGIES	ACTIVITIES	INTERMEDIATE INDICATORS	OUTCOME	BANK GROUP INTERVENTIONS		OTHER DONORS
					NON-LENDING	LENDING	
D. Trade							
Increase the contribution of trade in the economy	<ul style="list-style-type: none"> ■ Trade policy to be made compatible with regional / international agreements. ■ Enhance competitiveness. ■ Involve private sector for export promotion. 	<ul style="list-style-type: none"> ■ Acts/rules compatible with WTO/SAPTA (2004 onwards). ■ Operationalization of ICD, Birgunj (03/04). ■ Technical support service to enhance competitiveness of exports (on-going). ■ Emphasis on quality improvement (on-going) ■ Introduce selected services in the management of private sector in major customs terminal (by 2004). 	<ul style="list-style-type: none"> ■ Accession to WTO/SAFTA. ■ Trade diversification enhanced product wise and country wise. ■ ICD Birgunj operationalized. ■ Exports of supported commodities increased. ■ Quality certification expanded. ■ Involvement of private sector in providing services in customs terminals. 	<ul style="list-style-type: none"> ■ Export GDP ratio increased. ■ Market/product diversification. 	Follow up on Trade and Competitiveness Study	Multi-modal Trade and Transport; PRSC II (FY05)	EU, IMF, Norway, UK, UNDP
E. Labour							
Increase employment to reduce poverty. Ensure congenial industrial environment for better industrial relations. Protect children from exploitation	<ul style="list-style-type: none"> ■ Make employment intensive growth objectives. ■ Reform vocational training program to link with employment policy objectives and labor demand. ■ Make labour laws flexible. ■ Enhance foreign employment. 	<ul style="list-style-type: none"> ■ Reorient public expenditure to make it more employment intensive. ■ Incentives and policies improvement for private sector to generate employment growth. ■ Streamline present training programs based on market and demand for such training identified by CBOs at district level. ■ Consultative process strengthened and cooperation initiated and institutionalized with the private sector in making the training program more demand driven and effective. 	<ul style="list-style-type: none"> ■ Employment opportunities expanded. ■ Efficiency of labor enhanced. ■ Labour law amended. ■ Number of labourers employed overseas increases. ■ Number of disputes decreased. ■ Number of child labourers rescued and rehabilitated. 	<ul style="list-style-type: none"> ■ Under-employment/ unemployment rates decline. ■ Industrial relations improved. ■ Labour productivity enhanced. ■ Rights of labour protected. ■ Worst form of Child labour reduced significantly. ■ Remittance income increased. 	Follow up to Trade & Competitiveness Study, Policy dialogue/IAP, Study on Labor Remittances	PRSC II (FY05), PRSC III (FY06)	Germany, ILO, IMF, UNDP, UNICEF

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HMGN's Policy Matrix for the Poverty Reduction Strategy Reform (PRS) Agenda and World Bank/Partner Programs of Support¹ cont....

OBJECTIVE ²	STRATEGIES	ACTIVITIES	INTERMEDIATE INDICATORS	OUTCOME	BANK GROUP INTERVENTIONS		
					NON-LENDING	LENDING	OTHER DONORS
	<ul style="list-style-type: none"> ■ Promote industrial relationship for increasing labour productivity. ■ Eliminate child labor. 	<ul style="list-style-type: none"> ■ Reform labour laws by (2004) ■ Agreements with labour importing countries increased/strengthened (continued). ■ Skill development program encouraged for outward migrant workers (continued). ■ Support services for labourers enhanced (continued). ■ Orientation/training on industrial relations increased and guidelines/regulations strengthened (continued). ■ Legal measures and strict monitoring for eliminating child labour and their rehabilitation (on-going). 					
F. Infrastructure Development: Roads							
Develop & manage road transport network in cost effective way to support socio economic development effort (P1-F)	<ul style="list-style-type: none"> ■ Expansion of road network link the districts without road. ■ Encourage private sector participation. ■ Maintain the road network in serviceable condition. ■ Enhance the institutional capacity in the context of liberal economy and decentralization. 	<ul style="list-style-type: none"> ■ 10 Additional District headquarters connected by road (by FY06/07). ■ Act developed for BOT projects (FY03/04). ■ Rural roads management responsibility transferred to DDCs (FY03/04). ■ Road Board fully operational (FY03/04). ■ Framework planned for road maintenance system (FY03/04). ■ Capacity building of Department of Roads in the context of liberal economy and decentralization (FY03/04 onwards). 	<ul style="list-style-type: none"> ■ Additional 1025 km. To be constructed. ■ Detail plan approved enough and budget allocation. ■ Rural Roads responsibilities transferred to DDCs. ■ Full levy collected. ■ 90% of SRN in good/fair condition. ■ Act implemented. ■ Annual maintenance plan for 2003/04 received and approved (2003 April) ■ Technical auditing agency operational. 	<ul style="list-style-type: none"> ■ Road access increased to 70 District Headquarters. ■ Road length increased by 1025 km. ■ Reduced transport cost. ■ Sustainable Road Maintenance Fund available in a accordance with annual maintenance plan ■ Management efficiency improved in planning, procurement, and implementation. ■ BOT legal frame finalization. ■ 90% of SRN in good/fair condition. 	Road Maintenance & Development, Improving Rural Access (FY05), Infrastructure Development (FY05)	ADB China, Germany, India, Japan, Sweden, Switzerland, UK, US	

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HMGN's Policy Matrix for the Poverty Reduction Strategy Reform (PRS) Agenda and World Bank/Partner Programs of Support¹ cont....

OBJECTIVE ²	STRATEGIES	ACTIVITIES	INTERMEDIATE INDICATORS	OUTCOME	BANK GROUP INTERVENTIONS		OTHER DONORS
					NON-LENDING	LENDING	
G. Power Sector							
Expand electricity coverage in a reliable, financially and environment-ally sustainable manner (P1-G)	<ul style="list-style-type: none"> ■ Promote private sector participation in power sector. ■ Improve financial viability of NEA. 	<ul style="list-style-type: none"> ■ Establish power development fund (FY03/04). ■ Establish an independent regulatory body (FY03/04). ■ "Develop" profit-making centers within NEA (FY03/04 onwards). ■ Internal unbundling of NEA into generation, transmission, and distribution units (FY03/04). ■ Initiate explicit subsidy policy for grid-based rural electrification (FY03/04). 	<ul style="list-style-type: none"> ■ Power Development Fund established. ■ Regulatory Body established. ■ Reduce system losses 1% a year from 23% at the beginning of Tenth Plan. ■ Complete internal unbundling of NEA by FY04. ■ Adopt a subsidy policy for grid-based rural electrification by FY 2004. 	<ul style="list-style-type: none"> ■ Increase in percentage of population with access to electricity from 40 to 55%. 		Power Development Project IFC Investments	ADB Canada, Denmark, Finland, Germany, Japan, Norway, Sweden, UNDP, US
	<ul style="list-style-type: none"> ■ Integrate rural electrification with rural economic development. ■ Promote cooperative based grid-based rural electrification. <p>■ Expand and reinforce power infrastructure.</p>	<ul style="list-style-type: none"> ■ Promote productive end-uses (continued). ■ Capacity building of cooperatives (continued). <p>■ Expand and reinforce generation, transmission and distribution (on-going).</p> <p>■ Promote small-, medium- scale and storage hydropower projects (on-going).</p>	<ul style="list-style-type: none"> ■ Adopt a framework for cooperative based rural electrification. ■ Training programs to cooperatives. ■ Increase installed capacity from 527 MW to 830 MW. ■ Increase length of transmission lines (66, 132 and 220 kV) from 1962 km to 2392 km. ■ Initiate construction of a storage project. 				
H. Information and Communication							
Improve access of information and communication	<ul style="list-style-type: none"> ■ Private sector participation ■ Clarity on role and responsibility of public and private operators. 	<ul style="list-style-type: none"> ■ Private sector involvement in telecom (FY03/04 and onwards). ■ Expansion of broadcasting services (continued). 	<ul style="list-style-type: none"> ■ Convert NTC to a Company under Company Act by 2002/03. 	<ul style="list-style-type: none"> ■ Competitive and liberalized market of Telecom service. 		Telecommunications Sector Reform, IFC Investments	ADB Denmark, Finland, Japan

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HMGN's Policy Matrix for the Poverty Reduction Strategy Reform (PRS) Agenda and World Bank/Partner Programs of Support¹ cont....

OBJECTIVE	STRATEGIES	ACTIVITIES	INTERMEDIATE INDICATORS	OUTCOME	BANK GROUP INTERVENTIONS		OTHER DONORS
					NON-LENDING	LENDING	
	<ul style="list-style-type: none"> ■ Functional autonomy. 	<ul style="list-style-type: none"> ■ Creation of legal frame for functional autonomy of postal service (FY03/04). 	<ul style="list-style-type: none"> ■ Private GSM operator in place. ■ Private RTS operator in place in Eastern Region. ■ Radio and Television service extension to the whole country initiated. ■ Approval of Rules and Regulation for functional autonomy of postal service by 2003/04. 	<ul style="list-style-type: none"> ■ Access of Telecom service to all VDCs. ■ Telephone penetration 40 lines per 1000 inhabitants. ■ Radio and Television service available to all people. ■ Effective function of postal service. ■ At least two telephone lines in all VDCs. 			
I. Tourism, Infrastructure, Services and Promotion							
Expand tourism activities	<ul style="list-style-type: none"> ■ Tourism promotion marketing and product development ■ Infrastructure development. 	<ul style="list-style-type: none"> ■ Promotional activities focused in regional markets (on-going) ■ Development and conservation of national heritage religious sites (on-going) ■ Promote eco-tourism (on-going). ■ Develop Infrastructure and institutions particularly for eco-tourism (on-going). ■ Manage solid-waste and air pollution (on-going). ■ Manage air-safety (by FY04/05). 	<ul style="list-style-type: none"> ■ Number of promotional activities increase ■ World heritage guidelines followed ■ National heritages developed and conserved. ■ Infrastructure and physical structure improved. ■ New destination opened. ■ Increase tourist activities in National Parks and Nature conservation areas. ■ Air services at eco-tourism areas enhanced. ■ Infrastructure and institution for eco-tourism developed. ■ Dumping site/incinerators established. ■ Air pollution standard imprinted. 	<ul style="list-style-type: none"> ■ Increase in the number of tourists to 516 000 ■ Length of stay of tourist increases to 13 days ■ Tourism earnings distributed widely to rural areas also. ■ Domestic tourism enhanced. ■ Contribution of tourism in the economy enhanced to 3%. 			ADB Japan Netherlands UK UNDP

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HMGN's Policy Matrix for the Poverty Reduction Strategy Reform (PRS) Agenda and World Bank/Partner Programs of Support¹ cont....

OBJECTIVE ²	STRATEGIES	ACTIVITIES	INTERMEDIATE INDICATORS	OUTCOME	BANK GROUP INTERVENTIONS		OTHER DONORS
					NON-LENDING	LENDING	
	<ul style="list-style-type: none"> ■ Tourism facilitation 	<ul style="list-style-type: none"> ■ Simplify immigration system (on-going) ■ Expand transportation facilities for tourism industry (on-going). ■ Promote quality of tourism services (on-going). 	<ul style="list-style-type: none"> ■ Air safety standard strengthened are executed ■ Visa pressing simplified ■ Domestic air services enhanced ■ Number international connection and briers increased. ■ Tourism service standard strengthened and monitored. 				
J. Industry							
Expand Industrial-ization	<ul style="list-style-type: none"> ■ Strengthened market oriented policies. ■ Strengthening SMEs. ■ Improved Industrial environment. 	<ul style="list-style-type: none"> ■ Tariff rationalization (on-going). ■ Foreign investment policy reform (by 2004). ■ Industrial acts & policies reform (by 2004). ■ Incentive and programs for technological improvement and upgrading SMEs. (on-going). ■ Institutional mechanism/ acts sub-contracting to SMEs (2005). ■ Entrepreneurship training skill development (on-going). ■ Incentive for backward linkages to industries (on-going). ■ Information technology development (on-going). ■ Tripartite industrial relationship improved (on-going). 	<ul style="list-style-type: none"> ■ Industrial competitiveness improved. ■ Foreign investment increased. ■ Acts and policies reformed. ■ Labour/ company law amended. ■ Exit policy introduced. ■ Acts amended according to WTO/ SAFTA. ■ Action plan developed according to Industrial Perspective Plan. ■ Production and productivity increased. ■ Act amended. 	<ul style="list-style-type: none"> ■ Contribution of GDP enhanced. ■ Employment generation. ■ Product expansion. ■ Information institutionalization. ■ Harmonious industrial relation. ■ Industrial production expanded in average 7.8% per annum. ■ SME Additional employment generated to 250,000. 	Follow up on Trade and Competitiveness Study, Development Policy Review	<p>PRSCs (FY05, FY06, FY07), IFC TA for SME development</p>	ILO, Japan, UNDP, US

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HMGN's Policy Matrix for the Poverty Reduction Strategy Reform (PRS) Agenda and World Bank/Partner Programs of Support¹ cont....

OBJECTIVE ⁴	STRATEGIES	ACTIVITIES	INTERMEDIATE INDICATORS	OUTCOME	BANK GROUP INTERVENTIONS		OTHER DONORS
					NON-LENDING	LENDING	
K. Food Security							
Improve the supply and distribution of essential commodities	<ul style="list-style-type: none"> ■ Strengthen food supplies in remote areas. ■ Market based petroleum price. 	<ul style="list-style-type: none"> ■ Rationalization of NFC activities and strengthen supply system (on-going). ■ Enhance food supply and distribution in food deficit areas (on-going). ■ Management of NOC improved, leakage reduced and private sector's involvement in NOC activities initiated (by 2004). ■ Rationalization of petroleum product prices (by 2003). 	<ul style="list-style-type: none"> ■ Number of trainings trainees ■ Industrial production expanded ■ Access to information improved. ■ Smooth industrial operation. ■ Focus distribution in districts and strengthened networks. ■ Supply and distribution of 35000 MT food per annum mainly in remote districts. ■ Loss of NOC reduced. ■ Storage capacity of petroleum product will be increased. ■ Private sector involvement increased. ■ Petroleum price will be market based. 	<ul style="list-style-type: none"> ■ Food security will be improved. ■ Price of petroleum products competitive. 	Policy dialogue/ IAP	PRSC I (FY04)	Canada, FAO, France, Germany, Japan, UK, UNICEF, WFP
PILLAR 2: SOCIAL DEVELOPMENT							
L. Education							
L.1 Improve quality of and access to education especially primary education (P2-B)	<ul style="list-style-type: none"> ■ Decentralization of school management to communities/local bodies and change in role of district and central level agencies from implementation to facilitation, monitoring and evaluation. 	<ul style="list-style-type: none"> ■ Transfer of management of schools to communities/ local bodies (on-going). ■ Framework for the assessment of students' learning outcome (2004). 	<ul style="list-style-type: none"> ■ At least 6,000 schools transferred to local community management. 	<ul style="list-style-type: none"> ■ Net primary school enrollment increased from 82 to 90%. 	Evaluation of Community Management of Schools (FY07)	BPEP II Phase I, Community Schools LIL, BPEP II, Phase II (FY04)	ADB, Canada, Denmark, EU, Finland, Japan, Norway, UK, UNDP, UNFPA, UNICEF

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HMGN's Policy Matrix for the Poverty Reduction Strategy Reform (PRS) Agenda and World Bank/Partner Programs of Support¹ cont....

OBJECTIVE	STRATEGIES	ACTIVITIES	INTERMEDIATE INDICATORS	OUTCOME	BANK GROUP INTERVENTIONS		
					NON-LENDING	LENDING	OTHER DONORS
	<ul style="list-style-type: none"> ■ Improve and expand teachers training program. ■ Strengthen school monitoring and supervision system 	<ul style="list-style-type: none"> ■ Promote private sector for production and distribution of textbooks with a view to facilitate timely distribution of textbooks (to be started from 2004). <ul style="list-style-type: none"> ■ Review and Rationalize teaching/learning package. ■ New recruitment of teachers done locally. ■ Teachers' certification process expanded and strengthened (on-going). ■ Teachers training facilities for primary school increased (on-going). ■ Expand teacher training for secondary education (on-going). ■ Framework for school monitoring mechanism developed and strengthened (2004) <ul style="list-style-type: none"> ■ Schools expansion only on the basis of mapping and accepted norms (2004). ■ Partial grant for community schools not receiving Government funding (on-going). 	<ul style="list-style-type: none"> ■ Guideline for partial grant for community schools completed; all community schools receive grant. ■ Timely distribution of textbooks. <ul style="list-style-type: none"> ■ Number of trained teachers in primary school increased from 52 to 100%. ■ Establishment of Child Development Centers in VDCs/ municipalities. ■ Increase in number of trained teacher in secondary level. ■ A system of regular school maintaining in place in all districts ■ School-mapping completed. 	<ul style="list-style-type: none"> ■ The Primary completion rate increases from 59 % to 75 %. ■ Percentage of primary school repeaters declines. ■ Drop out rates at the primary level declines. 			
L.2 Delivery of literacy programs with focus on livelihood improvement	<ul style="list-style-type: none"> ■ Integration of literacy programs with CBO-based income generation activities facilitated by local bodies. 	<ul style="list-style-type: none"> ■ Expand literacy campaign by increased involvement of CBOs/NGOs/ local bodies (on-going). ■ Expand Community Learning Centers (on-going). 	<ul style="list-style-type: none"> ■ At least 200,000 out of school children in the 6-10 and 10-14 age groups to receive informal education. ■ Post literacy skill generating programs to 20% of literates. 	<ul style="list-style-type: none"> ■ Adult literacy rate (+15) increased from 49 to 63%. ■ Female adult literacy rate (+15) increased from 34 to 55%. 			Canada Germany UK

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HMGN's Policy Matrix for the Poverty Reduction Strategy Reform (PRS) Agenda and World Bank/Partner Programs of Support¹ cont....

OBJECTIVE ²	STRATEGIES	ACTIVITIES	INTERMEDIATE INDICATORS	OUTCOME	BANK GROUP INTERVENTIONS		OTHER DONORS
					NON-LENDING	LENDING	
L.3 Improve access of girls, Dalits and disadvantaged children to education (P2-B)	<ul style="list-style-type: none"> ■ Mitigate social, cultural and financial barriers for access to education. ■ Social contracts for access improvement. 	<ul style="list-style-type: none"> ■ Enhanced scholarship for children of poor families (on-going). ■ Expand school feeding program in deprived areas (on-going). ■ Secondary scholarships for children, girl and Dalit/ disadvantaged from poor families (on-going). ■ Separate latrines for girls (on-going). ■ Incentive grant for schools employing female teachers (on-going). 	<ul style="list-style-type: none"> ■ Enroll all of age 6 children to primary education. ■ Number of students for disadvantaged receiving scholarship increased. ■ Increased share of female teachers in primary schools from 26 to 30%. ■ Share of girls and disadvantaged children in primary and secondary levels increase. 	<ul style="list-style-type: none"> ■ Enrolment rate of girls and disadvantaged children increase. ■ Improvement in the ratio of girls enrollment rate to that of boys. 	Social and Gender Analysis	BPEP II Phase I Community Schools LIL, BPEP II, Phase II (FY04)	ADB Canada, Denmark, EU, Germany, Japan, Norway, UNDP, UNESCO, UNFPA, UNICEF
L.4 Meet national demand for basic and middle level technical human resources	<ul style="list-style-type: none"> ■ Vocational courses attached to existing secondary school. ■ Promote private provision of basic and middle level technical training. 	<ul style="list-style-type: none"> ■ Initiate and strengthen the program in 25 schools as an annex program (to start from 2004). ■ Introduction of voucher system targeted to poor for basic and middle level technical training (to start from 2004). 	<ul style="list-style-type: none"> ■ Short and medium term technical training to more than 30,000 people. 	<ul style="list-style-type: none"> ■ Increase share of semi-skilled and skilled labour in the labour force. 			ADB, Switzerland, UNFPA
M. Health							
Increase essential health care services to all with special emphasis to rural/remote/poor population (P2-A)	<ul style="list-style-type: none"> ■ Development and retention of trained staff specially in rural areas. 	<ul style="list-style-type: none"> ■ Terms and conditions of recruitment and transfer made transparent (end 2003). Incentive mechanism devised to encourage health workers to work in remote and rural areas (FY03/04). ■ Fulfill vacant positions (on-going). 	<ul style="list-style-type: none"> ■ Sick individuals (%) who visited rural health centers (during the past month). ■ Number of absentee health workers. 	<ul style="list-style-type: none"> ■ Reduction in infant mortality rate from 64 to 45. ■ Reduction in child (U5MR) mortality rate from 91 to 72. ■ Reduction in maternal mortality from 415 source & date to 300. 	Sector policy dialogue	Health Sector Operation (FY05)	Australia Canada, China, EU, Germany, India, Japan, Norway, Switzerland, UK, UNAIDS, UNDP, UNFPA, UNICEF, US, WHO

Annex B11

HMGN's Policy Matrix for the Poverty Reduction Strategy Reform (PRS) Agenda and World Bank/Partner Programs of Support¹ cont....

OBJECTIVE ²	STRATEGIES	ACTIVITIES	INTERMEDIATE INDICATORS	OUTCOME	BANK GROUP INTERVENTIONS		OTHER DONORS
					NON-LENDING	LENDING	
	<ul style="list-style-type: none"> ■ Training and upgrading of health personnel. ■ Increased supply of essential drugs, vaccines ■ Expand accessibility facilities 	<ul style="list-style-type: none"> ■ Increased availability of Auxiliary Health Midwife/ nurse in the health posts especially to address MCH problems (FY03/04-FY07/08). ■ Training programmes strengthen and manpower production enhanced (on-going). ■ Procurement of drugs, vaccines and equipment based on program priorities (on-going). ■ Expansion of community drug program (on-going). ■ Initiation of health insurance scheme (FY03/04 onwards). ■ Focus of the program on immunization, safer motherhood, control and prevention of communicable diseases, malaria control, JE, TB and leprosy, HIV/AIDS and CDP Programmes (on-going). 	<ul style="list-style-type: none"> ■ Women receiving at least 4 antenatal visits increased from 14 to 40%. ■ Births (%) attended by skilled health personnel increased from 13 to 40%. ■ Number of drug outlets where 15 of the most essential drugs available. ■ Number of sub/health posts with community drug program increases. ■ Availability of essential and priority drugs increased to 90% places. ■ Population under health insurance. ■ One year olds (%) fully immunized against target diseases. 	<ul style="list-style-type: none"> ■ Life expectancy increased from 61.9 years to 65 years. 			

Annex B11

HMGN's Policy Matrix for the Poverty Reduction Strategy Reform (PRS) Agenda and World Bank/Partner Programs of Support¹ cont....

OBJECTIVE ²	STRATEGIES	ACTIVITIES	INTERMEDIATE INDICATORS	OUTCOME	BANK GROUP INTERVENTIONS		
					NON-LENDING	LENDING	OTHER DONORS
	<ul style="list-style-type: none"> ■ Up-gradation of primary health centers and hospitals. ■ Decentralized operation and management. 	<ul style="list-style-type: none"> ■ Accessibility, increased on the basis of mapping (starting from FY03/04). ■ Effective family planning program (on-going). ■ Reorientation/relocus of programmes based on mapping of HDI under nutrition from FY03/04). ■ Expand nutritional program (on-going). ■ Education/awareness (on-going). ■ Up-gradation of hospitals/ health centres to manage the increasing problem of accidents and injuries a phased manner (FY04 onwards). ■ Transfer of sub health post, health post etc. to local management committees (on-going). ■ Recruitment of health workers at the local level (FY03/04 and onwards). ■ Procurement of drugs at the local level (FY03/04 onwards). 	<ul style="list-style-type: none"> ■ Proportion of TB/malaria/JE/ leprosy/ HIV/AIDs etc. cases detected and prevention and treatment measures taken. ■ Population more than hour's walk or travel to rural health facilities. ■ Contraceptive prevalence rate increase from 40 to 55%. ■ Condom use by 14-35 years old men increased to 35%. ■ Number of health centers and hospitals upgraded. ■ All sub health post and more than 50% of health posts and a 25 hospitals handed over to local bodies/management. ■ Guidelines/ frameworks local recruitment developed. ■ Number of health centers authorized for procurement. 				

Annex B11

HMGN's Policy Matrix for the Poverty Reduction Strategy Reform (PRS) Agenda and World Bank/Partner Programs of Support¹ cont....

OBJECTIVE	STRATEGIES	ACTIVITIES	INTERMEDIATE INDICATORS	OUTCOME	BANK GROUP INTERVENTIONS		OTHER DONORS
					NON-LENDING	LENDING	
	<ul style="list-style-type: none"> ■ Promotion and coordination with NGO/INGOs and private sectors. ■ Improved regulatory mechanism. 	<ul style="list-style-type: none"> ■ Avoid duplication with private sectors and NGOs. ■ Environmental and occupational health care and sanitation facilities provided with inter-sectoral collaboration (on-going). ■ Strong supervision and monitoring mechanism devised and implemented for the availability, quality and accessibility of health services (private nursing home/hospitals/colleges). 	<ul style="list-style-type: none"> ■ Coordination guideline developed. ■ Level of collaboration improved. ■ Strong supervision and monitoring mechanism devised and implemented for the availability, quality and accessibility of health services. 				
N. Drinking Water							
N.1 Increased/improved access to sustainable basic drinking water services in rural areas.	<ul style="list-style-type: none"> ■ Scale up the demand driven and participatory approach to rural water supply and sanitation schemes. This approach involves NGOs, CBOs, local private sector to assist communities to plan, design and implement and operate and maintain their own schemes. 	<ul style="list-style-type: none"> ■ Revise the 1998 rural sub-sector policy to include clear roles & responsibilities of sector actors by 2003. ■ Reform/consolidate the institutional mechanisms and approaches to service delivery to facilitate implementation by 2003. ■ Strengthen autonomy of the RWSS Fund Development Board through an Act by 2003. ■ Rehabilitate rural water supply schemes for community management (continued). ■ Districts develop/update district water development plans regular to improve planning starting 2003 and continuous. 	<ul style="list-style-type: none"> ■ A consistent sector policy in place and implemented. ■ Community driven approach adopted to provides sustainable water systems to benefit some 2.0 million additional people. ■ Fund Board operational as a regular sector agency. ■ Sector monitoring system established; the sector monitored effectively and regularly and budget allocations to sector agencies are performance based. 	<ul style="list-style-type: none"> ■ Consistent community driven approach operational sector wide. ■ About 3.8 million people have access to safe and sustainable drinking water services. ■ Increased opportunity for enrolment of girl child in schools due to time saved in fetching water. ■ Reduced water borne and water washed diseases. 		Rural Water Supply & Sanitation (RWSSP I), RWSSP II (FY04)	ADB, Canada, UK, UNICEF, Water Aid

Annex B11

HMGN's Policy Matrix for the Poverty Reduction Strategy Reform (PRS) Agenda and World Bank/Partner Programs of Support¹ cont....

OBJECTIVE ²	STRATEGIES	ACTIVITIES	INTERMEDIATE INDICATORS	OUTCOME	BANK GROUP INTERVENTIONS		OTHER DONORS
					NON-LENDING	LENDING	
			<ul style="list-style-type: none"> About 150 schemes rehabilitated and community managed. 				
N.2 Improve and expand basic sanitation facilities in rural and urban areas	<ul style="list-style-type: none"> Promote sanitation as an integral part of water supply projects through public education and awareness campaigns by mobilizing NGOs, CBOs, local bodies and the private sector. 	<ul style="list-style-type: none"> Every new water supply scheme should include sanitation as a component of the project and provide for promotional activities (continued). Promote sanitation activities in areas that already have water supply services but no sanitation facilities (continued). Promote appropriate sanitation facilities in urban and semi-urban areas through users' participation (continued). 	<ul style="list-style-type: none"> About 450,000 households build and use latrines in rural areas. About 150,000 households with appropriate sanitation services in urban areas. 	<ul style="list-style-type: none"> Health and hygiene improved. Reduction in diarrheal diseases. 		RWSSP I, RWSSP II (FY04)	ADB, Canada, Germany, UK, UNICEF, Water Aid
N.3 Improved access to and up-gradation of basic drinking water services in urban and semi-urban areas through involvement of private sector and/or local bodies	<ul style="list-style-type: none"> Create a conducive environment for private sector participation & local bodies involvement in urban and semi-urban water supply services by legislative reforms, cost recovery policy & a national water quality standards/ guidelines. Increased supply in the valley by reducing unaccounted for water. 	<ul style="list-style-type: none"> Implement cost recovery policies starting 2003. Develop national water quality standard/guidelines and strengthen water quality monitoring by 2004. Frame legislation, establish and make operational a regulatory body by 2003. Reduce unaccounted-for water in Kathmandu Valley towns by 4% annually. 	<ul style="list-style-type: none"> A private operator in place by 2004 in Kathmandu Valley towns. Carry out a study to develop a strategy for PSP and local body involvement in the other urban and semi-urban areas by 2004. Unaccounted for water reduced by 4% annually. 	<ul style="list-style-type: none"> Arrangements and regulatory framework for PSP in urban WSS services established. More efficient and cost effective services available to urban and semi-urban areas. Reduction in water borne and water washed diseases. 			ADB, Germany, Japan, Norway, Sweden

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HMGN's Policy Matrix for the Poverty Reduction Strategy Reform (PRS) Agenda and World Bank/Partner Programs of Support¹ cont....

OBJECTIVE ²	STRATEGIES	ACTIVITIES	INTERMEDIATE INDICATORS	OUTCOME	BANK GROUP INTERVENTIONS		OTHER DONORS
					NON-LENDING	LENDING	
O. PILLAR 3: TARGETTED PROGRAMS & SOCIAL INCLUSION							
<p>O 1 Bring poor/socially excluded/disadvantaged groups out of poverty trap (P3)</p>	<ul style="list-style-type: none"> ■ Reorient sectoral programmes to focus on targeted groups/ areas. ■ Make local bodies more responsible for designing and implementing local poverty programmes. ■ Supplement the targeted programmes of local bodies and the government with the participation of NGOs/ CBOs. 	<ul style="list-style-type: none"> ■ Initiate the system of expanding/ developing sectoral activities based on poverty mapping (FY03/04 onwards). <ul style="list-style-type: none"> ■ Framework for addressing the problems of deprived communities/regions developed and implemented (FY03/04 onwards). ■ Use decentralize mechanism for implementation (on-going). <ul style="list-style-type: none"> ■ Increase grant to local bodies on the basis of poverty index (FY03/04 onwards). <ul style="list-style-type: none"> ■ Train local bodies and make them accountable for the poverty reduction program at the local level (FY03/04 onwards). ■ Train local bodies and make them accountable for the poverty reduction program at the local level (FY03/04 onwards). <ul style="list-style-type: none"> ■ Strengthen social mobilization (continued). ■ Use PAF to supplement targeted programmes, to be carried out mainly by NGOs/CBOs (FY03/04 onwards). 	<ul style="list-style-type: none"> ■ Budget allocation for deprived communities/areas increased. ■ DIDO and service delivery agencies transferred to local level. <ul style="list-style-type: none"> ■ Allocation to district with low HDI increased. <ul style="list-style-type: none"> ■ Number of training program under LGDP/ LGFC/ PAF increased. ■ PAF guidelines approved. Program implemented for targeted groups. <ul style="list-style-type: none"> ■ PAF office established (FY03). 	<ul style="list-style-type: none"> ■ HDI index of Far-western and Midwestern increase by 8% per annum. <ul style="list-style-type: none"> ■ Literacy rate of dalits and indigenous people increases significantly. ■ Increased life expectancy of deprived communities/ regions. <ul style="list-style-type: none"> ■ Mean years of schooling of deprived communities and regions increase. 	<p>Poverty Alleviation Fund (PAF I, FY04), PAF II (FY06)</p>	<p>ADB Canada, Germany, Norway, Switzerland, UK, UNDP, UNICEF</p>	

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HMGN's Policy Matrix for the Poverty Reduction Strategy Reform (PRS) Agenda and World Bank/Partner Programs of Support¹ cont....

OBJECTIVE ²	STRATEGIES	ACTIVITIES	INTERMEDIATE INDICATORS	OUTCOME	BANK GROUP INTERVENTIONS		
					NON-LENDING	LENDING	OTHER DONORS
	<ul style="list-style-type: none"> ■ Reorient and coordinate NGO/INGOs activities towards targeted groups. ■ Initiate and implement effective mechanism for poverty monitoring. ■ Encourage philanthropic organization in expanding poverty reduction strategy. ■ Special programs from Far-west and Mid-west regions districts. 	<ul style="list-style-type: none"> ■ Encourage coordination and develop partnership with NGO/CBOs and the private sector to work in the poorer areas. ■ Design special mechanism to monitor outcome and input indicators for targeted group (FY03/04 onwards). <ul style="list-style-type: none"> ■ Initiate and support district level poverty monitoring mechanism (FY03/04 onwards). ■ Enhance public awareness campaign for voluntary work, welfare activities and poverty reduction programmes to be generated by philanthropic organizations and private sector (FY03/04 onwards). ■ Assistance for overseas employment (FY03/04-04/05). <ul style="list-style-type: none"> ■ Micro credit/micro-enterprises training/education/land bank etc and or strengthened. ■ Special scholarship program of higher education (FY03/04 onwards) initiated. 	<ul style="list-style-type: none"> ■ Mapping of INGOs activities done and INGOs encouraged to work for deprived areas/communities. ■ Poverty monitoring disaggregated by gender/social groups/regions. <ul style="list-style-type: none"> ■ District poverty monitoring mechanism assessed and system strengthened. ■ More resources mobilized by local NGOs locally. ■ Assistant to poor people for foreign employment. <ul style="list-style-type: none"> ■ Asset creating activities increases. ■ At least 100 scholarship per annum for deprived women, Dalits and indigenous people for higher education. 				
O.2 Main-stream gender in development activities	<ul style="list-style-type: none"> ■ Women empowered by removing the social, legal, economic and other constraints. 	<ul style="list-style-type: none"> ■ Production loan and social mobilization (on-going). ■ Incentives to increase proportion of girls in education (2003 onwards). <ul style="list-style-type: none"> ■ Special health care system to women to reduce maternal mortality (2004-05). 	<ul style="list-style-type: none"> ■ Number and volumes of loan awarded. ■ Scholarship to girls. ■ Number of trained Midwives or AHM or nurses. 	<ul style="list-style-type: none"> ■ Economic status of women improved. ■ Proportion of women in socio-economic political activities and public positions improved. 			<p>ADE Canada, Germany, Netherlands, UK, UNDP, UNFPA</p>

Annex B11

HMGN's Policy Matrix for the Poverty Reduction Strategy Reform (PRS) Agenda and World Bank/Partner Programs of Support¹ cont....

OBJECTIVE ²	STRATEGIES	ACTIVITIES	INTERMEDIATE INDICATORS	OUTCOME	BANK GROUP INTERVENTIONS		OTHER DONORS
					NON-LENDING	LENDING	
O.3 Mainstream deprived communities	<ul style="list-style-type: none"> ■ By removing social legal and economic constraints. ■ Empowerment. 	<ul style="list-style-type: none"> ■ Coaching classes and alternative actions to increase females in teaching and civil service (on-going). ■ Eliminate legal discrimination (on-going). ■ Legal and other changes to prevent violence against women (2003-04). ■ Special scholarship program for higher education (FY03/04 on-going). ■ Special monitoring system in improving gender equality (2004). ■ Credit facility and social mobilization (on-going). ■ Incentives to increase proportion of deprived children in education (on-going). ■ Affirmative actions to increase the proportion of people recruited in teaching and public service (2004). ■ Special emphasis in skill training, income generating activities and special scholarship program for higher education (on-going). ■ Legal and other constraints removed (on-going). ■ VDC and DDCs to focus on the mainstreaming of deprived communities (FY03/04). ■ Special infrastructure, income generating and human development activities for deprived communities and areas. ■ Special monitoring system in improving the status of derived community (2004). 	<ul style="list-style-type: none"> ■ Proportion females in civil service and teaching. ■ Legal amendment. ■ Number of violence cases reported and mitigation program. ■ Number of scholarship for higher education to girls. ■ Monitoring reports/analysis. ■ Credit program and number of beneficiaries. ■ Scholarship increased. ■ Number of Dalits in teaching and public agencies. ■ Number of scholarship and training award to dalits and deprived janajati groups. ■ Legal amendment. ■ Training and guidelines for targeting programs in VDCs/DDCs. ■ Monitoring reports/ analysis. 	<ul style="list-style-type: none"> ■ Status of women enhanced. ■ Proportion of deprived communities below poverty line declines significantly. ■ Human development indicators of deprived communities improves. ■ Proportion of socially excluded people increased in socio-economic and political activities. ■ Derived communities empowered. 		<p>PAF I (FY04), PAF II (FY06)</p>	<p>ADB, Canada, Denmark, Germany, Netherlands, Norway, UK, UNDP, UNFPA</p>

Annex B11

HMG's Policy Matrix for the Poverty Reduction Strategy Reform (PRS) Agenda and World Bank/Partner Programs of Support¹ cont....

OBJECTIVE ²	STRATEGIES	ACTIVITIES	INTERMEDIATE INDICATORS	OUTCOME	BANK GROUP INTERVENTIONS		
					NON-LENDING	LENDING	OTHER DONORS
PILLAR 4: GOOD GOVERNANCE							
P. Civil Service Reform							
Civil service (including Judiciary) made competitive accountable and service oriented (P4-B)	<ul style="list-style-type: none"> ■ Improvement in recruitment and promotion system. ■ Reduce political interference in civil service functioning. ■ Strengthening Personnel information system (PIS) and human resource management. ■ Proportion of women, ethnic and disadvantaged group in civil service increased. 	<ul style="list-style-type: none"> ■ Curriculum and testing mechanism for recruitment and promotion revised and improved (continued). ■ Introduce necessary laws (by 2005). ■ Computerize functions of public service commission (2007). ■ Institutionalization of the PIS system in all Ministries (2002-2005). ■ Coaching classes to perspective women, ethnic and disadvantage groups candidates for civil service facilities (on-going). ■ Motivate women, ethnic and disadvantage groups to join civil services (on-going). 	<ul style="list-style-type: none"> ■ Revised and improved curriculum and testing mechanism developed (by 2004). ■ Better and qualified candidates recruited by 2004. ■ Governance Act amended by 2003. ■ A full fledged PIS system operationalised by 2005. ■ Increased percentage of women and ethnic groups joining civil service. 	<ul style="list-style-type: none"> ■ Merit based recruitment and promotion strengthened. ■ Young graduates attracted in civil service. ■ Civil Service is depoliticized. ■ Civil service efficiency and accountability enhanced. ■ Up to date records. ■ Better pensions management. ■ Corruption control. ■ Success rates of female, ethnic and disadvantaged groups increased. ■ Women, ethnic and disadvantaged groups well represented in civil service. 	Policy dialogue	Reform TA/ Capacity Building (FY05)	ADB, EU, Switzerland, UNDP
Ensure efficiency of resources use and improve service delivery	<ul style="list-style-type: none"> ■ Preventive actions for anti-corruption strengthened and implemented. ■ Action against corruption strengthened. ■ Judicial system strengthened. 	<ul style="list-style-type: none"> ■ Anti-corruption strategy adopted and implemented (2003). ■ National Vigilance Center activated and strengthened (2003). ■ Public Department (PWD) directives implemented 2003). 	<ul style="list-style-type: none"> ■ Draft procurement Act prepared by April 2004. ■ Technical Audit Agencies and made established operational. 	<ul style="list-style-type: none"> ■ Corruption reduced. ■ New Procurement Act effective. ■ Resources efficiency improved. ■ Delivery of services effective. 			ADB, Denmark, Norway, Switzerland, UK

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HMGN's Policy Matrix for the Poverty Reduction Strategy Reform (PRS) Agenda and World Bank/Partner Programs of Support¹ cont....

OBJECTIVE	STRATEGIES	ACTIVITIES	INTERMEDIATE INDICATORS	OUTCOME	BANK GROUP INTERVENTIONS		
					NON-LENDING	LENDING	OTHER DONORS
		<ul style="list-style-type: none"> ■ Anti money laundering Act enacted (2004). ■ CIAA continued to be active (continued). ■ Judicial system strengthened through training and by improving management (continued). 	<ul style="list-style-type: none"> ■ Increased quality of public construction works. ■ Number of corruption cases registered in the court increase. ■ More corruption cases prosecuted and convicted. ■ Prompt decisions by the courts. ■ Number of pending judicial cases decreased. 	<ul style="list-style-type: none"> ■ Enhance integrity in public service. ■ Delivery of justice improves. 			
R. Decentralization							
Enhance development process with the participation and empowerment of people at large in the governance (P3)	<ul style="list-style-type: none"> ■ Enhance development process with the participation and empowerment of people at large in the governance. ■ Devolve service delivery functions to local bodies. ■ Capacity building. 	<ul style="list-style-type: none"> ■ DDO transfers to local bodies (FY03/04). ■ Education, health, postal service transfer to local bodies (on-going). ■ Agriculture and small irrigation services transfer to local bodies (2004). ■ Rural roads transfer to local bodies (2003 onwards). ■ Reconcile conflicting Acts and Regulations (2003 onwards). ■ Local service cadre constituted (2004). ■ Enhance planning, management and evaluation capacities of local bodies (continued). ■ Train and equip local bodies offices (continued). 	<ul style="list-style-type: none"> ■ At least 800 primary schools handed over to communities (first year). ■ Health post of at least 10 districts each year transferred to communities. ■ Agriculture service centers transfer to local bodies. ■ Local road tolls handed over to Road User Group in 20 districts for the maintenance of roads. ■ Preparations to reconcile conflicting Acts and Regulations. 	<ul style="list-style-type: none"> ■ Service delivery improves. ■ Electronic MIS operationalized in 60 districts. ■ Increase share of local revenue in budget expenditure reconciled. ■ Transparency and accountability improved. ■ Ownership in programmes/ projects increased. ■ Citizens charter in all DDCs and Municipalities prepared. 			<p>Development Support Operation (FY07)</p> <p>Canada Denmark, Germany, Netherlands, Norway, Switzerland, UK, UNDP, UNFPA, US</p>

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HMGN's Policy Matrix for the Poverty Reduction Strategy Reform (PRS) Agenda and World Bank/Partner Programs of Support¹ cont....

OBJECTIVE ²	STRATEGIES	ACTIVITIES	INTERMEDIATE INDICATORS	OUTCOME	BANK GROUP INTERVENTIONS		OTHER DONORS
					NON-LENDING	LENDING	
	<ul style="list-style-type: none"> ■ Fiscal decentralization. 	<ul style="list-style-type: none"> ■ Central grants allocated to local bodies on poverty based formula (FY03/04). ■ Improve revenue collection (on-going). ■ Fiscal management, auditing accounting system (on-going). ■ Road map for fiscal decentralization (2003). ■ Fiscal framework introduced in pilot basis (FY03/04). ■ Performance reports publicized (FY03/04). ■ Preparation of citizen's charter (FY03/04). 	<ul style="list-style-type: none"> ■ Local services cadre designed in the first year. ■ District profile of 20 districts for the DPP completed in the first year. ■ Electronic MIS operational in 25 districts. ■ Central grants allocated to local bodies on poverty based formula begins. ■ Increase share of local revenue in budget expenditure. ■ Fiscal arrears reduced. ■ Transparency, auditing and accountability improved. ■ Public Audit of development projects practiced. ■ Road map for fiscal decentralization adopted by FY03/04. ■ Fiscal framework introduced in pilot basis in 5 districts by FY03/04 ■ Citizen Character in 15 districts prepared by mid-July 2003. 		<p>Technical Assistance/AAA</p>		Germany

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HMGN's Policy Matrix for the Poverty Reduction Strategy Reform (PRS) Agenda and World Bank/Partner Programs of Support¹

OBJECTIVE 2	STRATEGIES	ACTIVITIES	INTERMEDIATE INDICATORS	OUTCOME	BANK GROUP INTERVENTIONS		OTHER DONORS
					NON-LENDING	LENDING	
S. Human Rights							
Promotion of human rights for the dignity of people (P4)	<ul style="list-style-type: none"> ■ Acts and laws made compatible with international conventions. ■ Institutional strengthening. 	<ul style="list-style-type: none"> ■ Formulate and amend major Acts and regulations (continued). ■ Strengthen Human Rights commission, women commission and Dalit Commission (continued). ■ Establish and strengthen human rights cells in major government agencies (FY03/04). 	<ul style="list-style-type: none"> ■ Number of human rights violation investigation cases increased. ■ Human rights action plan prepared by 2003. ■ Support the capacity building of human rights cells. 	<ul style="list-style-type: none"> ■ Human Rights violation cases decreased. ■ Reduction in discrimination, violation and exploitation cases. ■ Empowerment of people to exercise their rights. 			Canada, Denmark, EU, Norway, Switzerland, UNDP, UNFPA, UK
T. Integrated Security Development Plan							
Enhance security and expand development activities Rehabilitation of victims of violence	<ul style="list-style-type: none"> ■ Enhance the security umbrella and the sense of security and peace to continue and expand development activities and service delivery. ■ Rehabilitation of the victims of violence. 	<ul style="list-style-type: none"> ■ Provide security to big projects. ■ Enhance internal security and development program strategic locations and violence-affected areas. ■ Rehabilitation of the victims of violence. 					US

Appendices



Appendix I: The Millennium Development Goals and Related Indicators

NEPAL COUNTRY PROFILE

	1990	1995	2001	2002
1. Eradicate extreme poverty and hunger				
<i>2015 target = halve 1990 \$1 a day poverty and malnutrition rates</i>				
Population below \$1 a day (%)	..	37.7	..	..
Poverty gap at \$1 a day (%)	..	9.7	..	..
Percentage share of income or consumption held by poorest 20%	..	7.6	..	..
Prevalence of child malnutrition (% of children under 5)	..	48.5	48	..
Population below minimum level of dietary energy consumption (%)	19	..	19	..
2. Achieve universal primary education				
<i>2015 target = net enrollment to 100</i>				
Net primary enrollment ratio (% of relevant age group)	..	..	72.4	..
Percentage of cohort reaching grade 5 (%)	52	..	..	..
Youth literacy rate (15-24)	46.6	54.6	61.6	62.7
3. Promote gender equality				
<i>2005 target = education ratio to 100</i>				
Ratio of girls to boys in primary and secondary education (%)	52.8	63.8	82.1	..
Ratio of young literate females to males (15-24)	40.7	48.2	57.3	58.9
Share of women employed in the nonagricultural sector (%)	..	..	..	..
Proportion of seats held by women in national parliament (%)	6	3	6	6
4. Reduce child mortality				
<i>2015 target = reduce 1990 under 5 mortality by two-thirds</i>				
Under 5 mortality rate (per 1,000)	145	120	91	..
Infant mortality rate (per 1,000 live births)	100	85	66	68.6
Immunization, measles (% of children under 12 months)	57	56	71	..
5. Improve maternal health				
<i>2015 target = reduce 1990 maternal mortality by three-fourths</i>				
Maternal mortality ratio (modeled estimate, per 100,000 live births)	..	830	..	..
Births attended by skilled health staff (% of total)	7.4	9	11.9	..
6. Combat HIV/AIDS, malaria and other diseases				
<i>2015 target = halt, and begin to reverse, AIDS, etc</i>				
Prevalence of HIV, female (15-24)	..	..	0.3	..
Contraceptive prevalence rate (% of women ages 15-49)	..	29	..	..
Number of children orphaned by HIV/AIDS	..	..	13,000.00	..
Incidence of tuberculosis (per 100,000 people)	..	..	207.6	..
Tuberculosis cases detected under DOTS (%)	..	6	58	..
7. Ensure environmental sustainability				
<i>2015 target = various (see notes)</i>				
Forest area (% of total land area)	32.7	..	27.3	..
Nationally protected areas (% of total land area)	..	7.8	7.8	8.9
GDP per unit of energy use (PPP \$ per kg oil equivalent)	2.6	3.3	3.8	..
CO2 emissions (metric tons per capita)	0	0.1	0.1	..
Access to an improved water source (% of population)	67	..	88	..
Access to improved sanitation (% of population)	20	..	28	..
Access to secure tenure (% of population)	..	..	..	..

NEPAL COUNTRY PROFILE

	1990	1995	2001	2002
8 8. Develop a Global Partnership for Development	<i>2015 target = various (see notes)</i>			
Youth unemployment rate (% of total labor force ages 15-24)	..	..	..	..
Fixed line and mobile telephones (per 1,000 people)	..	..	13.9	..
Personal computers (per 1,000 people)	..	1.2	3.5	..
General indicators				
Population	18.1 million	20.4 million	23.6 million	24.1 million
Gross national income (\$)	4.0 billion	4.6 billion	5.8 billion	5.6 billion
GNI per capita (\$)	220	220	250	230
Adult literacy rate (% of people ages 15 and over)	30.4	36	42.9	44
Total fertility rate (births per woman)	5.3	4.6	4.2	4.2
Life expectancy at birth (years)	53.6	56.3	59.4	59.9
Aid (% of GNI)	11.5	9.6	6.7	..
External debt (% of GNI)	44.4	53.7	46.7	..
Investment (% of GDP)	18.4	25.2	24.3	24.1
Trade (% of GDP)	31.6	58.8	54.4	47.8

Source: World Development Indicators database, April 2002

Note: In some cases the data are for earlier or later years than those stated.

GOAL 1 TARGETS: Halve, between 1990 and 2015, the proportion of people whose income is less than one dollar a day. Halve, between 1990 and 2015, the proportion of people who suffer from hunger.

GOAL 2 TARGET: Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling.

GOAL 3 TARGET: Eliminate gender disparity in primary and secondary education preferably by 2005 and to all levels of education no later than 2015.

GOAL 4 TARGET: Reduce by two-thirds, between 1990 and 2015, the under-five mortality rate.

GOAL 5 TARGET: Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.

GOAL 6 TARGETS: Have halted by 2015, and begun to reverse, the spread of HIV/AIDS. Have halted by 2015, and begun to reverse, the incidence of malaria and other major diseases.

GOAL 7 TARGETS: Integrate the principles of sustainable development into country policies and programs and reverse the loss of environmental resources. Halve, by 2015, the proportion of people without sustainable access to safe drinking water. By 2020, to have achieved a significant improvement in the lives of at least 100 million slum dwellers.

GOAL 8 TARGETS: Develop further an open, rule-based, predictable, non-discriminatory trading and financial system. Address the Special Needs of the Least Developed Countries. Address the Special Needs of landlocked countries and small island developing states. Deal comprehensively with the debt problems of developing countries through national and international measures in order to make debt sustainable in the long term. In cooperation with developing countries, develop and implement strategies for decent and productive work for youth. In cooperation with pharmaceutical companies, provide access to affordable, essential drugs in developing countries. In cooperation with the private sector, make available the benefits of new technologies, especially information and communications.

Source: DEC (as of 10/14/2003)

Appendix II: Implementing the Previous CAS and Lessons Learned

A. Background

As indicated, the last CAS for Nepal was discussed by the Board of Directors on December 13, 1998. Although outcomes to be achieved during the CAS period were not explicitly elaborated, the triggers for the base case scenario provide useful insights on the main outcomes the Bank intended to influence through the CAS interventions, specifically:

(i) at the lower end—of the base case scenario—stabilization of the situation and no further deterioration in economic and administrative management, characterized by:

- (a) Domestic revenues as a share of GDP remaining at or above 11%, domestic borrowing below 2% of GDP, and satisfactory implementation of VAT; and
- (b) Improved management of public expenditures, with no further increase in the number of projects in the public investment program, and adequate funding for donor-assisted and other priority projects.

(ii) beyond stabilization—i.e., within a more solid base case scenario—with a modest, but clear reform effort, as reflected in the following types of steps:

- (a) Tangible progress in decentralization and local self-government, with greater local involvement in the management of development programs;
- (b) Action on improving central government administrative performance, such as stricter enforcement of rotation rules;
- (c) Privatization of three public enterprises, and improvement of the efficiency and transparency of privatization procedures and decision-making processes;
- (d) Introduction of a three-year rolling investment program, and full funding of core programs and projects;
- (e) Progress in restructuring RBB and preparing its divestiture, completing the privatization of NBL, improving banking regulations and improving NRB's supervisory and regulatory capacity;
- (f) Progress in telecommunications reform, including introduction of competition; and
- (g) Introduction of new measures to reduce corruption.

PUBLICIZING THE CAS

The 1998 CAS was the first such document to be publicly discussed in its entirety in Nepal and also widely disseminated, including in Nepali. As a result, not only did the strategy and the various lending scenarios quickly enter the development lexicon, the benchmarks/triggers helped broaden people's understanding of governance, that previously had been narrowly understood as corruption.

Since this was the first CAS that explicitly linked Bank support to overall progress against governance-related benchmarks, it took a while for Government officials to understand the implications of this shift with regard to the funding of specific sectors. However, gaining this understanding has forced some senior officials to think more holistically about development. They realized that "good performance" in their

particular sector was not sufficient to warrant Bank support, but that such support can only be forthcoming with improvements in overall governance; hence, resulting in the development of a healthy peer pressure for accountability and governance improvements. As it has been put "the 1998 CAS eventually shook the whole tree to the point that the branches were sufficiently threatened."

An appropriate mix of Bank interventions—both lending and non-lending—were proposed to assist Nepal in achieving these outcomes.

the direct link to the system of poor governance—specifically, the possible risk of a financial sector crisis, the huge drain on public resources and an indication of HMGN's willingness to do away with the 'old way' of doing business—also led the Bank to attach special importance to financial sector reform. As the first major step towards implementing the financial sector reforms, the introduction of external management teams in the two large ailing commercial banks became the 'litmus test' for moving into a base case scenario. The Bank's position in this regard was well-known and other donors—most notably the IMF and DfID—also selected this important reform measure as a key milestone for providing additional support to Nepal.

Outputs

Lending. The low case lending program focused on community-based projects—to mobilize and leverage social capital at the grassroots level—and on supporting specific but modest reform efforts. Implicitly

B. Achievements during the CAS period**Background**

For four years—until December 2002—given the limited and slow progress in implementing reforms, Nepal remained in a low case scenario. Given the fungibility of aid resources, without substantial improvements in public expenditure management and public service delivery, more financial assistance from IDA would not have been a solution to Nepal's problems. HMGN clearly began recognizing poor governance—reflected most acutely in weak implementation of reforms, poor service delivery and corruption—as a central obstacle to development (see Box 1). Growing recognition of the gravity of the financial sector conditions and

assuming a quick transition to the base case, the Bank continued to prepare a number of larger, 'reform-heavy' projects and in retrospect may have missed an opportunity to develop and deliver a few more 'low case appropriate' projects.

While in the low case scenario—i.e., between December 1998 and December 2002—four projects were approved for a total of US\$94.6 million; specifically:

The **Second Basic and Primary Education Project** (BPEP, Cr. 3185-NEP) was approved in March 1999 (US\$12.5 million). Conceived as an Adaptable Program Loan (APL), the objectives of the first phase are to develop institutional capacity for qualitative and quantitative improvements in primary education. Through the project, a number of donors—including IDA, Denmark, the European Union, Finland, Norway, Japan, UNICEF and the ADB—are providing joint support to a well-formulated ten-year sectoral program;

The **Rural Infrastructure Project** (Cr. 3215-NEP) was approved in May 1999 (US\$5 million) to strengthen the institutional capacity of a decentralized governance system in its planning and managing capabilities to improve the quality, efficiency and sustainability of rural roads with active participation of project beneficiaries. Given limited Bank experience implementing community-based road projects in Nepal, a Learning and Innovation Loan (LIL) was selected as the appropriate vehicle to test this fundamental shift in approach. Through this project a number of decentralization options are being tested, including working: (i) directly with the DDCs; (ii) with DDCs through contractors; (iii) with CBOs; and (iv) through NGOs. The many implementation challenges associated with this project have made it a learning experience for all involved. Nevertheless, recent results are

promising as confidence and experience are being accumulated to work more effectively at grassroots levels;

The objective of the **Road Maintenance and Development Project** (Cr. 3293-NEP)—approved in November 1999 (US\$54.5 million)—is to help achieve sustainable maintenance, rehabilitation and construction of an economically justifiable strategic road network, while also promoting more sustainable funding and efficient public sector management of road maintenance. The project supports key sectoral policy reforms by establishing a Roads Board and Road Fund to assure a stable source of funding for maintenance expenditures, while at the same time providing motorable access to isolated districts in the mid- and far-west regions of the country (the heart of the insurgency area); and

The **Telecommunications Sector Reform Project** (Cr. 3581-NEP) was approved in December 2001 (US\$22.6 million) and supports on-going sectoral reforms and increasing rural access to telecommunications services through the licensing of a private operator (selected on a competitive basis) and establishing public telecommunications centers.

Following the move to the base case scenario in December 2002, three additional projects have been approved for a total of US\$96.9 million, specifically:

The **Financial Sector Technical Assistance Project** (Cr. 3227-NEP) was approved in December 2002 (US\$16.0 million) and supports the efforts of HMGN to improve the financial sector in order to bring macroeconomic stability and promote private sector-led economic growth. The project focuses on three major objectives: (i) helping to restructure and re-engineer the Central Bank (Nepal Rastra Bank, NRB) so that it can

effectively perform its key central banking functions; (ii) initiating commercial banking reform in the two large ailing commercial banks that dominate the sector—Rastriya Banijya Bank (RBB) and Nepal Bank Limited (NBL)—by introducing stronger bank management that protects their financial integrity; and (iii) supporting a better environment for financial sector reforms in areas such as enhanced credit information, better financial news reporting, and better training for staff in financial institutions;

The **Power Development Project** (Cr. 3293-NEP) was approved in May 2003 (US\$50.4 million IDA Credit and US\$25.2 million IDA Grant) to help: (i) develop Nepal's hydropower potential in an environmentally and socially sustainable manner so as to help meet electricity demand; (ii) improve access of rural areas to electricity services and (iii) promote private sector participation in the power sector as a way to improve sector efficiency and to mobilize financing for the sector's investment requirements. In early-FY04, the potential for a parallel Global Environmental Facility (GEF) operation—to possibly include contingency financing for pipeline development of small and micro hydro projects, and support for institutional development to facilitate private sector delivery of energy efficiency services—will be assessed, with a possible operation coming later on; and

Another LIL—the **Community School Support Project** (Cr. 3808-NEP)—was approved in June 2003 (US\$5 million) to support the devolution of the responsibility for management of schools to communities. The project provides support for school grants, scholarships, capacity building, and monitoring and evaluation. The lessons learned from this project will help IDA (together with HMGN and the other educa-

tion development partners) design further phases of BPEP.

Analytical and Advisory Activities

(AAA). Consistent with the low case scenario, strong emphasis was placed on helping to build the agenda and needed consensus for reform. To a large extent, the introduction of the Medium Term Expenditure Framework (MTEF) and the Immediate Action Plan (IAP) have been prompted by the Bank's dialogue with HMGN. The *Public Expenditure Review* (PER, April 2000) was very influential in this regard. The PER helped to shape the framework for many of the public expenditure reforms that are currently under implementation or envisioned. This has been followed up with intensive technical assistance and dialogue—in collaboration with the UK Department for International Development (DfID)—which have helped (and will continue to help) HMGN develop and implement the MTEF. As important, the Bank's continuing dialogue with the authorities on the topic of the financial sector reforms—including financing the RBB/NBL diagnostic studies and the *Nepal: Financial Sector Study* (October 2002)—have kept the process on track, although admittedly progress has at times been slow¹. Other key pieces have also focused on reform agenda items, including: (i) *Priorities and Strategies for Education Sector Reform* (July 2001) which helps to identify and build consensus on a comprehensive reform agenda at all levels in this fundamental sector²; (ii) *Proposed Power Sector Development Strategy* (March 2001) which identifies the key constraints and makes recommendations to expand Nepal's hydropower resource potential to service the electricity needs of the people and to generate export potential; (iii) *The Business Environment and Manufacturing Performance in Nepal* (December 2000), the first investment climate survey carried out

in the South Asia Region; and (iv) more recently, the *Nepal: Trade and Competitiveness Study* (July 2003), carried out under the Integrated Framework (IF).

Another AAA focus area has been governance, including decentralization and improving service delivery. The study *Poverty at the Turn of the Twenty-First Century* (May 1999) analyzed poverty trends and projections, the poverty profile and key elements for a poverty alleviation strategy. Related to service delivery, the *Terai Options Study* (October 2000) examined experience with various institutional arrangements for delivery of rural services in the Terai and makes recommendations for future development of cost-effective service delivery in the context of decentralization. A *Country Procurement Assessment Report* (CPAR) was finalized in FY01 and many of its recommendations are being implemented. A *Country Financial Accountability Assessment* (CFAA)—carried out with an extremely committed HMGN partner and other donors—was completed in FY02, also with an agreed action plan currently under implementation³. In the area of decentralization, three areas—the proposed Poverty Alleviation Fund (PAF), fiscal decentralization, and local institutions in the delivery of services in rural areas—have been selected as focal areas for the coming years. The PAF policy note *Towards a Sustainable Approach for Poverty Reduction and Decentralization in Nepal* was finalized in November 2002.

The majority of the formal reports have been—and continue to be—followed up by policy dialogues, consensus building, and technical assistance, which have resulted in a remarkably high level of achievement on many of the original CAS outcomes, especially in the areas of public expenditure management, decentralization, financial

sector reform, telecommunications, and education reform.

Among the informal studies, the Bank facilitated and OECD/DAC led a *Review of Development Partnerships*. The review—a highly consultative exercise—covered the whole gamut of donor-recipient relationships that have impacted development partnerships in Nepal. The findings complemented HMGN's own formulation of a Foreign Aid Policy (FAP) that was endorsed by the development partners during the 2002 Nepal Development Forum.

Outcomes

Over the last few years, the South Asia Region has emphasized a results-focused work programming. The Nepal Country Team has been in the forefront of these efforts, and has set the standard for the countries in the region. Over the last two years, the team has adopted a 'portfolio approach' to outcomes, in which the entire team—not an individual—is held accountable for achieving a high proportion of outcomes that have been selected using specific criteria. The approach employed—discussed below—ensures that riskier, but high importance outcomes will also be attempted. The structure used over the last two years is as follows:

- Each 'outcome' is a significant change that would be highly desirable and possible within the four-year CAS horizon. For the immediate year ahead, a specific 'milestone'—i.e., key step toward achieving the three-year outcome—is defined;
- Such a milestone is expected to have less than 100% probability of happening—for practical purposes probabilities of 20, 40, 60 and 80% are assigned—even with best efforts on the part of the Bank;

- The set of outcomes is seen as a ‘portfolio’ in its entirety—i.e., consisting of some high-probability, but relatively low-impact outcomes, and some low-probability, but high-impact outcomes. To avoid extremes, the set of outcomes is normally constructed with an expected overall annual success rate of around 65 – 70%⁴.
- The matrix and annual milestones are updated each year, with some outcomes replaced—either through achievement or a change in strategic priorities—and new milestones defined;
- Rather than holding staff accountable for achievement of specific outcomes, the Country Team is collectively held accountable for the overall outcome of the portfolio⁵; and
- The same approach is applied to a set of annual milestones as well, so that annual performance can be monitored against some expected overall achievement rate.

Near the end of each FY, the country team evaluates the achievement of the milestones during the year. Reflecting on the lessons learned and the experience in general, the team then updates the outcomes matrix and annual milestones for the following FY. Such a process has led to a situation in which there is real team ownership and awareness of the milestones and outcomes. This has also resulted in a more holistic approach to the Bank’s efforts in Nepal, in which sectors and instruments are initially ‘ignored’ as the team focuses wholly on outcomes, with the discussion on instruments to achieve those outcomes becoming secondary.

The results of the review exercise for FY03 are presented in Table 1. Of the 15 milestones established for FY03, 11 were substan-

tially achieved, resulting in an overall ‘success rate’ of slightly higher than 70%, as compared to the original expectation of 60%. It is interesting to note that a number of milestones assessed as having a relatively high probability (i.e., 80%) of being achieved in the beginning of the FY—such as developing the design of the decentralization fiscal framework, and launching a joint review of the experience of community-based rural development programs—were not achieved. However, a number of milestones assessed as having a relatively low probability (i.e., 20 or 40%) of being achieved in the beginning of the FY—such as piloting the transfer of management of primary schools to communities, and establishing a realistic resource ceiling for development expenditures—were achieved.

Many of the outcomes adopted by the country team for the FY03-FY05 period are closely linked to the outcomes implicit in the 1998 CAS. These links, as well as an assessment of the CAS outcomes and the instruments employed to achieve these outcomes, are provided in Table 2.

C. Lessons Learned

Today, there is a realization within Nepal that the Bank is truly concerned with the well-being of the poor and that it is not possible to simply ‘negotiate’ aid out of IDA. However, this realization was not necessarily quick or easy in coming, and along the way, a number of important lessons have been learned—both from our experiences in Nepal and world-wide, including through initiatives such as *The Global Poll* (May 2003). While many of these lessons have been alluded to above, they can be summarized as follows:

- In an environment of poor governance, closely linking lending levels to progress

in implementing reforms and achieving results on the ground—not just promises—can be tremendously effective in a country such as Nepal. In doing so, it is important to send a firm and consistent message—and most importantly, stick with it—that unless the important issues are seriously tackled—improving governance and service delivery—additional funding will not be forthcoming (at least from the World Bank). While such an approach by itself would not prompt reforms, when spontaneous reform initiatives emerge, it can provide an important and constructive discipline to the process and can even strengthen the hands of the reform leaders. Such a stance can foster peer pressure among senior officials to look at development more holistically, as they realize that sectoral funds are held hostage to improvements in larger country goals (i.e., governance);

- A work program grounded in an outcomes approach—in which all team members share responsibility for achievement of a portfolio of outcomes—encourages a more holistic and multi-sectoral approach. Outcomes should be realistic, focused on those areas where the Bank plays a significant role, and clearly linked to stated country objectives (such as PRS objectives or MDGs). In addition, it is important to be able to measure milestones/intermediate indicators and periodically monitor and evaluate whether these milestones are being achieved;
- The introduction of a number of important reforms—such as the MTEF, the financial sector reforms, the IAP, and the transfer of primary schools to community management—have resulted from a long Bank association and consistent

dialogue with HMG. To be most effective, it is essential to invest in a solid relationship built on a strong dialogue with key counterparts. In addition to building consensus for change/reform, such an investment also builds and encourages ownership of and buy in for the reform programs, while proactive outreach contributes to a wider understanding of development challenges and opportunities;

- Implicitly assuming a quick transition to the base case, the Bank continued to prepare a number of larger, 'reform-heavy' projects during the CAS period. In retrospect, opportunities were likely missed to develop and deliver a few more 'low case appropriate' projects—typically modest in size, and often supporting community-based projects or small, sector specific reform efforts (e.g., telecommunications sector);
- The interplay of diverse political economy realities has an important impact on reform implementation and hence, needs to be understood better for the Bank to be more opportunistic in its support. When reforms do happen, they often appear to be spontaneous and episodic, and tend to fall outside the conventional frameworks that donors prefer to work in. Finally, Government officials are not necessarily good at showcasing reform progress, nor are they practiced at communicating successes to the public at large. These are important aspects to stress if the benefits of reforms are to be the best arbiter for deeper reforms in the future;
- The linkages between peace and stability, and reducing poverty are strong—i.e., a potential vicious circle. Development/poverty reduction can not be delayed/

postponed until there is peace and stability, as the root causes of conflict—i.e., failure of governance, including lack of delivery of public services, and horizontal inequality and social exclusion—are often the major challenges of reducing poverty; and

- Donor coordination is important, but is not always easy as donors often send different and mixed messages to the Government—e.g., the Nepali reform efforts of the late-1990s/early-2000s warrant low case lending levels vs. these

reform efforts warrant base case lending levels. Ultimately, the Government must be encouraged to coordinate donor assistance by setting out its own development strategies and priorities. Clearly, donors—including the Bank—need to respect Government efforts to ‘regulate’ foreign assistance through vehicles such as a Foreign Aid Policy (FAP). Such an effort, along with a firm foundation for donor assistance—such as that contained in a Poverty Reduction Strategy—will encourage more holistic and coordinated development.

- 1 DFID and the IMF have been important partners in these efforts. In addition, IMF has been providing technical assistance to the central bank.
- 2 The intense sectoral dialogue that followed this work and has continued through the implementation of BPEP has in large part been responsible for triggering the current efforts to transfer school management to community-based groups.
- 3 Financing was obtained under two different Institutional Development Fund (IDF) Grants to assist in the efforts to implement certain recommendations/action plans of the CPAR (related to public procurement reform) and CFAA (related to public audit reform).
- 4 This does not imply that for outcomes that are not fully achieved, there will be no progress. In many cases, it is likely that some progress toward the ultimate outcome will have been made.
- 5 Unless an entirely unforeseen event changes the country setting profoundly, a significant shortfall in reaching the expected rate of achievement would mean either: (i) the initial assessment or strategy was unrealistic; or (ii) the Bank's efforts were inadequate.

Table 1: Nepal Strategic Outcomes for FY03-FY05 and Evaluation of FY03 Milestones

	OUTCOMES	FY03 MILESTONE	ASSESSED LIKELIHOOD	EVALUATION OF FY03 MILESTONES
1	An effective and transparent fiscal decentralization mechanism established.	■ Develop the design of the decentralization fiscal framework.	80%	No. DDCs were dissolved in September 2002 and never reconstituted.
2	A Poverty Alleviation Fund (PAF) established and operationalized.	■ Establish a good PAF framework.	60%	Yes. The ordinance is awaiting approved by cabinet.
3	At least 10% of primary schools have community based management supported by Government grants.	■ Establishment of a decentralized funding framework and initiation of piloting.	20%	Yes, transfer of 150 schools started.
4	A coherent health reform program is in place supported by HMGN and donors.	■ Broad consensus on the sector-wide program among HMGN/donors.	40%	Yes, preparation of comprehensive program is underway.
5	A system established to support community-based rural development programs.	■ Joint HMGN/Bank review of experience launched.	80%	No, couldn't find a suitable person to do the work.
6	Priority funding of the Agriculture Perspective Plan (APP).	■ Significant matching of budget allocation to APP priorities.	60%	No, Focus on P1s has held, but not enough.
7	Private operators introduced in Kathmandu, rural telecom, and inland container terminals; Power Development Fund (PDF) established.	■ PDF created ■ Rural telecom operator introduced.	80% 80%	Yes for PDF; No for introduction of rural telecom operator.
8	Roads Board established and operationalized.	■ Roads Board established and its operations started.	80%	Yes, the Board has been created and expected to start working in next year.
9	RBB and NBO restructured	■ Management teams installed in RBB and NEL, and effectively supervised by NRB.	80%	Yes, NEL and RBB under external management teams.
10	Regulatory functions and organizations of NRB strengthened.	■ Agreed plan for NRB strengthening.	60%	Yes, re-engineering support team is in place.
11	MTEF (with realistic resource ceiling) established and made operational; mechanisms in place to monitor and evaluate outcomes and cost-effectiveness of public expenditures.	■ Establish realistic resource ceiling for MTEF.	40%	Yes. FY02 ceiling is soft, but priority funding for P1s has served as a reasonable ceiling.
12	Public debate on development agenda established.	■ Regular appearances of think pieces by donors and political leaders in Nepal & English media.	60%	Yes, significant improvement in the quality of debate.
13	HMGN/donor acceptance of common principles of behavior.	■ Acceptance of common principles of behavior.	40%	Yes, the Foreign Aid Policy paper is being respected.
14	Other fiduciary work and some preparatory work.	■ CPAR/CFAA follow up.		Yes, recommendations of CPAR and CFAA accepted and being implemented.

Table 2: Evaluation of CAS Outcomes

CAS OUT- COMES ^{1/}	FY03-FY05 OUTCOMES ^{2/}	EVALUATION	INSTRUMENTS
(i) (a)	N.A.	Historical revenue to GDP ratios: FY99/00: 10.7%; FY00/01: 11.4%; FY01/02: 11.5%; FY02/03: 12.3%Real progress in implementation of VAT , although domestic borrowing has risen	Dialogue [traditionally more in the realm of IMF]
(i) (b)	11	Number of development projects reduced from 785 (mid-1990s) to 470 (FY02/03); MTEF adopted and all development projects prioritized (P1, P2, P3); Funding ensured for P1s	Dialogue, PER, MTEF/IAP support/TA
(ii) (a)	2, 3, 4	Progress in decentralization legislation and in devolving schools, health facilities, agricultural extension and postal services to local levels; some (although limited) progress towards establishing Poverty Alleviation Fund (PAF)	Dialogue/IAP; Education Reform Strategy AAA; BPEP, Community School Support Project; PAF policy note
(ii) (b)	N.A.	A hiring freeze has been maintained and a number of successful voluntary retirement schemes implemented; civil service roster and payroll computerized; Office of the Controller General producing/circulating periodic expenditure reports	Dialogue/IAP
(ii) (c)	N.A.	Butwal Power Company privatized; two SOEs closed; privatization of five additional SOEs initiated	Dialogue/IAP
(ii) (d)	11	[see (i) (b) above]	[see (i) (b) above]
(ii) (e)	9, 10	External managers in place in NBL in July 2002; external managers in RBB in February 2003; re-engineering support team in place in Central Bank in February 2003	Dialogue/IAP, Financial Sector Study, Financial Sector Technical Assistance Project
(ii) (f)	7	National telecommunications policy focused on sector liberalization adopted in 1999; 65 new private operators provide value added services; second private mobile operator selected in March 2001; license granted to second private national operator for basic services in May 2001; delays in introduction of rural operator (in part due to security situation)	Dialogue, Telecommunications Sector Reform
(ii) (g)	14	CIAA strengthened; CIAA arresting of 5 former ministers and other senior officials; independent commission review of property disclosure statements of political leaders and senior civil servants; citizen's charter in place	Dialogue/IAP, CFAA, CPAR, IDA Grants

Notes: ^{1/} CAS outcome as identified in the first paragraph of this appendix.

^{2/} Nepal strategic outcome as identified in Table 1.

Appendix III

The 2003 Immediate Action Plan

The development of the 2003 Immediate Action Plan (IAP) marks the second year of HMGN's continuing efforts to bolster the country's track record for implementing reforms. In June 2002, the Council of Ministers adopted the first Immediate Action Plan (IAP) to establish a track record for implementing what it promises. The 2002 IAP focused on expediting reforms in three areas—prioritizing public expenditures, improving service delivery and fighting corruption, as well as improving accountability. The successful implementation of the first IAP established a common understanding on the essential need to carry out all the actions included in the IAP. Moreover, their implementation has helped to establish credibility for HMGN for undertaking reforms. Building on the success of the 2002 IAP, HMGN has subsequently decided to formulate an annual IAP to bridge capacity gaps and expedite key reforms.

The 2003 IAP contains a set of measures that are critical for the successful implementation of the Poverty Reduction Strategy (PRS). This second IAP consists of 24 reform actions—an increase from the set of 19

contained in the 2002 version. Not only are the measures directly linked to the four PRS pillars, most programs are tied to the Medium Term Expenditure Framework (MTEF). The Cabinet approved the IAP in July 2003 and implementation of most actions is expected to begin by September 2003. In addition to the three areas covered under the 2002 IAP, the current IAP includes reforms in agriculture, private sector development, rationalization of SOEs, infrastructure development, targeted programs, decentralization, as well as measures to address human rights. The Reform and Development Group—a joint government-donor task force responsible for developing the IAP—identified lead Ministries and donor agencies ('Lead Agencies') responsible for carrying out detailed assessments of the respective actions.

The assessments include an explanation of the impact or importance of the actions, monitoring indicators, specific outcomes, preliminary cost estimates, timeframe for implementation and the key implementing agencies on both HMGN and donor sides. The 2003 IAP actions and assessments are presented in the following matrix.

Table 1
The 2003 Immediate Action Plan

ACTION	IMPACT/ IMPORTANCE OF ACTION	INDICATORS	TIME FRAME ¹	ESTIMATED COST ²	LEAD AGENCIES
PILLAR 1: BROAD BASED ECONOMIC GROWTH					
P1-A. Macroeconomic stability					
Full implementation of Medium-Term Expenditure Framework (MTEF) to improve the outcomes focus and prioritization of the budget system. Extension of MTEF to all ministries, and use of recurrent and capital expenditure concepts.	To make a clear link between the Tenth Plan/PRSP and the Annual Plan and to ensure increased productivity of the government expenditure.	<ul style="list-style-type: none"> ■ MTEF extended to all ministries and the allocation to the P1 projects in development budget increased substantially, i.e., at least to 65 percent. ■ Aggregate budget figure presented using recurrent and capital classification and produced as an annex to the Red Book.³ 	Completed July 2003	N/A	NPC/MOF & WB/DFID
Annual Plans of all P1 projects (FY2003/04) published in the Red Book (as the basis for performance-based funds release) to bring transparency to high-priority investment activities.	To make a clear link between the Tenth Plan/PRSP and the Annual Plan and to ensure increased productivity of the government expenditure.	<ul style="list-style-type: none"> ■ All P1 projects published in the Red Book. ■ Annual plans of all P1 projects made public (NPC). 	Completed July 2003	N/A	
P1-B. Agriculture					
Fifty season-long farmer field schools (FFSs) on "integrated pest management (IPM)" organized in appropriate areas within Mid- and Far-Western districts in collaboration with and/or by contracting out to NGOs/CBOs.	To improve farmer knowledge of pest management in an eco-friendly way, increase yields of food grains (those having comparative advantage), decrease occurrence of pests and increase number of farmers participating the program.	<ul style="list-style-type: none"> ■ 35 trained officers on IPM approach ■ 1250 farmers trained on IPM. ■ 50 year round FFS established. 	October 2003 ⁴ January 2004 February 2004	NRs 20 million	MOA & ADB

1 Timeframe refers to either the adoption or implementation of the measure.

2 For certain sectoral or targeted programs, cost estimates could be made. However, costing is not applicable for those actions relating to a broad policy change or introduction and hence indicated as N/A.

3 The Red Book is the budget's appropriation book.

4 Work in progress; activity to be completed by November/December 2003.

Table 1
The 2003 Immediate Action Plan cont...

ACTION	IMPACT/ IMPORTANCE OF ACTION	INDICATORS	TIME FRAME ¹	ESTIMATED COST ²	LEAD AGENCIES
Farmer's Agricultural Funds established in 6 districts, at least 4 of which are in Mid and Far Western Region.	Funds will help deliver appropriate agricultural support services to rural poor through improved resources and institutional arrangements at the local level. This is in line with HMGN's commitment in the Tenth Plan/PRSP to enable poor farmers to support their livelihoods through appropriate and decentralized service delivery.	<ul style="list-style-type: none"> ■ Guidelines for implementing Local Initiative Fund (LIF) and District Extension Fund (DEF) developed and approved. ■ District Agriculture Development Fund and institutional framework established. ■ Representatives of at least 20 farmer groups selected by District Agricultural Development Committee (DADC) given orientation training on the use of LIF. ■ At least 10 CBOs/NGOs/ private sector organizations given orientation training on the use of DEF. ■ 25 percent of staff of DDCs and concerned line agencies given training on LIF and DEF. ■ Use of LIF by at least 10 farmer groups in each district. ■ Use of DEF by at least 3 organizations in each district to implement activities. ■ One participatory M&E of LIF and DEF implementation carried out in each district. 	<p>November 2003</p> <p>January 2004</p> <p>January 2004</p> <p>February 2004</p> <p>February 2004</p> <p>April 2004</p> <p>April 2004</p> <p>July 2004</p>	NRs. 25 million	MOA & DFID
P1-C. Irrigation					
On-farm water management program scaled up from the current 9 districts to 20 districts.	Efficient use of available water will increase cropping intensity and yield per hectare and resultant increase in farmers' income since most of the irrigation systems have limited water for winter and spring crops.	<ul style="list-style-type: none"> ■ 30 officers trained. ■ 5400 farmers involved in FFS. ■ On-farm water management programs scaled up to 20 districts. 	<p>October 2003⁵</p> <p>January 2004</p> <p>October 2003⁶</p>	NRs. 2 million	DOI/DOA & ADB

5 Work in progress; activity to be completed by November/December 2003.

6 Work in progress; expected to be completed by November 2003.

Table 1
The 2003 Immediate Action Plan cont....

ACTION	IMPACT/ IMPORTANCE OF ACTION	INDICATORS	TIME FRAME ⁷	ESTIMATED COST ⁸	LEAD AGENCIES
Legal authority provided to water user associations (WUA) through revision to the Irrigation Regulations 2000 for collection of irrigation services fees (ISF) from water users.	The 1997 Irrigation Policy includes provisions to provide legal authority to WUAs for collection of ISF. However, the provisions are not well addressed in the 2000 Irrigation Regulations. This measure will help improve O&M cost recovery of irrigation systems and their sustainable management.	<ul style="list-style-type: none"> ■ The Irrigation Regulations 2000 is revised and shared within DOI's division offices and WUAs through their national federation. ■ Water User Association empowered to charge and collect user charges. 	September 2003 ⁷	N/A	DOI & ADB
P1-D. Public enterprise rationalization					
Boards of all public enterprises (PEs) with majority Government shareholding reconstituted in line with the Cabinet decision of 17 December 2002.	As an immediate step towards reform of PEs, this action will address political interference and mismanagement of PEs by removing political appointees on their boards, possibly improving their performance with positive fiscal implications. This will also demonstrate the Government's commitment to further reform PEs, i.e. ultimately through privatization or liquidation.	<ul style="list-style-type: none"> ■ Boards of all PEs listed in the Yellow Book⁹ reconstituted-i.e., no more than 5 members in each board (chairman, general manager, representatives of MOF and line ministry, and an expert in the concerned sector), and the chairman and GM selected as per the procedure established by the Cabinet. 	October 2003 ¹⁰	Professional management of PEs leading to improved performance of PEs and positive impact on the budget.	MOF & WB
P1-E. Financial system					
Passage issuance of Bank and Financial Institutions Act/Ordinance to protect depositors from fraudulent or irresponsible banking practice, and safeguard the integrity of the financial system.	Long sought action aimed at improving the entire financial sector.	<ul style="list-style-type: none"> ■ Act/Ordinance enacted ■ Implementation of Act/ Ordinance with immediate effects. 	October 2003 ¹⁰	N/A	NRB & IMF

⁷ The Irrigation Regulation has been forwarded to the Water User Association (National Federation) for comments.

⁸ The Yellow Book contains the targets and performance of public enterprises.

⁹ Boards of the 11 public enterprises have been reconstituted and the selection process is on-going.

¹⁰ Cabinet has approved the Bank and Financial Institutions Act and the process has been initiated for Royal assent.

Table 1
The 2003 Immediate Action Plan cont....

ACTION	IMPACT/ IMPORTANCE OF ACTION	INDICATORS	TIME FRAME ¹	ESTIMATED COST ²	LEAD AGENCIES
P1-F. Infrastructure development					
<p>Roads Board operationalized and funded with a special fuel levy as authorized in the previous annual budgets. Annual maintenance plan received from Road agencies and reviewed by the Roads Board.</p>	<p>Preservation of capital investments. Substantial savings in rehabilitation costs, which could be diverted to other priority sectors. Accessibility, seasonability and trafficability improved in rural areas. Substantial economic benefits due to low vehicle operating cost (VOC) and time savings. A public-private partnership-oriented Roads Board effective in maintenance planning, funding and monitoring of the activities of the public road agencies. Performance-based funds release to road agencies implemented. Priorities fixed on the basis of pre-set criteria and least affected by political decisions.</p>	<ul style="list-style-type: none"> ■ Annual maintenance plan prepared. ■ Fuel tax levied. ■ Road board operationalized. 	<p>Completed August 2003</p>	<p>NRs. 32 million</p>	<p>DOR/MOF & WB</p>
P1-G. Public expenditure management					
<p>Responsibility for distribution of electricity to local consumers handed over from NEA to 25 cooperatives/user groups/private entities.</p>	<p>This action will help to improve NEA's efforts to improve electricity distribution efficiencies through the involvement of cooperatives and user groups. In addition, it will help to reduce distribution losses and to provide electricity access to a larger proportion of the rural population because of the flexibility of cooperatives/user groups to mobilize their own resources to expand the electricity coverage. Moreover, based on the experience of rural areas, this scheme could be extended to city areas with modifications as necessary.</p>	<ul style="list-style-type: none"> ■ NEA Board approval of NEA by-laws for bulk electricity distribution. ■ Handover of electricity distribution to 25 cooperatives/ user groups in rural areas and handover agreements concluded.¹¹ 	<p>Completed October 2003</p>	<p>N/A</p>	<p>NEA & ADB</p>
PILLAR 2: SOCIAL SECTOR DEVELOPMENT					
P2-A. Health					
<p>Essential health services package (EHSP) implemented.</p> <ul style="list-style-type: none"> ■ Upgrade mother and child health workers (MCHWs) to auxiliary nurse midwives (ANMs). 	<p>Implementing EHSP is feasible as it narrows down the multiple interventions by primary health care providers with capped resources for EHSP. Selected interventions of prioritized EHSP will provide health care that is reported causing major sickness and deaths in</p>	<ul style="list-style-type: none"> ■ 150 MCHW upgraded to ANM ■ 250 buildings constructed. ■ 250,000 persons vaccinated. ■ 500 SHPs managed by communities. 	<p>June 2005 June 2005 June 2004 June 2004</p>	<p>NRs. 1.35 million NRs. 5.0 million NRs. 130 million NRs. 50 million</p>	<p>MOH & WB</p>
				<p>Total cost of NRs. 211.35 million</p>	

¹¹ On-going.

Table 1
The 2003 Immediate Action Plan cont....

ACTION	IMPACT/ IMPORTANCE OF ACTION	INDICATORS	TIME FRAME ¹	ESTIMATED COST ²	LEAD AGENCIES
<ul style="list-style-type: none"> ■ Sub-health posts (SHPs) building construction. ■ Program for control and prevention of Japanese encephalitis. ■ SHPs handed over. <p>Scheme to hand over sub-health posts to Local Health Management Committees (LHMCs) supported by VDCs/DDCs. Scheme expanded in existing 'IAP 2002' Districts and scaled up to include 10 new (conflict affected) Districts.</p>	<p>Nepal, i.e., accounting for 50 percent of deaths and 69 percent of disease burden. These interventions are proven cost effective, and with little improvement in modality of service delivery in addition to community participation, a good referral back-up system and public private partnership can make a significant difference in health outputs and ultimate outcomes such as maternal and child mortality rates and fertility behavior.</p> <p>Local management of health facilities is important for ensuring: (a) improved management of health facilities by the local bodies/LHMC with high levels of ownership, participation and a sense of accountability; (b) motivation for wider service coverage and utilization; (c) increased resource mobilization; (d) creating awareness; (e) inclusion of poor, marginalized and outcast members of communities; (f) adequacy of essential drugs, presence of service providers in the facility in designated time and days; (g) wider infrastructure, human resource and other logistics support; and (h) most importantly, the poor availing of adequate health care despite their inability to pay.</p>	<ul style="list-style-type: none"> ■ Increased number of districts with LHMC management of health facilities. ■ LHMCs will function in sub-health posts of at least 20 districts. ■ Increased quality services in sub-health posts. 	<p>June 2004</p>	<p>Money is to be made available for:</p> <ul style="list-style-type: none"> ■ Orientation and training to local bodies, health service providers, LHMC members. ■ LHMC needs continuous capacity building support to better understand and carry out their respective role and responsibilities and to coordinate with local stakeholders. ■ District, regional and central health officials need adequate financial support for providing technical and management support to ensure quality of care, 	<p>MOH & WB</p>

Table 1
The 2003 Immediate Action Plan cont....

ACTION	IMPACT/ IMPORTANCE OF ACTION	INDICATORS	TIME FRAME ¹	ESTIMATED COST ²	LEAD AGENCIES	
P2-B. Education	Transfer of 600 schools to community management. (It is expected that a majority of the schools will be at the primary level but those at the lower secondary and secondary levels may also be included.)	<ul style="list-style-type: none"> ■ Develop local capacity in managing schools. ■ Improve school efficiency and effectiveness. ■ Ensure quality of education. ■ Develop transparency, sense of accountability and local control over resources. ■ Apply subsidiary principle. ■ Strengthen monitoring system. 	<ul style="list-style-type: none"> ■ 600 schools handed over to school management committees and these schools receiving regular HMGN block grants. ■ Measures in place for recruitment of teachers in these 600 schools by school management committees. ■ Increased number of schools handed over to communities. 	April 2004	NRs. 60 million	MOE & DANIDA
Provision of 25 percent of the cost of teacher salaries to 3,150 community primary schools (CPS) for a number of teacher positions calculated on the basis of Teacher Regulations (1 teacher per 55 pupils in Terai, 1:45 in the hills and 1:35 in the mountains.	<ul style="list-style-type: none"> ■ Encourage devolution of school education. ■ Develop partnership with communities. ■ Improve management. 	<ul style="list-style-type: none"> ■ Number of CPS receiving grants for 25 percent of teacher salaries. 	2003/04	NRs. 176 million	MOE & DANIDA	

supervision and monitoring visits more frequently and organizing local level workshops with LHMCs prior to preparation of annual health work programs and budgets indicating their contributions.

- HMGN's grant and other alternate financing means.

The level of funding is expected to decline in a few years when LHMCs have gained adequate experience and capacity to manage by themselves.

Table 1
The 2003 Immediate Action Plan cont....

ACTION	IMPACT/ IMPORTANCE OF ACTION	INDICATORS	TIME FRAME	ESTIMATED COST	LEAD AGENCIES
<p>Responsibility for school feeding transferred from the primary schools (PSNFP) to the District Education Officers in 21 districts. School feeding for 450,000 children made an integral part of school management in primary schools in these districts.</p>	<ul style="list-style-type: none"> ■ Increased enrolment particularly girls and disadvantaged children. ■ Improved retention. ■ Improved success rate of students promoting to the next grade. 	<ul style="list-style-type: none"> ■ 450,000 school children provided with food. 	January 2004	N/A	MOE & DANIDA
PILLAR 3: TARGETED PROGRAMS AND SOCIAL INCLUSION (P3)					
<p>A fully functioning autonomous and accountable Poverty Alleviation Fund (PAF).</p>	<p>This is in line with Nepal's Tenth Plan and PRSP objectives of poverty reduction. It would help alleviate poverty and reach out to the socially excluded, improve donor coordination and effectiveness in poverty alleviation, demonstrate more innovative and effective ways of addressing poverty and social exclusion, and deepen decentralization. The PAF would demonstrate ways of reaching the socially marginalized groups. The PAF is needed by Nepal because: (i) foreign financing and budgetary constraints make it difficult to finance needed services of foreign and local experts; and (ii) arranging sufficient alternative sources of funding from other sources is difficult.</p>	<ul style="list-style-type: none"> ■ Legislation imparting strong autonomy to the Board of the PAF with a professional secretariat to enable it to operate independently flexibly and effectively. ■ Act enacted. 	January 2004	NRs 35 million	NPC & WB
<p>Approval and implementation of affirmative action policies and programs to promote the participation of women as well as Janajati and Dalit groups in the civil service, including the upper layers.</p>	<p>It will contribute to an increase in women's participation in the civil service. At present, there are 75 percent women in civil service. This first step should help build momentum for broader affirmative action to increase the proportion of women, Dalits and disadvantaged Janajati groups in the civil service.</p>	<ul style="list-style-type: none"> ■ Training provided to 250 women/dalit/janajati graduates. ■ Training provided to 500 undergraduate women/dalit/ janajati. 	August 2004	N/A	MOGA & ADB

Table 1
The 2003 Immediate Action Plan cont....

ACTION	IMPACT/ IMPORTANCE OF ACTION	INDICATORS	TIME FRAME ¹	ESTIMATED COST ²	LEAD AGENCIES
Public spending in Mid- and Far-West increased on the basis of needs assessment. Appropriate monitoring systems set up.	Regions with lower development levels compared to other regions need increased efforts to help their inhabitants live dignified lives.	<ul style="list-style-type: none"> ■ Allocations increased ■ Part 2 of the Program Book (Districts) of the NPC made public. ■ Increased levels and shares of funds disbursed through District Treasury and Comptroller Offices in the regions. 	Completed August 2003	Significant	NPC & WB DFID
PILLAR 4: GOOD GOVERNANCE					
P4-A. Anti-corruption and transparency					
Legal action initiated against major bank defaulters (at RBB and NBL) and parties responsible for the major irregularities identified in the Auditor General's report.	This is urgent for maintaining soundness of the banking sector, curbing corruption and ensuring productivity.	<ul style="list-style-type: none"> ■ List of defaulters made public.¹² ■ Cases/enforcement results published in the national dailies.¹³ ■ Legal action initiated against those involved in the major cases of embezzlement as reported in the AG report.¹⁴ 	October 2003 ¹⁵	N/A	AG & NORAD/IMF/ CIAA
Police reform towards creating a professional, modernized police force and establishment of an independent Police Commission.	<ul style="list-style-type: none"> ■ An independent Police Service Commission would reduce the opportunity for political/corrupt external influences on recruitment, transfer and promotion which affect the activities of the police force. ■ A professional, modernized police organization places greater emphasis on 'service' than force. Training and a system of monitoring can reduce corruption and improve the police force's record of respect for human rights. 	<ul style="list-style-type: none"> ■ Enactment of Ordinance. ■ Formation of Police Service Commission. 	October 2003 ¹⁶ August 2004	N/A	MOHA & DFID

¹² Expected to be completed within the stipulated timeframe.

¹³ High profile cases have been reported in the press.

¹⁴ In the absence of the Parliament, the Auditor General's report has not been made public.

¹⁵ On-going, expected to be completed within the timeframe.

¹⁶ The act has been drafted and sent to the Ministry of Law, Justice and Parliamentary Management for clearance.

Table 1
The 2003 Immediate Action Plan cont....

ACTION	IMPACT/ IMPORTANCE OF ACTION	INDICATORS	TIME FRAME ¹	ESTIMATED COST ²	LEAD AGENCIES
P4-B. Decentralization					
Fiscal decentralization framework developed and implementation initiated in FY2003/04, including release of conditional or unconditional grants to local governments for poverty alleviating activities. Local Body Fiscal Commission (LBFC) capacity developed in the process.	N/A	<ul style="list-style-type: none"> ■ Framework in place. ■ Conditional/unconditional grants provided to local bodies in health, agriculture, education and infrastructure continued thereafter. ■ Poverty sensitive DDC grant formula implemented. ■ LBFC secretariat physically functional. 	September 2003 ¹⁷ September 2003 ¹⁸ January 2004 January 2004	N/A	MLD, MOF NPC & DANIDA
Tourism fees shared with concerned DDCs as provided in the Local Self Governance Regulation (LSGR).	This action will help to demonstrate HMGN's commitment to improving implementation of its policies. This would also convey a clear message about HMGN's commitment to effectively implement its decentralization policy and enable local bodies/ communities to receive part of the resources generated in their areas as provided in the LSGR.	<ul style="list-style-type: none"> ■ Sharing of tourism fees announced in FY04 budget. ■ Identification of various tourism fees to be shared with DDCs. ■ Clear mechanism for sharing the fees with DDCs, including opening of necessary accounts and a formula for sharing the proceeds among DDCs where more than one DDC is involved. ■ Monitoring system in place to ensure DDCs receive the funds. 	August 2004	Developing and implementing the revenue sharing mechanism does not involve any costs.	MLD/MOT & DANIDA/ MOWR
Local civil service system established and implementation initiated in FY2003/04.	N/A	<ul style="list-style-type: none"> ■ Draft concept paper prepared (MLD). ■ Personnel with devolved functions made fully accountable to LBs (MLD/MOGA). ■ Bill approved. 	August 2003 ¹⁹ August 2003 ²⁰ August 2004	N/A	MLD & DANIDA

¹⁷ Road map completed and overall principle of fiscal framework is under preparation to be finalized within this fiscal year.

¹⁸ Conditional grant as program related devolved, but unconditional grant interim formulae development to be finalized within this fiscal year.

¹⁹ Draft concept paper has been prepared and consultation is on-going with stakeholders.

²⁰ Guidelines for devolution of three sectors (education, health and agriculture/livestock) have been prepared.

Table 1
The 2003 Immediate Action Plan

ACTION	IMPACT/ IMPORTANCE OF ACTION	INDICATORS	TIME FRAME ¹	ESTIMATED COST ²	LEAD AGENCIES
<p>P4-C. Human rights</p> <p>HMGN's human rights record improved with respect to its handling of the conflict. Action includes provision of sufficient funds to National Human Rights Commission (NHRC) to fulfill its mandate.</p>	<p>This action is judged as an important action, and it would send an important signal to strengthen the NHRC and thereby focus on human rights issues. Human rights issues should be more up front, and NHRC has an important role to play in addressing them.</p>	<ul style="list-style-type: none"> ■ Finalization of National Human Rights Action Plan. ■ Necessary funding of NHRC arranged. 	<p>September 2003¹</p>	<p>Significant</p>	<p>MOF, NHRC & NORAD/ MOHA</p>

21 In progress.

Appendix IV

Fund Relations Note

Public Information Notice (PIN) No. 03/110
EMBARGOED
NOT FOR NEWSWIRE TRANSMISSION
UNTIL 11:30 AM WASHINGTON TIME
(1530 GMT)

September 5, 2003

International Monetary Fund
 700 19th Street, NW
 Washington, D. C. 20431 USA

IMF Concludes 2003 Article IV Consultation with Nepal

On August 22, 2003, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Nepal.¹

Background

Nepal remains among the poorest countries in the world with almost 40 percent of the population living in poverty due to insufficient growth and inadequate targeting of the poor. During the 1990s, macroeconomic conditions remained broadly stable and the fiscal position was manageable, but growth was constrained by financial sector weaknesses, weak public sector management, and poor governance. In the financial sector, Nepal Rastra Bank (NRB) oversight is still weak, and intermediation is inadequate

largely due to a banking environment in which loan default is endemic, especially by well-connected borrowers. Partly as a result of this, the two largest commercial banks now have large nonperforming assets. Similar problems exist at two large development banks. In the public sector, investment has been spread thinly over projects and enterprises suffer from weak management and accountability. More recently, intensified security problems and adverse external developments contributed to lower growth and the fiscal position has deteriorated since 2000/01.

The ceasefire agreed in January 2003 with the insurgents has renewed hopes for peace and efforts have been made to sustain the reform momentum. Progress in achieving lasting peace would facilitate poverty

reduction and implementation of policies contained in the government's Poverty Reduction Strategy Paper (PRSP). However, political uncertainties persist as major political parties continue to maintain that the appointment of governments by the King since the dissolution of parliament is unconstitutional. The parties have also refused to join the peace talks.

GDP growth is estimated to be 2 percent in 2002/03. The ceasefire has helped restore some normality in the transport and service sectors and the decline in tourism may have halted. There are also signs that some exports and manufacturing production are rebounding. Inflation, which rose to about 7½ percent in mid-May (12-month basis) reflecting price developments in India, administrative price changes, and supply factors, is expected to moderate by early 2003/04.

The 2002/03 budget met revised targets set in a mid-term review. Based on weak revenue performance due to lower activity during the first half of the year and external aid shortfalls relative to the initial budget targets, the authorities revised the budget at mid-year. Specifically, the tax revenue target and external financing were revised down. To compensate for these shortfalls, total expenditure was also revised down and the revised budget set a net domestic financing target of 2 percent of GDP. Following the announcement of the ceasefire, economic activity picked up and revenue performance improved. However, capital spending was below the revised budget, reflecting continued implementation constraints at the local level. As a result, domestic financing was around 1¾ percent of GDP.

Monetary policy has been accommodative and the real effective exchange rate has depreciated. To help economic recovery, the

NRB lowered cash reserve requirements by 1 percentage point in August 2002 and maintained a refinancing facility for lending to "sick" industries. Aided by the recovery in activity and monetary easing, private credit appears to have revived and higher remittances contributed to a rise in banking system foreign assets. However, reserve money growth has been curtailed, due largely to lower net credit to the government. Lending and deposit rates have declined somewhat. The Nepalese rupee has depreciated in real effective terms since early 2002, reflecting the peg to the Indian currency which has appreciated only somewhat against the weakening US dollar.

Balance of payments developments turned favorable in mid-2002/03 and external reserves are adequate. Large and increasing remittances helped buoy the current account. Garment exports began recovering in late 2002, while recorded exports to India declined, carpets and pashmina exports continued to stagnate, and imports increased with the recovery. The current account (excluding official transfers) is expected to move into a deficit of about ? percent of GDP, but with higher aid and other inflows official foreign exchange reserves are expected to rise to US\$1 billion (6¼ months of imports of goods and services).

In 2002/03, significant progress was made in financial sector reform implementation. The NRB took steps to reduce staffing through a voluntary retirement scheme (VRS). Progress was made in restructuring the two largest commercial banks, which had external management teams installed. The teams have prepared management plans, made progress in assessing the banks' financial status, and proposed VRSs to reduce overstaffing. Some improvements have already taken place with success in loan recovery and branch rationalization,

although loan recovery from well-connected borrowers continues to be difficult. Prioritization of budgetary spending improved, anti-corruption efforts were boosted, and public enterprise reform implementation and governance reforms progressed. To improve prioritization, a Medium Term Expenditure Framework was introduced with World Bank assistance to help align development spending with national and sectoral priorities. Administered price increases for petroleum products were announced in March 2003, although some price increases were rolled back under public pressure. Liquidation procedures were initiated for four public enterprises; preparations for the privatization of one enterprise were brought to an advanced stage.

Governance reforms progressed and anti-corruption efforts were boosted. The cabinet approved in September 2002 the elimination of 7,500 vacant civil service positions. To tackle corruption in public life, the Commission for Investigation of Abuse of Authority and a newly established Judicial Commission initiated investigations against politicians and revenue officials perceived to have accumulated unaccountable assets. The Anti-Corruption Strategy was adopted.

Executive Board Assessment

Executive Directors stressed that to address the pervasive level of poverty in Nepal, growth needs to be raised significantly over the medium term through vigorous implementation of structural reforms, particularly in the financial and public sectors. In this regard, Directors welcomed the authorities' Poverty Reduction Strategy Paper (PRSP), which is founded on broad-based growth, social sector development, targeted programs for the poor and deprived groups, and improved governance. Directors looked

forward to considering a Joint Staff Assessment of the PRSP in the near future. They encouraged the authorities to reach early agreement on a program that could be supported by the Poverty Reduction and Growth Facility to help achieve PRSP goals.

Directors welcomed the ceasefire agreement with the insurgents reached in January 2003. They underlined that continued peace was essential to help sustain the economic recovery currently under way. Directors also noted that progress in the peace talks and the build up of confidence should help relieve budgetary pressures for security spending.

Directors commended the authorities' for maintaining broad fiscal stability to create conditions to support economic growth. Looking forward, Directors endorsed the authorities' fiscal strategy based on revenue mobilization, expenditure prioritization, and a reduction in domestic borrowing. They welcomed the 2003/04 budget as the first step in implementing this strategy. However, Directors called for a determined effort to meet the revenue targets and to resist spending pressures. To raise revenue over the medium term, Directors suggested cuts in exemptions, improvements in tax and customs administration, and increases in the VAT rate. Directors welcomed the steps taken to prioritize development spending to help achieve poverty reduction goals, including the introduction of a medium-term expenditure framework, and encouraged the extension of such efforts to all expenditures. Directors noted that the envisaged reductions in domestic borrowing would help maintain fiscal sustainability over the medium term, especially in view of potentially large contingent liabilities from financial sector and public enterprise reforms. Continued technical assistance in the fiscal area will help address capacity constraints.

Directors agreed that monetary and exchange rate policies should remain geared to supporting the exchange rate peg to the Indian rupee, stressing that the peg had served Nepal well given its close links with India. Looking forward, they noted that prospective external developments, such as the phasing out of the Multi-Fiber Agreement, would likely have implications for external competitiveness and the appropriate choice and level of the peg. Directors pointed to the need for policy measures to ensure that remittances are sustained, as well as for efforts to diversify Nepal's export base. They also noted that external competitiveness could be enhanced by measures to raise labor productivity and lower transport costs.

Directors commended the authorities for progress in financial sector reforms, but noted that much remained to be done. They stressed the need for strengthening Nepal Rastra Bank (NRB) supervision of the financial sector. The NRB should also improve performance incentives for skilled personnel, while encouraging separations at lower levels. Directors welcomed the appointment of external managers at the two largest insolvent commercial banks, and noted recent steps taken by the new managers to improve the financial condition of the banks. To help support these efforts and, more generally, to

Public Information Notices (PINs) are issued (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. The Staff Report for the 2003 Article IV Consultation with Nepal is also available.

create a sound banking environment, Directors noted the authorities' intention to phase out priority sector lending requirements, and emphasized the effective implementation of recently adopted debt recovery mechanisms, including the Debt Recovery Tribunal and blacklisting of loan defaulters.

Directors welcomed ongoing public sector reforms, including the elimination of vacant positions, the introduction of merit-based promotions, the decompression of the wage scale, as well as improvements in the public procurement process. Looking forward, Directors recommended the adoption of civil service accountability in order to improve policy implementation. They welcomed the public enterprise reform efforts that would lower government ownership in the economy and increase the enterprises' net budgetary contribution—through privatization and restructuring of viable enterprises and liquidation of unviable ones. Several Directors stressed that due regard should be paid to the pace and sequencing of these reforms. Also, an appropriate compensation scheme could help smooth implementation of workforce reductions.

Directors welcomed recent efforts to combat corruption, but emphasized the need to pursue forcefully those responsible for the misuse of public funds. Directors supported the authorities' plans to increase decentralization to enhance service delivery. However, they noted that the implementation of these measures should be accompanied by improved public sector governance and capacity building at the local level.

Directors supported measures to improve the business climate for private sector development through legal reforms and streamlining of administrative procedures to facilitate trade. They recommended revisions to labor legislation to make labor hiring more flexible

and modifications to the Company and Insolvency Acts to allow more orderly and timely exit of unviable firms.

Directors commended Nepal for its open trade regime, and welcomed the authorities' efforts to gain early World Trade Organization (WTO) accession. Directors welcomed the

elimination of the exchange restriction arising from quantitative limits on payments for personal travel. Directors encouraged the authorities to further improve statistics to enhance policy formulation and monitoring. They urged full implementation of Fund technical assistance recommendations.

Nepal: Selected Economic Indicators, 1998/99-2002/03 ^{1/}

	1998/99	1999/00	2000/01	2001/02	2002/03
					Est. ^{2/}
	(Percent change)				
Output and prices					
Change in real GDP	4.5	6.1	4.8	-0.5	2.0
Change in CPI (end-period)	9.0	0.6	3.4	3.5	7.5 ^{3/}
	(Percent of GDP)				
Budgetary operations					
Total revenue	10.2	10.7	11.4	11.5	12.0
Total expenditure	15.4	15.7	17.6	17.2	16.7
Current expenditure	9.3	9.6	11.2	11.6	12.4
Capital expenditure and net lending	6.1	6.1	6.4	5.7	4.2
Overall deficit ^{4/}	3.9	3.5	4.5	4.3	2.4
	(Percent change)				
Money and credit					
Domestic credit	16.1	17.8	18.8	9.2	12.4
Broad money	20.8	21.8	15.2	4.4	8.1
	(In millions of U.S. dollars, unless otherwise indicated)				
External sector					
Exports, f.o.b. ^{5/}	763	971	942	754	670
Imports, c.i.f.	1,390	1,713	1,773	1,496	1,623
Current account ^{6/}	24	28	65	144	-32
(In percent of GDP) ^{6/}	0.5	0.5	1.2	2.6	-0.6
Overall balance	136	192	38	-31	27
Gross foreign assets	795	946	1,020	1,048	1,088
Rupees per U.S. dollar (end-period)	68.5	70.8	74.7	78.0	75.1

Sources: Nepalese authorities; and IMF staff estimates.

^{1/} Fiscal year ending July 15.

^{2/} As of July 25, 2003.

^{3/} Mid-May.

^{4/} After grants.

^{5/} Includes re-exports.

^{6/} Before grants.

1 Note: This Appendix is as of July 25, 2003 and as such, the indicators deviate from the more updated indicators provided elsewhere in the document.

2 Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

Appendix V: The Main Findings of Two Key Fiduciary Assessments: The Country Financial Accountability Assessment (CFAA) and the Country Procurement Assessment Report (CPAR)

A. The Country Financial Accountability Assessment¹

Context

Nepal's legal and regulatory framework for ensuring public sector financial accountability is impressive for a country at its level of economic development. The 1990 Constitution requires the Ministry of Finance to submit a detailed comparison of the financial results and budgets of all ministries to Parliament at the end of each fiscal year. The Constitution also accords the Auditor General (AG) complete legal and professional independence, exempting his emoluments and the budget of the Office of the Auditor General (OAG) from parliamentary vote. The Constitution also created a Commission for the Investigation of Abuse of Authority (CIAA) to investigate and recommend actions against errant and corrupt officials and prosecute them, if necessary.

Furthermore, when the Public Accounts Committee (PAC)—headed by a member of the main opposition party in Parliament—was in session, it was proactive in its undertakings. It is schedule to meet year round discussing public accounts and the AG's annual report and recommendations, as well

as all aspects of public sector financial management. All meetings are open to, and receive full coverage in, the press, and it intervenes in on-going procurement processes when impropriety is suspected. Its collaboration with the AG is exemplary. It sends the AG's recommendations to the HMGN with a directive for the implementation of such recommendations.

The 1999 Financial Procedures Act and 1999 Financial Administration Regulations (FAR) contain detailed and comprehensive provisions for: (i) budget preparation and approval; (ii) accounting and reporting on budget implementation every four months; (iii) a detailed report (Schedule 2 of the FAR) that includes a statement, not only of expenditures, but also of physical results and goals achieved; (iv) elaborate procurement and internal control procedures; (v) annual financial statements at all levels, with a consolidated financial statement for the whole public sector at the end of each fiscal year; (vi) internal and external audits; (vii) ministerial review of project implementation at regular intervals throughout the year, with rewards for good performers and explanations for poor performance.

The 1999 Local Self-Governance Act (LSGA) presents the structure of local government. The roles, responsibilities and relationships of District Development Committees (DDCs), Municipalities, and Village Development Committees (VDCs), and the Councils which govern them are explained in the LSGA. The regulations for financial accountability at the local level are even more impressive than those at the center. They contain provisions and instructions for: (i) budget preparation; (ii) proper accounting and reporting; (iii) creation of an Accounts Committee in every local body to oversee financial management; (iv) internal and external audits; (v) project monitoring; and (vi) an elaborate system for “ex-post” evaluation of projects which assesses, not only the direct costs and benefits of each project, but also the impact on employment creation and on the environment.

Key Findings

The following are the CFAA’s key findings.

While the legal framework appears comprehensive, Nepal has been less successful with compliance and implementation of the regulations, but commitment to upgrade the public sector’s financial management is strong. Compliance with the provisions of the FAR either has not been accorded the priority implied by the regulations. Schedule 2 of the FAR which requires reporting on physical and goal achievements is inadequately monitored. With adequate monitoring, the linkages between financial progress and physical outputs/outcomes could be measured in ways that would fully meet the Bank’s financial management requirements for Bank-financed projects. The imposition of penalties and fines prescribed by the FAR for non-compliance with reporting or other requirements is not

strictly enforced. Until recently, 95% of the legal cases brought by the CIAA against errant officials have been unsuccessful but the success rate is reported to have improved to as much as 50%.

At the local level, monitoring has been weak with the lack of adherence to M&E by most institutions as required by the LSGA. While accounting staff possess minimum technical qualifications required for the job, they have little or no experience in project accounting and financial management. Technical staff are known to give low priority to resource allocation and to establishing good financial management systems in their respective agencies/projects. Compliance with internal controls and internal audits have to be strengthened. While the proactive involvement of the PAC during project implementation process has helped to check any malpractices or misdeeds, it can at times cause delays in decision-making with negative implications for development.

Several explanations have been given for the dichotomy between precept and practice: (i) insufficient political commitment or demand for compliance with financial accountability rules and regulations; (ii) reluctance to punish or impose sanctions on anyone; (iii) reported corruption in civil service appointments, promotions and transfers; (iv) politicization of the civil service and its decision-making processes; and (v) some donors and foreign development partners bypassing the requirement for establishing financial systems and requirements for the projects they support, thereby contributing to the lack of compliance with the country’s laws and regulations.

Ultimately, the problem with compliance can be attributed to two basic factors. First, Nepal is still in the process of fully developing a solid financial management framework

for implementing the laws and regulations on public accountability. For example, tying expenditures to outputs and outcomes requires a budgetary system that specifies outputs or results expected from expenditures as well as funds; accounting and reporting systems that record/report quantitative and qualitative achievements in addition to financial data/financial statements; and an auditing system which enables an independent auditor to trace expenditures and their results. Second, political instability including frequent government changes and more urgent priorities have diminished the attention on financial management needs.

The present challenge for Nepal is supporting institutional changes to shift away from inadequate compliance to earnest and consistent implementation of the country's existing impressive legal and regulatory framework. The CFAA's Development Action Plan (DAP) contains a host of recommendations towards improving financial accountability of the public sector and a summary is provided below.

Budgeting and Accounting

Transparent criteria must be developed for selecting officials to handle state funds, whether in the form of revenue or as spending budget. A key requirement would be the ability of the individual to properly account for the funds as stipulated by existing regulations, including reports on physical results or measurable goals achieved from previous expenditures and to be achieved from the proposed program/development expenditure.

No budget should be accepted or approved for any public office, whether at the village, municipal, district, department or ministry level, nor should Parliament approve the national budget unless the relevant budget

contains: (i) a retrospective account of physical or other measurable achievements or goals resulting from previous expenditures; and (ii) a prospective forecast of the physical results or other measurable goals expected from proposed expenditures. A suitable simplified framework should be developed that can be realistically implemented at the local (village, municipal and district) level.

Each disbursement to any office (whether at local or at central level) should be made against a report from that office showing: (i) expenditures for the immediately preceding period and their physical or other measurable achievements; and (ii) the proposed expenditures and their anticipated physical or other measurable achievements.

Independent Auditing and Parliamentary Oversight

The following measures would go a long way to improving the chances that the recommendations of the OAG and the PAC are implemented.

- The Monitoring Section of the National Planning Commission (NPC) should be strengthened to ensure full ownership by NPC for instituting a realistic system of monitoring all development projects, in addition to the core projects, in close collaboration with concerned line ministries, and to report their progress three times a year.
- The Financial Comptroller General Office (FCGO) and the internal audit services at central and local levels ought to be strengthened to be able to: (i) certify offices qualified to receive and properly account for funds; (ii) monitor compliance with the new regulations (that is, the above recommendations) all through the year; and (iii) take proactive actions to rectify any violations of rules and regulations before they are raised by external auditors.
- The OAG should improve its capacity to confirm annually whether or not the new

rules are being complied with and to provide services in financial auditing and outcomes-based performance auditing.

- Capacities of the line ministries have to be built to effectively monitor their programs and prepare time-bound action plans to rectify issues or implement recommendations in the OAG's report. MOF must monitor the implementation of the action plans of all ministries.
- MOF should establish an effective monitoring system to follow up on reported irregularities and periodically report on the actions taken. Such monitoring should include the status of the following: (i) audit backlogs and action plan to keep all audits up-to-date; (ii) revenue realization; (iii) clearing reimbursable grants and loans; (iv) tax deduction at source; (v) repayment of principal and interest made by HMGN on guaranteed loans but not recovered from concerned institutions; (vi) dividends receivable, and other receivables, from corporate bodies and boards; (vii) amounts to be paid by HMGN to various entities; and (viii) follow-up on the recommendations of the PAC.
- The PAC must be given an unambiguous and enforceable mandate to insist on political demand for accountability and transparency and compliance with the new regulations.

Fiduciary Risk and Programmatic Lending

For fiduciary risk on programmatic lending to approximate the fiduciary risk now accepted for project lending, accountability and internal control standards in the whole civil service must approximate those currently existing in Bank-financed projects. The existing legal/regulatory framework meets these standards but compliance must be enhanced. The objective for HMGN should be to harmonize the reporting system that is acceptable to all donors. There is no reason to not consider some budgetary support/programmatic lending, but it

should be accompanied by: (i) a pragmatic program of targeted assessment and strengthening of sectors and institutions scheduled to benefit from such lending; and (ii) implementation of the recommendations made in the DAP for the public sector over the medium term.

Sectors, ministries and institutions envisaged for budgetary support should be the first to be assessed and certified by a panel of independent experts representing the accountability institutions which include MOF, FCGO, NPC and OAG (or may also include experts designated by donor partners participating in budgetary support) as complying with the accountability standards recommended above.

Following the full implementation of the proposed integrated financial management improvement program, a quick review would be desirable to confirm the effectiveness of the compliance system, before generalized programmatic lending benefiting all sectors, ministries, and institutions is launched. All levels of government would need to be reviewed for adequate compliance before moving forward.

A Task Force or a Reform Monitoring Committee should continue to monitor the implementation of the recommendations of the CFAA. Implementation status should be periodically reported to the Finance Committee of the Parliament, the Finance Secretary, and Nepal's development partners.

Capacity Building and Implementation of CFAA Recommendations

Implementation of the CFAA recommendations in the form of the DAP by the entire public sector has been underway since mid-2002. A progress report of the Plan is regularly updated and posted on the MOF's external website. In addition, the Government requested the Bank's assistance in two

areas: capacity building of the accounting and auditing staff and upgrading the quality of audits. Specifically, the request entailed enhancing the capacity of the OAG towards improving public sector financial accountability. In March 2003, the Bank provided an Institutional Development Fund (IDF) grant of US\$0.5 million. On the basis of the CFAA recommendations and agreement reached with the OAG, the grant will finance: (i) the revision of the audit guidelines and reporting methodology to be compatible with international standards or best practice; and (ii) the establishment of institutionalized training arrangements within OAG to implement the guidelines.

B. The Country Procurement Assessment Report²

Context

Like most countries, Nepal's constitution does not address the issue of public procurement, but in contrast to most countries, there is no law (in the sense of a generally applicable set of rules enacted by the legislature) about public procurement. In this respect, Nepal (like its neighboring countries Pakistan and India, and a few others) is different from most other countries in the world. Most countries have introduced a public procurement law, enacted by parliament which alone can change it, which law deals exclusively with the public procurement of goods, works and services by governmental entities at all levels, and most often both for the central authorities as well as those on a provincial and communal level.

The system used in Nepal is represented by the Financial Administration (Related) Rules of 1999" (FAR99) was originally introduced by the British but is no longer practiced in the U.K. This approach consists of the issuance by government (rather than by the legislature) of a set of financial rules which

essentially describe the financial powers of various governmental authorities, and in particular the procedures they should follow in securing and disbursing the public funds required to discharge their functions, including the rules governing the procurement of public contracts. Having been issued by government, these rules—i.e., FAR99—can also be changed by government, without any approval by the legislature, which it is felt in most countries is not in the public interest. Rules of this nature, which govern the use of huge amounts of public funds, should be difficult rather than easy to change, and they should be changed only in a public and transparent manner.

Key Findings

Procedures and Practices

FAR99 represents an improvement over its predecessor but the enactment of a Public Procurement Law is a necessity. The Bank revised the rules for National Competitive Bidding (NCB) under Bank-financed contracts, in order to properly reflect the interests of the public purchaser. In fact, the list (noted below) indicates the areas of the public procurement system requiring attention.

- Provision of sufficient time for bid preparation.
- Bidders access to bidding documents by mail or in person.
- Evaluation of bids according to pre-disclosed criteria.
- Bid opening in only one place and immediately after deadline for bid submission.
- No preference to local bidders competing with foreign bidders.
- Contract awarded to lowest evaluated bidder.
- No post-bidding negotiations with the lowest or any other bidder.
- No bid rejection on the basis merely of price estimates.
- No rebidding without IDA's prior concurrence.

- Requirement for all bidders to provide bid and performance securities.
- No awards by lottery.
- Extension of bid validity only according to Bank's International Competitive Bidding (ICB) rules.
- No bidding on the basis of a percentage premium over estimated cost.

Bidding Documents

There following includes further recommendations to strengthen the National Competitive Bidding (NCB) provisions in the procurement schedules of credit agreements.

- Bidders must be allowed, prior to the deadline for bid submission, to amend or withdraw their bids.
- Larger civil works contractors must not be prohibited from competing against smaller contractors; a two-envelope system must not be used for the procurement of goods and works.

Issues Related to Expertise, Audit, Anti-corruption

In addition to the problems related to the legal and procedural framework in which procurement is conducted in Nepal, there are other problems mentioned below:

- Like in almost all borrowing countries of the Bank, there is a tremendous need to train public officials in the principles and practices of public procurement.
- The Auditor General's staff has been found, in the case of donor-financed contracts, to insist upon the application of local procurement rules instead of the donor's procurement rules (although the applicable Nepalese rules make it clear that the latter should apply).
- Nepalese laws and rules dealing with corruption seem to penalize only passive corruption (i.e., the soliciting or accepting of bribes by public officials), but not acts (just as dangerous) of active corruption (i.e., the offering or

giving of bribes to public officials by private parties).

- There is a perception amongst the bidders and business community that corruption is a problem in public procurement in Nepal.

Summary of Major Recommendations

The 2002 CPAR contains the following principal recommendations:

- Enacting a modern, transparent and competitive public procurement law, based on the UNCITRAL Model Law for Procurement, to apply to public procurement by all public entities in Nepal at all levels, as well as to parastatals.
- Creating a small, independent procurement agency, with functions defined by the Public Procurement Law (essentially policy, and not oversight or line clearances of procurement decisions).
- Pending the enactment of such a Public Procurement Law, amend FAR'99 in the sense of changing the anti-competitive rules and practices listed in this Executive Summary.
- Review and develop as needed standard bidding documents to be used for procurement financed by HM own government.
- Develop and accelerate procurement training at all levels of government, including the Auditor General's staff.
- Instructing the Auditor General's staff, in the case of donor-financed procurement, to insist on the application of the donor's procurement rules and not of local procurement rules.
- Amending the anti-corruption legislation in such a way as to (i) impose harsh penalties (including blacklisting) on the acts of active fraud and corruption, particularly the offering/giving of bribes to public officials, and (ii) specifically allowing/inviting bidders to report acts of corruption by other bidders, as well as solicitation of bribes by public officials.

Capacity Building and Implementation of CPAR Recommendations

The Government is strongly committed to implementing the CPAR recommendations. The Government revised provisions of the FAR99 soon after the publication of the CPAR. They include ensuring sufficient time for bid preparation, evaluation of bids according to pre-disclosed criteria, awarding of bids and prohibiting post-bidding negotiations with bidders.

The Bank is currently providing technical assistance through a three-year IDF grant of about US\$0.3 million to implement three areas of the above-mentioned CPAR recommendations. The grant—launched in March 2003—will finance: (i) the development of a draft modern transparent and competitive Public Procurement Law in line with international standards and related rules and procedures; (ii) the creation of a comprehensive framework for public procurement training and building a pilot training program particularly for trainers and officials responsible for the management of public procurement.

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- 1 The CFAA was jointly carried out by HMGN and the Bank beginning in December 2001, with the establishment of a high level National Steering Committee (NSC). The NSC played a pivotal and strong leadership role which demonstrated the high level of HMGN ownership, and also was extremely useful in guaranteeing a high quality product. Throughout the process, a number of stakeholder meetings were held, including with representatives of donors, government agencies, oversight agencies and private sector agencies. Following a stakeholder's workshop in which over 200 people participated, formal discussions of the final CFAA report were carried out in June 2002. Subsequently, HMGN adopted the Development Action Plan of the CFAA.
 - 2 The CPAR was carried out as jointly between the Bank and HMGN. The work was initiated in November 1999 and finalized in April 2002.



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