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INDEPENDENT EVALUATION GROUP

The World Bank in Nepal 2003–2008

Country Program Evaluation

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Abbreviations

AAA	Analytic and Advisory Activities
ADB	Asian Development Bank
APP	Agricultural Perspective Plan
BFIA	Bank and Financial Institutions Act
BOGs	Basic Operating Guidelines
BPEP-II	Basic and Primary Education Project II
CA	Constituent Assembly
CAE	Country Assistance Evaluation
CAS	Country Assistance Strategies
CASPR	Country Assistance Strategy Progress Report
CBA	Central Bank Act
CBD	Community-Based Development
CBOs	Community-Based Organizations
CBRA	Central Bank Regulatory Act
CFAA	Country Financial Accountability Assessment
CIAA	Commission for the Investigation of Abuse of Authority
CPA	Comprehensive Peace Agreement
CPAR	Country Procurement Assessment Report
CPIA	Country Policy and Institutional Assessment
CPN	Communist Party of Nepal
CPN-M	Communist Party of Nepal - Maoist
CSSP	Community Schools Support Project
DANIDA	Danish International Development Agency
DDCs	District Development Committees
DFID	United Kingdom Department for International Development
DHS	Demographic and Health Surveys
EFA	Education for All
EHCS	Essential Health Care Services
ERTA	Economic Reform Technical Assistance
ERTAC	Economic Reform Technical Assistance Credit
ESW	Economic and Sector Work
FCGO	Financial Comptroller General's Office
GDP	Gross Domestic Product
GNI	Gross National Income
GTFP	Global Trade Finance Program
GTZ	Deutsche Gesellschaft fur Technische Zusammenarbeit (German Agency for Technical Cooperation)
HDI	Human Development Index
HFMC	Health Facility Management Committees
IAP	Immediate Action Plan
IC	Interim Constitution
IDA	International Development Association (of the World Bank Group)
IEG	Independent Evaluation Group
IFC	International Financial Corporation
IMF	International Monetary Fund
INS	Interim Strategy Note
IPDPs	Indigenous People's Development Plans
ISN	Interim Strategy Note
JICA	Japanese International Cooperation Agency
MFDBs	Micro-Finance Development Banks
MOHP	Ministry of Health and Population
MTEF	Medium-Term Expenditure Framework
NGOs	Non Governmental Organizations
NBL	Nepal Rastra Bank
NEA	Nepal Electricity Authority
NPR	Nepalese Rupees
OAG	Office of the Auditor General
ODA	Official Development Assistance
OECD/DAC	Organization for Economic Co-operation and Development/Development Assistance Committee
OP	Operational Policy

PAC	Public Accounts Committee
PAD	Project Appraisal Document
PAF	Poverty Alleviation Fund
PDF	Power Development Fund
PEM	Public Expenditure Management
PPMO	Public Procurement Monitoring Office
PRSC	Poverty Reduction Support Credit
PRSP	Poverty Reduction Strategy Paper
PSD	Private Sector Development
RBB	Rastriyas Banijya Bank
RWSS	Rural Water Supply and Sanitation
SDC	Swiss Agency for Development and Cooperation
SEDF	South Asia Enterprise Development Facility
SEZ	Special Economic Zone
SHEP	Second Higher Education Project
SMC	School Managed Committee
SME	Small and Medium Enterprise
SOEs	state-owned enterprises
SWAps	Sector-Wide Approaches
SPA	Seven Party Alliance
TA	Technical Assistance
UNDP	United Nations Development Programme
USAID	United States Agency for International Development
VCDPs	Vulnerable People's Development Plans
VDCs	Village Development Committees

Acknowlegements

This Country Assistance Evaluation (CAE) provides an independent assessment of World Bank assistance to Nepal during the fiscal 2003-08 period. The CAE examines whether: (a) the objectives of Bank assistance were relevant; (b) the Bank's assistance program was effectively designed and consistent with its objectives; and (c) the Bank's program achieved its objectives and had a substantial impact on the country's development during this period. The CAE draws lessons and recommendations for future Bank assistance. Annex H describes the methodological approach.

The basis for the CAE consists of Independent Evaluation Group (IEG) background papers, sectoral reviews, projects assessments, and interviews with senior government officials, representatives of the private sector and civil society, non-governmental organizations (NGOs), members of the donor community, and World Bank and International Monetary Fund (IMF) staff at headquarters and in Nepal. An IEG mission visited Nepal in September 2008. A list of those interviewed is contained in annex G.

This CAE is based on the findings and preliminary report of the mission to Nepal led by Claude Leroy-Themeze, with contributions by Helen Abadzi, Gita Gopal, Narpat Johda and John Johnson. The CAE was written by Claude Leroy-Themeze (Task Manager). This evaluation benefited from the comments of peer reviewers, including René Vandendries, Robert Chase, Gary Milante, David Steeds,and of external reviewer Clare Lockart. William Hurlbut provided editorial support. Min Joo Kang provided research and data support, and Silvana Valle provided administrative assistance.

The International Finance Corporation (IFC) chapter is based on findings of the mission to Nepal and the South Asia Region by Asita de Silva and Stephen Pirozzi. It benefited from interviews with senior government officials, representatives of the private sector, civil society, members of the donor community, and IFC and World Bank staff in Nepal, Bangladesh, India, and at headquarters. The IFC chapter was written by Asita de Silva with a contribution by Stephen Pirozzi. Maria Elena Pinglo provided analytical support.

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Foreword

This report evaluates International Development Association (IDA) support to Nepal during 2003-2008. IDA's overarching goal during this period was to support the Government's efforts to reduce poverty and improve human well-being. IDA focused on helping to foster broad-based growth, social development, social inclusion, and good governance.

IDA was Nepal's largest development partner, providing 13 percent of (gross) overseas development assistance (ODA) flows during 2003-2008. The Bank successfully led efforts to strengthen government ownership of and leadership in development assistance coordination in 2002-03. But this approach ran into progressively greater challenges as Nepal's political situation deteriorated and the ensuing internal conflict and suppression of democracy worsened. Development partners increasingly took issue with providing budget support against a backdrop of questionable legitimacy of the government and feasibility of government programs under conflict and increasing political instability. Tensions among development partners notwithstanding, the Bank was able to lead or contribute to productive development partnerships. Rapprochement on the peace and development agenda among IDA, the UK Department for International Development (DFID), and the Asian Development Bank (ADB) resulted in a joint assistance framework in 2009.

The evaluation concludes that IDA's strategy during 2003-2008 was relevant to Nepal's development needs, but that its relevance to the more immediate situation was compromised by several factors. These included limited ownership of the Bank-supported government reform program and its lack of realism with respect to political instability and insecurity. Despite a difficult backdrop, IDA assistance during the review period had positive outcomes in social development and to some extent social inclusion. In contrast, the outcome of IDA support fell short of the Bank's program objectives, as well as outcome targets in broad-based growth and governance. The low overall efficacy of IDA's assistance strategy is explained mainly by its failure to account for the country's specific circumstances. Some elements of IDA's program—IDA credits and/or policy reforms that they were intended to support—could not be implemented as planned.

The evaluation highlights the need to introduce greater realism into the country assistance strategy, and to retain flexibility to adjust to changing circumstances. It also stresses the need to consult widely and continually with national stakeholders and development partners. In addition, it points to the importance of making agriculture and rural development central to the program. The evaluation also focuses on the significance of designing and implementing a mechanism to systematically track the impact of the Poverty Alleviation Fund and adjust its design to enhance benefits to the poor. Finally, supporting reforms in public finance management through policy-based lending or (if the prerequisites for budget support cannot be met) sector-wide approaches is also key.

Given Nepal's characteristics, in particular its heavy reliance on remittances, the current financial crisis is underscoring Nepal's socio-economic vulnerability. The World Bank Group has a role in helping the country cope with the impact of the crisis and in getting Nepal onto an environmentally and socially sustainable development path. In particular, the Bank Group has a vital role to play in supporting the country's investments and in helping to get the most impact from those investments through policy and institutional reforms.

Vinod Thomas
Director-General, Evaluation

Nepal: Summary of World Bank Program

Outcome Ratings

IEG's Country Assistance Evaluations (CAEs) assess and rate the outcomes (the "results") of a given World Bank country program relative to its objectives as stated in the Country Assistance Strategy (CAS). This differs from rating country outcomes or Bank or client government performance. The central question underlying the table that follows is: "To what extent did the World Bank program achieve the outcomes that it set out to achieve?" Distinct ratings and sub-ratings (Annex H) are typically assigned to each "pillar" or set of strategic goals set out in the relevant Bank strategy document(s)..

Bank Strategic Goals [1]	Achievement of Associated Country Assistance Strategy Outcomes or Results	Bank Program Outcome Ratings [2]
1. Broad-based Growth		Unsatisfactory
Public Expenditure Management	The Medium-Term Expenditure Framework was established and functioned successfully through FY04, but was later abandoned and has not functioned as an expenditure management tool since FY06. Negligible progress was made in restructuring the state-owned enterprise (SOE) sector and reducing the budget drain.	Unsatisfactory
Private Sector Development	Private sector investment failed to achieve the expected recovery, as it was hampered by the impact of civil war and political instability on the investment climate. The financial sector was partially restructured but, after 2006, progress stopped and in some cases was reversed. Some progress was made in infrastructure but except for telecommunications, outcome objectives were not met.	Unsatisfactory
Pro-Poor Agricultural Development	Although this was a linchpin of the growth and poverty reduction strategy, the International Development Association's (IDA's) major planned interventions—an agricultural sector study and follow up sector reform operation—did not materialize. Agricultural growth and yield improvements were negligible.	Unsatisfactory
2. Social Development		Moderately Satisfactory
Education	Through support for the Education For All program, IDA contributed to a significant increase in access to basic education including for marginalized groups, but limited in quality improvement.	Moderately Satisfactory
Health	Through a successful sector-wide approach (SWAp), satisfactory progress was made toward improved health care services and health outcomes and a reduction of access disparities, despite challenging operational conditions on the ground.	Satisfactory
Rural Water and Sanitation	Access to safe drinking water in rural areas continued to improve during the CAE period, and access disparities were reduced. Improvements in sanitation lagged behind improvements in access to safe water. IDA support facilitated some improvements in sustainable access, but was not successful in achieving sectoral institutional reforms.	Moderately Satisfactory

Bank Strategic Goals [1]	Achievement of Associated Country Assistance Strategy Outcomes or Results	Bank Program Outcome Ratings [2]
3. Social Inclusion	On balance, given the weight of IDA resources allocated to the Poverty Alleviation Fund (PAF) (which received 100 percent of IDA funding dedicated to this pillar), the overall outcome is rated moderately unsatisfactory.	Moderately Unsatisfactory
Mainstreaming Sector Projects	Through its lending, IDA helped improve access to basic services for the socially excluded, whether on a gender, caste, or ethnicity basis.	Satisfactory
Public Funds Used by Disadvantaged Rural Groups for Services	IDA's PAF was effective in channeling funds to the socially-excluded. However, contrary to plans, it financed mostly private goods, in particular goats, rather than improved access to services. Also, it did not have the envisaged institutional development impact. Moreover, in the absence of systematic evaluation, there is little hard evidence that it has been an effective instrument for poverty reduction and social inclusion.	Moderately Unsatisfactory
Diversity of the Civil Service	The Bank supported a workshop which helped to debate and discuss the policy on affirmative action. An affirmative action policy was approved by the Parliament in 2007 as part of an Amendment of the Civil Service Act. Although it addressed the inclusion problem, the Amendment did not include safeguards regarding pay-for-performance and risks of political interference.	Moderately Satisfactory
4. Good Governance		Unsatisfactory
Decentralization	IDA's objective of supporting decentralization was highly relevant, but given Nepal's political context and the fact that local elected governments had been suspended since 2002, a planned IDA operation to support decentralization did not materialize.	Unsatisfactory
Autonomy and Accountability of the Civil Service	Little improvement occurred over the CAE period, and the CAS's specific outcome target was not achieved. A bill to increase civil service autonomy was drafted and approved by the cabinet, but was never enacted. Moreover, as noted above, the 2007 Amendment of the Civil Service Act may have had unintended adverse consequences.	Unsatisfactory
Accountability and Transparency of Public Finance	IDA's support achieved some (as yet) incomplete steps, such as the passage of the Procurement Act. However, the Act had little impact on actually improving the quality and efficiency of public financial management. To the contrary, there has been some significant regression in the quality since 2005. Moreover, for most of the CAE period, the Public Accounts Committee (PAC) at the Parliament was suspended and could not oversee government accounts. The end-of-year government financial statements were not disclosed. Many public enterprises and agencies remain out of compliance with laws for regular reporting.	Unsatisfactory
Overall	Progress was made toward improving access to basic services and reducing disparities based on gender, caste, or ethnicity. Diversity of the civil service is also expected to increase following the 2007 adoption of an affirmative action policy. More public resources are reaching the rural poor through the PAF, but the CAS objective of providing them with better services has not been achieved and there is no evidence of any reduction in poverty or exclusion impact. In the other areas of IDA intervention concerning broad-based growth and governance, progress was limited or negligible. Given the large share of IDA resources devoted to the growth pillar and the centrality of improving governance in Nepal's Tenth Plan/PRSP as well as in IDA's assistance strategy, the overall outcome of IDA support relative to its stated objectives and outcome targets would, on balance, be rated unsatisfactory. However, given the 2003 CAS's explicit recognition that only two-thirds of IDA's objectives and outcome targets would realistically be met, the adjusted rating is *moderately unsatisfactory*.	Moderately Unsatisfactory

Evaluation Summary

Nepal Country Assistance Evaluation

The fiscal 2003-08 evaluation period was one of tumultuous political turmoil, conflict, and dramatic change in Nepal. Today, prospects for sustainable peace are brighter, though still fragile. In such difficult and unpredictable conditions, formulating and implementing an effective development assistance strategy and programs were great challenges for development partners, including the Bank. To its credit, the Bank managed to remain constructively engaged in Nepal despite a challenging political and security context, and has achieved some significant results on the ground.

The International Development Association's (IDA's) strategy for Nepal during this period was embodied in a January 2003 Country Assistance Strategy Progress Report (CASPR), a November 2003 CAS, and a January 2007 Interim Strategy Note (ISN). Shifts in emphasis over the period notwithstanding, IDA's strategy covered four "pillars": broad-based growth, social sector development, social inclusion, and good governance. The strategy was relevant in that it was tailored to Nepal's longer-term development needs and was closely aligned with the government's Tenth Plan and Poverty Reduction Strategy Paper (PRSP). Nevertheless, it was poorly adapted to the country's conflict situation and political instability, and until recently (fiscal 2008) underwent little adjustment in response to the rapidly-evolving conditions on the ground.

Overall, the outcome of the Bank's program is rated moderately unsatisfactory. As many of the objectives and outcome targets set by IDA were not met, the overall outcome of IDA support would be rated unsatisfactory. However, given the 2003 CAS's explicit recognition that only two-thirds of IDA's objectives and outcome targets would realistically be met, the adjusted rating is moderately unsatisfactory. Most of the outcomes targeted under the broad-based growth pillar, which focused on public expenditure management, private sector development, and agriculture, were not achieved. Nevertheless, many of the outcomes targeted under the social development pillar, notably improvements in access to basic education, healthcare, and water and sanitation services, were achieved, despite difficult country circumstances. With respect to social inclusion, although there were some positive outcomes, such as increased access of socially-excluded groups to basic services, several key outcomes targeted (notably under the IDA-supported Poverty Alleviation Fund (PAF), were also not achieved. Under the governance pillar, very few of the outcomes targeted were achieved, whether with regard to decentralization, increasing the autonomy and accountability of the civil service, or increasing transparency and accountability in public finance.

Looking forward, the Independent Evaluation Group (IEG) recommends that IDA introduce greater realism into its strategy and program design and maintain flexibility against a backdrop of a clear long-term vision. The Bank should apply frequent course corrections in response to changing circumstances, and consult widely with national stakeholders and development partners.

Given the importance of improving the living conditions of the poorest, agriculture and rural development need to form the centerpiece of IDA's assistance program. For the PAF to realize its potential, it needs to incorporate a mechanism to systematically track its impact on poverty and social exclusion. Its design needs to be adjusted to optimize benefits to the poor and socially-excluded. Finally, as long as prerequisites for policy lending are not met, sector-wide approaches (SWAps) can offer an alternative way of supporting public finance management and other institutional reforms.

With the exception of its existing portfolio of two hydropower projects, the International Finance Corporation (IFC) did not make a significant contribution to Nepal's development over most of the review period. The IFC's gradual re-engagement beginning in 2006 was successful, resulting in two Global Trade Finance Program (GTFP) investments, an investment in a domestic airline in 2008, a pipeline of investment projects in the financial sector, and a constructive dialogue with the government on the business climate.

Country Background. Nepal is a small landlocked country with few natural resources and difficult terrain bounded by two giant, nascent economic superpowers, India and China. The country is largely dependent on low-productivity, mostly subsistence agriculture for income and employment. Remittances from abroad have steadily increased over the last 15 years and now represent over 15 percent of gross domestic product (GDP). Economic growth accelerated in the 1990s following democratization and economic liberalization. However, economic growth again slowed, in part due to the decade-long Maoist Insurgency that started in 1996 and intensified in late 2001. Economic growth was also curtailed due to the lack of progress in implementing much needed structural reforms.

Nepal is the 12th-poorest country in the world and the poorest in South Asia with a gross national income (GNI) per capita (Atlas method) of US$340 (2007). It is plagued by substantial disparities in caste, ethnicity, gender, and geographic location. In the 2005 Human Development Index (HDI), Nepal ranked 142nd out of 177 countries, although the gap with South Asia has steadily declined over the last 20 years. Despite the conflict and modest economic growth after the mid-1990s, remarkable progress was posted in terms of social well-being: income poverty incidence declined from 45 percent in 1996 to 31 percent in 2004, and most social indicators steadily improved. Moreover, although income inequality increased, disparities in access to basic services— based on gender, cast, ethnicity, poverty status, and geographic location— declined.

During the assessment period of this Country Assistance Evaluation (CAE), fiscal 2003-08, Nepal experienced intense political turmoil, conflict, and change. This had major implications for the implementation of IDA's assistance strategy. For example, between 2002 and April 2006, democratic institutions were progressively suspended, and in February 2005 King Gyanendra assumed direct rule. In addition to the political instability of the period, the Maoist Insurgency, which had started in the 1990s, continued to escalate, with a serious deterioration of security. In April 2006, the King was forced to restore parliament by a pro-democracy movement and eventually a peace agreement was reached with the Maoists. In April 2008, successful elections were held for a Constituent Assembly and the monarchy was abolished. A Maoist-led coalition government assumed power in September 2008.

With a highly fluid political and security situation as a backdrop, IDA operated under three strategy documents during the period of fiscal years 2003-08: the 2003 the CAS Progress Report (CASPR) covering fiscal years 2003-05, the 2003 CAS covering fiscal years 2004-07, and the 2007 Interim Strategy Note (ISN) covering fiscal years 2007-08.

During this period, the Bank's role in Nepal recovered from the low level of the early 2000s. As part of this renewed effort, IDA substantially contributed to the design of the government reform program. The 2003 CASPR initiated a significant shift in Bank strategy. Since the late 1990s, owing to the lack of progress in implementing governance and economic reforms, Nepal had been placed under the low-case lending scenario as specified in the 1998 CAS. The 2003 CASPR shifted the program to a base-case lending scenario, and the 2003 CAS was prepared in its wake. Total lending commitments in support of IDA's strategy averaged US$150 million per year over the evaluation period, albeit with large annual variations. About half of new commitments over the period were made in fiscal 2008, and there were none in fiscal year 2006. In addition, IDA conducted extensive economic and sector work (ESW), engaged in policy dialogue, and provided substantial technical assistance.

Two elements were consistently part of IDA's strategy. The first element was fostering broad-based economic growth through strengthened public expenditure management, an improved environment for private sector development, and agricultural growth and rural development. The second element was social development, which was to be accomplished through investment in education, health, and rural water and sanitation. Following the preparation of Nepal's first Poverty Reduction Strategy Paper (PRSP) in 2003, which coincided with the government's Tenth Plan, the strategy also increasingly emphasized two other themes: social inclusion and good governance. The Bank supported these themes through measures to strengthen public financial management and to promote decentralization.

Development Assistance Coordination. The Bank successfully led in strengthening government ownership of and leadership in development assistance coordination in 2002-03. However, its approach was met with challenges as the conflict and suppression of democracy intensified. Increasingly, many development partners took issue with providing budget support against a backdrop of the questionable legitimacy of the government. They were also concerned with the difficulty of implementing government programs under the conditions of conflict and political instability. Despite the tensions among development partners, the Bank contributed to and led several productive partnerships with: (i) the United Kingdom's Department of International Development (DFID) in financial sector restructuring, (ii) the International Monetary Fund (IMF) in macroeconomic management, and at the sectoral level with SWAps in education and health. In addition, IDA, DFID, and the Asian Development Bank (ADB) initiated a promising rapprochement on the peace and development agenda that resulted in the preparation of a joint assistance framework in 2009.

Overall Assessment

Bank strategy was relevant in that it was tailored to Nepal's longer-term needs, and was based on several pieces of ESW. The strategy was also closely aligned with the objectives defined by the government in the Tenth Plan/PRSP. However, full ownership of the government's reform program was limited to a handful of technocrats in Kathmandu. The relevance of the strategy was further compromised by a lack of realism, above all with regard to political economy considerations. For example, IDA's strategy did not factor in such considerations as the environment of physical insecurity and political instability, which was not conducive to achievement of politically sensitive structural reforms. These included the ongoing Maoist Insurgency, which made project implementation difficult, as well as the difficulty of addressing governance issues when a majority of the population questions the legitimacy of the government.

Failure to account for the specific circumstances of Nepal (at least in formal strategy documents) goes a long way toward explaining the low efficacy (that is, the extent to which it achieved the outcomes that it had targeted) of the Bank's assistance strategy, with the exception of social development and to some extent social inclusion. Bank assistance in basic service delivery, primary education, health, and rural water supply and sanitation, as well as its support for social inclusion in those same sectors, was characterized by substantial efficacy. Except for telecommunications, efficacy was weak regarding interventions in support of broad based-growth, including the private sector and agriculture. Efficacy was also negligible for the governance agenda.

Broad-based Growth. The focus in this pillar was on public expenditure management, private sector development, and agriculture. IDA took the lead in the effort to improve the quality of public expenditure management through policy advice and technical assistance for establishing output-based budgeting and a Medium-Term Expenditure Framework (MTEF). These activities yielded some positive results in the early part of the review period and allowed for an increase in pro-poor expenditure, particularly for education and health. However, with the dismissal of the champions of that reform in 2005-06, and their replacement by officials new to the concept of medium-term expenditure planning, the process was almost entirely reversed. Due to political turmoil and lack of confidence in the government's budgetary process, at least half of capital spending by development partners remained off-budget. Negligible progress was made in restructuring state-owned enterprises and reducing their drain on the budget. Based on the failure to establish an improved public expenditure management system and an inability to create fiscal space to increase social expenditure and public investment, the outcome of IDA support to improving public expenditure management is rated *unsatisfactory*.

The promotion of private sector development encountered some initial success and some financial deepening occurred. This was assisted by moderately successful efforts to rein in the irresponsible lending practices of the two large state-owned commercial banks. However, from 2006 onward this healthy process of rationalization was partially rolled back as the political climate changed, the desire to use state banks to achieve social goals increased, and Central Bank leadership weakened. Despite strong and steady support from IDA, little improvement in Central Bank regulatory and supervisory effectiveness has occurred, and, after seven years, the restructuring of the two main loss-making commercial banks has not been completed. Moreover, although the CAS had sought either privatization or liquidation of these banks, their disposition is now uncertain. Private investment failed to achieve the expected recovery, hampered by the impact of several factors— above all the negative impact of the conflict (and related insecurity), political instability, and uncertainty on the investment climate. On this basis, the outcome of IDA's support to private sector development is rated *unsatisfactory*.

Although the Tenth Plan and PRSP had identified agricultural development as a priority for reinvigorating income and employment growth in rural areas, planned Bank support to agricultural development did not materialize. Given the centrality of agriculture to improved living conditions for the poorest, the failure to support agricultural growth constitutes a major setback to the growth and poverty reduction goals that were at the heart of IDA's strategy. On this basis, the outcome for IDA assistance to agriculture is rated *unsatisfactory*.

The 2003 Tenth Plan /PRSP had laid out a range of environmental issues to be addressed, given the importance of environmental management for sustainable development and the well-being of the people of Nepal. IDA helped the government to articulate an effective strategy for environmental conservation and management. Thus far, however, the strategy has not been operationalized and there is little evidence of impact.

Overall, because of the limited relevance of IDA's strategy and very low efficacy, the outcome of IDA assistance for broad-based growth is rated *unsatisfactory*.

Social Development. IDA support was well aligned with the government's main objective of increasing access to and the quality of basic education and health, thereby also reducing disparities. Enrollment in primary education increased significantly, and the proportion of out-of-school children of primary age declined dramatically, particularly for girls and socially-excluded populations. However, there was little progress on improving the quality of education. IDA's strategy relied on the assumption that community school management would be sufficient to increase the quality of education, and that the community school management committees would be able to monitor this quality. However, this assumption remains untested as the evaluation of the pilot was delayed. The outcome of IDA's assistance for basic education is rated *moderately satisfactory*.

IDA assistance helped the government meet several of its goals for extending access to health services and reducing social disparities in access. The health SWAp has been successful in scaling-up cost-effective public health services, which are credited with contributing to sustained improvement of health outcomes over the CAE period. On this basis, the outcome of IDA's assistance in health is rated *satisfactory*.

Access to safe drinking water and sanitation services in rural areas continued to improve during the CAE period and disparities were reduced. IDA support facilitated some improvements in sustainable access to safe drinking water and sanitation, and in promoting social inclusion with regard to this service. However, in the absence of a sound sector-wide monitoring and evaluation system, IDA's contribution is difficult to establish. Moreover, IDA support has not been successful in achieving sectoral institutional reforms. The outcome of IDA's support to rural water supply and sanitation is rated *moderately satisfactory*.

On balance, given that support to education represented more than half of total IDA resources allocated to social development, the overall outcome of IDA's support for social development is rated *moderately satisfactory*.

Social Inclusion. Through its lending, IDA helped improve access to basic services for those who were socially excluded based on gender, caste, or ethnicity. The efforts were especially effective in education, and to a lesser extent in the health and water and sanitation sectors. The outcome of IDA support in this area is rated *satisfactory*.

In the 2003 PRSP/CAS, the PAF initially aimed to support integrated infrastructure development (drinking water, small-scale irrigation, schools, health posts, and trails) for the most disadvantaged communities in remote rural areas, including the socially excluded. It also sought to strengthen the capacity of local institutions and help the government to better coordinate support targeted to these populations. The PAF successfully placed money in the hands of socially excluded people, helped to improve incomes of PAF beneficiaries in many cases, and initiated a habit of savings among the poor. However, contrary to plans, the bulk of its financing was directed at private goods, mainly livestock, rather than focusing on providing better access to services. Also, it did not have the envisaged institutional development impact. Moreover, in the absence of systematic tracking of outcomes, there is little hard evidence that it has been an effective instrument for poverty reduction or that it has promoted greater empowerment and social inclusion. Partly as a result, other development partners have been reluctant to participate. On this basis, the outcome of IDA support through the PAF is rated *moderately unsatisfactory*.

Some progress was made toward the objective of improving the diversity of the civil service through IDA support for an affirmative action policy. However, although it addressed the inclusion problem which was a tremendous achievement, the 2007 amendment to the Civil Service Act did not include safeguards regarding pay-for-performance and risks of political interference. The outcome of IDA support in this area is rated *moderately satisfactory*.

On balance, given the weight of IDA resources allocated to the PAF, the overall outcome of IDA support for social inclusion is rated *moderately unsatisfactory*.

Good Governance. IDA's strategy of supporting decentralization was highly relevant. However, given the political context and the fact that local elected governments had been suspended since 2002, it could not be implemented. The outcome of IDA support in this area is therefore rated *unsatisfactory*.

IDA's objective of improving the autonomy and accountability of the civil service was not met and little improvement occurred over the CAE period. Moreover, the 2007 Amendment of the Civil Service Act carries a risk of significant unintended adverse consequences. Overall, the outcome of IDA support for civil service reform is rated *unsatisfactory*.

IDA's objective of improving accountability and transparency of public finance achieved some significant steps, such as the passage of the Procurement Act. However, it has had little impact on the actual improvement of the quality and efficiency of public financial management. To the contrary, there has been some significant regression in quality since 2005. Moreover, for most of the CAE period, the Public Accounts Committee (PAC) at the parliament was suspended and could not oversee government accounts. End-of-year government financial statements were not disclosed. The outcome of IDA support for public finance is rated *unsatisfactory*.

Overall, the rating for governance is *unsatisfactory*.

Overall Rating. Progress was made toward improving access to basic services and reducing disparities based on gender, caste, or ethnicity. Diversity of the civil service is also expected to increase following the 2007 adoption of an affirmative action policy. More public resources are reaching the rural poor through the PAF, but the objective of providing better services has not been achieved. There is little hard evidence on their poverty impact. In the other areas of IDA intervention, broad-based growth and governance, progress has been limited or negligible. Given the large share of IDA resources devoted to the broad-based growth pillar and the centrality of improving governance in Nepal's Tenth Plan and PRSP, as well as in IDA's assistance strategy, the overall outcome of IDA support to Nepal would, on balance, be rated *unsatisfactory*. However, given the 2003 CAS's explicit recognition that only two-thirds of IDA's objectives and outcome targets would realistically be met the adjusted rating is *moderately unsatisfactory*.

Findings

Among the results of this evaluation of IDA's assistance program in Nepal over fiscal years 2003–08, the following findings are highlighted.

Most of the economic and governance objectives targeted under the broad-based growth and good governance pillars were not achieved. The prerequisites for effective implementation were not met and the Bank's assistance strategy was not realistic and attuned to the country circumstances. The Bank's experience in Nepal is similar to that of other fragile states. Specifically, it shows that the continuation of Bank lending in a situation characterized by a deteriorating political environment and weakening commitment to reforms does not lead to the achievement of declared goals, nor does it serve economic development and poverty reduction.

IDA has been disengaging from the agriculture sector since the mid-1980s—a process that reached its nadir during the CAE period. Over the fiscal 2004-06 period, there were no active IDA projects in agriculture, including irrigation and forestry. Moreover, although the PAF targets the rural poor, it does not constitute an alternative for supporting agriculture growth. In a country where 85 percent of the population depends on agriculture for subsistence and employment, and poverty is predominantly a rural issue (and the 2003 Tenth Plan/PRSP had prioritized agriculture and rural growth), IDA's failure to support agriculture is a critical gap.

Despite Nepal's conflict conditions and political instability, progress was made in improving basic services (primary education, essential health care, and water and sanitation) for which demand is high. Progress in basic services was made with respect to reaching the poor, particularly in rural areas. Importantly, basic services improved for all, regardless of political dividing lines. Moreover, this progress was achieved mostly through programs implemented by central government departments (education and health) whose administrations (central and deconcentrated) were strengthened over the period.

Over the past decade, Nepal made significant progress in reducing social disparities, despite difficult country circumstances. Although in practice IDA support focused more on economic than social inclusion, it contributed substantially to bringing social inclusion issues to the center of the development strategy. It accomplished this by raising awareness and understanding of those issues, as well as by supporting critical measures such as equal access to education, civil service diversity, and PAF targeting based on gender, caste, and ethnicity.

The Bank failed to tailor its assistance strategy to country circumstances. The Bank did not adequately account for the implications of Nepal's fragility in designing its strategy, and adjust when major assumptions proved to be no longer valid. This undermined its effectiveness. In addition, the failure to formalize strategy and program shifts detracted from the Board's ability to exercise oversight.

Recommendations

Based on the analysis and findings of the evaluation, IEG recommends that IDA:

Inject greater realism into the country assistance strategy and program design, retain flexibility to adjust to changing circumstances, and consult widely and continually with national stakeholders and development partners throughout program design and implementation. Although the prospects for political stability and the sustainability of peace look more promising today than in years past, the current government faces enormous challenges in the face of high popular expectations. In many areas, the details of the government's policy agenda—let alone the feasibility, pace, exact form of implementation, and likely repercussions— are uncertain. Under such conditions, the lessons of recent history suggest a need for IDA to inject more realism into strategy and program design and to be prepared for course corrections. This should be done with responsibility and accountability for signaling major shifts. Moreover, broad consultations on a regular basis would help ensure that IDA's strategy and program remain relevant.

Make agriculture and rural development the centerpiece of the assistance program. Given the centrality of agriculture in any realistic plan to improve the lives of many of Nepal's poor and marginalized inhabitants, placing agricultural and rural growth, including issues of food security and malnutrition, at the heart of IDA's strategy is needed. In parallel with the focus on economic growth in rural areas, IDA needs to step up its efforts to help increase the access of poor and marginalized people to basic services (basic education, healthcare, safe water and sanitation, and roads), notably in traditionally lagging regions. In striving to increase such access to basic services, the focus needs to be on delivery schemes that have worked and proved sustainable elsewhere in Nepal's rural environment. Finally, to have any significant impact, IDA's engagement in agriculture and rural development will need to be sustained over a long period of time, and not follow the stop-and-go patterns of the past.

Design and implement a mechanism to systematically track the impact of the PAF on poverty and social inclusion, and adjust its design as needed to optimize benefits to the poor and socially excluded. The major weakness of the PAF, despite its potential as an instrument for addressing social exclusion, is that it has not had a mechanism to track the extent to which its activities are effectively addressing the various dimensions of social exclusion. Given the importance that the PAF is now assuming as an outlet for IDA funds, this shortcoming needs to be remedied as soon as possible.

Support public expenditure and public finance management and other institutional reforms, preferably through policy-based lending coupled with technical assistance as needed, or SWAps (as was done in primary education and health), if the prerequisites for policy-based lending cannot be met. In Nepal, SWAps have proven so far to be the most promising vehicle for achieving gradual but lasting change. If conditions for policy-based IDA budget support do not come together, IDA could usefully explore the prospects for supporting such reforms through SWAp instruments.

Evaluation of IFC Activities

As the political and security situation deteriorated (after 1999), the IFC withdrew its local field presence and had very limited activities in Nepal (between 1999-2006). Other than two existing IFC investments in hydropower generation that made important contributions to Nepal's domestic electricity supply, the IFC's other operations in Nepal were not successful. To a large extent, the IFC's inability to develop successful investment projects through much of the decade can be attributed to the increasingly difficult investment environment.

After 2006, the IFC began a gradual reengagement in Nepal that involved: (i) advisory work with several local banks; (ii) development of Global Trade Finance Program (GTFP) facilities that enabled the IFC to deepen its relationships in the financial sector; (iii) engagement in the investment climate, where no other donors were active, through small diagnostic studies that helped establish relationships with government counterparts; (iv) a subsequent expansion of Advisory Services programs in the investment climate and financial sector; and (v) establishment of a single-person field office within the World Bank office in Kathmandu. Although it remains too early to assess the long-term development contributions of these interventions, the IFC's gradual reengagement in the context of the difficult overall investment environment has resulted in: two GTFP investments; an investment in a domestic airline in 2008; a pipeline of investment projects in the financial sector; and; a constructive dialogue with the government on business-enabling environment issues.

Management Action Record

MAJOR MONITORABLE INDEPENDENT EVALUATION GROUP (IEG) RECOMMENDATIONS REQUIRING A RESPONSE	MANAGEMENT RESPONSE
Inject greater realism into the country assistance strategy and program design, retain flexibility to adjust to changing circumstances, and consult widely and continually with national stakeholders and development partners throughout program design and implementation. Although the prospects for political stability and sustaining peace look more promising today than in years past, the current government faces enormous challenges in the face of high popular expectations. In many areas, the details of the government's policy agenda— let alone the feasibility, pace, and exact form of implementation, and the likely repercussions— are uncertain. Under such conditions, the lessons of recent history suggest a need for IDA to inject more realism into strategy and program design and to be prepared for course corrections, yet with responsibility and accountability for signaling major shifts. Moreover, broad consultations on a regular basis would help ensure that IDA's strategy and program remain relevant.	Management agrees with IEG's recommendation that it is critical to retain flexibility and consult widely. The past six years have witnessed unprecedented changes in Nepal's political and socio-economic setting, and all donors have been adjusting to a challenging situation. Further changes are on the horizon as a new constitution is expected to be adopted within the new Interim Strategy Note (ISN) period. This new ISN lays out a path with a more modest program that is balanced and takes into account the lessons brought out in the IEG Report. As we implement the ISN and move towards the next strategy, we will continue broad consultations and be prepared to reorient our support in response to the dynamic post-conflict environment.
Make agriculture and rural development the centerpiece of the assistance program. Given the centrality of agriculture in any realistic plan to improve the lives of many of Nepal's poor and marginalized inhabitants, placing agricultural and rural growth, including issues of food security and malnutrition, at the heart of IDA's strategy is needed. In parallel with the focus on economic growth in rural areas, IDA needs to step up its efforts to help increase access of poor and marginalized people to basic services (basic education, healthcare, safe water and sanitation, and roads), notably in traditionally lagging regions. In striving to increase such access to basic services, the focus needs to be on delivery schemes that have worked and proved sustainable elsewhere in Nepal's rural environment. Finally, in order to have any significant impact, IDA's engagement in agriculture and rural development will need to be sustained over a long period of time, and not follow the stop-and-go patterns of the past.	Management agrees with IEG on the importance of agriculture and rural development, and the new ISN places rural development, including agriculture, at the heart of our ongoing and future development activities. This is consistent with the government's forthcoming Nepal Development Strategy, which also emphasizes agriculture and rural development (including health, education, water and sanitation, energy, etc.) with attention to those who were underserved and excluded in the past. Most of the projects approved in the last few years have focused on rural areas, and this emphasis will be even stronger under the ISN. The proposed Project for Agriculture Commercialization and Trade (PACT) will be presented to the Board along with the ISN. In addition to agriculture, Management believes that continued emphasis on social development and social inclusion in education (where progress is strong), health, and nutrition will have an important impact on the lives of rural people. We would argue that IDA-supported education programs in Nepal have had more success than the IEG report claims. We recognize the lack of clear evidence of improvements in quality of education programs (learning outcomes), but this is a Bank-wide conceptual problem and management believes that the IEG report has unduly judged the performance in this sector on account of this conceptual point. Finally, we believe that IEG has not given sufficient credit to the successful micro-hydro program which is transforming the lives of newly electrified villagers.

MAJOR MONITORABLE INDEPENDENT EVALUATION GROUP (IEG) RECOMMENDATIONS REQUIRING A RESPONSE	MANAGEMENT RESPONSE
Design and implement a mechanism to systematically track the impact of the Poverty Alleviation Fund on poverty and social inclusion, and adjust its design as needed to optimize benefits to the poor and socially excluded. The major weakness of the PAF, despite its potential as an instrument for addressing social exclusion, is that it has not had a mechanism to track the extent to which its activities are effectively addressing the various dimensions of social exclusion. Given the importance that the PAF is now assuming as an outlet for IDA funds, this shortcoming needs to be remedied as soon as possible.	Management agrees with IEG's conclusions on the PAF, and the need to devise stronger monitoring and evaluation (M&E) systems. In addition, an impact evaluation of the program is underway and preliminary results are being analyzed. Management is committed to intensifying the Bank's efforts to help the PAF achieve stronger results, and the M&E system will be an important part of this effort.
Support public expenditure, public finance management and other institutional reforms, preferably through policy-based lending coupled with technical assistance as needed, or SWAps (as was done in primary education and health), if the prerequisites for policy-based lending cannot be met. In Nepal, SWAps have proven to be the most promising vehicle for achieving gradual but lasting change. If conditions for policy-based IDA budget support do not come together, IDA could usefully explore the prospects for supporting such reforms at the sectoral level through SWAp instruments.	Greater donor coordination has proven to be particularly important during this transition period, and Management considers the SWAps to be an important instrument for resource transfer and for harmonized support. We will continue to support SWAps in health and education as long as the fiduciary and safeguard arrangements are acceptable and critical policies are maintained. We will explore the possible application of SWAps in other sectors, especially rural roads, trail bridges, and rural water/sanitation, recognizing that the design of such sector-wide instruments—often involving many partners can involve longer lead-times in developing the harmonized framework. In considering further application of SWAps, the Bank will be flexible, practical, and results-oriented.

Chapter 1
Country Context and Development Challenges

Introduction

This Country Assistance Evaluation (CAE) assesses the World Bank's Nepal program over the fiscal 2003-08 period.[3] The primary goal of the CAE is to assess the outcome of the Bank's assistance program. The assessment applies IEG's standard evaluation criteria to the Bank's Nepal country program: relevance, efficacy, efficiency, and sustainability (see annex H). The CAE discusses and assesses the relevance of IDA[4] objectives and instruments, the extent to which those objectives were achieved (efficacy), how they were achieved (efficiency), and the institutional development impact of the Bank's assistance and resilience to risks of the attendant development benefits. The CAE also assesses the Bank's contribution to the achievement (or otherwise) of the government's development goals. In addition, the CAE draws lessons from the key findings and provides recommendations for future Bank assistance strategies for Nepal.

Chapter 1 provides an overview of Nepal's country characteristics—notably roller-coaster political developments and insecurity, structural vulnerabilities in the economy, inequality and exclusion among the population, and weaknesses in governance—that have been major constraints to the country's development and the well-being of its people. Chapter 2 provides a broad overview of IDA's strategy during the period reviewed. The subsequent four chapters cover the main areas or "pillars" of the Bank's assistance program—achieving broad-based economic growth (chapter 3), social development (chapter 4), social inclusion (chapter 5), and promoting good governance (chapter 6)—with each providing an assessment of the outcome of the IDA program under the pillar in question. Chapter 7 presents an evaluation of the International Finance Corporation (IFC)'s activities. Chapter 8 provides an overall assessment of outcomes and resilience to risk. The final chapter summarizes the main findings and sets out recommendations to improve the effectiveness of the Bank's program.

Geography and Demographics

Nepal is a landlocked, largely mountainous country that stretches from the flat river plain of the Ganges to the mountains of the Himalaya. It shares boundaries with two nascent economic superpowers, India and China. The country has few natural resources and its main economic activity is agriculture. The population of 29.5 million people (2008 estimate) is ethnically and linguistically diverse, with 103 different ethnic and caste subgroups that can be clustered into two main groups, the Tibetan-Nepalese and the Indo-Nepalese. The former are historically the larger and dominant group, although they now constitute only 43 percent of the population. There is steady migration from the impoverished hill and mountain areas to the relatively urbanized Kathmandu Valley in the center of Nepal, the fertile Terai region in the southern part of the country, and abroad.

Political Context

Over the review period, IDA formulated its strategy and implemented its program against a backdrop of unprecedented political turmoil and, particularly in the latter part, colossal change.[5] Two major episodes can be distinguished. The first, between late 2001 and about March 2006, saw the King, as head of a hereditary monarchy that had ruled Nepal for more than two centuries, progressively suspend arrangements for democratic governance. Key milestones included:

- The November 2001 declaration of a state of emergency, which was thereafter coupled with more overt mobilization of the armed forces to counter the Maoist Insurgency. In response, the insurgency—which had begun some five years earlier following a split in the Communist Party of Nepal (CPN) and a decision by the Maoist faction to resort to underground armed struggle—escalated from a low-intensity conflict to a full-scale military confrontation (see maps on the geographic spread of conflict over time and its intensity by district in annex D). There was an attendant rise in human rights abuses and, in several places, conditions approached humanitarian crisis proportions.
- The May 2002 dissolution of Parliament and appointment of prime ministers by royal decree thereafter significantly shortened the lifespan of subsequent governments, (further) detracting from their effectiveness.
- The culmination of this episode came in the royal coup of February 2005 in which the King seized absolute power, in parallel broadening the suspension of civil rights and tightening restrictions on movement and communication, notably among the mainstream political parties. This had the effect of eventually uniting the mainstream and dissident opposition in a common purpose, namely antagonism toward the King.

The second episode, between April 2006 and about the autumn of 2008, saw the King's usurpation of power reversed and the monarchy eventually abolished altogether. The former Maoist Insurgency was brought into mainstream politics and—to the surprise of many—at the head of a newly elected coalition government. Key milestones in this episode included:

- In April 2006, an alliance of the mainstream political parties and the CPN was able to exert sufficient popular pressure on the King to secure reinstatement of the House of Representatives and the appointment of an interim government. Initially, widespread discontent in the wake of the royal coup had induced the non-royalist mainstream political parties to group themselves into a Seven Party Alliance (SPA) in mid-2005 to oppose the royal takeover.[6] Then in November, the SPA and the CPN-M formed a coalition against the King, paving the way for a reinstatement of democratic politics.

- In November 2006, ahistoric deal between the SPA and CPN-M—the Comprehensive Peace Agreement (CPA)—was concluded. It provided for Maoist participation in the interim government, in effect securing the Maoists' return to the fold of mainstream politics. The CPA also provided for an Interim Constitution and legislature (and Maoist participation in the latter) to cover the period leading up to elections for a Constituent Assembly (CA), initially envisioned for June 2007.
- The elections were postponed twice and eventually took place in April 2008, resulting in a surprise plurality (but not an outright majority) of CA seats for the CPN-M. At its inaugural meeting, the CA abolished the monarchy and declared Nepal a republic. In turn, a CPN-M led coalition government took office in August 2008.

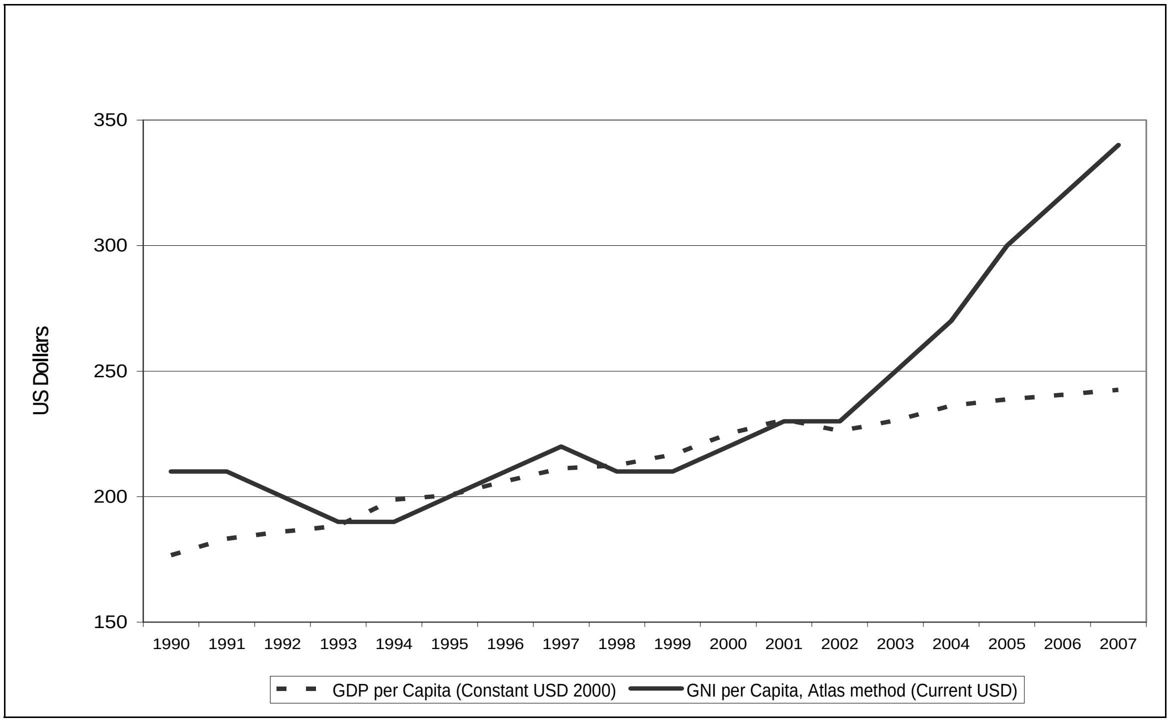
Together with the recent start of work by the CA to draft a new Constitution (in line with a provision in the CPA), the elections and subsequent inauguration of the Maoist-led coalition government mark critical milestones on the road to durable conflict resolution and a reinstitutionalization of democratic political governance with open mainstream political participation. Nevertheless, there have been frequent reminders that the newfound peace is fragile. Although many of the "big pieces" needed to implement the CPA have taken shape, many of the detailed implementation arrangements (for instance, concerning the absorption of Maoist commanders and fighters into the Nepali army), are proving more difficult to put in place. In addition, domestic minorities continue to harbor grievances, which can lead to a rekindling of violence at crucial junctures.

One illustration of this, often referred to as the Terai uprising, came about with the enactment of the Interim Constitution following the signature of the CPA. The Interim Constitution was contested by the Madhesis[7] the day after its promulgation, on the grounds that it offered insufficient constitutional protection against the barriers they have traditionally faced in public life. After protracted negotiations, in February 2008 the SPA-CPN-M coalition government signed an agreement with the United Madhesi Democratic Front. This agreement provided the Terai region with considerable autonomy, reserving a greater proportion of seats in the (then to be) Constituent Assembly for Madhesi representatives, integrating Madhesi forces into the Nepali Army, and advancing Madhesis and representatives of other minorities in the civil service. A separate but similar deal was signed with the Federal Republican National Front on March 1, 2008. Despite these efforts at defusing the sources of potential conflict, however, certain armed groups left out of the negotiations have continued to carry out killings, bombings, and abductions and have threatened further violence.

The Economy

Nepal's economy has experienced a marked slowdown in growth during the 2000s, averaging only about 3 percent annually compared to about 5 percent over the period 1985–2001 (see annex table A2a). With the population expanding by nearly 2.3 percent annually, per capita incomes have improved little in Nepal, and much less than in neighboring countries (see annex table A2b). Political instability, insecurity, adverse external shocks, and slow progress on key structural reforms largely explain this performance.

Figure 1.1. Nepal: Real GDP and GNI per Capita, 1990–2007



Source: World Bank Development Indicators.

Transportation, construction, and services have provided the main sources of growth over the evaluation period. The primary sector (agriculture and timber) grew in line with the overall economy. Industry was hampered by labor unrest and work interruptions due to the civil conflict, and lagged seriously behind at 1 percent per annum in real terms.

Agriculture accounts for almost 40 percent of gross domestic product (GDP) (the highest share in South Asia), and remains a critical sector. In rural areas, where 85 percent of the population lives, 93 percent of households are engaged in agriculture, which accounts for some 60 percent of total household income. Low-productivity subsistence farming is the dominant form of agriculture, and only a small proportion of agricultural output reaches the market. However, commercialization of agriculture has increased in recent years. Exports have also been increasing, from less than 5 percent of agricultural GDP in the early 1990s to over 35 percent.

Manufacturing accounted for less than 10 percent of GDP in 2007 and its share has declined since the late 1990s. Manufacturing is concentrated in a few sectors that produce mainly for export markets. Annual manufacturing growth rates averaged only 1.8 percent in real terms during 2003–07 compared to 5.4 percent during 1995–2001, indicating deteriorating competitiveness of these sectors in world markets. In addition, export-oriented manufacturing has weak backward linkages into the rest of the economy, further limiting the sector’s impact on overall growth. The service sector accounted for about 50 percent of GDP in 2007, reflecting the weak performance of agriculture and industry over the 2000s.

Nepal's dependence on remittances (16 percent of GDP in 2007) increased significantly over the review period. Official development assistance (ODA), although declining as a share of GDP, remained high. These foreign inflows have made possible a substantial acceleration in the growth of domestic consumption, which in turn has led to a significant reduction in the incidence of poverty in both rural and urban areas over the 1996–2004 period (annex B).[8] More generally, Nepal's economic relationship with India is a key factor in its development. Some two-thirds of Nepal's trade is with India, and its annual trade deficit with India amounts to approximately 9 percent of GDP, or about 50 percent of Nepal's overall trade deficit in 2007. In addition, along the border, porous over much of its length, there is considerable unrecorded trade in goods and exchange of labor and services. Currently, about 70 percent of the Nepalese labor force working abroad works in India.

Over the period reviewed, macroeconomic policy and outcomes were remarkably stable. Growth was supported throughout most of the period by prudent fiscal and monetary policies consistent with the macro-financial program supported by a three-year International Monetary Fund (IMF) Poverty Reduction and Growth Facility (PRGF) arrangement (November 2003–07). With Nepal's currency peg to the Indian rupee, fluctuations in inflation closely followed trends in India, and the period was characterized by low levels of inflation (below 10 percent). Revenue mobilization improved significantly with government revenue as a ratio of GDP increasing on average by 2 percentage points over the 2000s (from 9.4 percent of GDP on average in 1985–2001 to 11.6 percent over 2002–07).Public expenditure declined from 17 percent of GDP to 15.5 percent, mainly due to implementation constraints. The fiscal deficit averaged about 4 percent of GDP, and was financed by a combination of very low-cost foreign assistance (about two-thirds of the deficit) and domestic borrowing (about one-third). The deterioration of the trade deficit, led by a decline in the export to GDP ratio, was offset by an increase in inflows of remittances. Overall, the external current account balance improved from an average deficit of 5.6 percent over 1985–2001 to a surplus of about 2 percent of GDP over 2002–07.

Financial sector liberalization led to rapid growth in commercial banking, with a significant increase in the number of banks. However, such growth has remained confined to urban areas, and rural banking expanded only minimally. Credit growth has been rapid (the domestic credit to GDP ratio increased from 33 percent on average over 1985–2001 to 48 percent over 2002–07), fueled by several factors in addition to the natural deepening of the financial system. These factors included an accommodative monetary policy, intermediation that translated deposits of workers' remittances into housing and consumer loans, and proliferation of new financial institutions.

Development Challenges

Aside from some of its physical characteristics, such as its landlocked position, difficult terrain, and vulnerability to natural disasters, Nepal has several unique features that constrain the country's development. These constraints will need to be resolved in order to realize and sustain better growth and poverty reduction outcomes in the future.

Economic Constraints. Following some progress in the early 1990s in the wake of political liberalization, structural reforms stalled and Nepal's development was marred by political instability and uncertainty. In addition to the political environment, several features of Nepal's economy have acted as constraints to the attainment of sustainable broad-based growth and poverty reduction. Foremost among them were: (i) heavy reliance on low-productivity, mostly subsistence, agriculture; (ii) limited private investment, owing to the poor business environment (including costly and unreliable public utility services, a weak judicial system, a cumbersome regulatory framework, and limited financial sector development); (iii) weak human capital combined with rapid population growth and high (and still increasing) male migration rates; and (iv) dependency on India for a large proportion of its trade and jobs.

Poverty, inequality, and social exclusion. Nepal is the 12th poorest country in the world and the poorest in South Asia, with a gross national income (GNI) per capita (Atlas method) of US$340 in 2007. [9] Poverty is pervasive. Indeed, the most recent household survey in 2003/04 indicated a poverty headcount of 31 percent of the population (annex B). Poverty is essentially rural, affecting 35 percent of the population in such areas, which accounted for 86 percent of total population (2001 census), against 10 percent in urban areas. In addition, the poor in rural areas (where 95 percent of poor people are concentrated) derive their income predominantly from agriculture, underscoring the centrality of agriculture as a means of affecting poverty and the limited opportunities that many poor people face in diversifying their sources of income. Substantial inequality by caste, ethnicity, gender, and geographic location is also pervasive, reflecting differential access to education and other basic services, traditional attitudes toward women, caste and ethnic differences, unequal access to economic assets, weak governance and the presence of discriminatory policies, and spatial differences, notably between rural and urban localities. These factors not only pose severe challenges to poverty reduction but also exacerbate social tensions and serve to sustain conflict or the risk of it.

Governance and state effectiveness. Nepal has built up a wide range of public institutions—including laws and organizations and checks and balances—in a relatively short time. At the same time, though, these young institutions are fragile. Four sets of factors underlie the challenges relating to the governance and effectiveness of the state:

- *Geography and History*. The high degree of ethno-linguistic fractionalization and the isolation of mountain and hill communities have made it hard to consolidate services and realize economies of scale. It has also complicated efforts to form a unified state in which all citizens are able to participate. Historically, political and economic power has been concentrated in the Kathmandu Valley among a small group of upper caste elites. Consistent with this tradition, the civil service has historically been dominated by upper caste Nepalese from the Kathmandu Valley.
- *Recent Development of the State*. From its image in the 1950s as an isolated, feudal state locked between India and China with extremely low human development indicators, Nepal has made considerable progress in establishing the elements of a modern parliamentary democracy and public administration. Unlike most of South Asia, where the legal and administrative roots of public administration were established in the middle of the 19th century, it was only in 1951 that the civil service was established. Likewise, it was only in 1951 that schooling for the general population began. Public schools were established in 1971.

- *High Turnover in Public Administration*. Nepal's 12-year experience with parliamentary democracy has been characterized by chronic instability, with a total of 12 prime ministers holding office. Ministerial posts often served as rewards for coalition partners, resulting in frequent changes at the top and attendant changes in the bureaucracy. One study of Nepalese politics from 1994 to 1998 revealed that, out of 265 members in Parliament, 121 acceded to ministerial portfolios. Frequent turnover at the political level has constrained implementation, and has often held the public administration hostage to electoral and political interests.
- *Weak Legitimacy of State Institutions*. Political fluidity and the inability of the state for many years to bring an end to the insurgency—which claimed over 10,000 lives during its 10-year span—substantially eroded trust in politicians and in their ability to meet the aspirations of the people. The Maoist Insurgency gained strength from the failure of state institutions to deliver basic public services, to include the poor in accessing growth and services, and to prevent corruption and instability. The insurgency aggravated problems of outreach, and confined the purview of the government largely to urban and semi-urban areas.

Armed conflict and violence. The insurgency began to have widespread effect on ordinary Nepalis living outside the Kathmandu Valley from about 2001 onwards. As violence escalated, normal life was disrupted and people began getting killed. State resources were increasingly diverted to the government's fight against the Maoists. Security deteriorated further as both sides committed human rights violations, and unreliable security arrangements forced people to leave their homes. The states of emergency curtailed press freedoms and many fundamental rights. The escalation of violence also wrought havoc on infrastructure, and on economic and social activity more generally. By late 2001, government representation had been withdrawn from up to 80 percent of Nepal's territory, including virtually all rural areas beyond the boundaries of district headquarters in the hills and mountainous areas, and large swathes of the rural Terai.

Development work became impossible in these areas without the tacit acquiescence of the Maoists. The Maoists favored development projects that delivered tangible benefits to the rural poor, particularly water supply (for drinking and irrigation), infrastructure (especially bridges, trails, and roads), health, and education. Indeed, the Maoists did not typically disrupt programs that they considered to be serving poor people and would even monitor health staff and teachers' attendance in the rural areas under their control to ensure service delivery. This led most development partners to adjust their assistance strategies and programs to the conflict situation so that they could continue to operate, particularly in Maoist-controlled areas (as will be discussed in detail in chapter 2).

Unfortunately, violence and insecurity did not disappear with the ending of the Maoist Insurgency in late 2006. The state of law and order in Nepal remains weak and threatens the completion of the peace process, particularly in the case of the Terai unrest in 2007–08. Poor public security has continued to erode trust in the state and the political leadership, as well as undermining development efforts and the delivery of basic services. National statistics show a clear reduction in the worst forms of crime since their peaks in early 2008, but residual instability in the Terai is a real threat. Reestablishing law and order and public security remains a critical challenge for democracy, development, and peace.

Chapter 2
IDA's Strategy and Program in Nepal 2002–2008

This chapter reviews the main elements of the Bank's assistance program to Nepal over the evaluation period of July 2002 through June 2008 (fiscal 2003 to fiscal 2008). It examines the relevance of the country strategy and program in light of the Bank's overarching goal of supporting government efforts to reduce poverty. The objectives underlying the Bank's strategy over the evaluation period are reviewed by sub-period, each covered by a distinct Bank strategy document (in order to arrive at a set of objectives that can apply to the entire evaluation period (and accurately capture the Bank's objectives in any given sub-period).

Origins of the Bank Program. Nepal joined the World Bank Group in 1961. Beginning with one credit for a telecommunications project from IDA in 1969, 108 credits and grants have been approved to date, totaling US$2.5 billion in cumulative commitments. As of the end of fiscal 2008, the Bank's portfolio comprised 18 active projects with associated commitments of US$808 million.

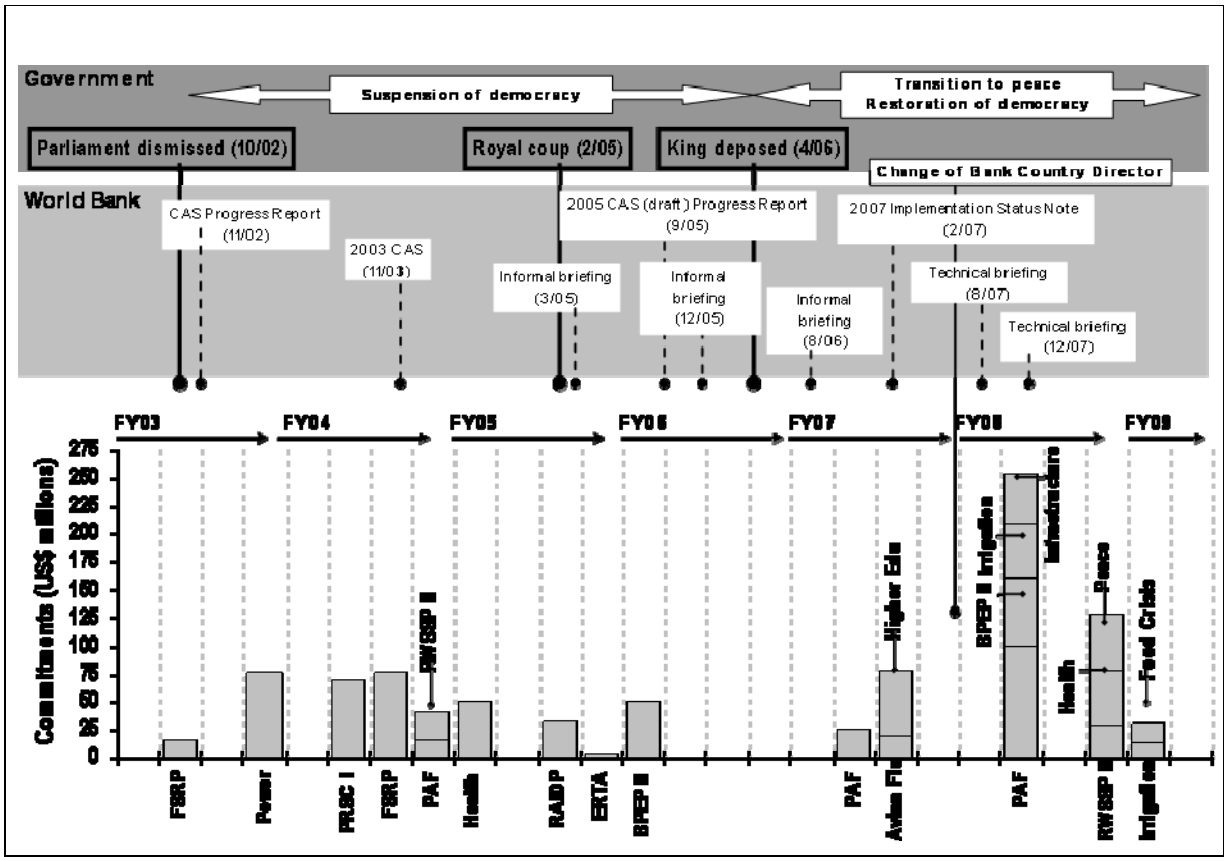
Assessment of Bank program in the 1990s. A 1999 IEG evaluation (1999) assessed World Bank support to Nepal in the 1990s and judged the outcome unsatisfactory. A poor enabling environment was found to have limited the extent to which Bank-supported investment projects in the agriculture, infrastructure, power, and social sectors attained their development objectives. The projects had a range of implementation problems, and in many instances provided benefits with limited or no sustainability. Frequent changes in key decision-makers due to political instability as well as inadequate management and lack of counterpart funds undermined project implementation and sustainability. Poor donor coordination, political interference in projects, and corruption further complicated the environment for public investment. Private sector development in the 1990s was limited by the absence of critical infrastructure, low investor confidence due to instability and corruption, inefficient public enterprises in key sectors, lack of access to investment finance, and difficult access to markets in India.

The evaluation concluded that the Bank should have done more to address institutional and policy constraints to create an enabling environment for cost-effective and sustainable public investment, as well as for much greater private sector activity. Among other deficiencies, the enabling environment had no agreed policy framework after 1995. No policy loans were made in the 1990s. Moreover, the Bank did not engage in policy dialogue in such important areas as agriculture, finance, and privatization. The Bank also did not press for civil service or public expenditure management reform. IEG's recommendations stressed the need to focus Bank assistance on four areas: improving public sector management; close monitoring of the structural and social policy environment; coordination among development partners to further the reform agenda; and development of rural infrastructure, with an emphasis on management by nongovernmental, private, and autonomous public entities.

IDA's Country Assistance Strategy

Objectives during the evaluation period. Bank support to Nepal during the evaluation period was framed by one Country Assistance Strategy Progress Report (CASPR) the 2003 CASPR, which referred to the 1998 Country Assistance Strategy [CAS]), one CAS (2003 CAS), and one Interim Strategy Note (ISN) (2007). Figure 2.1 situates these Bank strategy documents, as well as the flow of IDA support to Nepal, against key events in the country. Based on the following discussion of each of IDA's strategy documents, Bank objectives over the evaluation period can be clustered around the four pillars of the 2003 PRSP: broad-based growth, social development, social inclusion, and good governance.

Figure 2.1 Nepal: Strategic Timeline, FY 2003–08 (Country Assistance Strategy, political events)



Source: Various World Bank sources.

Notes: BPEP= Basic and Primary Education Project; CAS= Country Assistance Strategy; ERTA= Economic Reform Technical Assistance Project; FSRP= Financial Sector Restructuring Project; PAF= Poverty Alleviation Fund; PRSC= Poverty Reduction Support Credit; RAIDP= Rural Access Improvement and Decentralization Project; RWSSP= Rural Water Supply and Sanitation Project.

The 2003 Country Assistance Strategy Progress Report. The 2003 CASPR essentially shifted the IDA program from the low-case lending scenario to the base case as defined in the 1998 CAS. The shift was based on a promising initial round of reforms in the financial sector, public expenditure management, service delivery, the fight against corruption, and coordination of development partner support. These reforms had been initiated by the government, largely under the leadership of a small group of reform-minded technocrats, with the support of the Bank and other partners. The reforms came in response to the build-up of fiscal pressure following the intensification of the Maoist Insurgency in late 2001.

The shift to the base case notwithstanding, Bank support continued to be guided by the 1998 CAS, which embodied a twofold strategy of bringing resources closer to intended beneficiaries, and strengthening donor coordination as a way of improving governance and enhancing aid effectiveness. The 1998 CAS also embodied eight sectoral objectives which can be clustered into three pillars. The first, social development, focused on providing essential health and family planning services, access to safe water, and access to as well as improved quality of, education– especially for girls and women. The second pillar, growth, aimed at improving public expenditure management, the efficiency and stability of the financial sector, and agricultural productivity and yields as well as on- and off-farm employment to help reduce poverty and ensure sustainable management of natural resources. The third pillar, infrastructure, sought improved access to and quality of basic infrastructure, including roads, telecommunications, and power.

The 2003 Country Assistance Strategy. The 2003 CAS aimed to build on the achievements under the 2003 CASPR, namely to support the Nepali-led beginnings of a determined reform effort. The 2003 CAS was fully aligned with, and supported key elements of, Nepal's first Poverty Reduction and Strategy Paper (PRSP), adopted in May 2003. The objectives of the 2003 CAS were structured around four pillars: (i) achieving and sustaining high broad-based economic growth, focusing particularly on the rural economy; (ii) accelerating social development through renewed emphasis on effective delivery of basic social services and economic infrastructure; (iii) ensuring social and economic inclusion of the poor, marginalized groups, and the less developed regions; and (iv) improving governance as a means of delivering better development results and of ensuring social and economic justice.

The 2007 Interim Strategy Note. The 2007 ISN was developed in response to the emerging signs—notably the April 2006 appointment of the interim Seven-Party Alliance (SPA) government and the November 2006 peace agreement between the SPA and the CPN-M—that a political settlement would succeed in resolving the country's long-standing conflict. Although recognizing that the significant uncertainty and fluidity associated with the political situation called for a flexible assistance strategy, the 2007 ISN emphasized the need to continue to focus on Nepal's longer-term development agenda, especially education, basic infrastructure, and state institution-building. Bank assistance would focus on protecting past reform gains, and helping the government to prepare for the important post-conflict development agenda. The Bank would continue to prepare new projects, in particular those building on community engagement and strengthening the foundations for faster growth. The Bank would also provide support to the formulation of a new national vision and development of a major post-conflict economic program. The ISN also foresaw the possibility of providing budget support. The indicative lending program was organized along the lines of the four pillars in the 2003 PRSP and the 2003 CAS.

Relevance of IDA's Strategy

Over the initial part of the evaluation period, IDA made certain strategic shifts in an effort to address weaknesses in its past strategy that had been identified in the 1999 CAE.

Nevertheless, a loose results framework and an insufficient tailoring of IDA strategy to Nepal's conflict and political instability —reflecting underlying weaknesses in the government's Tenth Plan/PRSP—detracted from its relevance. In addition, although IDA rightly sought increased engagement on institutional and policy reforms, Poverty Reduction Support Credits (PRSCs) were not the right instrument with which to do so. Finally, for much of the evaluation period, IDA showed little responsiveness (formally, at least) to the major changes in Nepal's circumstances that quickly rendered formal strategy documents obsolete.

Shifts relative to past strategy. Bank strategy during the evaluation period reflected three shifts relative to the previous strategy, increasing its relevance to Nepal's long-term development challenges. The first, partly in response to the criticism of the 1999 CAE, was IDA's plan to actively engage in policy dialogue in key areas, including the financial sector, agriculture, public finance management, and decentralization. This strategic shift was reflected in the lending program, with the planned onset of policy lending (a series of PRSCs for about 30 percent of the base-case lending scenario) for the first time since IDA had begun lending to Nepal. A second shift was the greater focus on addressing social exclusion. This shift was also reflected in both lending and non-lending plans. For instance, the Poverty Alleviation Fund (PAF), which was designed to improve services for the poorest, made up a significant amount ($45 million) of total lending plans. Finally, the CAS sought greater coordination with other development partners through stronger government ownership and leadership and better alignment of development partners' programs with the government's PRSP and Medium-Term Expenditure Framework (MTEF). The Bank's program reflected the efforts to improve aid effectiveness with technical assistance for the formulation and implementation of the MTEF, the development of sector-wide approaches (SWAps) in education and health, and joint supervision work with other development partners.[10]

CAS results framework. Over the two-year period preceding the 2003 CAS, the Bank's work program in Nepal took a more outcomes-based approach. [11] This approach was further refined under the 2003 CAS. The 2003 CAS outcome targets were clearly defined, as was their link with higher-order country outcomes as defined in the PRSP (see 2003 CAS, annex B10). The CAS outcomes were defined as "a significant change that would be highly desirable and possible within the four-year CAS horizon." For the immediate year ahead, specific "milestones"—that is, key steps toward achieving the four-year outcome target—were defined and expected to be updated annually. The entire matrix of outcomes was seen as a "portfolio" consisting of some high-probability but relatively low-impact outcomes, and some low-probability but high-impact outcomes. The expectation was explicitly that some two-thirds of the stipulated outcomes would be achieved and the rest would not. Moreover, unless an entirely unforeseen event changed the country setting profoundly, a significant shortfall in reaching the expected achievements would mean that either the initial assessment or strategy was unrealistic, or that the Bank's efforts were inadequate.

There were a number of commendable steps taken by the Bank toward strategic realism, including: (i) lowering the bar by defining success as equivalent to reaching roughly two-thirds of the desired CAS outcomes; (ii) accepting that the probability of achieving certain high-impact outcomes was less than 50 percent; and (iii) allowing for annual revisions in outcomes and milestones as circumstances dictated. However, the rationale for choosing the particular CAS outcome targets, as well as the precise strategy that the Bank would follow to reach each of these targets, were not, for the most part, explicitly laid out in the 2003 CAS document. Part of the rationale for the outcome targets chosen can be inferred from several good-quality pieces of Economic and Sector Work (ESW) completed after the 2003 CAS, including: the *2005 Development Policy Review, the 2006 Unequal Citizens, Gender, Caste and Ethnic Exclusion in Nepal, The 2006 Resilience Amidst Conflict, and An Assessment of Poverty in Nepal, 1995-96 and 2003-04)*. Rigor in spelling out the results chain was frequently missing, in particular with respect to challenging issues such as social inclusion, decentralization, community-based service delivery, and governance reform in a weak state prone to conflict and political instability. The 2007 ISN did not fundamentally alter the Bank's assistance strategy and the direction of the proposed lending program relative to the 2003 CAS. Although the ISN did update the 2003 CAS results matrix to report on progress in achieving the outcome targets and associated milestones, no specific targets were defined (or revised) going forward.

Insufficient tailoring of strategy toward Nepal's conflict circumstances. IDA's assistance strategy over the period also had other weaknesses, which reflected underlying deficiencies in Nepal's PRSP (see annex E). One such weakness was insufficient tailoring of the strategy to the country's major conflict situation. Although the Bank's strategy did acknowledge the repercussions of the Maoist Insurgency and subsequently the unrest in the Terai, it did not consider the implications of conflict for government capacity to implement planned reforms and programs. Thus, the Bank was unrealistic in setting objectives and outcome targets.

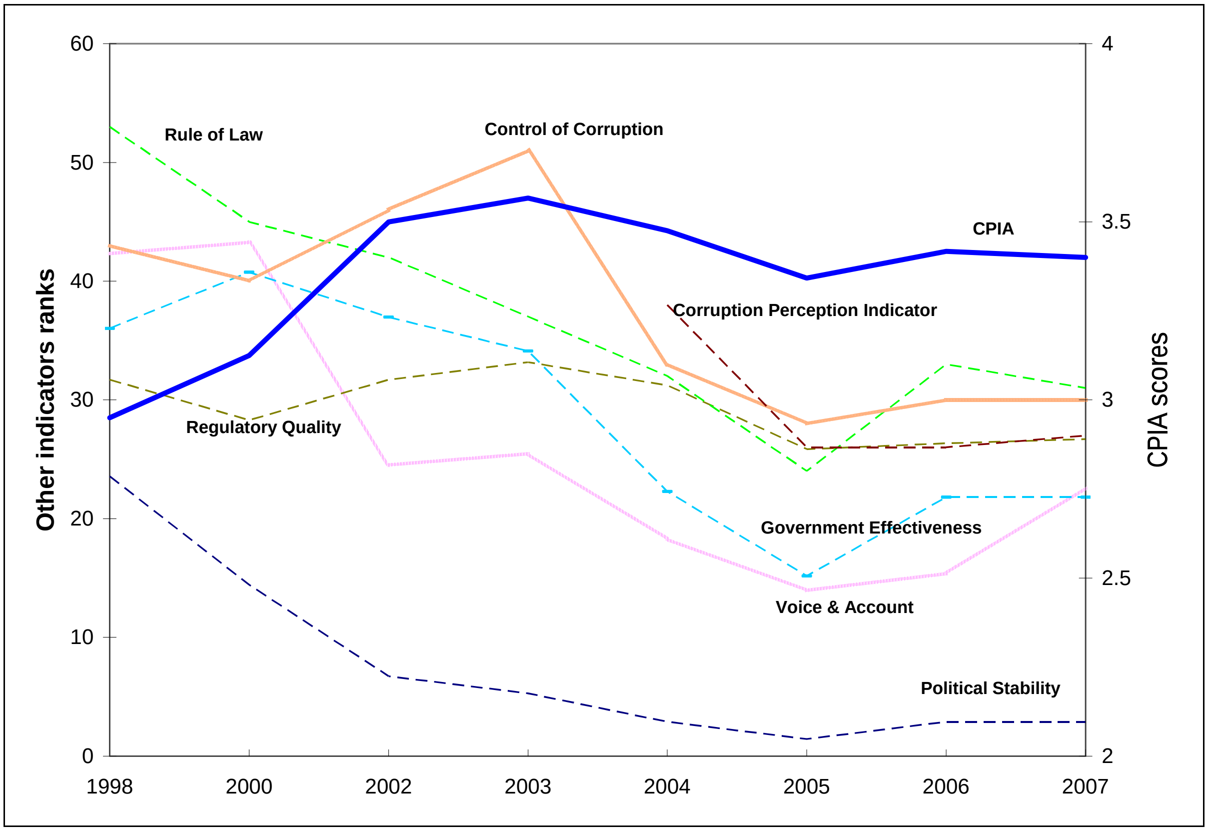
In addition, the Bank made no attempt to identify the reasons—notably past failures of the state—that underlay the conflict itself. Therefore, it could not propose alternative courses of action that were more likely to succeed. Moreover, its strategy relied heavily on a small number of reform-minded technocrats (mostly in the Ministry of Finance and the National Planning Commission as well as one or two line ministries) who were arguably remote from the situation on the ground and who wielded little power given the limited country ownership of the PRSP framework that the Bank was to support. In hindsight, at least, this was a very risky bet.

Indeed, it is particularly striking that although Nepal's conflict increased in intensity after 2001, the Bank did not move to classify Nepal as a conflict-affected or fragile state. Instead, as for any other "standard" IDA country, the focus was predominantly on long-term development and poverty reduction. After the insurgency escalated in 2001, most standard international definitions of armed conflict reclassified the conflict in Nepal as high-intensity. Moreover, at around the same time, most of Nepal's main development partners began to focus specifically on how the conflict was affecting their assistance programs, and to reassess their strategies in order to mitigate the impact of the conflict on their programs and/or to be able to continue to operate in conflict-affected rural areas. The United Kingdom's Department for International Development (DFID), the United States Agency for International Development (USAID), the Swiss Agency for Development and Cooperation (SDC), the German Agency for Technical Cooperation (GTZ), the Canadian International Development Agency (CIDA), the Asian Development Bank (ADB), and the European Union all conducted conflict assessments in 2002-03 as a basis for developing conflict-sensitive assistance strategies. Later, Nepal was put forward as a pilot under the

Organization for Economic Co-operation and Development/Development Assistance Committee (OECD/DAC) *Principles for Good International Engagement in Fragile States and Situations*. [12]

Throughout this period, Nepal's country policy and institutional assessment (CPIA) remained above 3.0,[13] contrary to the deterioration in indicators of governance and state effectiveness indicators over the period (see figure 2.2). As a result, Nepal was never classified as a fragile state, and the Bank's then nascent toolkit for engaging in conflict-affected or fragile states was not applied to it. Even without classifying Nepal as a conflict-affected or fragile state, the Bank could have tailored its strategy and program design to the specific circumstances of Nepal that made a standard CAS highly risky, namely political instability, lack of law and order, a conflict situation, the suspension of democratic institutions both at the national and local levels, and the limited state outreach.

Figure 2.2 Nepal: Country Policy and Institutional Assessment (CPIA) and External Governance Indicators, 1998-2007



Source: Annex Table A2J.

Prerequisites for PRSCs were not met. Nepal had met the formal eligibility criteria for programmatic lending, but not the prerequisites for PRSCs (see 2001 *Interim Guidelines for Poverty Reduction Support Credits*). A PRSP was in place and core fiduciary analytics were available (2003 Country Financial Accountability Assessment [CFAA], 2002 Country Procurement Assessment Report [CPAR)]. However, in hindsight it is clear that country ownership of the PRSP was limited, and the feasibility of implementing the PRSP was questionable given the country circumstances. Moreover, Nepal's reforms were very recent and fragile, and the country context was not conducive to an effective implementation of a PRSC series. The predictability needed for effective implementation of a programmatic PRSC series did not exist and could not realistically be expected. During the Board discussion of the 2003 CASPR, some Executive Directors had gone further, stressing that it was premature to consider budget support and that a shift to such support needed strong justification. These factors notwithstanding, the first PRSC was presented to the Board in November 2003, three months after the breakdown of talks between the government and the then-insurgents.

Little formal strategy adjustment. The Bank overestimated the government's capacity to implement the reforms agreed under the 2003 CASPR and the 2003 CAS. Less than six months after the Board discussion of the 2003 CAS, most of the reforms that had been on the agenda were stalled and were to remain so. The 2003 CAS had foreseen presentation of a CASPR 18-24 months into the CAS period or earlier, depending on political developments. In fact, no written strategy document was presented to the Board until the ISN covering the period fiscal 2007–08 in February 2007. Instead, management kept the Board informed of country developments by using oral briefings.[14] Following the Royal coup, some Executive Directors voiced concerns that the PRSP no longer constituted an adequate framework for development support from partners in general, and for Bank support in particular. Referring to Bank work on fragile states,[15] they asked for a formal discussion of a CAS Progress Report that would reflect the country's realities and focus on what was possible under the circumstances (Oral Briefing to the Board, March 2005). Revising the strategy and adjusting the outcome objectives downward to reflect the actual conditions on the ground would have led to a more positive evaluation of Bank assistance.

Under the leadership of the Country Director, the country team did in fact prepare a draft CASPR. A Bank-wide Operational Committee decision meeting on the draft was held on September 16, 2005. Although all written comments supported the proposed shift from the base-case lending scenario to the low-case, at the Operations Committee review, senior management decided not to present the CASPR to the Board, opting instead to brief the Board informally on changes in country circumstances and the Bank's response. In addition, management opted to scale back financial support to a level significantly below the existing annual IDA allocation, along the lines stipulated under the low-case scenario of the CAS. Management also opted to be cautious in moving forward with new operations and to prepare a brief Interim Strategy Note when a more informed judgment could be made regarding the course of events and the authorities' commitment to moving the reform agenda forward.

The context for development interventions changed again when the King was forced to cede power in April 2006. An interim coalition government was installed and security improved with the end of the Maoist Insurgency. However, soon thereafter, the unexpected Terai uprising came in response to the enactment of the interim constitution. The Bank was unprepared for these events, and there was a delay in its response. The January 2007 ISN acknowledged the dramatic change in the political environment but did not make any major adjustment to the IDA assistance strategy. The hesitation regarding the direction to take was reflected in the inconsistency between the August 2007 Information Note to the Board ("Towards Implementing the World Bank's Interim Strategy on Nepal through an Integrated Program of Donor Support"), which announced a joint donor response, and the dramatic unilateral increase in IDA lending in December 2007. A Technical Briefing was held in December 2007 to inform Executive Directors on developments in Nepal ahead of the submission (on a streamlined, no-objection basis) of four new IDA grants totaling US$252.6 million (which doubled the undisbursed balance). Such a large intervention in a high risk environment should have warranted a full Board discussion.

Lending Services

Volume of commitments**.** During the fiscal 2003-08 period, the Bank committed a total of US$896 million to Nepal against the planned lending of US$1.3 billion under the 2003 CASPR, 2003 CAS, and 2007 ISN combined (table 2.1). Even though overall commitments remained below the planned amount, a shortfall over the fiscal period from 2003 to the first half of 2007 was partially offset by an excess relative to plans over the fiscal period from the second half of 2007 to 2008. In the earlier period, corresponding to the coverage of the 2003 CASPR and 2003 CAS and the suspension of the democratic rule, new commitments were less than half of what was planned (US$346 million actual versus US$765 million planned) with no lending in fiscal 2006. The execution rate was similar to the 1998 CAS, about 45 percent. In the absence of progress on implementing structural reforms, three PRSCs (meant as the second, third, and fourth in a sequence, together amounting to US$210 million) were dropped, as was the third phase of the Financial Sector Restructuring Project (US$75 million) and the planned Decentralization Support project (US$30 million). Other sector projects in agriculture, infrastructure development, and higher education were also delayed (see annex tables A4b).

Table 2.1. Nepal: Planned and Actual Lending by PRS/CAS Pillar, FY 2003–08

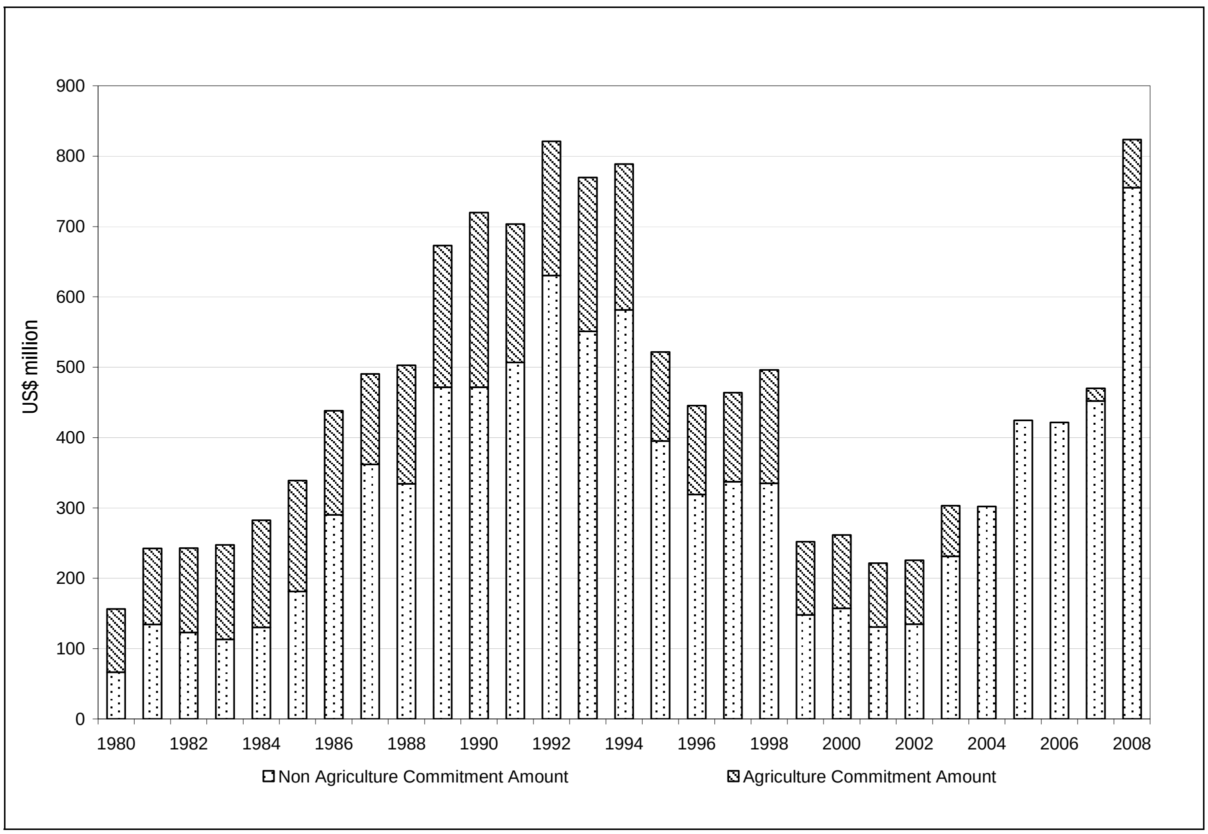
Planned					Structure			
PRS/CAS Pillar	FY03	FY04–07	FY07–08	FY03–08	FY03	FY04–07	FY07–08	FY03–08
	US$ millions				Percentage			
Broad-based growth	150	535	165	850	88.2	69.9	45.2	65.4
Social sector development	20	155	100	275	11.8	20.3	27.4	21.2
Social inclusion	0	45	100	145	0.0	5.9	27.4	11.2
Governance	0	30	0	30	0.0	3.9	0.0	2.3
Total	170	765	365	1,300	100.0	100.0	100.0	100.0
Actual					Structure			
PRS/CAS Pillar	FY03	FY04–07	FY07–08	FY03–08	FY03	FY04–07	FY07–08	FY03–08
	US$ millions				Percentage			
Broad-based growth	92	181	111	383	100.0	52.2	24.1	42.7
Social sector development	0	125	198	323	0.0	36.2	43.2	36.1
Social inclusion	0	40	150	190	0.0	11.6	32.7	21.2
Governance	0	0	0	0	0.0	0.0	0.0	0.0
Total	92	346	459	896	100.0	100.0	100.0	100.0

Source: Annex Tables A4a, A4b, A4c.
Note: Columns 3 and 4 as well as 7 and 8 divide FY07 interventions.
CAS= Country Assistance Strategy; PRS=Poverty Reduction Strategy.

By contrast, over the 2007 ISN period that followed the restoration of democracy, new commitments rose sharply and exceeded planned lending by about 26 percent (US$459 million actual against US$365 million planned). Although lending averaged about US$150 million per year over fiscal years 2003-08, there was an extraordinary peak in fiscal 2008 amounting to US$380 million, or 42.2 percent of the overall lending for the CAE period. The difference relative to plans came from higher-than-planned commitments for several projects (Irrigation and Water Resource Management, Infrastructure Development, and Education for All Additional Financing) as well as unplanned operations (Health Sector Operation Additional Financing, Second Rural Water Supply and Sanitation Additional Financing, Peace Support Project). Such deviations may have been appropriate and some, such as the Peace Support Project, were critical in keeping the peace process and the election for a Constituent Assembly on track. However, they also tended to undermine the usefulness of the CAS/ISN in managing Bank assistance to Nepal.

At the end of the CAE period, the Bank's portfolio in Nepal had recovered from the steady contraction of the 1990s, from 29 active projects in fiscal 1990 to 8 in fiscal 2001- 2002 (see figure 2.3). However, the sectoral composition of the portfolio had changed significantly. In particular, IDA steadily disengaged from agriculture (including irrigation and forestry) starting in the mid-1980s, reaching its nadir during the CAE review period. There were no active IDA projects in agriculture during fiscal 2004-06. Only in fiscal 2008 did the Bank again approve an irrigation project for Nepal.

Figure 2.3 Nepal: IDA Commitments for Active Projects, Non-Agriculture and Agriculture, FY 1980–2008



Source: World Bank internal database, 2/20/09.

Note: FY= fiscal year; IDA= International Development Association;

IDA's per capita commitments to Nepal during fiscal years 2003-08, which averaged US$5.40 per year, were higher than for Bangladesh (US$3.50) or Pakistan (US$4.20), and slightly higher than the average for the South Asia Region excluding India and Afghanistan (US$4.30) over the same period. This reflects the extraordinarily high level of new commitments in fiscal 2008. In this fiscal year only, new IDA commitments reached US$13.30 per inhabitant.

Lending by PRS/CAS pillar and sector. The detailed composition by PRS/CAS pillar and sector is outlined in annex table A4. Over fiscal 2003- 08, the largest proportion of commitments went to the growth pillar (43 percent), but this proportion declined from 93 percent over fiscal years 1999-2003 (the period covered by the 1998 CAS), to 52 percent over fiscal years 2004-07 (2003 CAS), and 24 percent over fiscal years 2007-08 (2007 ISN) (see table 2.1). This decline was in part a result of the shift in emphasis toward social development and social inclusion. However, it was also due in part to the difficulties in implementing the growth pillar in a country in conflict. The execution rate of the growth pillar over the CAE review period as a whole was only about 50 percent, and was particularly low over the 2003 CAS period (34 percent).

The second largest allocation (36 percent) went to social development, including education, health, and rural water and sanitation. This reflected not only the planned shift, but also an unplanned transfer of resources to this pillar. Under the 2007 ISN, actual lending for social development was double the amount planned.

Social inclusion emerged as a priority with the 2003 CAS and received about 21 percent of commitments against 11 percent planned. Surprisingly, given the focus in the CAS documents, there was no commitment under the governance pillar. Only one decentralization operation was planned under this pillar, but no progress was made in preparing the groundwork for it in practice. The suspension of elected local institutions ultimately kept the Bank from proceeding.

Portfolio performance**.** During fiscal years 2003-08, IEG reviewed eight closed projects in Nepal, representing US$265 million in commitments (table 2.2). The development outcome was rated satisfactory for 86.4 percent of the closed projects (by commitments), which is above the South Asia Region (82.9 percent) and Bank-wide averages (83.6 percent). The eight projects that exited the IDA portfolio during the CAE period had a moderately satisfactory outcome rating (if each project is weighted by its share in total commitments). It should be noted that this represents a small number of projects and that for some of them, for instance PRSC-I and Road Maintenance and Development, progress during project implementation, which was reflected in IEG ratings (six months after closure), has since been reversed (see chapter 3).

TABLE 2.2 NEPAL: SUMMARY EVALUATION FINDINGS (EXIT YEAR FY03–08)

	TOTAL EVALUATED-NET COMMITMENT (US$ MILLION)	TOTAL EVALUATED (NO.)	OUTCOME % SATISFACTORY (US$)	OUTCOME % SATISFACTORY (NO.)
Nepal	265	8	86.4	75.0
South Asia Region	15,547	135	82.9	79.3
Bank-wide	101,261	1,494	83.6	78.2

Source: World Bank internal database, 3/24/2009.
Note: Satisfactory rating includes highly satisfactory, satisfactory, and moderately satisfactory.

Analytic and Advisory Activities

Overall volume and coverage. The share of the Bank's administrative budget allocated to analytic and advisory activities (AAA) over fiscal years 2003-08 is estimated at 29 percent, slightly higher than for the South Asia Region and Bank-wide, respectively estimated at 29 percent and 27 percent over the same period (annex table A7). When measured as a percentage of total commitments, the intensity of AAA in Nepal, at 0.8 percent, was higher than for the South Asia Region (0.5 percent), and similar to that of the Africa Region (0.8 percent), and slightly higher than the Bank-wide average (0.7 percent) (table 2.3). A significant part of the AAA was not planned (table 2.4).

TABLE 2.3. NEPAL AND COMPARATORS—RELATIVE COST OF BANK'S OPERATIONS, FY03–08
(percentage of total commitments)

COUNTRY/ REGION		COUNTRY SUPERVISION	LENDING	AAA	AAA: ESW	AAA: TA	AAA: OTHER AAA	COUNTRY PROGRAM SUPPORT	OTHER COUNTRY SERVICES
Nepal	2.6	0.8	0.7	0.8	0.7	0.1	0.0	0.4	0.0
South Asia Region	1.7	0.5	0.5	0.5	0.4	0.1	0.0	0.2	0.0
Africa	3.4	1.1	0.8	0.8	0.6	0.2	0.0	0.5	0.1

Region									
Bank-wide	2.7	0.8	0.7	0.7	0.5	0.2	0.0	0.3	0.1

Source: World Bank
Note: AAA= analytic and advisory activities; FY= fiscal year.

TABLE 2.4 NEPAL: PLANNED AND ACTUAL ANALYTIC AND ADVISORY ACTIVITIES BY PRS/CAS PILLAR, FY 2003–08

PLANNED					STRUCTURE			
PRS/CAS PILLAR	FY03	FY04–07	FY07–08	FY03–08	FY03	FY04–07	FY07–08	FY03–08
					PERCENTAGE			
Broad-based growth	250	1,625	400	2,275	52.6	65.1	72.7	64.6
Social sector development	0	150	150	300	0.0	6.0	27.3	8.5
Social inclusion	75	430	0	505	15.8	17.2	0.0	14.3
Governance	150	290	0	440	31.6	11.6	0.0	12.5
Total	475	2,495	550	3,520	100.0	100.0	100.0	100.0
ACTUAL					STRUCTURE			
PRS/CAS PILLAR	FY03	FY04–07	FY07–08	FY03–08	FY03	FY04–07	FY07–08	FY03–08
					PERCENTAGE			
Broad-based growth	161	2,713	31	2,905	66.0	64.2	54.4	64.2
Social sector development	0	0	0	0	0.0	0.0	0.0	0.0
Social inclusion	83	711	0	794	34.0	16.8	0.0	17.5
Governance	0	803	26	829	0.0	19.0	45.6	18.3
Total	244	4,227	57	4,528	100.0	100.0	100.0	100.0

Source: Annex Tables A5a, A5b, A5c.
Note: Columns 3 and 4 as well as 7 and 8 divide FY07 interventions. CAS= Country Assistance Strategy; FY= fiscal year; PRS= Poverty Reduction Strategy

AAA services by PRS/CAS pillar and sector. The detailed composition of AAA by PRS/CAS pillar and sector is shown in annex tables A5. Under the growth pillar, the important pieces were the *Poverty Assessment* (December 2005), the *Development Policy Review* (June 2005), the *Legal Financial Review Policy Note* (February 2005), *Access to Finance* (March 2007) and the *Country Environment Analysis* (June 2007). Under the social inclusion pillar, a major study was prepared jointly with DFID on *Gender, Caste, and Ethnic Exclusion in Nepal* (June 2005). Under the governance pillar, substantial analytical work was done on public finance management including a *Public Finance Management Review* (July 2007), a Public Expenditure and Financial Accountability assessment (February 2008) with inputs from a number of other partners (ADB, DfID, Danish International Development Agency (DANIDA), IMF, Norway, and United Nations Development Programme [UNDP]). In addition, IDA provided extensive technical assistance to help the government lead the preparation of the Public Expenditure and Financial Accountability assessment, prepare a medium-term expenditure framework, strengthen public audit institutions, and reform public procurement.

There were also important gaps in AAA. Planned work on agriculture (rural sector issues and the rural factor market study) and education (evaluation of community-managed schools) was not delivered. Also, because there had been a long gap between the poverty assessments, the 2003 CAS could not incorporate updated poverty trends (the CAS assumed that poverty was increasing in the early 2000s, whereas the December 2005 poverty assessment showed essentially the opposite). Similarly, although work on gender, caste, and ethnic exclusion had been initiated by the time the 2003 CAS was under preparation, the latter could not be informed by the study's findings. In addition, although Bank lending to education, health, and rural water and sanitation was substantial, there were no prior sector reviews to inform the lending (although this may in part have been the result of a division of labor with other development partners involved in the education and health SWAps). However, the 2003 CAS was informed by major AAA pieces on education and health completed in the early 2000s (*Priorities and Strategies for Education Reform,* July 2001; *Nepal Operational Issues and Prioritization of Resources in the Health Sector,* June 2000; and *Public Expenditure Review,* November 2000).

Coordination and Partnership

Nepal has depended on highly fragmented development assistance. Official development assistance represented about 6 percent of GDP over the 2003-07 period, and about 40 percent of public expenditure. However, this assistance is provided by about 60 bilateral and multilateral agencies, and no partner is in an obvious position to provide sustained leadership (annex table A3d). Over the CAE review period, in net disbursement terms, IDA contributed about 9 percent of total ODA and was the fifth largest donor—behind DFID (14 percent), Japan and Germany (11 percent), and USAID (10 percent). The ADB came just behind IDA at 7 percent. In gross disbursement terms, IDA was the largest donor (13 percent), followed by Japan and DFID (12 percent), and ADB (11 percent) (table 2.5). In addition, two major development partners, China and India, have operated largely outside of traditional coordination mechanisms. Their assistance is not recorded in OECD/DAC data and their development support activities are largely unknown to other partners.

IDA did successfully lead in strengthening government ownership and leadership in development assistance coordination in 2002-03, but its approach met increasing challenges as the conflict and suppression of democracy intensified. However, IDA, DFID, and ADB recently initiated a promising rapprochement on the peace and development agenda that resulted in the preparation of a joint assistance framework in 2009.

TABLE 2.5. NEPAL: OFFICIAL DEVELOPMENT ASSISTANCE (ODA) DISBURSEMENTS - GROSS, 2003–07
(in current US$ million)

	2003	2004	2005	2006	2007	TOTAL 2003-08	AVERAGE (2003–07)	SHARE PERCENTAGE
All donors, total	521	490	524	618	708	2,861	572	
Top 10 donors								
International Development Association (IDA)	102	73	46	65	78	363	73	13
Japan	62	58	94	74	70	357	71	12

United Kingdom	53	66	62	75	88	344	69	12
Asian Development Fund (AsDF)	34	23	44	108	100	308	62	11
Germany	63	53	63	33	50	262	52	9
United States	38	35	52	62	54	241	48	8
Denmark	40	34	28	33	50	184	37	6
Norway	20	23	25	25	44	138	28	5
European Communities	16	22	10	24	25	97	19	3
Switzerland	14	16	16	17	19	82	16	3
Multilateral Agencies, Total	193	162	138	261	297	1,051	210	37
Bilateral Agencies, Total	327	329	386	358	411	1,810	362	63

Source: Organization for Economic Co-operation and Development Assistance Committee (OECD-DAC) online database, and World Bank internal database, 1/22/09.

The Bank's role in alignment and harmonization of development assistance, with stronger government leadership. In the early 2000s, in the absence of effective collaboration with the central government, development partners adopted a variety of coping strategies for delivering assistance.[16] However, without effective national involvement, three critical ingredients to effective implementation and sustainable results were lacking and often the cause of poor results. These were counterpart funds, sound and sustainable institutional settings, and legislative changes (or at least formalities such as ratification) required to support many programs. In addition, given the lack of effective accountability mechanisms, even specific projects could not escape concerns about the fungibility of donor funding. Generous development assistance also tended to keep Nepal's budget constraint very soft, thereby weakening discipline in public expenditure management and delaying important reforms.

It was in this context that IDA successfully took the lead on development assistance alignment and harmonization in 2001-02. The Bank's critical input to this effort included support to: (i) the Immediate Action Plans (IAPs); (ii) formulation, implementation, and monitoring of the PRSP; and; (iii) the MTEF, all of which were at the core to IDA's assistance strategy over the fiscal years 2003-07 period. Despite its shortcomings, the PRSP has created consensus on the agenda among Nepal's development partners, who largely agreed to align their assistance with the PRSP framework. The seven largest development partners—DFID, Japan, Germany, United States, ADB, and IDA, which account for about 80 percent of ODA over 2003-07—pledged to support the PRSP. The Bank also took the lead on budget support and strengthening the country systems for public finance management and public procurement as a basis for channeling more development assistance through the country budget.

As the insurgency and suppression of democratic governance intensified, the Bank's efforts met with increasing challenges and criticism on the part of development partners, in particular the European bilateral donors. This undermined progress on alignment and harmonization. Whereas other development partners were adjusting their assistance to the country's conflict circumstances, the Bank remained mostly in a "business-as-usual" mode. The main bilateral donors, meanwhile, strengthened their coordination and followed a common agenda for conflict transformation, defense of human rights, and promotion of democratic institutions as necessary pre-conditions for sustainable development in Nepal. Major development partners, such as the DFID, GTZ (Germany), Denmark (DANIDA), Switzerland, the European Commission (EC), and the ADB also developed, with varying degrees of success, conflict-sensitive assistance strategies that in some cases included peace-building objectives and adjustments to their assistance programs and modalities allowing them to remain engaged in all parts of the country. In October 2003, ten bilateral agencies[17] endorsed the Basic Operating Guidelines (BOGs)—12 principles of engagement. These defined the common approaches to program management in a conflict environment and defense of the development space against insurgent claims and the interference of security forces.[18]

The majority of development partners accepted a technical alignment with government development policies as laid out in the PRSP. However, they refused to endorse a state which in their view was lacking in legitimacy, and therefore unable to promote development for and by the people. At the 2004 Nepal Development Forum (an annual forum for coordination between the government and its development partners), development partners almost unanimously dissociated themselves from any attempt to solve the political crisis by military means and demanded full respect of human rights and the restoration of democracy as an integral part of a successful development policy.

The multilateral donors that ignored the tension between technical alignment and fundamental political dissent and opted to follow a purely technical approach found themselves unable to exercise any influence on main events or to promote their agenda of economic reforms. Differences of opinion within the international community crystallized around the desirability of providing general budget support to the governments that led the country in 2004 and 2005. The issue was never tested, as Nepal never met the conditions for PRSC-II.

The arguments illustrate real development dilemmas in conflict-affected countries where the state, in the absence of democratic institutions, lacks legitimacy. Four of these are apposite. First, partners disagreed on the provision of budget support to a government that was internationally isolated (especially after the royal coup), and whose recurrent expenditure had been inflated by substantial increases in military and security spending (the Royal Nepalese Army doubled the number of recruits over a period of four years). Second, development partners disagreed on providing budget support in the name of poverty reduction to a state that was unable to implement more than 60 to 65 percent of its development budget, and that was therefore unable to translate additional budgetary resources into concrete results for the majority of the population. Third, most development partners argued that it was impossible to sustain broad-based growth as long as the conflict hampered the operation of the national and international private sector. And fourth, there were divergent views on what constituted appropriate conditions for budget support when conflict resolution and state-building were at the heart of the development process.

Repositioning IDA. After the restoration of democracy in 2006 and until recently, IDA has struggled to reposition itself within the international donor community, much of the time without the active presence of the IMF. [19] With the restoration of democracy, the debate among development partners shifted to the tension between supporting peace, an immediate priority, and supporting long-term development to sustain peace. The Bank adopted a “wait and see” attitude, continuing to withhold new operations. In the meantime, other donors were stepping in with increased assistance to support the fragile peace process.

Even the January 2007 ISN, which came almost a year later, was ambivalent about the Bank’s strategy. On the one hand, the 2007 ISN acknowledged that the “state has been gravely short of legitimacy” and that “moving forward, Nepal must focus on two central issues: state-building and inclusion.” On the other hand, it did not adjust the strategy accordingly. The 2007 ISN remained focused on the long-term development agenda, largely ignoring the immediate challenge of taking the peace process to a conclusion. It noted that “the PRS fundamentally remains a robust framework for guiding the country’s development” and “by extension, the broad framework in the existing CAS (2003 CAS) also retained considerable relevance.” In addition, the Bank was still considering budget support for Nepal on the basis of the PRSC broad-based growth reform agenda (progress against defaulters, adjustment of fuel prices, introduction of more flexible labor laws, and passage of the Governance Act). Also, after more than a year of commitment suspension, the first project presented to the Board was the Higher Education Project, clearly in support of long-term development goals. Even on the growth agenda, other partners were developing approaches more sensitive to Nepal’s context.[20]

At the 2007 ISN discussion, the Board urged Bank management to be more proactive in coordination with other development partners. In response, the Bank announced in an August 2007 Information Note to the Board that it was taking the lead in preparing an integrated program of donor support. However, this effort was short-lived. In December 2007, the Bank dramatically stepped up its assistance,[21] although contrary to what had been proposed four months earlier, this was not part of an integrated program of donor support. Another indication of Bank management’s hesitation was the August 2007 Information Note’s proposal to modify its lending program to include: (i) a program of community block grants as well as public works programs; (ii) access to finance by small borrowers; and (iii) an effective HIV/AIDS program. These modifications have thus far not materialized.

More recently (in the latter part of fiscal 2008), the Bank shifted its assistance program more decisively toward successful areas of intervention, in particular social services and rural infrastructure and toward supporting the peace process with a dedicated operation (May 2008). Also, the Bank joined two other partners, DFID and ADB, to coordinate the preparation of their assistance strategy.

Productive partnerships in some areas. The Bank contributed to and led several productive partnerships, with DFID in financial sector restructuring, with the IMF in macroeconomic management, and at the sectoral level in the health and education SWAps. However, in other areas concerning the growth agenda, governance, decentralization, and social inclusion, the Bank faced significant challenges, and development partners disagreed with the Bank’s approach.

Chapter 3
Progress in Achieving Broad-based Economic Growth

This chapter focuses on the three areas that were central to the Bank's assistance program under the growth pillar: (i) improving public expenditure management, (ii) fostering private sector development, and (iii) promoting agricultural development. This chapter also reviews outcomes in environmental sustainability, a cross-cutting theme.

The Bank strategy was fully aligned with the government's poverty reduction strategy. The first pillar in both the 2003 (CAS) and the 2003 Poverty Reduction Strategy Paper (PRSP), fostering broad-based growth, was the overarching goal of the Bank strategy. Both the PRSP and the CAS sought outcomes in three areas: public expenditure management (PEM), job-intensive private sector development (PSD), and broad-based agricultural development.

Improving Public Expenditure Management

IDA supported improvement of PEM in two areas: (i) establishing outcome-focused public budgeting and monitoring and; (ii) rationalizing the state-owned enterprise (SOE) sector.

Establishing Outcome-Focused Budgeting and Monitoring

A. Objectives and Instruments

The country-level objective was to create fiscal space to increase public investment and its effectiveness in growth-enhancing sectors and social services to benefit the poor. IDA's contribution would consist of: (i) establishing an outcome-focused public budgeting and monitoring (mostly through the introduction of a Medium-Term Expenditure Framework [MTEF]); and (ii) rationalizing the state-owned enterprise (SOE) sector. The strategy was to be implemented through Poverty Reduction Support Credits (PRSCs), ongoing technical assistance, and policy dialogue.

B. Results

Limited progress was made in improving pro-poor budget allocations. The share of social and pro-poor expenditure increased, but security spending also increased and expenditure on two key economic sectors—agriculture (also largely pro-poor) and infrastructure—declined sharply. Social expenditure constituted nearly 38 percent of the 2004/05 budget. It increased from 5.6 percent of GDP on average over fiscal years 1998–2002, to 6.3 percent over fiscal years 2003–07 (annex table A2d). The increases have been widely and proportionately distributed across education, health, water and sanitation, local development, and other social services in budget allocation. Currently, the largest beneficiary in absolute terms is education, at 3.5 percent of GDP. However, in terms of actual expenditure, only education saw a significant increase from 2.5 percent of GDP in fiscal years 1998–2002 to 3.2 percent in fiscal years 2003–07.

Progress registered in social sectors outcomes (see chapter 4) resulted mainly from greater efficiency of both public expenditure and external assistance. Security spending—military and police—rose from 1.9 percent of GDP in fiscal years 1998-2002 to 2.8 percent in fiscal 2008, before declining to 2.6 percent in fiscal 2008 as civil strife diminished. The proportion of Nepal's budget devoted to security spending remained the lowest in South Asia in 2008. The sharpest contraction in sectoral public spending was in agriculture (-13.5 percent annually), despite the high priority accorded to agriculture in Nepal's Tenth Plan and the PRSP. This raises serious questions about the "pro-poor" nature of Nepal's budgetary spending. The decline of expenditure on infrastructure reflects completion of several large infrastructure projects in the early 2000s, and a deteriorating project portfolio thereafter—given the intensification of the armed conflict and deterioration of the security conditions that hampered implementation of infrastructure projects.

Progress in establishing outcome-focused budgeting and monitoring was limited and not substained. The MTEF planning process, launched in the year before the 2003 CAS was completed, had no practical application until fiscal 2005. Once the King's focus shifted in 2005 to quelling the insurgency, many reforms, including the MTEF, were placed on hold, and in 2006 the new Minister of Finance discarded the MTEF. As noted below, the MTEF process was hampered by the lack of progress in aid integration and donor harmonization. With external support accounting for two-thirds of the development budget, and the inability of development partners to provide indicative figures on time, the MTEF became increasingly futile. Thus, this CAS objective was not achieved.

Budgeting throughout the fiscal year 2003–08 period generally followed traditional line-by-line, non-programmatic procedures, ignoring the guidance of the MTEF. Perhaps the MTEF's only significant impact occurred in 2003–04, when it was used to identify public investment projects having the lowest expected development impact so that the bottom third could be removed from the capital budget. But the impact was transitory. By fiscal 2007, more than 80 percent of public projects in the budget had been assigned to the highest priority category by the line ministries, which had calculated that this was the bureaucratic method most likely to ensure continued funding. Once nearly all projects became "priority" projects, little could be done to improve allocation of the investment budget.

Some early progress was made on integrating foreign aid into the budget, but the objective ultimately was not achieved because of setbacks in donor coordination following the royal coup. In fiscal 2004, an estimated 50 percent of all official development assistance continued to be delivered outside the public budgetary framework because of donor concerns about fiduciary controls and government implementation capacity. Budgetary monitoring showed little systematic improvement and concerns among development partners and civil society about widespread public corruption remained significant. As of fiscal 2007, only cash disbursements from the 12,000 or so treasury accounts were being tracked systematically. Physical implementation and impact were mostly not tracked.

C. Role of IDA

IDA support to establish output-based budgeting and monitoring was strong, but did not lead to sustained outcomes. The MTEF was discarded, and more than half of foreign aid continued to be extra-budgetary. Monitoring systems were not developed. IDA supported the establishment of output-based budgeting and monitoring through the PRSCs and technical assistance and analytical work on the MTEF. The PRSC program supported the rationalization of the development budget and the introduction of the MTEF as a planning tool. The objectives were to increase the share of pro-poor expenditure, make budget planning and execution more outcome-focused, and at a broader level, coordinate aid and harmonize donor practices. Some improvement in budget management took place. The MTEF was extended to the recurrent side of the budget. The share of pro-poor expenditure in total government spending increased. However, with discontinuation of the PRSC series this progress was not sustained and eroded thereafter.

IDA also helped Nepal to improve public expenditure management through technical assistance and policy dialogue on the MTEF, and through good-quality analytical work. In particular, the 2007 Nepal Public Finance Management Review provided a useful update of the 2000 Public Expenditure Review. It included an analysis of fiscal trends and sectoral allocation of public expenditure, a detailed review of expenditure in important public services (education, health, local roads, and agriculture), and some concrete recommendations for reform. Although a good basis for dialogue with the government and other development partners interested in providing general and/or sectoral budget support, it is unclear whether there will be a follow-up.

RATIONALIZING THE SOE SECTOR

A. Objectives and Instruments

The country-level (PRSP) objective was to rationalize the SOE sector, to which IDA's contribution would consist of diagnosis of the magnitude of the problem and the design of a strategy and action plan. The principal instruments were analytical work and technical assistance on SOE issues through the PRSC series and a public expenditure review.

B. Results

Modest progress was made with respect to the rationalization of SOEs, but financial flows from the government to SOEs remained large. Although gross profitability increased, in net terms many public enterprises operated at a loss and many continued to have large negative net worth. Of 36 public enterprises, 14 operated at a loss in fiscal 2008. Overall profitability increased, and nearly all of it was accounted for by just five enterprises: Nepal Doorsanchar (telecommunications), Rastriya Banijya Bank, the Agricultural Development Bank, the Nepal Industrial Development Corporation, and the Rastriya Beema Life Insurance Company. The national oil company's losses reached record levels, and the Nepal Electricity Authority, which was still making profits until 2002, began making losses of several billion rupees per year. Finally, if liabilities for pension and health benefits of the SOEs were properly accrued (which they were not in Nepal's cash-based budgeting system), most public enterprises were actually operating at a loss and may also have had a large negative net worth.

During the CAS period, four enterprises were liquidated, four sold, and one, Nepal Telecom, underwent a partial sale (15 percent) of its shares. Only the latter enterprise produced a significant impact on the government fiscal situation, realizing revenue of Nepalese rupees (NPR) 8.5 billion in fiscal 2008. Moreover, again with the exception of Nepal Telecom, all of these transactions presented unexpected difficulties. For example, inaccuracies on quality, quantity, and condition of the assets promised to the private buyers led to frequent disputes and lawsuits, resulting in years of delay before the actual privatization or liquidation could be finalized. By the end of fiscal 2008, the government had paid out over NPR 365 billion, four times its investment in all remaining SOEs, just to cover the liabilities of privatized, liquidated, and dissolved public enterprises. In addition, the government faced large additional expenses in future years for enterprises where the process has not yet been completed.

Negligible progress was made in achieving the outcome objective of identifying the magnitude of the financial problems afflicting the SOEs, and devising a strategy and action plan for restructuring the SOE sector. A plan to deal with the loss-making enterprises through restructuring, liquidation, or privatization— a specific instrument contemplated in the 2003 CAS— was never formally approved, although a High-Level Public Enterprise Reform Committee was finally constituted under the interim government in fiscal 2007 and has since submitted its recommendations.

A prerequisite was to enforce compliance with the legal obligation that every enterprise submit annual audited accounts. However, as of the end of fiscal 2008, of 36 SOEs, only 21 had completed the required final audit for fiscal 2007. Another seven had submitted audited accounts for fiscal 2006, and four had submitted their audited accounts for fiscal 2005. Four SOEs had audited accounts only for fiscal 2004 or earlier. The Financial Comptroller General's Office (FCGO), which is responsible for overseeing the initial stage of this process, has frequently been unable to reconcile significant differences in the total registered government investment in at least ten public enterprises as of end-fiscal 2007. Overseeing the FCGO, the Auditor General (AG) has repeatedly signaled accounting discrepancies and proposed specific remedies. However, most of these have not been acted upon.

C. Role of IDA

Negligible progress was made in reaching the development objectives of PRSC-I and the Economic Reform Technical Assistance Credit (ERTAC). The PRSC series aimed to accomplish two goals. First, it sought to improve the transparency and efficiency of the SOE sector by completing annual audits and progressively privatizing the SOEs. Second, it intended to reduce and eventually eliminate losses by the National Oil Company (NOC) (estimated at 1 percent of GDP in fiscal 2002–03; losses were due to subsidized fuel prices). In the short-term, its approach to NOC losses involved raising fuel prices to cover cost of purchase, transport, and distribution. In the medium-term, the approach was to establish an automatic price mechanism for petroleum products, set a professional regulatory body, and liberalize petroleum product distribution.

As noted earlier, limited progress was made in clearing the audit backlog and improving audit accuracy. The reform of the parastatal sector has been progressing very slowly due to bureaucratic delays and weak capacity of the privatization unit. At this point, only 2 out of 30 non-financial SOEs have been privatized or liquidated. Privatization is in progress for five non-financial parastatals, and Nepal Telecoms Corporation has been converted into a public limited company. The losses of the NOC continue to mount and, at current crude prices, have been running at an annualized deficit of about 1.5 percent to 2 percent of GDP, a worsening of the situation when compared to the early 2000s.

The principal objective of the ERTAC was to strengthen public sector capacity to implement the national economic reform agenda. A component of the ERTAC focused on accelerating privatization. Government capacity was to be strengthened by preparing an enabling amendment to the Privatization Act to establish a privatization entity and ready the three heavy loss-making public enterprises (Nepal Airlines Corporation, Nepal Oil Corporation, and Nepal Telecom) for divestiture. The enabling amendment was drafted with the support of the Bank, but was never passed. Nepal Telecom was partially privatized in 2008 via legal conversion to a joint public-private venture, with the sale of 15 percent of its outstanding shares. Almost all of the planned work related to the other two companies has not been initiated, and the partial privatization of Nepal Telecom was prepared without Bank support. By the end of 2008, the new Maoist-led government had indicated an interest in public-private partnerships, but had not yet determined to what extent this new policy would include privatization. Moreover, the SOE review planned by the Bank as a basis for designing a privatization strategy was dropped.

Fostering Private Sector Development

The 2003 PRSP identified the leading role of the private sector in generating growth. IDA supported private sector development in three PRSP areas: (i) expanding private investment, trade, and employment opportunities; (ii) strengthening the financial sector; and (iii) improving infrastructure services.

Expanding Private Investment, Trade, and Employment Opportunities

A. Objectives and Instruments

IDA focused on three CAS outcome objectives: (i) helping to reform labor laws in order to promote employment flexibility; (ii) helping to lower the costs of doing business, and; (iii) fostering public capacity for trade policy formulation and implementation. These objectives were to be supported through the PRSC series, policy dialogue, and technical assistance.

B. Results

Private investment, (both domestic and foreign), exports, and employment were badly affected by the deterioration of the political and security environment over much of the Country Assistance Evaluation (CAE) review period**.** Reliable macroeconomic data are scarce, but the available evidence suggests that overall investment stagnated over the CAE review period and that exports fell significantly, with the export-to-GDP ratio declining from about 23 percent in 2000/01 to 15 percent in 2005, and to 12 percent by 2007. Foreign direct investment (FDI) was insignificant. Employment opportunities declined as out-migration peaked. The evidence on trends in the costs of doing business in Nepal does not permit an unambiguous conclusion. Nepal moved up in the Doing Business rankings between the early 2000s and 2007, notably reducing business licensing delays and overhead. On the other hand, the operation of labor markets did not materially improve. Although procedures in several areas, such as business licensing have improved, their impact on business costs have been offset by a number of factors. These include: the frequent turnover of government officials and policies toward the private sector; the proliferation of strikes, intimidation, and extortion in labor markets; and the deteriorating infrastructure, which reduced the reliability of transport and power.

C. Role of IDA

Negligible progress was made in achieving IDA's outcome objectives. The objective of reforming labor laws to allow greater flexibility in employment was not achieved. In 2004, amendments to reform the Employment and Retrenchment Laws were proposed within the Executive Branch, but they were never approved. Indeed, discussions over the second PRSC foundered in part due to the failure to achieve labor law reform. Survey respondents for Doing Business and other reports on the investment climate continued to cite the inflexibility of labor laws, which result in high overhead and act as a deterrent to investment. From a worker perspective, out-migration to India and elsewhere continued to be the most attractive option for young laborers, and in recent years the number of *émigrés* has more than doubled to roughly three-quarters of a million annually.

Little progress was made in liberalizing business support services to lower the costs of doing business. A key measure to improve the investment climate was to open up the business support services sector (including accounting, consulting, and marketing) to foreign direct investment by removing them from the negative list for FDI. However, this had little impact.

The objective to increase public capacity for trade policy formulation and implementation was also not achieved. The Nepal Trade and Competitiveness study, a high-quality piece of IDA ESW, was officially adopted as a government policy, but the current administration has not yet indicated the direction of its trade policies. Also, the study has been superseded by the new priority of WTO accession. Overall, there has been little or no visible impact.

STRENGTHENING THE FINANCIAL SECTOR

A. Objectives and Instruments

The Tenth Plan/PRSP sought to reform the financial sector to provide healthy, competitive, effective, and professional financial services. IDA's contribution would consist of promoting the Central Bank's effectiveness in performing regulatory and supervisory functions, including privatizing or liquidating the two main state-owned commercial banks, Nepal Rastra Bank (NBL) and Rastriyas Banijya Bank (RBB). Key lending instruments were the Financial Sector Technical Assistance (FSTA) Project, the second Financial Sector Restructuring Project (FSRP), and the PRSC series.

B. Results

Financial deepening occurred as other deposit-taking financial institutions multiplied to fill the vacuum created by reining in the lending of the state-owned commercial banks. The share of the state-owned banks in total bank assets declined from 64 percent in July 2003 to 33 percent in January 2008. The M2-to-GDP ratio increased from 42 percent in the mid-2000s to 62 percent in 2008. The credit-to-GDP ratio increased from 44 percent to 52 percent over the same period. The share of privately-owned institutions in total credit and deposit-taking increased, as did the number of privately-owned institutions. Although the vast growth in remittances from abroad appears to account for much of the financing of such credit, there are concerns that imprudent lending practices are becoming more common among privately owned intermediaries with weak internal risk management structures, particularly the non-bank financial institutions. Lending practices in real estate and shareholding have raised particular concerns among long-established private Nepalese bankers and financial experts, who are fearful that the system may become dangerously overstretched by speculative practices.

Despite progress in financial restructuring, access to financial services actually declined, and Nepal's banking sector penetration remains among the lowest in the world. As of 2006, only 26 percent of Nepali households had a bank account and usage of bank accounts was also low, even among the wealthiest. The number of deposit accounts per 1,000 people dropped from 113 in 2001 to 90 in 2005. Similarly, the number of loan accounts per 1,000 people fell from 19 to 10 during the period. From 1999 to 2005, the number of inhabitants per branch increased by 50 percent, mainly due to the closure of NBL and RBB branches, the Maoist Insurgency, and a process of rationalization.

Access to banking infrastructure is now skewed toward the Central region, where there is one branch for roughly every 50,000 inhabitants—compared with one for every 111,000 in the Midwestern region. Non-bank intermediaries, such as NGO-sponsored financial institutions (FINGOS) and financial cooperatives continue to play an important role in Nepal. Eighteen percent of all households have an account with them, and 41 percent of households with loans from formal institutions also borrow from FINGOs and cooperatives (versus 35 percent from banks). Also, banks have reduced their lending to micro, small, and medium enterprises (MSMEs), which accounted for only 3 percent of bank portfolios in fiscal 2006.

The objective of improving the Central Bank's effectiveness in performing regulatory and supervisory functions was partially achieved. A comprehensive Bank and Financial Institutions Act (BFIA) and amendments to Article 86 of the Central Bank Act (CBA) were approved in fiscal 2004 and fiscal 2005, respectively, significantly enhancing the Central Bank's regulatory powers. However, the amendments to Article 86 were not enforced.

The BFIA provides a legal framework for operation and regulation of a host of new non-deposit financial institutions which had previously operated in a legal and regulatory limbo. These included development banks, savings and credit cooperatives, finance companies, microcredit development banks, finance companies, and NGO-sponsored credit institutions. In mid-2000, there were only 91 institutions, but their number had grown to 235 by January 2008. The amendments to the CBA provided the Central Bank with important new regulatory powers.

Significant progress was made during 2003–04, but momentum was gradually lost in 2005. Early in the process, new Central Bank regulatory and supervisory powers were vigorously exercised against the large defaulters. At least two major defaulter cases were resolved, and prompt corrective action was taken against several troubled banks or banks in non-compliance with Central Bank guidelines. Some capacity building took place as over 50 Central Bank regulatory officials benefited from training and the number of supervisory visits to the 35 commercial banks was increased to an average of once every three years, an improvement over the previous period. Over 200 bank officials received training in improved risk-based management techniques. However, these new powers have gone largely unused since fiscal 2007 when the Central Bank Governor was sidelined by a series of corruption allegations.[22] This left the Central Bank leaderless and more timid, a consequence of suspicions that the Governor was targeted precisely because of his aggressive pursuit of willful defaulters. Also, non-bank financial institutions and micro-credit institutions remain largely unsupervised by the Central Bank, raising concerns about what risks they may pose to domestic financial sector stability.

Although significant restructuring took place, the objective of privatizing or liquidating the two main state-owned commercial banks was not achieved. Under new, foreign-led management teams, the two state-owned commercial banks—NBL and RBB—achieved substantial turnarounds, reducing nonperforming loans from 28.8 percent of assets in July 2003 to 9.0 percent in January 2008.Combined staffing levels were reduced from 10,700 to 6,000, and a shifting from joint operating deficits of NPR 5.1 billion in fiscal 2003 to a joint surplus of NPR 1.8 billion in fiscal 2007 was achieved.

The bank restructuring process came to a virtual halt after 2005. Of the remaining 6,000 staff in the two state-owned banks, only about half would be needed in an optimal commercial operation. Bad asset recoveries and write-offs vis-à-vis small and medium debtors were significant during 2003–05, but negligible vis-à-vis the 10–15 large willful defaulters accounting for half of all nonperforming loans. Cases brought by the Commission for the Investigation of Abuse of Authority (CIAA) against large defaulters have been regularly overturned in the courts. Moreover, creation of a Royal Commission for the Investigation of Abuses in 2005 sowed confusion about who was in charge of the large defaulter issue, weakening this and other aspects of the battle against corruption. The Debt Recovery Tribunal was created with the intention of providing a more agile court to handle defaulter cases, but it was never provided with any budget and is now moribund. Management contracts of the teams responsible for restructuring of the banks were not renewed in 2006. Instead, NBL is now managed directly by the Central Bank, and RBB has a new management team. In 2007, one large defaulter was given renewed access to credit from NBL under circumstances that were not transparent.

The final disposition of NBL and RBB is unclear. As of end-2008, the banks had not been privatized. Indeed, privatization was unlikely not only because these banks remain unattractive to the private sector, but also because privatization has become unpalatable for the government. Hence, the restructuring gains won during 2002–06 can now be said to be at risk. In 2006, the contracts of the top management in the two institutions, including the two expatriate chairmen, were not renewed. NBL is now run by three Central Bank officers with scant experience in commercial banking, and both institutions are said to be under strong pressure to resume the patronage-based credit processes that were largely responsible for past portfolio losses. The new administration has put privatization on hold while it mulls over a variety of options for partial divestiture or continued majority public ownership, though possibly under enhanced management and oversight. A major obstacle is that both banks still have significant negative net worth that the government would have to cover by absorbing nonperforming assets, and before the banks could be presented as likely candidates for privatization. Finally, since 2006, labor unions have become more militant in their demands for enhanced wages and benefits even as they resist right-sizing of bank staff. Potential private buyers cite the deteriorating state of labor-management relations as an even greater obstacle to privatization than the nonperforming assets.

C. Role of IDA

The FSRP, the FSTA Project, and the PRSC series represented a major effort by IDA to promote financial sector restructuring. The development objectives of bank support were closely aligned with the CAS outcome objectives. There were four main goals: (i) to strengthen the regulatory capacity of the Central Bank; to promote the passage of two major pieces of legislation, the BFIA and Amendments to the CBA; to restructure and privatize the two main state commercial banks, NBL and RBB, and; to pursue the 10–15 major willful defaulters whose debts constituted approximately half of the nonperforming assets of the banks. A PRSC-I prior action related to the appointment of the foreign management teams in the two loss-making commercial banks. The PRSC-II trigger on staffing and large defaulters was partially met. Although targeted staffing was achieved in RBB and NBL, progress in recovering claims from large defaulters has stalled.

Despite shortcomings, achievements were significant. However, in light of the unresolved status of the state-owned banks and the setback to Central Bank leadership,[23] resilience to risk is modest. Institutional development is substantial, reflecting not only the extensive record of new legislation but also the degree of financial deepening, the diminished role of state banking, and the modest improvement in Central Bank supervisory capacity. Finally, the IEG mission found widespread agreement that IDA support made a positive difference. Indeed, it was only IDA support that could provide effective follow-up to consolidate and extend these much needed financial reforms.

In addition, IDA completed a timely and useful unplanned ESW on Access to Finance as a basis for preparing an Access to Financial Services Project.

IMPROVING INFRASTRUCTURE SERVICES

In order to remove impediments to private investment and accelerate economic growth, the Tenth Plan/PRSP aimed to improve infrastructure services by reducing transportation costs and addressing deficiencies in access to telecommunication services and power.

Improving Road Access

A. Objectives and Instruments

The Tenth Plan/PRSP gave priority to the development of the strategic road network and the maintenance of major roads and highways. IDA focused on increasing the share of population with access to roads (within a half-day walk) by 4 percent, and decreasing the percentage of main road network in poor condition to 10 percent. Bank-planned assistance included the PRSC series and investment projects in Road Maintenance and Development and in Improving Rural Access.

B. Results

The road access objective was mostly achieved. However, after significant initial progress the road maintenance objective suffered setbacks and conditions sharply deteriorated after 2006. The access goal was largely achieved. Access increased over the implementation period by 3 percent compared to a target of 4 percent. Additionally, most maintenance funds were placed under the control of the National Road Board, an improvement over past practice. The creation of a National Road Board allowed for the rationalization of the allocation of maintenance funds. New road building was prioritized in ways intended to increase the access of Nepal's most remote locations.

However, after rising rapidly during 2003–06, funding for maintenance experienced a partial reversal, with the result that the goal of reducing the share of roads in poor condition to 10 percent was only partially achieved. The share of roads in poor condition has declined from 24 percent in 2002 to 16.4 percent in 2008. The new administration reduced the fiscal 2009 road maintenance budget by 20 percent in nominal terms, violating a major covenant on counterpart funding associated with the Bank's Road Sector Development Project.

C. Role of IDA

IDA supported road progress through the PRSC-I. A prior action under the PRSC-I included the establishment of an autonomous Road Board funded mainly by a fuel levy to oversee road maintenance. The Bank successfully supported the road access objective through the Road Maintenance and Development Project (RMDP), but progress was recently reversed. The project experienced two restructurings, neither of which were formalized by Board approval. A February 2008 IEG evaluation concluded that the project was substantially relevant to the CAS, but modest overall in the achievement of its objectives. The project achieved its planned physical targets as revised, and the capabilities of the Department of Roads staff were improved as intended. However, there were moderate shortcomings in the institutional framework and its implementation in terms of the Roads Board, maintenance funding (the new 2009 budget cuts maintenance funding by 20 percent), and use of the MTEF for identifying investment priorities. There also were delays in disbursements. The impact on transport costs and tariffs was positive, and project-supported roads experienced traffic increases ranging from 27 to 112 percent, indicating increased economic activity. IEG rated the RMDP moderately satisfactory in outcome and moderately resilient to risk. In December 2007, a new Road Sector Development Project (US$42.6 million) was approved.

Despite a number of setbacks, the Rural Access Improvement and Decentralization Project is achieving its objective of improving the rural transport infrastructure and services for residents in 20 participating rural districts, thereby enhancing access to social services and economic opportunities. As of early 2009, the project had experienced some cost overruns due to enhanced protection applications for gravel road surfaces not foreseen at project appraisal. As a result, targets for certain components have been revised downward. For example, the project will now aim to improve about 25 percent fewer all-season rural roads, nearly 70 percent fewer dry-season roads, and about one-half of the originally planned trail bridges. In three districts, works have been halted in areas where insecurity has been an issue, and in three other districts works have been either damaged or are defective. Collusion in bidding on one works project is being investigated by the World Bank's Institutional Integrity Department. There have also been delays in capacity building and advisory services financed by the project. For those works that have been completed and monitored for impact, the project appears to have achieved its key monitoring objectives, both intermediate and higher-level, and in some cases to have exceeded targeted benefits by a wide margin.

Telecommunications

A. Objectives and Instruments

The main objective of the Tenth Plan/PRSP was to improve the access to information and telecommunications facilities. In this context, the major strategy was to liberalize the telecom market and make it competitive through enhancing private sector participation in expansion of telecommunication networks and facilities. The outcome objective was for all Village Development Committees (VDCs) to have access to telecom services. The Bank's outcome objective was to introduce a private phone operator in the Eastern region. Bank assistance was provided through the ongoing Telecommunications Project.

B. Results

Mobile and landline tariff rates have declined sharply in real terms as competition has taken hold. Connectivity is said to have had important economic benefits, such as lowering farm marketing costs and garnering improved farm-gate prices. Moreover, the Nepal Telecom has now been 15 percent privatized, and is expected to have additional shares sold to the public in 2009. In addition, certain amendments reforming the Telecommunications Act are under consideration.

The Bank's objective of introducing a private phone operator in the Eastern region was fully achieved. As of 2008, two mobile operators were operating in the region (one nationwide), and a third had received its operating license, and is expected to begin operations soon. All Eastern Districts have at least one landline and most more than one.

C. Role of IDA

The IDA Telecommunications Sector Reform Project (TSRP) has mostly met its objective of strengthening the policy and regulatory environment in the telecommunications sector to facilitate competition and private sector participation, and increase rural access to services by facilitating private investments and operations. During 2008, competitive pressures facilitated by the measures supported by the TSRP helped bring about significant decreases in long distance and mobile phone tariffs.

Power

A. Objectives and Instruments

Key objectives of the Tenth Plan/PRSP included: expanding electricity coverage by generating low-cost power, accelerating rural electrification, and developing hydropower for export. Bank assistance focused on improving the efficiency of the National Electricity Agency (NEA), combined with greater private sector participation and providing micro-hydropower to 30,000 additional households in remote areas.

B. Results

The objective of improving power company efficiency and increasing private sector participation was not achieved. Although the sub-objective to unbundle the NEA was formally achieved, it had little impact and was not implemented as envisaged in the CAS. The NEA was formally unbundled in 2004 into separate generation, distribution, and transmission departments with a view to phasing out the public electric power monopoly. But this appears to have had little impact on NEA's internal culture or in the way it deals with the private generation sector. The Bank strategy had maintained that unbundling would require privatizing NEA's generation function. Responsibilities for distribution and transmission in the public sector would be retained, but on a non-monopoly basis. An autonomous regulatory authority was to be established to oversee all actors, public and private. Unbundling, at least in those terms, has not occurred.

Moreover, the previously sound finances of NEA have been significantly eroded in recent years by tariff adjustments that lagged far behind the rising costs of energy generation. The private power sector expressed strong concern about the slow progress toward expanding transmission capacity, particularly the interface between the northernmost sites and the national grid. An additional impediment has been the license "squatters" (over 100 licenses are outstanding, many repeatedly renewed by NEA over five or more years, despite little or no evidence of licensee activity), who have effectively blocked access to potentially attractive commercial power sites. They have demanded various concessions, such as equity participation in new power sites as the price for relinquishing their licenses, but with no earnest money attached. Among serious private power investors, squatters are regarded as rent-seekers, and not as acceptable business partners. This issue was one of several reasons why only two new investments in the medium-scale power projects (up to 30 MW) were made from the mid-1990s until 2003, when the IDA Power Project had to be restructured and the Power Development Fund, which was to have seeded such investments, dissolved.

Finally, of greatest immediate importance is the acute lack of reliable electricity supply. In late 2008, NEA was supplying an average of only 4.5 hours of power daily, a severe deterioration in service compared to the early 2000s. Unreliable power has become one of the three most significant reasons cited by the private sector as a deterrent to new investment. The situation has become so critical that IDA is currently contemplating an emergency lending operation to bolster Nepal's meager generation capacity, which currently is less than 1 percent of its potential.

The objective of increasing by 30,000 the number of households in remote areas served by micro-hydropower has been fully achieved. The most successful component of the Bank's strategy for power by far has been the micro-hydropower component, which was enlarged in 2001 when IDA's Power Project had to be restructured. Micro-hydropower projects are mainly run-of-the-river, and generate 1 MW or less. Over 44,000 households have benefited, far more than the CAS goal of 30,000. No data on the development impact of these micro-hydropower sub-projects is available, due to the Bank's tardy initiation of a tracking study expected to become available sometime in 2009. However, anecdotal information gathered by the CAE mission suggests that this energy has been employed not only in household consumption but also in support of small-scale agro-processing, such as milling and paper digesters.

C. The Role of IDA

IDA supported the development of electricity through the Power Development Project (PDP). The project had three objectives: (i) developing Nepal's hydropower potential in an environmentally and socially sustainable manner so as to help meet electricity demand; (ii) promoting private participation in the power sector as a way to improve sector efficiency and mobilize financing for the sector's investment requirements and; (iii) improving access of rural areas to electricity services. Of the three project objectives, only the third — improving rural access to electricity— was achieved.

The first two objectives were to be met by the creation of a Power Development Fund (PDF), which was intended to finance at least 12 medium-sized projects, as well as an indeterminate number of smaller projects. The PDF was expected to mobilize capital not only from the private sector but also from other development partners. In the end, only one medium-sized and one small-sized plant reached the Bank approval stage. Neither was implemented, and in 2007 the operation was restructured with the funds originally intended for the PDF reallocated to the other main component, namely the financing of thousands of rural micro-hydropower installations producing no more than 3 MW each. A key omission accounting for the lack of private sector interest in the PDF was the problem of license "squatters." A second major deterrent was the deterioration of security occasioned by the renewal of widespread internal conflict in 2003.

Promoting Agricultural Development

A. Objectives and Instruments

Since the mid-1990s, Nepal's agriculture development strategy has been driven by the 1995 Agriculture Perspective Plan (APP). The strategy aims at modernizing, diversifying, and commercializing crop and livestock production through increased use of technology and increased farmer access to modern agricultural inputs and credit. The Tenth Plan/PRSP acknowledged that the pattern of growth under the Ninth Plan ending fiscal 2001/02 had not been pro-poor. Therefore, the PRSP focused on reinvigorating income and employment growth in rural areas through agriculture development expected from stronger performance in implementing the 1995 APP. The Tenth Plan/PRSP targeted an acceleration of agriculture growth to at least 4 percent per year. This was to be achieved through improved irrigation facilities, uninterrupted supplies of chemical fertilizers, expansion of rural credit, and expansion of rural infrastructure, mainly roads and electrification. However, the plan did not analyze the factors behind the disappointing performance of the APP under the Ninth Plan, and it did not explain why the new strategy would be more effective this time.

IDA strategy focused on two outcome objectives: improving the enabling environment for factors of production (land, credit, labor, and water) and output markets, and increasing agricultural productivity and farm incomes. To achieve these objectives, IDA was implementing an irrigation sector project and preparing a policy note on agriculture. Building on intense policy dialogue and technical assistance in the context of the Immediate Action Plan (IAP), IDA had planned to produce two studies on improving agriculture performance and on the factors of production market. In addition, IDA had planned an agriculture operation.

B. Results

Since the early 1990s, agriculture has been growing at 2 percent annually, half the average growth of the nonagricultural economy. This increased slightly to 3 percent annually during the CAE review period, but remained below the projected 4 percent growth under the Tenth Plan/PRSP low case scenario. Diversification has also been slower than expected, with the share of land devoted to high-value crops limited. Domestic and export commercialization remains weak for most products.

Little progress was made in improving the enabling environment for factors of production (land, credit, labor, and water) and output markets. Labor markets tightened during the 2002–08 period, and real agricultural wages increased. However, this was mainly due to out-migration, primarily to India and the Middle East, rather than to any policy-related improvements in labor laws or practice. Although two-thirds of Nepal's labor force, and over 90 percent of the poor, are employed in agriculture, in 2008, as in 2002, less than 3 percent are able to make a living exclusively from that activity. The system of dual tenancy, which was legally repealed in 1998, remains largely unchanged, due to lack of enforcement. This has discouraged investment and the renting of land to more productive uses. Indentured servitude of the poor remains a widespread practice in the Midwestern and Far-Western regions. Lack of enforcement of legal strictures banning the practice is also part of the problem.

Official and private credit expanded significantly, as indicated by a tripling in the real volume of credit from the official Agricultural Development Bank (from NPR 140 million in 2002 to NPR 430 million in 2007), NBL, and two private banks. However, lack of payment discipline facilitated by several rounds of partial or complete debt forgiveness for small and medium farmers, has now exacerbated the financial position of the Agricultural Development Bank and NBL, adding to already serious financial difficulties. This has discouraged most private banks from expanding non-subsidized credit to agriculture, in marked contrast to rapid credit expansion to the nonagricultural economy. Moreover, little of what credit is available reaches the rural poor, with only 8 percent receiving any loans from official sources.

Surface irrigation coverage increased significantly to 60 percent from around 40 percent of all arable lands, but remains plagued by inadequate maintenance exacerbated by poor cost recovery (an estimated 1.3 percent), and the lack of either incentives or accountability for maintenance by irrigation agencies. Private spending on fertilizers increased significantly, as the public subsidy was phased out and the sector was opened to competition. However, concerns about quality and inadequate uptake of extension services have resulted in low efficiency and weak increases in yields.

There was little increase in agricultural productivity and farm incomes. Contrary to the APP's core assumption, a considerable increase in the use of modern inputs—expansion of irrigated lands by 50 percent (from 40 to 60 percent of all arable lands), improved access to district roads and credit, and extension of micro-hydropower to over 40,000 new rural households—has not led to more than modest increases in yields, a little over 2 percent annually. For example, average cereal yields in 2006, at 2,200 kilograms per hectare, remained the lowest in South Asia.

In retrospect, an overemphasis on specific inputs and outputs and an under-emphasis on measures to facilitate private sector choices, resolve conflicting institutional responsibilities in the public sector, and engage key stakeholders, such as the Department of Agriculture, in the design and implementation of the strategy appear to have been among the most important reasons for its lack of success. The lack of data make an assessment of the impact on the poor uncertain, as the slow growth of the sector overall was offset to some extent by the impact of a declining rural labor force, and its positive impact on wages. Nonetheless, it appears that any positive impact resulted mainly from private choices rather than public policy as promoted by the Tenth Plan and the CAS.

C. The Role of IDA

For reasons that are not entirely clear but appear to be related to the internal workings of the Bank, the Bank's assistance program in agriculture was mostly not implemented. Given the centrality of agriculture to the betterment of the lives of the impoverished, this constitutes a major setback to the CAS's growth and poverty-reduction goals.

Although originally included in the CAS, and carried over in the 2007 ISN, the proposed agriculture operation never materialized and is still in the pipeline. IDA maintained a continuous policy dialogue with the Ministry of Agriculture on both the preparation of the planned agriculture operation and the sector strategy (and all the preparatory studies) that were conducted. Moreover, IDA commissioned a rural sector policy note that was completed in 2003, but never reviewed and finalized. In addition, IDA prepared an irrigation project that was delayed up to December 2007. There appears to have been an internal disagreement within the Bank regarding the value and applicability of the APP and input subsidies. Although the APP, the Tenth Plan, and related policy statements all agreed on the need to reduce shallow tube well (STW) and other input subsidies (because studies of the private returns to application of those inputs suggested that such subsidies were not needed), in fact, the elimination of STW subsidies resulted in a large decline in the demand for irrigation services for both the existing IDA and Asian Development Bank irrigation projects.

The failure to deliver a planned Improving Agricultural Performance Study in fiscal 2004 and an Agriculture Factor Market Study in fiscal 2005 undermined progress in implementing the agricultural component of the CAS in two ways. First, as noted in the Development Policy Review (DPR), the failure of farmers to drill tube wells when not subsidized (even though private returns to such investments appear to be high relative to credit costs) represents an unexplained issue of market failure, which the two undelivered studies might have usefully examined. Second, although the APP and related policies had a commercial orientation, they offered little for the rural population, which comprised roughly two-fifths of the country's entire population, and was engaged solely in subsistence, non-market agriculture. Solutions to the agricultural conundrum, which appropriately balanced economic rationality with a due regard for social equity and inclusion, were at the center of the CAS's central goal of poverty reduction.

Over the CAE review period, IDA support to irrigation was intermittent, with a three-and-a-half year gap between the first and second irrigation projects. Under the first IDA project, Irrigation Sector Development Project, which closed in fiscal 2004, progress was achieved in expanding year-round irrigation and improving the efficiency of surface irrigation through transfer of full responsibility of operations and maintenance to small-scale farmers, with the result that irrigated production rose substantially. This was not the case for either groundwater development or public irrigation schemes. Moreover, what positive outcomes were achieved could not be fully attributed to IDA support, since exogenous factors benefited those project outcomes.[24] The second project, Irrigation and Water Resources Management Project, was approved only in December 2007. Based on satisfactory implementation, the Bank prepared additional financing that was approved by the Board in September 2008. But progress in implementation for the rest of 2008 was hampered by new and persistent bureaucratic delays as well as security issues in the central and eastern Terai. The project is currently rated moderately unsatisfactory.

Environmental Conservation and Management

A. Objectives and Instruments

The Tenth Plan/PRSP acknowledged that, because of the nature of Nepal's topography, comprehensive environmental management is a key determinant of sustainable development and the well-being of its people. The Tenth Plan therefore required the government to address a range of environmental issues. The Environmental Protection Act (1997) and the Environmental Protection Rules (1997) list the necessary measures and tools. However, they have gone largely unimplemented for want of resources and institutional capacities. Although there were no specific outcome objectives defined in the CAS documents, environmental policies were considered a cross-cutting theme in the country assistance program. IDA was to focus on helping the government articulate an effective strategy for environmental conservation and management and on capacity building. Based on a planned Country Environmental Analysis, IDA would determine possible outcome objectives and appropriate instruments to reach them.

B. Results

Little progress was made on environment and natural resource management as other more immediate priorities emerged during fiscal 2003–08.

C. The Role of IDA

The Bank prepared a highly relevant piece of ESW for Nepal called "Strengthening Institutions and Management Systems for Enhanced Environmental Governance." The report had three strengths. First, it quantified overall economic gains from proper environmental governance. Second, it integrated results of various studies and advisory work in a comprehensive and integrated framework for focused advocacy, awareness, and use by different agencies and stakeholders. Third, based on past experiences in Nepal and other countries, the study proposed three concrete models to operationalize and promote environmental governance. Thus far, however, there is little evidence of impact.

Chapter 4
Progress toward Social Development

The second objective of IDA's program was to improve the access to and quality of basic social services and ensure more equitable access with respect to education, health, and rural water and sanitation.

The Tenth Plan/PRSP placed a lot of emphasis on improving basic social services (education, health, rural drinking water, and sanitation) both as a means of reducing human poverty and improving living conditions in rural areas, as well as addressing critical grievances at the root of the conflict. Moreover, ensuring equitable access to these services and facilities was especially important for mainstreaming the very poor and for deprived rural communities.

Recognizing the importance of ensuring the effective delivery of basic services, the design of the strategy embodied four principles. First, the role of the government would continue to be particularly important in the social sectors because there are many programs whose costs cannot be fully funded by private providers, even though the social returns from such programs and activities may be high (for example, preventive health care programs). Second, the government would increasingly decentralize basic service provision to local governments (primary education and health care), and involve local communities in the management of primary schools and health centers. Third, greater involvement of the private sector (International/NGOs and Community-Based Organizations [CBOs]) through stronger partnerships would be pursued. Fourth, community-based approaches would be used for improving access of the very poor and deprived communities to social services. Better coordination, technical assistance, supervision, and funding from the central government agencies would also be employed to ensure satisfactory progress.

Improving Quality and Access to Education

Improving Quality and Access to Primary Education

The modern education system in Nepal is one of the youngest in the world. Nepal had hardly any schools until 1951. By 1971, when a public school system was established, there were about 4,000 schools that were managed by community committees. These schools served the high castes. After an educational system serving exclusively the most privileged social groups, the system has opened up considerably, particularly at the primary level.

A. Objectives and Instruments

Guided by the objective of Education For All (EFA), the Tenth Plan/PRSP aimed at improving primary education access and quality. The sub-objective included expanding access to education for socially excluded groups, especially girls, Dalits, Janajatis, and other disadvantaged children. The major strategy to achieve these objectives was decentralization of local school management. This was to be achieved by handing responsibilities over to local school management committees and changing the role of district and central-level agencies to that of facilitator, monitor, and evaluator. Other strategies included improving and expanding teacher training programs and strengthening school monitoring and supervision system.

IDA's country assistance strategy (CAS) objectives were fully aligned to the Tenth Plan/PRSP and focused on two outcomes: placement of 25 percent of public schools under community management, and efficient and timely textbook distribution. IDA's planned assistance program included the ongoing Basic and Primary Education Project (BPEP), BPEP-II, an ongoing Community Schools Support Project, and the planned Poverty Reduction Support Credit (PRSC) series. The only formal ESW planned in education was an evaluation of Community Managed Schools.

B. Results

Progress on access and equity was considerable during the CAE review period. However, very little progress was made on improving quality. Nepal was able to manage an overall enrollment increase accompanied by a reduction in gender and caste and ethnic disparities (table 4.1). If the trend continues, Nepal may attain the Millennium Development Goal (MDG) of universal primary enrollment by 2015. Regarding quality, a somewhat reduced dropout rates suggest that quality is improving. However, the general evidence is weak, and overall much less has been achieved than was targeted. There apparently remain huge inequalities in provision, with schools serving the poorest and the most marginalized communities being the least well staffed, resourced, and supported.

TABLE 4.1 NEPAL: SELECTED EDUCATION INDICATORS, 2003–08
(In percentages unless otherwise indicated)

	2003	2004	2005	2006	2007	2008
Literacy rate	53.7 a/					63 b/
Primary school enrollment (Net)	83.5	84.2	86.8	87.4	89.1	91.9
Gender parity index, primary NER	87	87	93	96	96	97
Repetition rate, primary	21.7	21.7	18.4	17.3	17.2	na
Survival rate to grade 5	60	76.2	79.1	80.3	81.1	73.4
Pupil: teacher ratio	35.8	39.7	49.8	54.7	42.3	43.8
Public spending on education (share of total public expenditure)	13.9	14.9				

Source: Annex Table A2c and Norad. 2009. *Joint Evaluation of Nepal Education For All 2004–09*.
a/ 2001census data. b/ Ministry of Education estimate.

Note: na= not available; NER= net enrollment ratio.

Incentives payments, in particular in the form of targeted scholarships, in addition to free primary education, are perceived as having made a huge impact on educational access for girls, Dalits, and Janajatis. Additional contributing factors include improvements in infrastructure and school management. Although there are more teachers, including more trained teachers, progress in improving quality is hampered by extremely overcrowded classrooms, the lack of key input standards, and monitoring of student learning achievement. Although Nepal is allocating more than the average proportion of GDP to primary education, the allocations are still not adequate given the very low base from which it started.

CAS quantitative targets regarding the transfer of school management to communities were mostly achieved and some positive impact was perceived. However, there is little hard evidence regarding improved inclusiveness and education quality. In 2002, the government offered all communities the option of taking over the management of government-funded primary schools, subject to meeting basic prerequisites. The assumption was that the involvement of beneficiaries, particularly parents, in the management, monitoring, and supervision of schools would ensure improvement in school management and performance, as well as in children's learning outcomes. However, due to political events, the mandate of elected local governments expired in 2002 and members of the District Development Committees (DDCs) and Village Development Committees (VDCs) have since been appointed by the government. Therefore, local bodies—VDCs in the case of primary schools—could not support community-managed schools as planned.

Although the devolution policy could not be implemented, the government proceeded with the transfer of school management to communities. Though the process gained momentum initially, it slowed after 2004/05 and picked up again only recently with the restoration of democracy. About 7,015 government-funded schools (18 percent) had been formally transferred by 2007, up from about 250 schools in 2005. Though this falls short of the CAS objective of 25 percent, progress is substantial given the country circumstances.

With respect to quality, the outcomes of school transfers are, thus far, uncertain at best. An impact evaluation was scheduled for 2007, but it has been delayed to 2010, so it is unknown whether these "formally transferred" schools[25] provide more inclusive and higher-quality education than "non-formally transferred" ones.[26] However, a 2005 baseline and a first measure about a year and a half later showed no differences in learning outcomes (except for science), and few differences in gender or inclusiveness outcomes between the treatment group and the control group. Due to a lack of random samples and a suitable design, the characteristics of schools of the treatment group and those of the control group are unknown. Therefore, it is not possible to control for the impact of other characteristics of these schools on school performance and the quality of education.

Qualitative assessments indicate some positive impact of the transfer, but significant challenges remain to be overcome in order to make this policy more widely effective. As evidence of positive impact, qualitative assessments based on a select number of schools,[27] point to three indicators. First, some local guardians and School Managed Committees (SMCs) are more proactive in reforming and improving their schools, including through raising funds locally. Second, there is increased parental and community awareness of school activities and student learning. Third, teachers' attendance and teaching performance has been increasing. On the other hand, numerous concerns continue to be raised, including excessive focus on physical improvements rather than on teaching quality, continued central government control, and inadequate mechanisms to ensure funding for poor schools.

The CAS objective of establishing an efficient and timely textbook distribution system—measured by all primary school children having books at the beginning of the school

year—was partially achieved. As of the end of 2008, it appears that more students got textbooks and that procurement and delivery became more timely. However, there is much variation between and within districts. The production and distribution of textbooks was successfully opened to the private sector, a significant achievement. Some improvement in the delivery of textbooks has already taken place as a result. However, timeliness and inequalities remain a challenge.

C. The Role of IDA

IDA was the lead donor in the education policy dialogue with the government, and a major financial supporter of the sector. IDA support was most effective in increasing access to education and improving equity for girls and marginalized groups. It was least effective in improving the quality of education.

IDA's Basic and Primary Education Project II (BPEP-II) (closed in July 2004), the Education for All project (approved in 2004), and the Additional Financing (approved in 2007)helped Nepal not only strengthen central planning and management, but also the capacity of district education offices to plan, implement, and monitor. The projects supported decentralization and shifted decision-making toward stronger community school management committees.

IDA also pioneered effective development partner cooperation (funding transfers using basket funding and joint supervision) and harmonization through a successful SWAp. During this CAE review period, development partners coordinated closely, and were in broad agreement with IDA's education strategy. The bilateral development partners undertook a lot of technical work and provided some technical assistance under separate programs. For example, Finland paid for teacher trainers, and Denmark supported an advisor in the Ministry of Education. The bilateral donors financed extra technical assistance not planned under the SWAp.

IDA's PRSC series and the Community Schools Support Project (CSSP; closed September 2008) supported the government's effort to hand over management of primary schools to local communities as a way improving the quality of education. Targets on the number of community managed schools, which were prior actions for both PRSC-I and PRSC-II, were met. However, there is no clear evidence that the development objective regarding improved education quality has been achieved so far, and that project-supported community schools are more inclusive than others.

Nonlending services during the CAE period have been limited. The only piece of education-specific sector work planned over the period was the Community Managed School Evaluation. However, it has been delayed due to problems in research design and the collection of baseline data. Nevertheless, most measures piloted under the CSSP have already been mainstreamed into the EFA/SWAp without proper evaluation. Some more general ESW completed during the CAE review period covered some aspects of education, including the *Development Policy Review* (2005), *Resilience Amidst Conflict*, *An Assessment of Poverty in Nepal, 1995–96 and 2003–04* (2006), and *Managing Public Finances for a New Nepal, A Public Finance Management Review* (2007). These reports were consistent with government priorities, but had limited impact on IDA's assistance strategy design as they were released after the main policy decisions had been taken. [28]

IMPROVING QUALITY AND ACCESS TO HIGHER EDUCATION

A. Objectives and Instruments

The Tenth Plan/PRSP aimed at producing a highly skilled labor force through the development of higher education. The main strategy was the introduction of cost recovery with a view to enhanced financial sustainability and improved market relevance of curricula. Quality improvement was considered a prerequisite before increasing cost recovery. To achieve this, initial investments and greater autonomy for academic institutions were required, as well as financial assistance to poor students. The Tenth Plan/PRSP did not set outcome objectives for higher education. The Bank, as the only development partner supporting government objectives in higher education, focused its assistance on improving the financial sustainability of public universities. IDA's planned assistance program consisted of an ongoing policy dialogue and a Second Higher Education Project (SHEP), which was approved in FY2007.

B. Results

The financial condition of higher education institutions improved modestly— but fell well short of being sustainable. Overall, cost recovery increased from an estimated 6 percent in 2001 to around 15 percent in 2008. Progress in increasing the autonomy of universities was limited. A draft University Act was considered by the cabinet in 2005 but never became law, and a planned University accreditation system was not established.

C. The Role of IDA

The sole lending instrument was the SHEP, approved nearly two years behind schedule in February 2007.[29] It had two objectives. First, it aimed to enhance the quality and relevance of higher education and research through a set of incentives for promoting effective management and financial sustainability of academic institutions. Second, it aimed to improve access for academically qualified, under-privileged students, including girls, Dalits, and educationally disadvantaged Janajatis, to higher education. This was to be accomplished through financial assistance and enhanced capacity in higher secondary schools.

The project outcome objectives are highly relevant, but implementation has been hampered by significant challenges. First, the timing of project approval was adversely affected by Nepal's fluid security and political situation, causing a delay of two years in project approval. There have been further delays in implementing some components. Thus far, achievement of the project's first objective is not on track, although the second objective is proceeding. Regarding the first objective, the project executing agency has not yet established acceptable financial reporting and it is still understaffed. As of February 2009, the Maoist Teachers' Union had blocked implementation of the plan to grant autonomy on a voluntary basis to constituent campuses of the Tribhuvan University, which educates over 90 percent of all higher education students. Without autonomy, the project's cost-sharing and managerial goals are unlikely to be met. Community colleges competing for matching grants have prepared plans, but no grants have yet been awarded.

Conversely, substantial progress has been made so far regarding improving access for under-privileged students. Over 400 community higher secondary schools received basic grants from the project in fiscal 2008. The remaining schools are expected to receive basic grants in fiscal 2009. Selection of upper secondary schools for performance and matching grants is underway, and grants are expected to start in fiscal 2009. An Administrator for the Student Financial Assistance Fund Development Board has started disbursing financial assistance to upper secondary and baccalaureate candidates from the Far-Western and Mid-Western regions.

As part of the preparation of the SHEP, IDA supported a significant amount of analytical work filling a critical knowledge gap and fostering consensus on new policy reforms among a wide circle of stakeholders. During 2004–05, IDA produced technical papers on higher and upper secondary education institutions, including such topics as: enrollments, financing, and performance; environmental guidelines for colleges and universities; funding for faculty and student research; student financial assistance schemes; decentralization and formula-based funding for potential autonomous campuses; autonomous campus rules; and a quality assurance and accreditation manual. The findings of this technical work proved material not only to the design of the SHEP, but also to advancement of the government's own policy framework for higher education.

Improving Basic Health Care Services with Emphasis on Poor/Underserved Populations

A. Objectives and Instruments

The health strategy in the Tenth Plan/PRSP was underpinned by a comprehensive health reform agenda[30] developed by the government with inputs from development partners involved in the sector, including the Bank. It was also built on project experience. The primary objective of the strategy was to extend basic healthcare services to all, with special emphasis on poor and underserved rural populations.

The strategy focused on implementing an essential health care package, based on preventive care, maternal and child health, and family planning. There was also an increased focus on improving access to safe drinking water of the rural population as a way to reduce mortality from water-borne diseases, and to generally improve health. Improvements in health service delivery were expected to occur through a gradual process of devolving health facilities—starting with health sub-posts—to local communities and working increasingly in partnership with the private sector and NGOs. Decentralization was intended to bring more bottom-up accountability to communities. Further, it was intended to give them more opportunity to tackle local problems, respond to local priorities, and hold service providers accountable. It was seen as an important instrument for tackling the problem of absent and poorly motivated staff.

IDA focused on the outcome objective of implementing essential health care services in 25 districts, at least half with low health indicators. IDA lending support came through the PRSC series and a 2004 Health Sector Support Program (SWAp), which received additional financing in 2008. No health-specific ESW was planned.

B. Results

Over the CAE period, there was a sustained improvement in health outcomes and an acceleration in the rate of change between 1996–2001 and 2001–06. According to the National Demographic and Health Surveys (DHS), infant, under-5, and maternal mortality rates all declined significantly over the past decade, and the CAE review period (table 4.2). Nepal met the Tenth Plan/PRSP health objectives and is on course to meeting the health MDGs related to child, and, possibly maternal mortality, as well as to tuberculosis and malaria.

Despite the challenging political and governance context and relatively low health expenditure per capita, Nepal outperformed several countries in the region. For instance, the infant mortality rate per 1,000 live births in Nepal was at 48/1000 in 2006, and lower than in India (57/1000 in 2005/06) and in Bangladesh (65/1000 in 2004). Life expectancy in Nepal is improving and reached an age of 63.2 in 2006, up from 59.2 in 1996. However, it remained lower than for most other countries in the region. The total fertility rate decreased. HIV prevalence has remained at 0.5 percent since the early 2000s, and there are signs that it is leveling off at least for some at-risk populations. Still, this is the highest incidence in the region.

TABLE 4.2 NEPAL: SELECTED HEALTH INDICATORS, 1996, 2001, AND 2006 DHSS

	1996	2001	2006
HEALTH OUTCOMES			
Infant mortality rate (per 1,000 live births)	79	64	48
Under-5 child mortality rate (per 1,000 live births)	118	91	61
Maternal mortality rate (per 100,000 live births)	539	----	281
Life expectancy	59.2	61	63.2
Total fertility rate (births per woman)	4.6	4.1	3.1
Children under-5 stunted (percent)		57	49
Children under-5 wasted (percent)	15	11	13
Children under-5 underweight (percent)	---	----	45
PUBLIC HEALTH INTERVENTIONS			
Child immunization rate (children 12–23 months; all vaccines; percent)	43	66	83
Vitamin A coverage (percent)	32	---	90
Antenatal care (percent)	42	50	72
Skill birth attendance (percent)	9	---	19

Source: 1996, 2001, and 2006 DHSs.

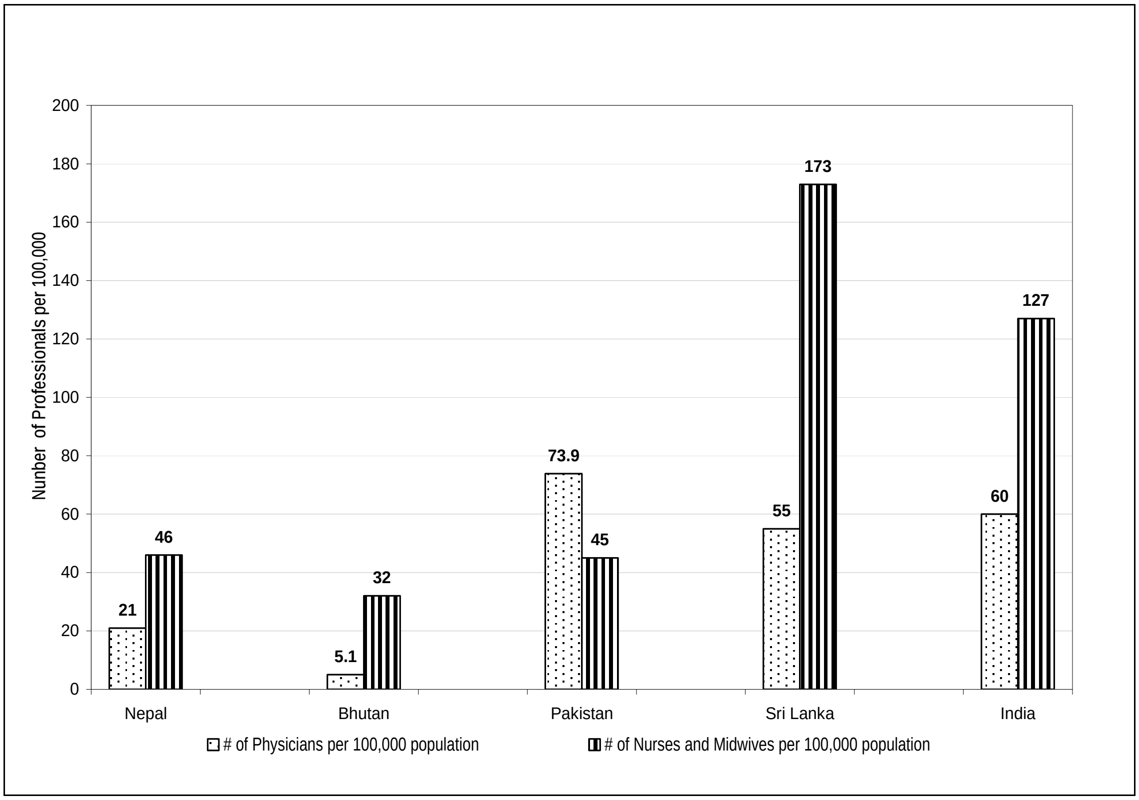
Note: DHS= Demographic and Health Surveys (Government of Nepal).

Little progress has been made in reducing the prevalence and severity of malnutrition, one major cause of child mortality. The percentage of stunted children under-five declined only marginally, whereas the percentage of those wasted children increased slightly. With 43 percent of all children younger than five years of age moderately to severely stunted (2006 DHS), the level of child malnutrition in Nepal remains among the highest in the world.

An independent review of the Nepal Health Sector Program[31] (2007) concluded that the majority of the mortality reduction can be explained by a small number of successful public health interventions. About three-quarters of the reduction in under-five mortality can be explained by the expansion of immunization, Vitamin A distribution, community-based management of childhood illness, neonatal tetanus control, and improved home care for newborns. Over the CAE review period, the child immunization rate for all vaccines improved dramatically, as did the coverage of Vitamin A. With respect to maternal care, antenatal care coverage improved significantly, although improvement of skilled birth attendance was more limited.[32]

Public health sector outreach has expanded, particularly in rural areas. Just a few decades ago, health services were primarily available in urban areas. In the past decade, the number of health care institutions quadrupled. Public health facilities expanded at the local and community levels with the establishment of sub-health posts at the village level and health posts at the District headquarters level. In addition, there are more than 15,000 primary health care clinics (extensions of health posts and sub-health posts staffed by volunteer health workers and maternal and child health workers). The commute time to health services has continued to decline with the improvement in roads and the increased number of public and private health facilities. The shortage of health professionals was reduced sharply since the early 2000s, but remains severe compared to neighboring countries. The number of doctors per 100,000 people increased from 5 in 2001 to 21 in 2006, and the number of nurses and midwives from 26 to 46 over the same period. However, in general, these numbers remained much lower than for neighboring countries (see figure 5). The availability of medical supplies also improved.

Figure 4.1 Nepal: Distribution of Healthcare Professionals in South Asia Region



Source: World Bank World Development Indicators (September 2008 update), 2004.

The CAS outcome objective of implementing Essential Health Care Services (EHCS) in 25 districts, at least half with low health indicators, has been largely achieved. All EHCS interventions are being implemented to varying degrees in all 75 districts. Relatively successful EHCS services include family planning, the Expanded Program for Immunization, Community-Based Integrated Management of Childhood Illness, Vitamin A distribution, Tuberculosis care, and antenatal care. They have either already reached very high national coverage or are rapidly expanding. The most effective are coordinated national programs, managed by divisions of the Department of Health Services, delivered by government staff, and increasingly using government systems for planning, budgeting, procurement, service delivery, and monitoring and supervision. The country has systematically prioritized the expansion of EHCS, which currently represent over 70 percent of the Ministry of Health and Population (MOHP) budget (from a baseline of 60 percent in 2003–04). The share of the MOHP in the government's total expenditures has increased from about 5 percent in 2003–04 to a planned 7.1 percent in 2007–08.

Significant progress has been achieved in reaching underserved populations. I Inequalities based on gender, caste, and ethnicity have been significantly reduced for a large number of health outcomes and health care services utilization. Although regional disparities may have increased as the Far Western region experienced a shift toward concentrated poverty between 1996 and 2006,[33] in all other regions there was a reduction of the percentage of households' members falling into the lowest wealth quintile. The under-five child mortality rate for the poorest quintiles decreased disproportionately compared to the wealthier quintiles. Similarly, the inter-ethnic inequality in infant mortality has gradually decreased over the past decade, although more slowly than for the under-five mortality rate.

However the inter-ethnic inequality in neonatal mortality has increased. This trend is consistent with the increase in inequality in health care utilization. Disparities increased in antenatal care and deliveries assisted by skilled birth attendants. The reduction in inequality in infant mortality rates and under-five mortality rates is consistent with the reduction in inequalities with respect to disparities in the use of immunization services, the incidence of diarrhea, and the treatment of acute respiratory infection.

Nepal's most significant challenge is to prioritize maternal health policies and programs. Levels of access to maternal health services are egregiously low in Nepal, and must be improved with particular attention to ensuring economic equity in the distribution of maternal health services. Trained attendance at delivery is the most important single intervention to increase the chances of neonatal and child survival. Yet few women have access to trained attendants and the inequality in access is severe: only 5 percent of the poorest women have access to trained care compared to a still-insufficient 58 percent among the wealthiest.

Implementation of the decentralization policy was stalled by the lack of elected bodies both at the district and village levels. Therefore contrary to plans, decentralization did not contribute significantly to progress in health service delivery. Health facilities at DDC/VDC levels were handed over to community or private/NGO management in one-third of the districts. After the management of 1,400 health facilities was handed over to Health Facility Management Committees (HFMC)—compared to a target of 1,800 by 2006—the lack of elected bodies at the district and village levels slowed the process.

The handover was partly motivated by the government expectation that communities would be able to mobilize more funds for local health services. They currently levy registration fees for those seeking services, and those with community drug funds may raise additional resources for medicines from this source. However, the evaluation of the handover reports that 60 percent of Sub-Health Posts (SHPs) see no possibility of raising additional funds. [34] In practice, HFMCs have little authority, and accountability to the community is weak in the absence of elected local bodies pending a political settlement on the future structure of the state. The evaluation found that existing clients do not believe that the HFMC represents them, not surprisingly when the chair is the Village Secretary– an employee of the Ministry of Local Development who is usually not from the village, and when the Secretary is the head of the Health Facility. The impact of this policy on the quality of health care services has not been systematically evaluated. Moreover, the budget flows from the DDC via the District Public Health Office and the VDC before reaching the facility, and the real power remains with the health professionals. The facilities that were handed over report that they have serious financial difficulties, and their nominal powers to recruit additional staff have not been used.

C. The Role of IDA

Through their support to the design of the Immediate Action Plans (IAPs), the PRSP preparation, and the Health Sector Strategy preparation, IDA and other development partners encouraged the government to design radical ways to improve public service delivery. The first IAP in 2002 and successive ones contained reform actions in three critical areas: prioritizing public expenditures, improving service delivery, and strengthening anti-corruption and accountability measures.

The PRSC emphasized creating fiscal space and galvanizing action in support of Nepal's PRSP, as well as specific priority actions contained in the IAPs. PRSC-I provided bridge financing to improve service delivery in the health sector over the 2003–04 period, when no Bank sector project was active.[35] With PRSC-I support, the management of about 50 percent of health sub-posts was transferred to community management committees. Initial evaluations carried out on a sample of health facilities indicated that service delivery improved at decentralized health facilities. However, it is not clear from these earlier evaluations how the decentralized facilities compared to the overall positive trend nationwide. Moreover, earlier evaluations have not been followed by more rigorous evaluations to confirm the impact of decentralization on service delivery. Finally, after the initial progress the transfer of health facilities management to communities stalled. The PRSC-II health-related prior actions— implementing essential health care services in 14 districts, and prioritizing those with poor health indicators— was partially done as EHCS was under implementation to various degrees in all 75 districts.

The objective of the Health Sector Program, approved in 2004, was to expand access to and the use of essential health care services, especially by underserved populations. The initial program was based on the 2004 *Health Sector Strategy: An Agenda for Change*. Eight areas of intervention or "outputs" were consolidated under two components: strengthened service delivery and institutional capacity and management development. The service delivery component included expansion of essential health care services, decentralization, and public-private partnerships (PPPs). Institutional development included sector management, sector financing, logistics management (including drugs and supplies), human resource development, and a health management information system.

Significant progress has been made toward development objectives and the four key performance indicators are likely to meet or exceed their initial target.[36] The country has systematically prioritized the expansion of essential health care services, and access to essential services has rapidly expanded. However, a few reforms did not proceed as planned. For example, decentralization was stalled by the lack of elected bodies at the district and village levels. Similarly, until recently, frequent MOHP leadership changes and the political context delayed ministry-level decision making and implementation.

IDA approved a Health Sector Operation Additional Financing in May 2008 based on two considerations. The first consideration was the faster absorption of resources in the first four program years that had resulted in early achievement of program performance targets, and a positive impact on reproductive health, child health, and communicable disease control. The second consideration was continued scaling up of essential health care services. With the Additional Financing, the geographic coverage of essential services would be expanded and policies aimed at increasing access by the poor more systematically implemented.[37] It is too early to assess progress.

The Bank had not planned any health-specific ESW over the review period. The Bank assistance strategy over fiscal years 2003–08 and health interventions were mostly based on analytical work done in 2000, specifically *Nepal Operational Issues and Prioritization of Resources in the Health Sector Report* and the *Nepal Public Expenditure Review*. Over the CAE review period, the Bank completed several pieces of multi-sector ESW covering health: the *Development Policy Review* (2005), *Resilience Amidst Conflict, An Assessment of Poverty in Nepal, 1995–96 and 2003–04* (2006), and *Managing Public Finances for a New Nepal, A Public Finance Management Review* (2007). As far as the health sector is concerned, these reports were not well timed and the quality was variable. Moreover, there were inconsistencies among them and also with Bank operational work on the assessment of the heath sector and policy performance. They had a limited impact on the policy dialogue which is conducted mainly in the context of the health SWAp.

The Bank has played an important role in ascertaining government priorities in health through intense policy dialogue. Bank Country Assistance Strategies reflect these priorities. In addition, the Bank has worked with the government to establish priorities, targets, measurable outcomes, and implementation strategies in Poverty Reduction Strategies, national health plans, and Bank projects.

Since 2004, the Bank's participation in Nepal's health SWAp is consistent and supportive of the Paris Declaration on Donor Harmonization as well as Nepal's policy on donor harmonization in health. Harmonization has long been advocated as a way of reducing parallel funding by many development partners that can "balkanize" country health systems and create duplicative systems of management, monitoring, and evaluation. Thus far, the Bank's participation in Nepal's SWAp appears to be on the right track, with initial indications that current arrangements are a more cost-effective way of doing business. This approach is endorsed by the development partners who support a common sector strategy, and the jointly developed Nepal Health Sector Program. Development partners jointly review program performance with the government twice a year.

Both the World Bank and DFID agreed to pool their funding with government expenditures in support of the overall program. Pooled funding from the Bank and DFID represented about 22 percent of total public expenditures on health in fiscal 2007–08, and more than 40 percent of overall donor financing. The remaining development partners[38] operate outside the government budget, providing parallel financing for various kinds of "integrated technical assistance and technical cooperation" in support of the overall program. All of these external development partners have expressed support of the SWAp and have endeavored to align their expenditures on the overall government-led programmatic goals. The only major external development partners that have declined to participate in the SWAp are China and India. They seem to operate outside of mainstreamed government-development partners' coordination mechanisms, allocating grants on the basis of criteria not shared by the other external development partners. Overall, donor funding for health, nutrition and population in Nepal was about 51 percent of total public expenditure over the 2005–07 period.

Improving Quality and Access to Water and Sanitation in Rural Areas

A. Objectives and Instruments

The core objectives of the Tenth Plan/PRSP were to increase sustainable access to basic drinking water and sanitation services in rural areas. The main strategy in the sector was to encourage NGOs, CBOs, and the private sector to participate in all phases of development. Among the major policies and activities was an expected government revision of the 1998 rural sub-sector policy to specify clear roles and responsibilities for the various sector actors. The revision was also expected to reform and consolidate the various institutional mechanisms and approaches to facilitate the implementation of demand-driven community managed programs and projects by making operational a sector monitoring and evaluation system within the line ministry.

Likewise, the government would formulate an act to ensure the autonomy of the Rural Water Supply and Sanitation (RWSS) Fund Development Board. With the completion of proposed activities, about 3.8 million people (about 13 percent of the population) would have gained access to safe and sustainable drinking water services by the end of the Tenth Plan/PRSP. Girls would have a better opportunity to attend school due to the time saved in gathering water. In addition, the incidence of water-borne diseases would be reduced considerably. IDA focused on two quantitative objectives: (i) extending water supply to an additional 10 percent of the rural population and (ii) extending coverage of sanitation services to an additional 5 percent of the rural population. The Bank had planned to assist Nepal with a second Rural Water Supply and Sanitation Project.

B. Results

Progress was made toward the quantitative CAS objectives but fell short of the targets. Most planned institutional reforms are still pending. Quality and access to sustainable rural drinking water improved over the period. Eighty percent of the population had improved access to water sources in 2006, as compared with 74 percent in 2001. Thirty-six percent have access to improved sanitation in 2006, as compared with 30 percent in 2001 (DHS data). Moreover, the greatest improvement in access to safe water occurred among the poorest. Whereas in 1996 access to safe water among the poorest quintile was only about one-third of that in the wealthiest quintile, by 2006 access to safe water was almost equally distributed across quintiles. Use of improved sanitary facilities has increased over time in general, and among the poorest in particular.

However, improvements in sanitation lagged behind improvements made in increasing access to safe water. , No sector monitoring and evaluation system and sector monitoring information system are yet functional at the Ministry of Physical Planning and Works. The support to rural water and sanitation is still fragmented in terms of institutional arrangements and service delivery approaches, and there is little consolidated data available at the rural sub-sector level. In particular, there is no effective monitoring of the Tenth Plan/PRSP outcome objectives related to the impact of time saved by girls in gathering water and the opportunity to go to school. The incidence of water-borne diseases is not monitored in any systematic way at the country level or even at the project level. Most of the planned institutional reforms have not yet occurred, including reform and consolidation of the various institutional mechanisms and approaches to facilitate the implementation of a demand-driven community-managed approach, as well as the envisaged move toward a sectorwide approach.

C. The Role of IDA

The first IDA-supported RWSS project that closed in December 2003 contributed to progress in facilitating provision of demand-driven rural water supply and sanitation services infrastructure and hygiene education. The attention to promoting good sanitation facilities through a Sanitation Revolving Loan Fund grant to each community leveraged substantial self-help efforts and community-led environmental clean-up activities. Increased awareness of disease vectors and good hygiene practices enhanced the health benefits from provision of infrastructure. The Rural Water Fund Board model (a semi-autonomous agency) successfully challenged existing government practice used to provide rural water and supply and sanitation in Nepal. It provided sustainable service delivery that is fully owned by the communities, and is not reliant on the government for routine operation and maintenance.

However, so far the enhancements envisaged under the second RWSS project have failed to materialize, especially those that were considered critical for the sustainability of project outcomes. In particular, since the project became effective in January 2005, the institutionalization and mainstreaming of the Rural Water Fund Board has been stalled. Progress in improving the project monitoring is hampered by the lack of progress at the national sector level. For instance, the data collection and timing for monitoring the percentage decrease in the prevalence of diarrheal disease morbidity among young children still needs to be improved. As of the end April 2008, it shows a reduction of only about 10 percent against an expected 80 percent reduction by end-August 2009. There are no indications that the proposed measures to ensure inclusiveness of service delivery are being implemented and monitored.

Implementation of the project, in particular completion of water schemes, has been delayed both by external and internal factors related to weaknesses in the Fund Board management and, de facto, to the lack of political support by the government (discontinuity in leadership and inability to attract professionals). Despite these implementation challenges, the Bank approved an Additional Financing in May 2008 to cover cost overruns and the cost of scaling-up activities (to complete an additional 450 water schemes covering an estimated additional population of 407,400 over the 2-year project extension).

Chapter 5
Progress toward Social Inclusion

An important objective of IDA's program was to help promote social inclusion through: (i) the mainstreaming of social inclusion in IDA's assistance program as a whole; (ii) increasing public funds used by disadvantaged rural groups for services; and (iii) increasing diversity in the civil service.

A variety of deep inequalities contribute to social exclusion. Indeed, it is social exclusion that retards economic growth, and severely constrains effective poverty reduction in Nepal. Hence, social inclusion was one of the four pillars of the 2003 Tenth Plan/PRSP. Consistent with IDA's mandate for poverty reduction and ensuring economic growth with equity, the strategy for social inclusion consisted of supporting three government interventions: (i) improved access to basic services in the education, health, and water sectors for socially excluded populations; (ii) increased fiscal transfers to disadvantaged groups; and (iii) affirmative action programs in different sectors for the disadvantaged. The main instruments for supporting social inclusion in the CAS were:

- Diagnosis and policy recommendations through analytical work on gender and social exclusion
- Mainstreaming social inclusion in the education, health, and water sectors, particularly through community-based development (CBD) approaches to empower disadvantaged groups through representation and participation in decision-making and to ensure benefits from improved access to services
- Establishment of a Poverty Alleviation Fund (PAF) as an autonomous entity to transfer public resources to disadvantaged groups and
- An affirmative action program to enhance diversity of the civil service.

Both the Tenth Plan/PRSP and IDA's assistance strategy for social inclusion were mostly derived from the seminal piece of analytical work on social inclusion (*Unequal Citizens, Gender, Caste and Ethnic Exclusion in Nepal*) produced jointly by DFID and IDA. This study advanced overall understanding of social inclusion issues in Nepal and proposed priorities for action.

Mainstreaming Social Inclusion in IDA Assistance's Program

MAINSTREAMING SOCIAL INCLUSION IN EDUCATION

A. Objectives and Instruments

Primary education is the foundation for ensuring educational parity among various groups and the first step toward effective social inclusion. The IDA strategy aimed at reducing out-of-school primary aged children (primarily Dalits, girls, and disadvantaged Janajati groups) by 50 percent. IDA's planned assistance consisted of finalizing the ongoing Social and

Gender Analysis, implementing the ongoing BPEP-II (phase 1) and Community School Support learning and innovation loan, and a planned BPEP II (phase 2).

B. Results

Considerable progress was made in improving access to primary education for girls, Dalits, and disadvantaged Janajati groups. Indeed, considerable progress was made in gender equity within the education sector as a whole. The proportion of girls aged 15–49 completing fifth grade doubled from 17 percent in 1996 to 35 percent in 2006, and the gap with boys decreased significantly. The ratio of girls to boys aged 15–49 who completed fifth grade increased from 0.38 in 1996 to 0.45 in 2001 and 0.56 in 2006 (Nepal DHS data[39]). Between 1996 and 2006, the percentage of girls attending school rose from 57 percent to 87 percent. Gender equity in school attendance increased in all quintiles over the same period (the female to male ratio of age 6–10 school attendance increased from 0.63 in 1996 to 0.73 in 2001 and 0.94 in 2006). For the Dalits and Janajatis, data on the primary education enrollment level (the only available data) show considerable increase over the FY 2003–08 period (table 5.1).

TABLE 5.1 NEPAL: PRIMARY EDUCATION ENROLLMENT BY CASTE AND ETHNICITY, 2003–08

	2003	2004	2005	2006	2007	2008	2003–08
Dalits							
Boys	340,261	321,007	634,615	395,243	435,376	488,912	43.7
Girls	265,569	265,397	334,444	368,965	412,036	477,234	79.7
Total	605,830	586,404	969,059	764,208	847,412	966,146	59.5
Ratio--Girls: Boys	78.0	82.7	52.7	93.4	94.6	97.6	
Janajatis							
Boys	---	497,080	825,905	833,242	911,542	967,072	94.6
Girls	---	455,792	776,142	810,233	896,389	960,006	110.6
Total	---	952,872	1,602,047	1,643,475	1,807,931	1,927,078	102.2
Ratio--Girls: Boys	----	91.7	94.0	97.2	98.3	99.3	

Source: Norad. 2009. *Joint Evaluation of Nepal's Education For All 2004–09.*

Government policies have helped reduce gender disparity in access and have enhanced access for Dalits and Janajatis. The government began implementation of scholarship packages for girls and Dalit children in primary and lower secondary schools. Communities also initiated efforts to enroll out-of-school children in their neighborhoods. Schools are distributing NPR 350 per year to all Dalit students, and NPR 150 to a large majority of the poor girls. However, some school staff considered the amounts too small to provide adequate incentives and, as a result, they believed that many Dalit children were not attending school regularly or completing their education.

The CAS overall outcome objective was met, as was the outcome objective for girls. In the case of Dalits and Janajatis, it was most probably met. The share of out-of-school children declined by about 50 percent from 2003 to 2008, and even more for girls (from 22.5

percent in 2003 to 9.6 percent in 2008; table 5.2). The gender parity index approached 1, meaning that, for all practical purposes, parity was achieved during the CAE period. However, little is known about enrollment decisions; some families send boys to private schools and girls to public schools.

There is no out-of-school series disaggregated by caste and ethnicity to assess achievement of CAS objectives for the Dalits and Janajatis. However, the primary school enrollment more than doubled for Janajatis and increased by 50 percent for Dalits over the 2003–08 period. Therefore, it is likely that this objective was achieved during the CAE period, even when taking the rate of population increase into account. Moreover, among the Janajatis, parity between girls and boys was reached in 2008, and reached almost 98 percent for Dalits. According to a detailed analysis of the remaining out-of-school children in 2008,[40] girls, Dalits, and Janajatis were over-represented.

TABLE 5.2 NEPAL: OUT-OF-SCHOOL RATIO BY GENDER, 2003–08

	2003	2004	2005	2006	2007	2008
Boys	10.6	9.9	9.9	10.7	9.3	6.8
Girls	22.5	22.0	16.6	14.5	12.6	9.6
Total	16.5	15.8	13.2	12.6	10.9	8.8
Girls: Boys	2.1	2.2	1.7	1.4	1.4	1.4

Source: Norad. 2009. *Joint Evaluation of Nepal's Education For All 2004–09*.

C. The Role of IDA

Overall, IDA has effectively promoted social inclusion through its education lending and the outcomes are satisfactory. Bank support to inclusive education included the BPEP-II (Phase 1) and the follow-up Education For All (EFA) project. In addition, the Community Schools Support Project (CSSP) provided enhanced support to selected public schools under community management. For the schools supported by the project (2,035 community schools compared to 8,002 community schools transferred to School Managed Committees (SMCs) as of September 2008), the targets were also achieved. However, there is no evidence that project-supported schools performed better than the other government-funded schools either on the social inclusion or on education quality dimensions.

MAINSTREAMING SOCIAL INCLUSION IN OTHER SECTORAL PROJECTS

A. Objectives and Instruments

The Tenth Plan/PRSP listed a number of areas—including agriculture, forestry, wage employment, and social sectors—where special efforts would be made to mainstream and empower women, Dalits, and the disadvantaged groups. This was to be achieved through a variety of means, including targeted programs. Other reforms included revising existing laws to eliminate legal discrimination against women, and implementing affirmative action programs to increase the social diversity of public service. The approach to mainstreaming deprived communities and vulnerable groups would be similar in that emphasis would be placed on ensuring social inclusion in all programs. Aligning with the Tenth Plan/PRSP and in addition to the focus on primary education, IDA aimed to mainstream social inclusion considerations into all sectoral projects, in particular for services in the higher education, health, and water sectors. This was to be achieved through two measures. First, measures would be taken to ensure access to services by the disadvantaged groups. Second, CBD approaches would ensure representation of disadvantaged groups in community decision-making bodies. Operational Policy (OP) 4.10 also required IDA to safeguard the interests of indigenous peoples.

B. Results

Overall, IDA made substantial progress in improving access to services for disadvantaged groups. The evaluation is based on a review of IDA projects. The implementation completion report (ICR) for the first water sector project notes that 58 percent of the population covered by the project is from Janajati and Dalit communities. The health sector support was not as successful. The Additional Financing Project Paper (October 2006) notes that the introduction of a cost-recovery policy at the facility level, which existed for most of the evaluation period, did not help services to reach the poorest. More recently, the policy has been revised, and access to services is expected to improve for Dalits and Janajatis.

The Bank's success in ensuring meaningful representation of disadvantaged groups in community decision-making was modest. Bank support has been less successful in ensuring the representation of disadvantaged groups with respect to health, water, and education community committees. Although there is a requirement to ensure that health management committees include Dalits, field visits suggest that this has yet to be fully implemented. The first water project, for example, did not include such a provision. However, the currently active water project is pushing to include Dalit and Janajati representatives in community groups. Regarding the education project, although the law requires that women be on the community management committees, there is no requirement for including Dalits and Janajatis. Not surprisingly, the representation of Dalits and Janajatis is low in school management committees, although they are better represented in Parent-Teacher Associations. The PAF, on the other hand, reached the disadvantaged communities, and led to the formation of 4,689 community organizations largely composed of Dalits or Janajatis who managed funds transferred for development activities. Although the lack of capacity and education imposed limits on their participation, the PAF activities nevertheless constitute a first step in bringing these disadvantaged groups into the planning and implementation of development activities.

Monitoring of social inclusion has progressed at the sectoral levels, particularly in education and health. The education sector collects enrollment data disaggregated by Dalits, Janajatis, and gender. All schools visited had such information available, as well as data concerning the caste and ethnicity of their staff. However, none of the schools were able to provide disaggregated data on school enrollment or completion rates. Health facilities are starting to collect relevant information, but did not have such data available yet. Although the Rural Water Fund Board has started to collect relevant data, this is not yet systematized at the sector level.

Although a country gender assessment was not undertaken until 2005, the Nepal CAS stated that it would mainstream gender across the portfolio and include country-level indicators that would be monitored. Much of this strategy has been implemented. Almost three-fourths of the relevant projects reviewed for the CAE had high or substantial levels of gender mainstreaming (some analysis of gender issues, some consultation with men and women, activities to support gender or women's empowerment, and appropriate indicators to assess). Gender integration is also improving. For example, the first Rural Water and Sanitation project was gender-blind. However, the second project may be considered good practice, with a clear gender analysis, integration of activities to improve women's empowerment, and inclusion of a Women's Technical Support Service Specialist to monitor how the project is being implemented. Field visits to projects suggest that women benefit from the project.

C. The Role of IDA

Overall, the outcomes of Bank support are substantial. IDA has paid significant attention to mainstreaming gender in its support of Nepal and has contributed to bringing women into the public arena through community groups. IDA's interventions in the education, water, and health sectors to promote inclusion of disadvantaged groups have generated some results, but need further strengthening. The PAF helped reach and organize disadvantaged groups, namely Janajatis, Dalits, and women, to participate in managing development activities.

Increasing Public Funds used by Disadvantaged Rural Groups for Services

A. Objectives and Instruments

Recognizing the limited effectiveness of poverty-targeted programs in the past, the Tenth Plan/PRSP adopted some new approaches, including: (i) consolidating similar programs; (ii) establishing the 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 Tenth Plan/PRSP proposed to implement an integrated infrastructure development program (drinking water, small irrigation, schools, health posts, and trails) in remote areas through local government, Community-Based Organizations (CBOs), and NGOs. In support of this strategy, IDA aimed at increasing public funds used by disadvantaged rural groups for services. The planned assistance program consisted of ongoing policy dialogue on the PAF, a proposed PAF I (FY04), and possibly a PAF II (FY06).

B. Results

CBD approaches were key to addressing social inclusion issues and to enhancing the capacity and role of excluded groups in community decision making. This section focuses on the achievements of the PAF, which was envisaged as the key instrument to transfer resources to disadvantaged groups for improved access to basic services and as an instrument for social inclusion.

Given that implementation significantly diverged from the initial plan, it is useful to go back to the vision underlying the establishment of the PAF. The CAS objective for the PAF was to increase access to services for disadvantaged groups. In 2003, the first PAF consisted of a Learning and Innovation Loan (US$15 million) aimed at piloting a new approach to targeted poverty alleviation that could be scaled up. The outcome objectives of the project were to provide direct/indirect benefits to the most deprived people in selected districts. This was to be accomplished by: (i) creating infrastructure, employment, and income-generating opportunities; (ii) enhancing the capacity of local bodies, particularly Village Development Committees (VDCs), to provide better services for this targeted population; and; (iii) improving government efforts to better coordinate support.

The PAF also was to provide a basis for government and donor harmonization of their support to social inclusion. The PAF was designed to work in collaboration with local bodies to the extent possible and to create incentives for local bodies to address the needs of the most marginalized populations. In the longer-term, the PAF was to be phased out or to be mainstreamed and institutionalized as a means to finance integrated infrastructure development programs in remote rural areas and through local bodies (see annex 1 in 2002 PAF Policy Note and the PAF I Project Appraisal Document [PAD]).

The pilot PAF targeted the most deprived and underserved communities in the six poorest districts of Nepal. The pilot had originally allocated about 57 percent of the $15 million loan for small communal infrastructure, and about 25 percent for income-generating grants to the poorest. In October 2006, in response to growing demand, IDA provided additional financing of US$25 million to the PAF and expanded the project to 25 districts. In November 2007, IDA approved a follow-up project (US$100 million) scaling up the project to all 75 districts on a no-objection basis. The PAF II intended to use the same design with no changes to the project components or implementation arrangements, which IDA management said were working well. The 2007 PAD noted that "all components have been implemented satisfactorily with the exception of the capacity building for local governments." Overall, actual financing for the PAF amounted to US$140 million against US$45 million planned under the 2003 CAS and the 2007 Interim Strategy Note (ISN).

The IEG evaluation finds that achievement of CAS objectives through the PAF is modest. It reaches this conclusion based on a review of the PAF, reports by the Bank and other development partners, interviews with PAF staff, government, and development partner representatives, and a limited number of field visits during the IEG mission.

As stated earlier, the PAF succeeded in reaching poor women, Dalits, and Janajatis.[41] About 80 percent of its beneficiaries were not only poor, but came from among the most disadvantaged groups. The PAF was designed and implemented in a difficult country context. Bank staff view PAF achievements as a first step in establishing the foundations for further and intensive investment in social capital of the poor.

PAF funding was allocated primarily to private goods. Contrary to what was stated in the CAS or the PAD, the PAF did not focus on service delivery to disadvantaged groups, though it provided modest financing for small-scale infrastructure to improve services. Due to demand for income-generating activities from the poor, the PAF changed course mid-way and focused on supporting livelihoods for the poor, reducing the focus on services.

The bulk of PAF funds, therefore, were provided as small loans to individual households[42] through community organizations created for purposes of the project.

As of August 2008, about 84 percent of the investment funds had been disbursed for individual income-generating activities, and only 16 percent had been spent on community infrastructure (PAF Brief).[43] In several cases, small-scale infrastructure included building household-owned livestock pens and sties. Further, at the time of the mission, about three-fourths of the support for income-generating activities had gone to individual households to purchase livestock. This approach raises some concerns. Although such assistance is based on successful efforts in other parts of South Asia—notably India (Andhra Pradesh), Sri Lanka, and Pakistan— where provision of livestock has helped to raise incomes in these countries, Bank support did not allow provision of funds for private goods to individual households.[44] By providing funds for private goods through a revolving fund, the PAF created significant demand for funds, which led to quick disbursement.

Although financing of privately-owned goods with public money is contentious, the experience with livelihood projects suggests that this is sometimes appropriate in countries in conflict, or in projects targeting extremely poor people, who have few assets and little capacity to earn an income. Thus, the overall approach may have been valid in the Nepalese context. However, Bank experience has shown that in such cases, there are significant risks that need to be mitigated in project design.[45] These precautions do not appear to have been factored in PAF I, although some features, such as training to credit and savings groups, have been integrated into PAF II.

Additionally, there are concerns that the PAF distorts competition in the microfinance market. The 2002 Policy Note for the PAF indicated that Nepal's microfinance industry was not constrained by a shortage of lending capital. The Note asserted that small groups do not even need outside capital in early developmental stages because they are functioning in a largely subsistence economy. Representatives of microfinance institutions in Nepal expressed some concern that a large portion of the PAF loans were not effectively targeted and were damaging the discipline and sustainability of the strong Savings and Credit Groups. However, given the lack of data, the seemingly effective poverty targeting mechanism of the PAF, and IEG's observation that microfinance agencies were not operating in localities visited, it is not possible to confirm or counter such assertions. A systematic evaluation would be needed to assess the impact of the PAF activities on the microcredit industry.

The PAF operates mostly in isolation. In particular, there are no functional links with local institutions. Consistent with the Tenth Plan/PRSP, the CAS had planned to strengthen local governments to plan and implement development interventions in a socially inclusive manner. The PAF was expected to strengthen local governments and enhance the demand for decentralization at the local levels. This objective was not achieved. This must be attributed in part to the suspension of elected village-level governments and the replacement of elected District Development Committees (DDCs) by civil servants. IDA management felt that these appointed DDC staff did not represent community views. Therefore, the PAF preferred to work directly with communities through district-level NGOs. However, during the same period, other donors, such as DFID and SDC, operated through the DDCs and aimed to support the local-level institutions at the district level (village-level offices were not functional).

More generally, there is an evident lack of consensus among the government and donors about the PAF approach. The Ministry of Local Development expressed concerns about the PAF approach to delivery of services. IEG's decentralization evaluation also showed the importance of aligning CBD approaches with the government decentralization strategy and with local governments. Recently, a Memorandum of Understanding was signed between the PAF and the Ministry of Local Government, but it is restricted to information sharing. Key donor representatives also felt that the PAF system of service delivery was inconsistent with development partners' commitments under the Paris Declaration on Aid Effectiveness, which required a strengthening of local governments.

The PAF has not provided a basis for government and donor harmonization. The LIL had anticipated that several development partners would cofinance with the PAF. However, except for an anticipated contribution by IFAD in 2008, other development partners did not support the project. Interviews with representatives suggest they are concerned about the approach, specifically about the lack of any systematic evaluation of the PAF approach. Some cite a recent qualitative evaluation of income-generating activities by four development partners, including IDA, concluding that did not find the PAF an effective instrument for poverty reduction.[46]

There is no effective monitoring of outcomes and poverty impact of the PAF, and the PAF pilot was not evaluated before the Fund was scaled-up. What monitoring exists focuses mostly on the number of participating households, their caste and ethnic background, and the amount of disbursements made through the community bank account. No data are available on intermediate outcomes such as loan recovery rates, the value of the asset provided, income generated, or the economic rates of return for the activities, even at a community level.

A 2009 (Nepal year 2065) Performance Audit Report of the PAF (conducted by the Auditor's General Office), reports on the results of the PAF in four districts. The report finds that PAF sub-projects helped to improve incomes of PAF beneficiaries in many cases and instilled a savings discipline among the poor. However, the report concludes that it is too early for the PAF program to be called successful in enhancing the economic status and living standards of targeted groups. It adds that the "the real hard core poor communities were hardly affected by the program." In fact, the report notes that they suffered losses because they had to deviate to other, alternative livelihoods as the small business with small investment did not pay enough to sustain a livelihood and they had very little to run the business. The report notes that the very few hard-core poor could not afford to borrow larger amounts to set up sustainable livelihoods due to the inability to repay. They mostly borrowed to buy goats or other livestock, but a large number of goats were lost in several areas due to diseases or were eaten by tigers.[47]

Although the report notes positive community participation, 301 (93 percent) out of 322 participants surveyed about rules, regulations, and procedures of the revolving fund said they had 'no idea', although the rules were discussed and passed in their presence. Yet on the grounds that the PAF was reaching the targeted groups, and that there was a demand for the funds, the LIL was expanded by US$25 million in November 2006, and by US$100 million in December 2007.

No exit strategy is in place as envisaged in the PAF PAD. On the contrary, IEG understands that the PAF has formulated a development plan for the next 25 years. The PAF was created following the model of the Water Fund Board, which was established in 1996. Some lessons may be learned from the difficulties encountered in mainstreaming and institutionalizing this approach after 13 years of operation.

C. The Role of IDA

The PAF has provided an instrument to reach disadvantaged groups in large numbers and to build social capital within them— particularly in a difficult and politically volatile country context, where there was little trust in government institutions. However, the evolution of the PAF into a livelihoods project, with an incomplete set of mechanisms to address the attendant risks (as discussed above), has significantly weakened its contribution to the desired outcomes (such as improving services for disadvantaged groups), or for that matter even improving livelihoods. Most importantly, there has been no evaluation of the effectiveness of PAF I before expansion. Such an evaluation and sound learning framework should have been built into the design of PAF-I. Indeed, an evaluation should at least have been undertaken before expanding the US$15 million LIL by another US$125 million to cover all 75 districts of Nepal.

Consistent with the PRSP, the CAS had envisaged strengthening local governments to plan and implement development interventions in a socially inclusive manner. The PAF did not achieve this objective. Whereas other development partners have worked with non-elected local bodies to strengthen them to deliver development interventions, the PAF preferred to function autonomously on the grounds that there were no elected local governments.

Increasing Diversity in Civil Service

A. Objectives and Instruments

Nepal's civil service has traditionally been highly exclusive and its composition has not been representative of the country's gender, caste and ethnic diversity. In the early 2000s,[48] about 97 percent of those accepted for the senior civil service ranks were Brahmins, Chettris, and Newars, even though these groups constitute only about 35 percent of the population. Only 5 percent of those recommended for recruitment were women.

The Tenth Plan/PRSP recognized that lack of voice, political representation, and empowerment are important dimensions of poverty and proposed affirmative action to level the playing field. However, it failed to present a realistic strategy and concrete mechanisms to mainstream social inclusion. In order to ensure adequate representation of women and deprived groups in the civil service, affirmative action was to be introduced. The CAS outcome objective was to support the government in putting in place a policy and implementation system for affirmative action that would improve the diversity of the civil service. Planned assistance included ongoing policy dialogue on the PRSP and proposed technical assistance to share best practice information.

B. Results

An affirmative action policy for the civil service was finally approved by the Interim Parliament in August 2007, and an implementation system is now in place. This constitutes a tremendous achievement. However, although addressing the inclusion problem, the 2007 Amendment to the Governance Act did not include safeguards regarding pay-for-performance and merit-based promotions. Without these safeguards, there is a potential risk of loss of professionalism and increased incidence of patronage and corruption.

C. The Role of IDA

IDA support to this effort consisted of policy dialogue and funding, as well as organizing a workshop to debate and discuss the benefits and risks of an affirmative action program. IDA also exercised an indirect role by placing diversity on the agenda of a wide range of public policy issues. It must be noted, however, that the law was revised only once an interim government came into place after the restoration of democracy.

Chapter 6
Progress towards Good Governance

One major Bank objective was to contribute to promoting good governance by helping the government in: (i) strengthening elected local governments; (ii) increasing the autonomy and accountability of the civil service; and (iii) promoting a more transparent and accountable public sector.

The Tenth Plan/PRSP acknowledged that improving governance in Nepal was critical both for development and for addressing grievances at the root of the Maoist conflict. Without control of corruption and leakages— as well as mechanisms to ensure accountability, the objectives of the other Tenth Plan/PRSP pillars could not be achieved.

Although significant progress had been made previously in creating institutional mechanisms and strengthening procedures to improve key governance aspects, effective enforcement of procedures and institutional arrangements remained weak. The government strategy had three objectives: accelerating decentralization to improve service delivery, with greater accountability and beneficiary/community participation; ensuring civil service efficiency; and increasing accountability and reducing corruption and leakages. Thus, IDA's assistance strategy was closely aligned with these three objectives.

Strengthening Elected Local Governments

A. Objectives and Instruments

IDA sought to support implementation of the government's decentralization policy as defined in the 1999 Local Self-Governance Act. The support consisted of ongoing technical assistance for developing a fiscal decentralization formula and a proposed decentralization support operation (FY07).

B. Results

With the suspension of local elected governments starting in 2002, decentralization has been delayed. The CAS objectives to support decentralization were highly relevant for Nepal given its own strategy, but the lack of elected local governments at the village level made it difficult to pursue the objective at this lowest tier. At the district level, local government officials were appointed by the central government to expedite vital administrative functions. In sum, decentralization could not be implemented.

C. The Role of IDA

The results of IDA support in this area were negligible. The fiscal decentralization framework was neither defined nor tested. The decentralization support operation—the only planned operation under the governance pillar—was dropped. IDA's focus shifted toward decentralization toward local facilities and communities, bypassing local governments. Other donors and the Ministry of Local Government felt strongly that the approach adopted by IDA for the Rural Water and Sanitation Projects and the Poverty Alleviation Fund (PAF) was undermining the decentralization strategy.

Increasing the Autonomy and Accountability of Civil Service

A. Objectives and Instruments

The Tenth Plan/PRSP sought to accelerate civil service reforms initiated in the early 2000s. It had three main objectives: (i) to right-size the government in accordance with the overall strategy of streamlining the role of the government and transferring responsibilities to local levels; (ii) to make the civil service efficient, accountable, and transparent and; (iii)to strengthen government institutional capacity to combat corruption. The reform program pertaining to the civil service included actions on two fronts. First, recruitment, transfers, and promotions would be merit-based, with transparent criteria backed up by an annual performance evaluation system. Second, accountability for work performance would be ensured through annual work plans and service standards together with the publication of Citizen's Charter.

IDA focused its support for civil service reform on the enactment of legislation to delineate the roles and responsibilities of senior civil servants and ministers. This was not a government priority, nor was it identified in the Tenth Plan/PRSP. This support was intended to minimize political interference in administrative and transfer decisions. Reform was to be supported through ongoing policy dialogue, proposed technical assistance and capacity building (FY05), and the Poverty Reduction Strategy Credit (PRSC) series.

B. Results

The turnover in ministerial appointments remained high, as did transfers of Secretaries and special grade and official gazetted civil servants, which nearly tripled in 2006 relative to 2005, rising to nearly 10,000 in a single year. Also in the wake of the 2007 Amendment to the Civil Service Act, 7,000 higher-level civil servants were promoted without regard to performance. Compensation practices and corruption in the civil service showed no evident improvement in 2007–08.

The objective of clearly delineating responsibilities between ministers and the civil service was not achieved. A draft bill was circulated and debated within the Executive Branch for over three years and finally approved by the cabinet in February 2006. However, it was never enacted. For final enactment, the bill required royal approval, which became moot after the King was divested of all authority in April 2006. After the Interim Government assumed power in fiscal 2006, the struggle for patronage intensified. The statement on delineation of responsibilities was viewed by the main political parties and the Interim Parliament as an undesired intrusion on their traditional privileges. As of late 2008, there was scant evidence of any remaining official interest in advancing this reform.

C. The Role of IDA

Despite strong IDA support through policy lending, technical assistance, and policy dialogue, the objective was not achieved. No lending directed specifically at civil service reform took place. However, the PRSC series was designed to support some selected civil service reforms. I In particular, the enactment of legislation delineating powers of ministers and civil servants was a PRSC-II trigger. Also, under the Economic Reform Technical Assistance (ERTA), IDA provided technical assistance for the drafting of this legislation. However, strong support from some reform-minded technocrats was not sufficient to carry out such an ambitious and politically sensitive reform. Furthermore, with the suspension of democracy, donor coordination in civil service reform deteriorated and civil service reforms became a low priority.

In the early part of the country assistance evaluation (CAE) review period other development partners, notably the ADB and DFID, supported IDA's efforts to promote civil service reform with parallel governance operations. However, after the royal takeover in 2005, development partners pulled back on their efforts to improve governance at the central government level. Instead, they emphasized expansion of service delivery directly at the district and village levels, bypassing the public administration. During 2005–06, IDA continued to press for central civil service reform, which was a source of persistent tension with other development partners, who opposed any further support for an authoritarian regime. In 2007–08, this tension largely disappeared as development partners found common ground in supporting the peace consolidation process— but with the result that civil service reform currently has low priority among development partners.

Promoting a More Transparent and Accountable Public Sector

A. Objectives and Instruments

The Tenth Plan/PRSP aimed to reduce inefficiencies in the use of public resources by improving the effectiveness of public financial management (PFM) (essentially presented as a compliance issue). Nepal already has a good institutional framework for ensuring sound financial management and accountability, including well-established regulations and administrative procedures, institutions for their enforcement. Nepal has independent auditing and reporting, and, for ultimate review, oversight by the parliament. However, these arrangements have not worked well, leading to considerable corruption, leakages and misuse of resources, and poor development results. The government's strategy to strengthen the financial management system and incentives for compliance was built on the Country Financial Accountability Assessment (CFAA) and the Country Procurement Assessment Report (CPAR) carried out in 2001/02. The key elements were to tie budgets to performance, improve financial transparency, improve accounting and auditing practices, and adopt an array of anticorruption measures, including increasing transparency in public procurement.

Consistent with its overall strategy to move toward programmatic budget support and to facilitate development assistance integration, IDA assistance concentrated on improving accountability and transparency of the public sector through implementation of key CFAA and CPAR recommendations. It also focused on the institutionalization of public expenditure tracking surveys, citizen charters, and client surveys in the public sector. Planned assistance included ongoing technical assistance for public expenditure tracking, and support for CFAA and CPAR follow-up actions as well as the PRSC series.

B. Results

Some progress was made in recent years in making budget information available to the public (through the Ministry of Finance Web site), but it is far from comprehensive. For example, the fiscal activities of many development funds and boards as well as local-level governments are covered by annual audit reports, but not by the budget itself or any other public report. In addition, transparency could be improved especially by making reports more analytical and systematic with respect to past achievements. There is no practice of making the awarding of contracts public. Moreover, from 2002 to 2005, year-end financial statements were not made available to the public as they were held by the King. Finally, the effectiveness of external oversight was limited as the activities of the Public Accounts Committee were suspended along with parliament in 2002.

Reporting by leading international agencies confirms that little improvement occurred in either corruption or public transparency between 2002 and 2007. After improving in 2002/03, the World Bank Institute (WBI) indicator of corruption control deteriorated sharply in 2004/05. It has neither improved since then nor recovered its end-1990s level (figure 2.2). The Transparency International Corruption Perceptions Index for Nepal also deteriorated in 2005 as compared to 2004, and has remained at that lower level since then.

On the main CFAA recommendations, progress has been spotty. Some progress was made in strengthening the audit capacity. A master plan and training to enhance the audit capacity of the Office of the Auditor General (OAG) were completed. But OAG's core problems persist. Its focus is on narrow regulatory compliance rather than physical implementation or impact. Further, its findings in the rest of the government have been disregarded. Significant deficiencies remain throughout the central and local government audit chain, which will require many years to fix, even in the best of circumstances. Parliamentary oversight via the Public Accounts Committee (PAC) was never revived as intended.

A Procurement Act passed in 2007 embodied many of the CPAR recommendations. It mandated: (i)open and competitive (but discriminatory) bidding on contracts above a low threshold; (ii) the creation of a new training and norms agency, the Public Procurement Monitoring Office (PPMO); (iii) the authorization of e-procurement and; (iv)an increase in sanctions for noncompliance. However, several of its provisions, such as the lack of institutional autonomy for the PPMO (nominally located in the Prime Minister's Secretariat), the low threshold for requiring that contracts be approved only by the cabinet (which is likely to slow procurement significantly), and preference for domestic and foreign-domestic bidders over solely foreign bidders, all violate internationally approved procurement practices. As of end-2008, implementation had scarcely begun, and procurement abuses worsened in 2007–08. At present, the PPMO lacks autonomy, qualified leadership, adequate budget, qualified staff, and high-level policy support, all of which are needed to make its role vital and the law effective.

Improvements in tracking public expenditure occurred mainly within the framework of roads and the health sector-wide approach (SWAp). Physical tracking has begun in addition to financial tracking. In addition, the education SWAp now reports on physical implementation and development impact. Elsewhere, tracking is done exclusively on a cash basis. By end-2008, roughly 10 percent of on-budget central government expenditures were being physically tracked, as well as 6 percent of expenditures related to development impact. Approximately one-third of public expenditures and more than half of development assistance remain off-budget.

Although a beginning has been made through the establishment of citizen charters in key departments, these have generally not brought about changes in accountability structures. The charters are largely ignored and do not reinforce a performance culture based on delivering to clients. If Nepal is to make citizen charters work, they will have to be accompanied by better systems for the redress of grievances. In addition, they will have to be better linked with individual civil servants' annual performance targets.

C. The Role of IDA

IDA support to improve transparency and accountability in the public sector has been scattered between various instruments. Therefore, it is difficult to find a comprehensive and consolidated assessment of its effectiveness in improving PFM. Moreover, IDA's CAS documents do not specify measurable targets for its assistance in this area. Some measures were supported by the PRSC series. In particular, the PRSC program supported strengthening of the Commission for the Investigation of Abuse of Authority (CIAA) and the legal power to initiate cases against all top officials was a prior action for PRSC-I. Greater transparency in public procurement is also an essential part of reducing corruption. Another prior action for PRSC-I was to amend the financial Administrative Regulations to comply with its key recommendations regarding bidding rules and procedures. The enactment of a new Procurement Law that meets international standards was a prior action for PRSC-II. Some other measures were supported by technical assistance provided under the multisector ERTA project. Both the PRSCs and the ERTA cover the four pillars of the PRS/CAS. Although the PRSC series was discontinued after PRSC-I, implementation of the ERTA is particularly slow. According to the internal project performance review, out of 27 sub-projects, only 5 had been completed since the project became effective in 2005. Completed projects include capacity building for the Financial Comptroller General's Office (FCGO) for upgrading PFM and support to strengthening the Office of the Prime Minister and Council of Ministers (OPMCM) through implementation of the Governance Act. Other measures were supported by targeted technical assistance (Institutional Development Fund [IDF] grants), including OAG Institutional Strengthening; Public Audit Reform and Capacity Building; Public Procurement Reform, and the recently approved Strengthening Institutional Capacity of the Public Procurement Monitoring Office.

IDA's ESW and policy advice on public financial management achieved some significant steps, such as passage of the Procurement Act, but has had little impact on actually improving the quality and efficiency. To the contrary, there has been some significant regression in the quality of PFM since 2005. IDA provided policy advice on PFM and some high-quality AAA, notably the 2007 Public Finance Management Review. A major collaborative piece delivered during this period (February 2008) was the first Assessment of the Public Financial Management Performance Measurement Framework. But because of high government turnover and rapid political change, IDA's advice was often ignored or rendered out-of-date.

Donor cooperation with regard to strengthening Nepal's PFM system has been adversely affected by political developments. First, the political changes, particularly the shift toward greater authoritarianism during the 2002–05 period, alienated many bilateral development partners. They shifted their assistance toward providing direct support for the delivery of key public services, rather than going through the public administration. Second, slow progress in enacting and implementing the Public Procurement Act discouraged development partners from bringing more of their aid on-budget, for fear of corruption and waste. Hence, budgetary transparency continues to be adversely affected by the reality that more than half of all donor aid is delivered off-budget, with each donor following distinct and diverse procurement procedures. Finally, since April 2006, donor attention has shifted heavily toward consolidating the peace and reestablishing democratic rule, which has left in abeyance certain central government reforms, including strengthening the country's public management system.

Were internal political and social conditions more amenable, strong cooperation on PFM reform among development partners would resume. These reforms would undoubtedly increase donor confidence in the fiduciary management of external aid. They would also meet a core principle of the Paris Declaration on Aid Effectiveness, namely that strong PFM is a prerequisite for integration of development assistance into country budget.

Chapter 7
Evaluation of IFC Activities in Nepal

Background

Nepal's economy saw some resilience through a decade of intense political turmoil, although limited growth was seen in key sectors. Following a decade of violent conflict, Nepal experienced a significant milestone with the end of the violent Maoist Insurgency in 2006, and the subsequent participation of the Maoist party in the political process. However, Nepal also underwent considerable political instability during the decade, with ten changes in government over and the longest tenure by a Prime Minister being just over two years.

The decade was also marked by events such as the royal massacre, the Indian Airlines hijacking, the dissolution of the elected government in 2002, and the suspension of the constitution in 2005. Through this difficult period, Nepal's economy experienced some resilience and positive growth. Supported by prudent macroeconomic management that helped control inflation and fiscal expenditure as well as a sharp rise in inward remittances from 4 percent of GDP in 1998 to 17 percent in 2007, GDP grew 3.5 percent a year (since 1999). Per capita income rose from US$210 in 1999 to US$340 in 2007. Growth was reflected primarily in the services sector (including transport, communications, and retail trade) which rose from 38 percent of GDP in 1999 to 50 percent in 2007.

However, other key sectors had limited growth. Agriculture declined from 40 percent of GDP to 34 percent in 2007; manufacturing from 9.6 percent to 7.8 percent of GDP; and tourist arrivals dropped by 44 percent between 1999 and 2002, before recovering to 1999 levels in 2007. Exports declined from 23 percent of GDP in 1999 to 12 percent in 2007. Foreign direct investment was minimal throughout the decade, averaging just US$4.5 million a year (compared to US$236 million a year in Sri Lanka).

A broad range of constraints need to be overcome in order for Nepal to realize its economic growth potential. Nepal offers growth potential in several areas including hydropower, tourism, agribusiness, and manufacturing. Regarding hydropower, Nepal has an estimated economically viable generation capacity of 43,000MW, of which just 600MW has been developed to date. Nepal remains an attractive tourist destination and its tourist industry showed some resilience throughout the difficult past decade. Potential exists for agribusiness development, both in the Terai and the hill areas between the Terai and the Himalayas. These regions have fertile soil and favorable climates for a range of agricultural and livestock production.

Nepal's large, low-cost labor force and access to rapidly growing Indian markets also offer some prospects for manufacturing. Large high quality limestone deposits could aid the potential expansion of the cement industry. Further potential uses of Nepal's extensive water resources such as aquaculture or bottled water production remain undeveloped.

However, a broad range of additional constraints to private sector activity arise from both Nepal's natural circumstances, as well as policy and institutional limitations that need to be overcome for it to realize its growth potential. These include: a difficult terrain with a widely dispersed population; inadequate infrastructure, including power, roads, communications, access to ports, and air links; a rigid labor regime; difficult access to international markets; limited natural resources; lack of depth and breadth in the financial sector; uncertain legal recourse for businesses; inconsistent implementation of tax, trade, and licensing policies; insecure property ownership rights; and perceptions of high levels of corruption.

IFC Objectives in Nepal, Fiscal 2000-09

The IFC lowered its objectives during the decade. Two Country Assistance Strategies and one Interim Strategy Note have been presented to the Board since fiscal 1999. None of these were joint IFC strategies, although both CASs identified IFC objectives and areas of focus in Nepal. The fiscal 1999 CAS identified the IFC's objectives as: (i) helping *establish a strong physical infrastructure* by supporting privately financed small and medium hydropower plants and the telecommunications sector; (ii) helping *reform and restructure the financial sector* by supporting institution-building and knowledge transfer through investments and advisory services in banking, leasing, and small and medium enterprise (SME) lending; and (iii) development of *industrial and tourism* projects. The fiscal 2004 CAS reiterated IFC's intention to support private investment in telecommunications, power, financial market development, SME development, and export-oriented manufacturing.

However, due to the weak security situation and political uncertainties, the IFC did not expect to make many new investments. Instead, it focused on Advisory Services through the Dhaka-based South Asia Enterprise Development Facility (SEDF). The three components of the SEDF aimed at: (i) increasing SME access to finance and business development services, improving the business environment for SMEs, and developing linkages with larger enterprises; (ii) strengthening the financial sector through the provision of technical assistance (TA), and training to banks to help introduce best practices and new products for SME lending; and (iii) supporting agribusiness and tourism through work with selected business associations in the agribusiness and tourism sectors. There was no mention of IFC in the 2007 ISN.

In retrospect, the IFC appropriately reduced its expectations, and its remaining areas of focus continued to be relevant. The IFC's objectives in the fiscal 1999 CAS turned out to be overly optimistic, reflecting the improving investment environment at the time, but underestimating the impact of the civil conflict and forthcoming political instability. As the security situation and political instability worsened, the likelihood of developing investment opportunities became increasingly remote, and IFC instead appropriately emphasized its Advisory Services as its most relevant instrument.

The areas of focus that the IFC identified also remained relevant to Nepal's development priorities. An emphasis on hydropower development was highly pertinent given the substantial untapped capacity in the sector, as well as the two successful past IFC investments that could serve as models for private small/medium hydropower generation.

The financial sector remains a promising entry point for the IFC, and there is a clear and continuing need for further development of best-practices and expanded breadth and depth in financial services. Tourism remains a critical industry for Nepal, but faces significant constraints to further development. The development of agribusiness remains an essential step in moving from primarily subsistence agricultural production toward a manufacturing base that can add value and generate employment.

None of the CASs during the review period were "joint Bank and IFC." Therefore, the IFC contribution to the CASs was modest. In both CASs, the IFC's "strategy" largely consisted of a statement as to which areas it intended to focus its investment and Advisory Services activities on. However, there was little discussion of potential constraints or risks to IFC engagement, including strategies to overcome them. In retrospect, some insight might have been provided, for example, how the IFC intended to overcome the issue of questionable or unknown sponsor quality in the banking sector that had hindered engagement to date.

With regard to the energy sector, IFC did not explicitly seek a role in supporting Nepal's hydro-power export potential during the CAS period. Although the sector has been fraught with difficulties, the IFC has a potentially important role to play in the sector. During the decade, the energy sector in India underwent considerable improvement, enhancing the prospects of power exports to Nepal. Successive governments since the 1990s have also indicated their intention to develop Nepal's hydro-power export potential and foreign investors have shown considerable interest in recent years. With the IFC's international experience in the sector, it has a potentially useful role in advising the government regarding establishing an optimal regime to both attract private investors and protect government revenues. The IFC can also support financial structuring of potentially very large projects, and provide some comfort to investors in the fragile investment environment in Nepal.

IFC Activities in Nepal Fiscal 2000-09

Investment Operations

The IFC had a very low volume of investments during the review period. The IFC made four investments in Nepal between fiscal 2000-2009, including: (i) a US$300,000 equity investment in a leasing company in fiscal 2001; (ii) two Global Trade Finance Program facilities with local commercial banks in fiscal 2007; and (iii) a US$10 million loan to a local domestic airline, Buddha Air in fiscal 2009.

In addition, three investments were active during the period under review: (i) a US$32 million loan to the first private hydropower project in fiscal 1994; (ii) a US$24 million equity investment and loan to a second hydropower project in fiscal 1996 and; (iii) a US$4 million loan to a local resort hotel operator in fiscal 1998. Each of the new investments was fully consistent with the IFC's stated CAS objectives.

However, anticipated new investments in banking, tourism, manufacturing, hydropower, and telecommunications were not realized. The volume of new investments was significantly lower than in other countries with similar levels of risk (table 7.2). To a large extent, the IFC's inability to develop investment projects through much of the decade can be attributed to the increasingly difficult investment environment. Lack of security in most parts of the country, political instability, inconsistent implementation of reforms, and increased labor unrest compounded Nepal's already very difficult investment environment. This complex environment is characterized by a lack of natural resources, inadequate infrastructure, difficult access to markets and local raw materials, and corruption.

Foreign investment remained at very low levels throughout the past decade. At the same time, the IFC faced a trade-off in expending resources on a very difficult country with limited prospects of success versus concentrating on countries with significantly better investment environments in the region. The IFC increased its attention to Nepal in 2006. Since then, two investments have been realized, several relevant advisory services have been initiated and subsequently expanded, and a promising pipeline of projects has been developed.

Table 7.1 List of IFC Investments in Nepal, FY 2000–FY09

Company	Project ID	Approval FY	Sector	Project Size ($000)	IFC Net Loan ($000)	IFC Net Equity ($000)	Total IFC Net Commitment ($000)
IFC INVESTMENTS MADE IN FY 2000-09							
International Leasing and Finance Co., Ltd.	010134	2001	Financial Sector - Leasing Services	1,100	0	297	297
Bank of Kathmandu	026083	2007	Financial Sector - GTFP	-	648	0	648
Nepal Industrial and Commercial (NIC) Bank	026084	2007	Financial Sector - GTFP	-	1,772	0	1,772
Buddha Air Private Limited	027247	2009	Infrastructure - Transport Aviation	13,500	10,000	0	10,000
PRIOR IFC INVESTMENTS ACTIVE DURING FY 2000-09							
Himal Power Limited	003848	1994	Infrastructure - Hydropower	125,700	32,049	0	32,049
Bhote Koshi Power Company Private Limited	007365	1996	Infrastructure - Hydropower	98,200	21,000	2,950	23,950
Jomsom Mountain Resort (Pvt.), Ltd.	008464	1998	Tourism - Hotels	8,000	4,000	0	4,000

Source: Internal World Bank databases, Dec. 2008.

Note: FY= fiscal year; GTFP= Global Trade Finance Program; ID= identification; IFC= International Finance Corporation.

Table 7.2 IFC Commitments in Nepal and Countries with Similar Levels of Risk, FY 2000-99				
COUNTRY	AVERAGE IICCR SCORES FY 2000-09	COUNTRY POPULATION (US$ MILLIONS)	TOTAL IFC COMMITMENTS FY 2000-09 (US$ MILLION)	IFC COMMITMENTS PER CAPITA FY 2000-09 (US$)
Mozambique	22.5	21.4	50.7	2.4
Nigeria	22.8	148.0	688.1	4.7
Uganda	23.0	30.9	174.5	5.6
Tanzania	23.2	40.4	91.8	2.3
Gabon	23.7	1.3	40.0	30.1
Nepal	24.6	28.1	12.7	0.5
Serbia & Montenegro	24.8	7.4	302.2	40.9
Ecuador	25.2	13.3	91.0	6.8
Kenya	25.3	37.5	194.1	5.2
Pakistan	25.8	162.4	796.4	4.9
Ghana	29.4	23.5	196.1	8.4

Source: Institutional Investor Country Credit Ratings (IICCR) database, MIS at end Dec. 2008.

Note: FY= fiscal year; IFC= International Finance Corporation; IICCR= Institutional Investor Country Credit Ratings.

ADVISORY SERVICES

The IFC did not have any Advisory Services from 1999-2004, but gradually expanded them after 2005. The IFC did not undertake any Advisory Services activities in Nepal between fiscal years 1999 and 2005. Following the IFC's establishment of the multi-donor regional South Asia Enterprise Development Facility (SEDF) based in Dhaka, six Advisory Services' projects were funded in Nepal (since 2005). These projects included:

- The SEDF *SME Toolkit BizMantra Project* in fiscal 2005 sought to help a local company disseminate an on-line business solutions toolkit for SMEs. The online component of the project turned out to be financially unviable. There was only limited dissemination due to inadequate access to the internet among SMEs as well as an unwillingness to pay for on-line information and services. The company did, however, use the toolkit to establish an advisory and consultancy service for SMEs and has provided services to some 45 SMEs. The company presently plans to link with a local bank to provide an integrated financial and advisory services package to SMEs.

- The SEDF/Foreign Investment Advisory Service (FIAS) *Special Economic Zones (SEZ) Project* in fiscal 2007 reviewed the SEZ regime and helped draft a new SEZ law. Although the project was a small, low budget intervention, it received a positive response from key officials in the government and succeeded in developing a broader discussion on the investment environment. Several other IFC projects to help improve the investment environment followed from this effort. Reportedly, the Nepali government has made progress in establishing an SEZ in Bhairahawa in southern Nepal. However, a SEZ law still needs to be enacted. Without such a law prospects for implementation remain uncertain.

- The SEDF/FIAS *Investment Climate Mini-Diagnostic Project* in fiscal 2007 conducted a quick assessment of the investment climate and recommended several actions. These included: (i) establishing an inter-ministerial Steering Committee for Private Sector Development (PSD) Reform; (ii) drafting a PSD Vision/Strategy; (iii) developing a public-private dialogue to manage stakeholder inputs into the reform process and generate support for reforms; (iv) developing a monitoring and evaluation system to track results of the reform program; (v) amending the legal and regulatory framework to remove ambiguities and eliminate contradictions; (vi) simplifying customs, tax, and licensing processes; and (vii) building capacity in government agencies to manage the reform process. The recommendations were well received by the government, and some initial implementation steps, including establishment of an inter-ministerial steering committee, were taken. However, further progress was interrupted by subsequent changes in government.

- The *Investment Climate Reform Program* in fiscal 2008 expanded initiatives commenced under the SEZ and mini-diagnostic projects, and opened avenues for further assistance. The initiative reflected a move to a more flexible, programmatic rather than project-by-project approach to accommodate the uncertain political commitment in various areas. To date, the project has initiated a full investment climate assessment, promoted efforts to institutionalize a public-private dialogue on investment climate reforms, and helped to design a Secured Transaction Registry. None of the components have been implemented as yet, although they have constituted an effective means of engaging officials of the new government, disseminating key messages, and stimulating debate on investment climate reforms.

- The *Banking Sector TA Project* in fiscal 2008 initiated several interventions including: (i) diagnostic studies for three local banks and support for the introduction of SME lending practices; (ii) development of a business plan and a review of legislation to help strengthen the credit information bureau; (iii) a feasibility study on establishing an Infrastructure Development Financial Institution; and (iv) support for operationalization of the Secured Transaction Registry. Results are as yet too early to assess.

- The *World Hotel Link Project* in fiscal 2009 aims to replicate a successful model developed by the IFC in the Mekong delta region in South-East Asia. The project provides SME hotel operators with an avenue to market themselves on the internet. Although the results are too early to assess, the experience with the 2005 SME Toolkit BizMantra Project, which also attempted to transfer a product developed elsewhere and relied on an internet platform, may carry relevant lessons.

Table 7.3 IFC Advisory Services in Nepal, FY 2000-09					
APPROVAL FY	PROJECT ID	PROJECT NAME	STATUS AS OF DEC. 2008	PRIMARY BUSINESS LINE	TOTAL FUNDING, US$
2005	531160	Nepal SME Toolkit BizMantra	Closed	Value Addition to Firms	149,977
2007	550245	Nepal SEZ Project	Closed	Business Enabling Environment	26,600
2007	553585	Nepal Investment Climate Mini-Diagnostic	Closed	Business Enabling Environment	95,600
2008	554927	TA for Nepal-ATF	Active	Access to Finance	470,000
2008	557305	Nepal Investment Climate Reform Program	Active	Business Enabling Environment	870,626
2009	564027	World Hotel Link	Active	Value Addition to Firms	56,000

Source: IFC; IEG database.
Note: ATF= Asia Trust Fund; ID= identification; IFC= International Finance Corporation; SEZ= Special Economic Zone; SME= small and medium enterprises;TA= technical assistance.

In sum, the IFC's Advisory Services were reactivated since 2005, but they are few in number. Their impact has been limited due largely to challenges in adapting standard Advisory Services products to the specific circumstances of Nepal, and to difficulties in securing continued government engagement and commitment as a result of political instability and frequent changes in government.

The IFC's Contribution to Private Sector Development

INFRASTRUCTURE

The IFC's investments in the first private hydropower generation projects in the country have provided reliable supply throughout a decade of political conflict. However,progress at the sectoral level has been lacking. In fiscal 1996, the IFC invested in the first private hydropower project in Nepal, a 60MW run-of-the-river project sponsored by a Norwegian group. The project involved a twenty-year purchase agreement with the Nepal Electricity Authority (NEA), after which 50 percent of the ownership of the plant would be transferred to NEA. The Multilateral Investment Guarantee Agency (MIGA) provided political risk insurance for the project.

In fiscal 1998, IFC made a further investment in a 36 MW run-of-the-river power plant sponsored by a U.S. group and local partners. A 25 year purchase agreement was established with NEA, after which 50 percent of the project would be transferred to NEA. Since signing the original agreements, the government has attempted to lower the agreed tariffs. Both projects operate under tax holidays, thereby not providing any revenues to the government. Both projects are successful: (i) together, they account for nearly 20 percent of Nepal's power generation capacity and remain the two largest private sector power generation projects in the country; (ii) both projects provided a reliable supply of electricity throughout the years of political unrest and conflict; (iii) both are financially sound; and (iv) both have undertaken adequate environmental mitigation measures and substantial community outreach programs in their local areas, including local electrification, and establishing schools and health clinics.

However, despite the good performance of the two IFC projects, the power sector overall is in a critical condition (see chapter 3 for more detail) and private participation remains small as shown in table 7.4 below. Subject to agreement on optimal tariff levels, the projects could offer a model for further development of small-to-medium hydropower generation to meet Nepal's domestic power needs.

Table 7.4 Private Participation in Infrastructure Projects, 1999-2007 (US$ million)

SECTOR	NEPAL	SRI LANKA	BANGLADESH	UGANDA	BOLIVIA	LAOS	MONGOLIA	SOUTH ASIA
Energy	39	348	518	937	1,129	2,050	0	30,247
Telecom	135	1,448	3,899	961	781	104	29	55,145
Transport	0	240	0	404	17	0	0	19,025
Water and Sewage	0	0	0	0	320	0	0	255
Total	174	2,037	4,417	2,301	2,246	2,154	29	104,674

Source: World Bank Group Private Participation in Infrastructure Database, 2008.

The IFC's recent investment in the aviation sector supports a critical domestic transportation need. In 2008, the IFC invested in Bhudda Air, the second largest domestic air carrier in Nepal. The domestic air transport industry remains highly relevant to the development of both the tourist industry, as well as local transport in the context of very limited land transportation routes in the hill and mountain areas that are unlikely to be improved in the near future. The company maintains differential pricing for locals and foreigners and has a high capacity utilization rate, with nearly 85 percent of its passengers being local Nepalis. During appraisal of the project, the IFC undertook a technical assessment of the company's operations that helped eliminate some unprofitable routes. IFC financing was used to purchase two larger, more fuel efficient aircraft to increase both passenger and cargo capacity. Although the IFC's investment is too recent to evaluate, the company remains well-managed and profitable and has a perfect safety record. Its continued operation and expansion is likely to impact positively on both the tourist industry as well as on connectivity between regions within Nepal.

The IFC was not able to make any other investments in infrastructure. Weaknesses in the energy and transport sectors remain major development constraints in Nepal. Private investment in infrastructure remained very limited over the past decade, with the private investment in infrastructure projects totaling US$174 million in Nepal, as compared to over US$2 billion in Sri Lanka over the same period.

Given the difficult overall business environment, the IFC was not able to catalyze any further investments in the power sector. Meanwhile, Nepal's hydropower potential remains severely undeveloped, with just 15 percent of the population having access to electricity (compared to 62 percent in Sri Lanka). Limited access and high levels of load shedding and outages remain major constraints to private commercial activity. Progress in the power sector was undermined by: the loss of momentum in the implementation of policy reforms;

financial stress in the Nepal Electricity Authority; suppressed domestic demand due to the limited distribution network; inadequate transmission capacity, particularly for cross-border transmission; and inefficiencies in the public-sector dominated power sector in India. Since the early 2000s, however, reforms in the power sector in India have made electricity exports from Nepal more viable.

Inadequate transport infrastructure also remains a major constraint to broad-based growth, with less than half the population currently having access to all-weather roads. Over the centuries, fertile soil and adequate rainfall led to small family subsistence settlements widely dispersed across the hill and mountain areas. The high level of dispersion across difficult terrain has severely undermined the ability of both the public and private sectors to reach the population with basic services and infrastructure. Difficult access to markets, information, and raw materials remain critical obstacles to commercial activity in rural areas. Lack of access to raw materials from rural areas constrains the development of an agro-processing industry that can link subsistence farming to a modern manufacturing industry. Access to international markets and inputs also remains cumbersome, with limited air links and a still high-cost and time-consuming cross-border route to the nearest seaport in India.

Table 7.5 Comparative Infrastructure Indicators, 2007

Indicator	Nepal	Sri Lanka	Bangladesh	South Asia	Low income Countries
GNI per capita, Atlas method (current US$)	290	1,300	480	1,107	487
Access to electricity (% of population)	15	62	20	29	28
Electric power consumption (kWh per capita)	64	297	100	210	631
Improved water source (% of population with access	90	79	74	76	64
Improved sanitation facilities (% of population with access)	35	91	39	53	38
Total telephone subscribers per 100 inhabitants	3	22	7	10	9

Source: World Bank Group Private Participation in Infrastructure Database, 2008.
Note: GNI= gross national income; kWh=kilowatt-hour.

Financial Sector Development

The IFC's efforts in the leasing sector had poor results. In the late 1990s, the IFC identified the leasing sector as an area of focus within the financial sector, given the lack of defined property rights that undermined access to finance. In fiscal 1999, an IFC review of the sector recommended several legislative changes to facilitate growth of the leasing industry. In fiscal 2001, the IFC made a US$0.3 million investment in one of the leading finance companies in Nepal that planned to focus on leasing and term lending to SMEs. The investment intended to help develop a "strong, well-capitalized and well-managed financial institution with a focus on leasing" that would in turn stimulate broader growth in the leasing industry.

However, the project did not achieve its development objectives. . There was limited progress in establishing adequate leasing regulation in the country. As a consequence, the leasing company did not expand its business and has remained too small to have a significant impact in the SME market or financial sector. The overall leasing market remains severely underdeveloped.

Since 2006, the IFC has gradually reengaged in Nepal's financial sector. In the late 1990s, the IFC endeavored to seek investments in several finance companies and banks, but none reached closure due to the questionable reputations of local sponsors and the weak financial outlook for the institutions. Not until 2006 did IFC then initiate a cautious re-engagement in Nepal's financial sector. The reengagement consisted of: (i) advisory work with several local commercial banks; (ii) a GTFP program through which the IFC familiarized itself with the banking sector; (iii) technical assistance to three banks for SME development; (iv) support to other financial institutions, including the credit information bureau, operationalization of the secured transaction registry, and a feasibility study for an infrastructure finance institution; (v) further development of the IFC's knowledge of the banking sector and relationships with several banks, including through establishment of a field office in early 2008 and; (vi) appraisal of two potential investments in the banking sector.

Although issues remain to be resolved, the pipeline and prospects for an IFC investment in the banking sector look positive. The local banks have expressed interest in establishing a strategic partnership with the IFC to enhance corporate governance, develop SME lending capabilities, and prepare for the entry of foreign banks in 2010. Participation in IFC's GTFP also helped local banks establish relationships with foreign banks. Although the banking sector has expanded rapidly over the past few years, strong concerns remain regarding corporate governance, the financial soundness of many banks, potential over-exposure to housing and equity market bubbles, and lack of lending to SMEs and regions outside Kathmandu.

TOURISM

The IFC's investment in the tourism sector was not successful and a range of challenges remain in the sector. In fiscal 1998, the IFC invested in a 100 room 3 star hotel project in the Annapurna region of western Nepal. Since commercial operations began in the year 2000, the hotel has had very low occupancy (about 10 percent) and has never been profitable. The project was affected by the overall drop in tourism as a result of a number of factors, including: the worsening security environment; a reduced number of tourists to the remote Annapurna region in particular; cumbersome air access, involving two flights from Kathmandu, including one in an un-pressurized aircraft; difficult access to the hotel from the airstrip; and the very limited market of higher-end tourists to the region to which the hotel had priced and marketed itself.

Overall, although Nepal's tourist industry had some resilience throughout the decade, it continues to face major constraints. Tourist arrivals declined from 490,000 in 1999 to 275,000 in 2002, but have since recovered to over 500,000 in 2007. Tourists have been largely younger, solo, lower-end tourists (government data). Successive government strategies have expressed a desire to increase the proportion of higher-end and family-unit visitors. Key constraints include: lack of up-market hotels outside the Kathmandu area; lack of major road transport routes; limited international air links; weak connectivity from local airstrips to the surrounding regions; lack of other supporting infrastructure such as communications and health facilities; inflexible labor regulations that discourage formal sector employment; and a cumbersome licensing regime for establishing private hotels. The Travel and Trade Competitiveness Index ranks Nepal 122 out of 130 countries with respect to the adequacy of the business environment and infrastructure for the tourist industry, with particularly low rankings for transport and information and communication technology infrastructure.

Business Enabling Environment

Policies to improve the business environment during the decade were undermined by political instability. The government introduced a range of policies to improve the business climate and encourage foreign investment, including opening sectors such as telecommunications and aviation to foreign investment, simplifying business licensing, and commencing reforms in the financial sector. However, the lack of political stability undermined implementation of these reforms. Key positions such as the Governor of the central bank and ministerial secretaries remained unfilled for extended periods. Frequent ministerial turnover resulted in inadequate delegation of authority to the civil service, and a gap between policy formulation and implementation. Limited rule of law, particularly outside Kathmandu, also affected the operation of businesses. Increased labor union activity added to already cumbersome labor regulations. This severely affected business operations and caused several large multinational firms to suspend or reduce production. Governance indicators declined significantly over the decade. The end of the violent conflict and increased prospects for political stability offer some promise for positive measures to be implemented. The current government has also made clear indications that it intends to promote the private sector and attract foreign investment into the country.

The IFC's engagement with respect to the investment climate has expanded since 2006, but results have yet to be seen. Although periodic attempts were made to initiate a dialogue on the business enabling environment after 2002, the IFC did not develop any activities between 1999-2006. Following the IFC's re-engagement in the financial sector in 2006, the IFC began a series of activities, commencing with a small low-budget diagnostic review of the SEZ regime that was subsequently expanded into a broader World Bank/ IFC investment climate reform program.

The SEZ review addressed a major area in the investment climate that generated a positive response among key parties in the government. In the context of very limited access to infrastructure, SEZ's are likely to play an important medium-term role in providing investors with fully-serviced locations. Proposed SEZ legislation has embraced several best practices recommended by the IFC, including reducing the export requirement for SEZ tenants. Both the Bank and the IFC are providing further assistance to support the establishment of SEZs. The subsequent mini-diagnostic identified several areas that need to be addressed and elicited a positive response from the government, including the establishment of an inter-ministerial steering committee. Although further implementation was interrupted by changes in government, a dialogue has since been established.

The IFC's initiative to institutionalize a public-private dialogue also reflects best practice in other parts of the world, although to date, there has been no clear consensus as to its implementation. Although substantive improvements in the business environment from the IFC's interventions have yet to be realized, the IFC's engagement has helped in developing relationships with key officials, identifying reform champions, and furthering its country knowledge-base. The current government has also given clear indications that it intends to encourage development of the private sector and attract foreign investment.

IFC Additionality

In the difficult country context, the IFC activities have retained broad additionality in Nepal. Given weak local markets for investment finance, lack of foreign investment, a degree of political risk associated with a Maoist government, and an unattractive overall investment environment, the IFC retains broad additionality in Nepal. Along with its provision of longer-term finance in a constrained local market, the IFC's limited number of investments served an important "hand-holding" function in the difficult investment environment. It also helped to strengthen corporate governance, and improve practices in technical, managerial, as well as environmental, and social areas.

The two power sector projects were the first private generation projects in Nepal. They were implemented in the context of a still new regulatory environment for private participation, frequent political changes, and an increasingly uncertain security situation. The IFC's participation played a key role in securing government performance guarantees that were critical to the feasibility of the projects. Although the domestic airline in which the IFC invested in 2008 was a well-established and managed operation, it is, nonetheless, an investment in a high risk industry in a still uncertain political and business environment. According to the company Chief Executive Officer, the IFC was able to bring useful operational advice to the company based on international practice. IFC advisory services in the business climate in 2006 helped fill a void in donor activity

IFC Performance

Although the IFC's activity in Nepal was minimal until 2006, it has been cautiously reengaging in what is still a challenging business environment. As with many countries with difficult investment environments, the IFC faced a trade-off between investing significant resources in Nepal in efforts that were unlikely to be productive versus deploying its resources in more favorable investment climates.

In Nepal, as the political and situation deteriorated after 1999, the IFC withdrew its local staff presence in 2000 and its subsequent activities were minimal. Only in 2006, did the IFC begin a cautious reengagement in Nepal. Key steps included: (i) the mapping of potential clients in the financial sector and development of GTFP facilities that enabled the IFC to develop its knowledge base and build relationships in the sector; (ii) engagement in the investment climate (where no other donors were active) through small diagnostic studies that helped establish relationships with government counterparts and disseminate core messages; (iii) subsequent expansion of programs in the investment climate, including promotion of a public-private dialogue; (iv) expansion of engagement in the financial sector through Advisory Services with several financial sector institutions; and (v) establishment of a single-person field office within the World Bank office in Kathmandu through which the IFC has been enhancing its familiarity with key parties and building relationships.

The gradual engagement resulted in an investment in a domestic airline in 2008 as well as the development of a pipeline of investment projects in the financial sector. Current and prospective clients have noted the change in the IFC in Nepal between 2006 and 2008, and express appreciation for the IFC's increased local presence. On the advisory side, the IFC remains an active advisor with respect to several key areas of the business climate. The IFC has also made efforts to coordinate its work with the World Bank, particularly in the power and financial sectors, and investment climate reform. The forthcoming CAS/ISN is expected to be joint document with the IFC for the first time. Although the impacts of these activities remain to be seen, the IFC is in a better position to make a contribution to Nepal's private sector development subject to continued political stability and government commitment to creating an investor-friendly environment.

Lessons and Challenges

- **The IFC's cautious reengagement in Nepal since 2006 illustrates an approach for engagement in challenging environments that can be applicable to other post-conflict countries**. Key steps included: (i) development of GTFP facilities with local banks that limited risks to the IFC, enabling it to develop its knowledge base and build relationships in the financial sector; (ii) expansion of engagement in the financial sector through advisory services with specific financial sector institutions; (iii) initial engagement in the investment climate through small diagnostic studies that helped establish relationships with government officials and disseminate core messages; (iv) expansion of programs to improve the investment climate around areas in which clear government commitment exits and; (v) establishment of a small representative field office to cover both investment and Advisory Services' activities to enhance familiarity with the country and build key relationships. In the case of Nepal, the strategy helped the IFC move from: minimal engagement to realization of several investment projects; a constructive dialogue with the government on business enabling environment issues; and a potentially influential position on the forthcoming reform agenda.

- **There is an opportunity for the IFC to support development of Nepal's hydropower resources for both the domestic and export markets.** The current government has indicated its priority to develop Nepal's hydropower capacity through both public and private investment for the local and export markets. The two successful hydropower projects that the IFC helped finance represent viable models for further development of hydropower resources for the local market. Although the government has not obtained revenues from these operations, they have provided reliable power supply to the national grid without public investment. At the same time, the IFC has a potentially important role in helping Nepal establish an optimal regime for private development of hydro-power for export. It can also help structure potentially very large transactions, and provide some comfort to investors in Nepal's still fragile investment environment.

- **With an opportunity for IFC Advisory Services to play a potentially influential role in improving the investment climate, a clear challenge will be to sustain the relevance, responsiveness, and quality of IFC Advisory Services.** The IFC's engagement in the business enabling environment over the past several years has placed it in a position to enhance its influence on the reform agenda. The government has actively sought IFC engagement in some regulatory reform initiatives. A clear challenge for the IFC will be to: focus its activities on the most relevant interventions; sustain a high quality level of outputs; and ensure an adequate level of responsiveness in the context of a limited field presence in order to enhance its impact on the reform process. Continued integration of the IFC's business enabling environment activities into the World Bank's broader support for private sector development is likely to be critical to enhancing the impact of the IFC's activities.

- **With several other donors beginning engagement in business climate issues, a further challenge for the IFC is to fully coordinate its efforts to reduce duplication and conflicting messages.** The IFC and the Bank have established a coordinated effort to support improvements in the business climate. In the meantime, there are some instances of less coordination with other development partners. In one case, the IFC established an initiative to build a public-private dialogue along the lines of successful experiences in Vietnam and other countries. Another donor commenced a parallel public-private dialogue initiative, causing some confusion among government counterparts. A clear challenge for the IFC, then, is to build close relationships with other development partners to maximize the overall impact of development institutions on Nepal's investment climate.

In the context of a broad array of needs and a fluid political environment, a programmatic rather than project-by-project approach to Advisory Services is more relevant. The IFC's initial Advisory Services project interventions contained logic models that identified outcomes and impacts that proved to be highly unrealistic for small, quick projects, and were of questionable relevance. Although the projects made useful contributions, a range of external factors or unrealized assumptions impeded realization of the outcomes and impacts identified. In the context of a broad array of weaknesses in the investment environment, each of which might warrant support along with varying political commitment to different initiatives, a project by project approach limits flexibility. It also remains highly unrealistic to attempt to attribute impacts and outcomes to small individual projects, given Nepal's broad outstanding reform agenda. The IFC has since moved to a longer-term, more programmatic approach for Advisory Services programs in both the business enabling environment and the financial sector that allows for more flexibility as well as a more realistic assessment of their expected impact on the investment environment.

Chapter 8
Assessing the Bank's Contribution

This chapter assesses the Bank's contribution to Nepal's development effort during the fiscal 2003-08 period by reviewing the overall relevance and efficacy of Bank assistance. In the difficult and unpredictable circumstances experienced by Nepal during the evaluation period, formulating and implementing an effective development assistance strategy and programs were great challenges for the Bank.

The Bank strategy was broadly relevant to Nepal's long-term development objectives and based on sound diagnostic and analytical work. However, it was not realistic given the country circumstances. Although it is unclear which more realistic and conflict-sensitive approaches would have worked better, it is clear that a more realistic approach might have had a greater chance of success. Moreover, although it soon became evident after the 2003 CAS inception that the strategy could not be implemented, the Bank failed to adjust and continued to focus mainly on long-term development goals.

Only recently (fiscal 2008), the Bank significantly shifted its program to the most successful areas, in particular basic services. Due to these shortcomings, key elements of the program were not or could not be implemented as intended and key outcomes of the assistance were not achieved. Hence, the Bank was effective only in some areas, particularly basic services, and overall efficacy was low measured against stated outcome objectives. Relative to its stated objectives and outcome targets, the outcome of Bank assistance during this period would be rated ***unsatisfactory***. However, given the 2003 CAS's explicit recognition that only two-thirds of IDA's objectives and outcome targets would realistically be met, the adjusted rating is ***moderately unsatisfactory***.

Relevance

The relevance of Bank assistance refers to the extent to which the Bank provided the right kind and mix of assistance to support the country's policy and reform agenda as spelled out in the Tenth Plan/PRSP, and as the Bank responded to changing circumstances. In its assessment of relevance, the CAE has considered the design of Bank strategy, its alignment with government programs, and the appropriateness of Bank interventions.

Coverage/Design. The formulation of Bank strategies and supporting programs during the period reflected strong client orientation and emphasized strong technical quality. It was appropriately tailored to addressing the most binding constraints to Nepal's longer-term development and poverty reduction. Actual coverage during implementation was more uneven. Several planned studies and operations were dropped, discontinued, or significantly delayed because: (i) the government was not in a position to meet the policy requirements (PRSC series), or (ii) the government could not implement the policy the Bank was committed to support (decentralization and to some extent higher education) or (iii) there was internal Bank management disagreement on the appropriate sector strategy to support (agriculture) (appendix tables A4 and A5).

The CAS was grounded in the Bank's traditional areas of expertise and experience, such as broad-based growth and social development. However, it was less adaptable for innovations, in particular social inclusion. The Bank did not have a clear analytical framework for addressing the complex and acute problem of social exclusion in Nepal. Social inclusion is not only about poverty, it is also about assets, skills, social networks, capacity, and institutional rules and organization that cause social exclusion.

Over the evaluation period, the Bank used the terms social and economic inclusion (poverty) interchangeably and tried to address both objectives using the same instruments and approaches. As a result of this confusion between social and economic inclusion, target groups were ill-defined. The CAS suggests that the focus of social inclusion is on Dalits, indigenous peoples (Janajatis), and women but then refers to "poor and marginalized groups," "disadvantaged ethnic groups," "indigenous groups," "disadvantaged rural groups," and "poor and deprived groups." This confusion seems derived from the Tenth Plan/PRSP that equated social inclusion with "mainstreaming the poor in development." Moreover by grouping these people together, the IDA strategy failed to acknowledge that because the factors driving the social exclusion of these groups are different, addressing social inclusion required specific inclusion strategies (box 8.1).

Box 8.1: Social Exclusion Factors in Nepal

By lumping together socially and economically disparate excluded groups under the umbrella of disadvantaged groups, the Bank support failed to recognize the significantly different historical and political economy issues that cause social exclusion—the focus being on one predominant outcome of such exclusion—poverty—rather than the causes of such exclusion:

- For Dalits, exclusion comes from the traditions associated with the caste system
- For women, patriarchal traditions and cultural practices have significantly limited their access to economic resources and restricted their ability to interact with the outside world
- For Indigenous People/Janajatis, important factors included loss of ancestral land and traditional ways of life, consequent migration to urban areas seeking livelihoods, loss of language and culture, adverse impact due to environmental degradation, and loss of traditional or indigenous methods of healing (as recognized by OP 4.10).

IDA may have adopted such a strategy because greater focus on social characteristics in identifying disadvantaged groups— without considering economic status— may have been seen as inequitable. It would have meant excluding economically disadvantaged poor who are socially "advantaged" (such as poor Brahmans and Chhetris in some areas). However, the pro-poor strategy adopted by the Bank was inadequate to achieve its stated and rather ambitious objective of bringing poor women, Dalits, and Janajatis into the social and economic mainstream.

The Bank's approach to governance was also not well specified and integrated. First, it was not built on a comprehensive and thorough analysis of Nepal's governance problems. It did not benefit from an analysis of the specific political and institutional impediments to improving governance, as well as the reasons for failure of past attempts. Probably as result of the previous shortcoming— although bad governance was considered the major impediment to development in Nepal by both the Tenth Plan/PRSP and the CASs— the Bank approach was not specified in Bank CAS documents.

The CAS outcome objectives were very general, and no concrete performance indicators were identified (for example, there was no concrete benchmark defined against which to assess the CAS objective of improving transparency and accountability). As a result, governance problems were to be addressed on a rather piecemeal basis, almost as separate capacity building projects (for example, technical assistance for the MTEF, procurement reform, the audit function, strengthening the PAC, and capacity building for the CIAA, and poverty monitoring and evaluation).

Little consideration was given to the political economy of such reforms, and the constraints imposed by the challenging institutional environment. For instance, introducing output-based budgeting through an MTEF to improve the link between public expenditure and development results was highly unlikely to succeed as long as the incentives in the public administration would remain dominated by patronage, politicization, and compliance with rules and regulations.

Finally, it is important to consider to what extent governance reforms could successfully be implemented in a country where democratic institutions had been suspended and the legitimacy of the state was being challenged both by a widespread armed conflict and political opposition. In sum, the lack of vision of both the government and the Bank approaches to governance reforms was not conducive to successful implementation.

IDA's assistance strategy was also ambivalent regarding its approach to state building, which remained largely opaque. For example, IDA was leading a major joint government-development partner effort to implement the Education for All (EFA) through government systems. However, the rationale for supporting some selected community-managed schools under the Community Schools Support Project (CSSP) was based on the analysis that the state was unable to improve the quality of education. Also, both the Rural Water Fund Board and the PAF are operating like Project Implementation Units that bypass government administration. Finally, although the government devolution and decentralization policy, as defined in the 1999 Local Self-Governance Act, could not be implemented given the lack of elected local governments, IDA bypassed local bodies and pressed on with its own decentralization approach in primary education and health.

Alignment. The Bank is to be commended for closely aligning its programs with the government's objectives as defined in the Tenth Plan/PRSP. Bank assistance made an effort to promote government ownership of the programs through which it was to be delivered. However, the Bank was not able to secure a strong commitment to reforms and programs from the authorities beyond a handful of reform-minded technocrats in Kathmandu. Clearly the constituency for reform was very thin, and implementation was hampered by a persistent lack of political will both inside and outside of the public sector. At lower levels of the civil service and among political appointees, support was decidedly weak. For example, many middle-level civil service officials considered work on CAS-related growth reforms like the MTEF as "extra duty," and would only attend meetings if paid a "meeting allowance." Other examples include royal and court interference with the pursuit of the large willful defaulters, and line ministry gaming of the system for prioritizing public investment projects.[49]

Outside of the public sector, stakeholder support was also mixed. Labor unions vehemently resisted labor reforms that would have made hiring and firing more flexible and disrupted workplaces with violence, threats, kidnappings, and extortions, which adversely affected the investment climate. Public support for privatization and raising the price of oil products was also noticeably low.

Realism. Although the Bank's assistance strategy was relevant to Nepal's long-term development challenges, the program was not always cognizant of country circumstances. First, some prerequisites for successful implementation of difficult and politically sensitive structural reforms were not met. These include the lack of political and administrative stability, security, enforcement of the rule of law, and state legitimacy. For instance, security and political stability is a prerequisite for any domestic or foreign investment to take place.

During the CAE period, the most immediate binding constraint to private sector investment was not the one identified in the CAS and considered as a trigger in the PRSC program. Rather, the biggest constraints were insecurity, deteriorating law and order, and frequent strikes and work stoppages that paralyzed day-to-day activities in many areas. As evidence of this, whereas the World Bank Institute (WBI) Regulatory Quality indicator remained quite stable over the period, private investment declined. As noted in chapter 2, the visibility, predictability, and stability prerequisites for successful implementation of a medium-term programmatic reform agenda such as the one proposed under the PRSC series were not met. In addition, key political elites strongly opposed some sub-components of the growth strategy. The Ministry of Agriculture, labor unions, customs, and supporters of the King, all stood to lose influence and rents from reliance on the 1995 Agricultural Perspective Plan, more vigorous pursuit of large defaulters, and labor law reform. The few technocrats who supported these reforms were soon forced out of government, after which the reforms lacked champions. Finally, in the context of intensification of the Maoist Insurgency and related deterioration of the security situation and loss of government control, the restoration of security took precedence over the economic reforms.

Second, the reform program supported by the Bank was overly ambitious given the institutional capacity constraints of Nepal even in peace time, let alone during such upheavals. For instance, the Bank PEM/PFM focus on introducing output-based budgeting was overly ambitious technically, particularly in a conflict environment. More focus on measures to facilitate budget implementation through integrated, computerized PFM systems may have been more effective. The armed conflict, political instability, and an administrative environment characterized by a very high turnover were not conducive to effective implementation of development programs (numerous delays in decision-making and implementation), let alone complex and politically sensitive structural reforms.

Third, some reforms supported by the Bank, although economically and technically sound, were not conducive to conflict resolution and were strongly opposed. Therefore, it was probably not reasonable to expect the government to implement them. For instance, the labor law reform was clearly not a priority, and was doomed to alienate workers and bring further deterioration to the business environment.

Fourth, the Bank underestimated the impact of the conflict and the political and administrative instability on project implementation. There were many reasons for the delays in decision-making and implementation, including : the conflict and related project staff security issues; lack of or intermittent access to project sites; and high turnover in Ministry-level officials, key civil servants and project staff. Many projects suffered serious disbursement delays.

Efficacy

Failure to account for the particularities of Nepal's situation during the review period goes a long way toward explaining the Bank's assistance low efficacy—that is, the extent to which it achieved the targeted outcomes. The exception is for social development and to some extent to social exclusion.

Bank assistance in basic services delivery, primary education, health, rural water supply and sanitation— and in reducing social disparities in access in the same sectors— were characterized by substantial efficacy. Except for telecommunications and improving road infrastructure, efficacy was weak on interventions supporting broad-based growth, including support to the private sector and agricultural development. Efficacy was also negligible for governance. To a large extent, the outcomes reflected varying government commitment to reform and capacity to implement given the country circumstances.

What went right? Bank assistance during this period achieved its objectives in basic service delivery and social inclusiveness of these services. Enrollments in primary school significantly improved, particularly for girls, Janajatis, and Dalits, and regional disparities decreased. Bank support to public health services contributed to the expansion of outreach, particularly in rural areas. Bank support also led to improved access to essential health care services, including for the poor and disadvantaged population. This progress in health services delivery had a sustained positive impact on health outcomes over the CAE period, and most inequalities based on gender, caste, and ethnicity declined. Despite delays, access to safe drinking water and sanitation services has increased in rural areas, including for the socially excluded populations. Access to safe water was almost even across wealth quintiles in the 2006 DHS.

IDA support to road infrastructure contributed to increased connectivity, though significant initial progress gave way to a sharp deterioration in road maintenance and conditions after 2006. IDA support to the telecommunications sector reform helped increase competition and reduce tariff rates as well as improve connectivity, which had important economic benefits.

What needed improvement? IDA support to creating fiscal space with the view to increased public investment in growth-enhancing sectors, as well as improving the effectiveness of these investments yielded few sustainable results. IDA's strong support to establishing output-based budgeting and monitoring did not lead to sustainable outcomes, except in the education and health sectors, which were supported with sector-wide programmatic approaches. Pro-poor expenditure in education and health did increase, but overall public investment decreased by 2 percentage points of GDP over the period. Little progress was achieved in rationalizing the SOE sector and reducing their fiscal burden.

IDA-supported reforms to improve the investment climate were not implemented (for example, more flexible labor laws and liberalization of business support services). Strong and assiduous support from the Bank to restructure and strengthen the financial sector yielded some gains. However, these gains are at risk and envisaged reforms could not be taken to their conclusion. The objective of improving the Central Bank's effectiveness in performing regulatory and supervisory functions was not achieved. After significant progress during 2003-04, the momentum was lost as the Central Bank Governor was sidelined by a series of corruption allegations that undermined the authority of the Central Bank to perform its regulatory and supervisory functions. Although significant restructuring of the two main state-owned commercial banks took place, the objective of privatizing or liquidating them was not achieved.

The objective of improving power company efficiency and increasing private sector participation has not been achieved. Power shortages have reached unprecedented levels. In late 2008, the NEA was supplying on average only 4.5 hours of power daily, a significant deterioration compared to the early 2000s. The envisaged assistance program in agriculture, designed to improve the enabling environment for agriculture factors and output markets and ultimately increase agriculture productivity and farm incomes, could not be implemented. Difficulties resulted in part due to internal Bank management disagreement on the strategy. This was a major failure given the centrality of agriculture in Nepal's economy and in the livelihood of a majority of Nepalis.

None of the Bank efforts in governance, whether in supporting implementation of the government decentralization policy or increasing the autonomy and accountability of the civil service or in promoting a more transparent and accountable public sector, yielded any significant and sustainable result. This was largely due to the fact that the envisaged reform measures were not taken. The decentralization policy was not implemented because the local elected governments had been suspended since 2002. Despite intense Bank support, the legislation delineating the responsibilities between the ministers and the civil servants was never passed. In the area of public sector transparency and accountability, the most promising improvement was the enactment of a Procurement Law in 2007 that meets some of the international standards. However, effectiveness will depend on implementation, which does not seem to be a government priority.

Overall Assessment

In order to rate the overall contribution of the Bank's assistance to Nepal's development effort during the review period, it is necessary to rank the various outcome objectives of Bank assistance and assign weights (see appendix H). The most important objective highlighted in the Bank's strategy was improving governance. However, judging from its low share of Bank assistance, it has not been given priority. Based on the share in planned lending, the major objective of Bank assistance was the acceleration of broad-based growth (64 percent), followed by social development (22 percent), and social inclusion (12 percent), The share of good governance was only 2 percent of the base-case lending program.

Broad-based Growth

The actual performance of the economy fell short of expectations. Real GDP growth averaged about 3 percent during the FY 2003-08 period, as against 6.2 percent projected in the Tenth Plan/PRSP. The government maintained prudent macroeconomic management, in particular fiscal discipline, which likely helped to keep economic growth above 3 percent. It is unclear how much these achievements can be attributed to the Bank rather than to the IMF.

Creating fiscal space. The Bank took the lead in the effort to improve the quality of public expenditure through policy advice and technical assistance with the goal of establishing output-based budgeting. This yielded some positive results in the early part of the review period and allowed for an increase in pro-poor expenditure, particularly for education and health. However, the MTEF has not been used for public expenditure management since FY06. Negligible progress was made in restructuring the SOE sector and reducing the budget drain. Based on IDA's failure to establish an improved public expenditure management system and its inability to create the fiscal space to increase both social expenditure and public investment, the outcome of IDA support to improving public management is rated *unsatisfactory*.

Private sector development. The Bank sought to foster private sector development through support to improve the investment climate, strengthen the financial sector, and improve infrastructure services. Satisfactory progress was made in telecommunications and some progress was made in expanding road access (with other development partners). None of the other stated outcomes in the CAS were achieved. Despite strong and steady support from the Bank, Central Bank regulatory and supervisory effectiveness has improved little, and the restructuring of the two main loss-making commercial banks has not been completed after seven years. Moreover, although the CAS has sought either privatization or liquidation of these banks, their disposition is now uncertain. Private investment failed to achieve the expected recovery, hampered by the impact of several factors, above all the country's conflict, political instability, and uncertainty. Also, exports stagnated, access to financial services declined, and access to power deteriorated sharply. The outcome for IDA assistance during the CAE period is rated *unsatisfactory*.

Pro-poor agricultural development. Although the Tenth Plan/PRSP had identified agricultural development as a priority for reinvigorating income and employment growth in rural areas, the planned Bank support to agricultural development was not implemented. Given the centrality of agriculture in improving the living conditions of the poorest, the failure to support agricultural growth constitutes a major setback to the overall growth and poverty reduction goals that were at the heart of IDA strategy. The outcome for IDA assistance to agriculture is rated *unsatisfactory*.

Overall because of the limited relevance of IDA's strategy and very low efficacy, the outcome for IDA assistance to broad-based growth is rated *unsatisfactory*.

Social Development

IDA's support was well-aligned with the government's main objective of increasing the access to and quality of basic services, and to also reducing disparities.

Primary Education. Enrollments increased significantly and the population of out-of-school children of primary age declined dramatically, particularly for girls and marginalized populations. However, there was little progress regarding the quality of education. The Bank's strategy relied on the assumption that community school management would be sufficient to increase education quality, and that community school management committees would be able to monitor quality. This assumption remains untested as the evaluation of the pilot was delayed. The outcome for primary education is rated *moderately satisfactory*.

Health. IDA assistance helped the government meet several of its goals for extending access to health services and reducing social disparities with respect to access. IDA's intervention in health through the SWAp has been successful in scaling-up cost-effective public health services that are credited with contributing to sustained improvement of health outcomes over the CAE period. Therefore, the outcome of IDA' assistance in health is rated *satisfactory*.

Access to safe drinking water and sanitation services in rural areas continued to improve during the CAE period and disparities were reduced. IDA support facilitated some improvements in access to safe drinking water and sanitation and social inclusion, but in the absence of a sound sectorwide monitoring and evaluation system, IDA's contribution cannot be firmly established. Moreover, IDA support has not been successful so far in achieving sectoral institutional reforms. The outcome of IDA's support in rural water supply and sanitation is rated *moderately satisfactory*.

On balance, given IDA's support to education represented more than half of total IDA resources allocated to social development, including 20 percent for higher education, the overall outcome for social development is rated *moderately satisfactory*.

Social Inclusion

Mainstreaming social inclusion in IDA projects. Through its lending, IDA helped improve access to basic services for those who were excluded based on gender, caste, or ethnicity. The efforts were especially effective in education, and to a lesser extent in the health and water and sanitation sectors. The outcome for mainstreaming social inclusion in IDA's portfolio is rated *satisfactory.*

Increased public funds used by disadvantaged rural groups for services. In the 2003 PRSP/CAS, the PAF was initially expected to support integrated infrastructure development (drinking water, small irrigation, schools, health posts, and trails) for the most disadvantaged communities in remote rural areas, including the socially excluded. It also aimed to strengthen the capacity of local institutions and help the government to better coordinate targeted support to these populations. The PAF successfully channeled money to socially excluded people, and promoted the participation of disadvantaged groups in development planning and implementation in a politically volatile and challenging situation. This led to some positive results in reaching disadvantaged groups, for example, in increasing the income of many beneficiaries and inculcating a savings habit among some beneficiary communities. Contrary to plans, however, the bulk of its financing was directed at private goods, mainly livestock. This shift was made without any real consideration of the risks of such interventions or of the project design factors that led to successes in other livelihood projects in South Asia. Also, it did not have the envisaged institutional development impact. Moreover, in the absence of systematic tracking of outcomes, there is thus far little hard evidence that it has been an effective instrument for poverty reduction, and that it has promoted greater empowerment and social inclusion. Partly as a result, other development partners have been reluctant to participate. On this basis, the outcome of IDA support through the PAF is rated *moderately unsatisfactory.*

Improving the diversity of the civil service. IDA's outcome objective was achieved with the approval of an affirmative action policy for the civil service in 2007, a tremendous achievement. IDA supported the introduction of this policy both directly and indirectly. However, the 2007 Amendment to the Governance Act did not include safeguards regarding pay-for-performance and risks of political interference. Given IDA's relatively limited contribution in achieving this outcome and the potential negative impact of the policy on civil service efficiency, this outcome rating is *moderately satisfactory*.

Overall given the weight of IDA resources allocated to the PAF (the only IDA operation specifically targeted to this CAS Pillar) and the limited relevance of the design of this pillar, the overall outcome rating is *moderately unsatisfactory*. When assessed according to IDA-DFID Gender and Social Exclusion Assessment framework, the outcome rating for this pillar is still *moderately unsatisfactory* (Box 8.2).

Box 8.2: Assessing the Outcomes of IDA Assistance to Social Inclusion According to the IDA-DFID Gender and Social Exclusion Assessment Framework

Given that the CAS was not based on a sound analytical framework, IEG reviewed IDA's support to social inclusion using the framework provided in the IDA-DFID study on Unequal Citizens, Gender, Caste, and Ethnic Exclusion in Nepal, 2006. The report notes that there are three domains of change where the state, civil society, and development partners can intervene to ensure the following for the socially excluded:

- Access to livelihood assets and services
- Ability to exercise voice, influence and agency and
- A more equitable opportunity structure with "rules of the game" that allow all citizens to participate on the same terms in the life of the state and larger society, as well as in their access to livelihood opportunities and political influence.

Access to livelihood assets and services: moderately unsatisfactory

Although the objectives were highly relevant in the Nepal context, the relevance was significantly reduced because the Poverty Alleviation Fund, the main instrument for social inclusion, operated primarily as a safety net transferring cash to individual households to finance private goods (livestock). It contributed little to increased services (public goods) for socially excluded groups (the main objective). It also did not help to strengthen services to disadvantaged groups as envisaged in the CAS or the PRSC-I. The PAF does not assess the sustainability of the assets created by such cash transfers, and field visits suggest that in the majority of the cases, the returns are inadequate to raise people out of poverty.[50]

Ability to exercise voice, influence, and agency: moderately unsatisfactory

Relevance was high, but eventually decreased due to a lack of targeting. Efficacy was modest. Through the PAF, Bank support provided Dalits, Janajatis, and women with an opportunity to organize themselves into community groups. However, such approaches gave them some voice and influence only over their own activities, mainly for women. It did not help to strengthen their voice in negotiating with the powerful elite in communities.

More equitable opportunity structure: Moderately Satisfactory

On the positive side, IDA and DFID jointly produced a seminal piece of analytical work on social inclusion that has contributed to the overall understanding of social inclusion issues in Nepal. This work also influenced the 2003 PRSP. Affirmative action for diversity in the civil service was achieved (approved by the Parliament in August 2007), and an implementation system is in place. On the negative side, the CAS aimed to support decentralization by strengthening local governments through the PAF. Unfortunately, this objective was not achieved. The PAF did not work with local governments or contribute to strengthening them. Other development partners and the Ministry of Local Government felt strongly that the approach adopted by the Bank for the Rural Water and Sanitation Projects and the Poverty Alleviation Fund had undermined the decentralization strategy. Thus, Bank support did not help to strengthen local governments with respect to social inclusion in a sustainable fashion.

Overall, IDA support targeted and reached the Dalits and Indigenous Peoples, as well as women. However, there is no evidence that it contributed to providing sustainable livelihoods that could help to raise these households above the poverty line in the medium term. These groups obtained improved access to services in rural water and sanitation and education (although the quality of education did not improve and completion rates are not assessed), and are likely to benefit from recent interventions in the health sector. However, empowerment of disadvantaged groups is weak, and Bank support had little or no influence in helping them address social constructs and identities that have left them disempowered them for several centuries. At the community level, the overall rules of the game remained the same. The only difference was at the civil service level. Given the weight of the PAF in this pillar, the outcome for social exclusion is rated *moderately unsatisfactory*.

Source: World Bank, DFID.
Note: CAS= Country Assistance Strategy; DFID= Department for International Development (United Kingdom); IDA= International Development Association; IEG= Independent Evaluation Group; PAF= Poverty Alleviation Fund; PRSC= Poverty Reduction Support Credit.

Good governance.

Decentralization. The objectives of IDA's strategy in supporting decentralization were highly relevant, but given the political context and the fact that local elected governments had been suspended since 2002, none of the objectives could be achieved. The outcome of IDA assistance, therefore, is rated *unsatisfactory*.

Autonomy and Accountability of the Civil Service. IDA's objective of improving the autonomy and the accountability of the civil service was not met. Little, if any improvement occurred over the CAE period. Moreover, as noted above, the 2007 Amendment of the Civil Service Act may have had unintended adverse consequences. Overall, the outcome of IDA's support to civil service reform is rated *unsatisfactory*.

Accountability and Transparency of Public Finance. IDA support for public finance management achieved some significant, yet incomplete steps, such as the passage of the Procurement Act. However, it has had little impact on actually improving the quality and efficiency of public financial management. On the contrary, there has been some significant regression in the quality since 2005. Moreover, for most of the CAE period, the Parliament's PAC was suspended and end-of-year government financial statements were not disclosed. The outcome of IDA's support to public finance is rated *unsatisfactory*. Overall rating for governance is *unsatisfactory*.

Overall Program Outcome

In sum, progress was made toward improving access to basic services and reducing disparities based on gender, caste, and ethnicity. Civil service disparities are also expected to improve following the adoption of an affirmative action policy. More public resources are reaching the rural poor through the PAF. However, the objective of providing better services was not achieved, and there is little evidence of their poverty impact.

In all other areas of IDA intervention, progress has been limited or negligible. Given the large share of IDA resources devoted to the broad-based growth pillar and the centrality of improving governance in Nepal's Tenth Plan/PRSP (as well as IDA assistance strategy and relative to stated objectives and outcome targets), the overall outcome would be rated *unsatisfactory*. However, given the explicit recognition in the 2003 CAS that only two-thirds of IDA's objective and outcome targets would realistically be met, the adjusted rating is *moderately unsatisfactory.*

Resilience to Risk

Despite the politically unstable and conflict-ridden environment, Nepal's economy demonstrated remarkable resilience over 2003-08. In particular, macroeconomic stability helped to maintain a reasonable pace of economic growth. Sound macroeconomic policies, increasing remittances, and significant development assistance contributed to this growth.

Going forward, in the short- to medium-term, several major risk factors are likely to undermine economic growth and improvement of living standards. These risks further compromise the government's capacity to deliver on peace "dividends", with possible adverse repercussions on the peace process itself. The risk factors include: (i) the current ambivalence regarding macroeconomic policies (for instance, the unrealistic economic growth targets); (ii) the persistence of uncertainty, insecurity, and weakness in the rule of law, which are likely to continue to deter investment (private and public, domestic and foreign); and (iii) the negative social and economic impact of the global crisis on remittances.

The risks to the outcomes of IDA assistance in basic services, primary education, basic health, and rural water and sanitation appear to be low. First, despite some disruption, primary schools and health centers remained functional during most of the Maoist Insurgency period, sometimes with the support of the Maoists themselves. Second, the demand for basic social services is high regardless of the political division lines. Access to education and health care have become individual rights in the 2007 interim Constitution. Third, for primary education and health, increasing ownership and leadership of the respective ministries and greater alignment of development partners with regard to government sector strategy and programs through SWAps are likely to withstand the current intense political tensions. Fourth, the positive experience and expertise gained by the government through successful implementation of the Education for All and public health programs, with financial and technical support from development partners, are likely to help sustain past progress. With regard to rural water and sanitation, the sustainability of the community-based approach adopted by IDA and a number of other donors is considered high. However, IDA's efforts to institutionalize and mainstream the Water Fund Board, which currently functions more like a Project Implementation Unit, have not been successful thus far. As long as service delivery continues to be fragmented into uncoordinated institutions following different approaches, effectiveness will remain limited.

Social inclusion is also high on the agenda of the main political parties and civil society. Therefore, risks to development outcomes also appear low. However, there will probably be a lot of intense debate and tension around how to address the social inclusion issue. In this regard, IDA's current approach of focusing on the PAF may need some adjustment, especially because the current government appears to be opposed to targeted programs delivered by institutions that bypass the government.

In all of the other areas of IDA intervention, risks to development outcomes are high given the risk of policy reversal, the lack of visibility of the current government's development strategies and policies, as well as its capacity to implement them in a still highly uncertain and unstable political environment. Although broad-based growth has wide acceptance within society as a key development priority, the means for achieving it reveal deep political splits. For instance, there are profound disagreements about: (i) whether the two main state-owned commercial banks should be privatized and subject to market forces; (ii) lead instruments for achieving public policies on directed credit for public enterprise expansion or rehabilitation; (iii) help for small farmers and; (iv) debt forgiveness for disadvantaged borrowers. Also there are deep differences over the role of input subsidies in stimulating agricultural productivity, as well as concerns that the current policy is insufficiently owned, defined, and attentive to demand-side incentives and private sector choice.

In broader terms, the CAS instruments, rightly or wrongly, are associated with initiatives supported by the now dissolved monarchy, and therefore lack political legitimacy. In addition, the political instability and uncertainty, and lack of security and law and order which characterized the CAE period deterred private sector investment, including in hydro-power. Hence, the persistence of such risks is likely to continue to negatively affect private investment. The resilience to risk of IDA support in higher education is low to modest. Despite a flexible project design and extensive consultation, key stakeholders within the university are threatening to undo what was already thought to have been settled. This has led to significant delay and great uncertainty about the future of autonomous campuses and the attainment of reasonable cost recovery levels.

Regarding governance reforms, the risk is also high. Decentralization and local governance is undoubtedly high on the government development agenda. However, given the envisaged state restructuring, it will take time before any concrete implementation can start. As of end-2008, the reform of the civil service appeared to have been relegated to a low development priority by both the government and most development partners; resilience to risk is therefore negligible. In the area of accountability and transparency of public finance, some institutional memory remains among a handful of higher-level civil servants. However, they must await political guidance from the new administration before proceeding to revive the initially promising governance transparency reforms. The new administration has expressed strong concern about corruption and public sector inefficiency, but as of end-2008, they had not yet spelled out the strategy they intend to pursue.

Summary Overall Assessment – IFC

With the exception of its two hydropower projects, the IFC did not make a significant contribution to Nepal's development over most of the period under review. Two existing IFC investments in hydropower generation that were approved prior to 1999 made a substantial contribution to Nepal's domestic electricity supply. These projects account for nearly 20 percent of Nepal's domestic electricity supply. They have provided a reliable supply of electricity throughout the years of political unrest and conflict. In addition, they are financially sound, and have undertaken adequate environmental mitigation measures and substantial community outreach programs.

However, the IFC was able to make only one investment in Nepal between 1999 and its "re-engagement" in 2006. Both this investment in a leasing company and an existing investment in the tourist industry were unsuccessful. Anticipated new investments in banking, tourism, manufacturing, hydropower, or telecommunications were not realized. To a large extent, the IFC's inability to develop successful investment projects through much of the decade can be attributed to the increasingly difficult investment environment. At the same time, however, the IFC faced a trade-off in expending resources on a very difficult country with limited prospects of success versus concentrating on countries in the region with significantly better investment environments. As the political and security situation worsened in 2000, the IFC withdrew its local staff presence. Its efforts to seek investments and develop advisory services were minimal.

Since 2006, the IFC has increased its attention to Nepal with positive results. Since 2006, key steps to gradually engage in the country included: (i) advisory work with several local banks, the development of GTFP facilities that enabled the IFC to deepen its knowledge base and build relationships in the financial sector; (ii) engagement in the investment climate (where no other donors were active) through small diagnostic studies that helped establish relationships with government counterparts; (iii) subsequent expansion of programs in the investment climate, including promotion of a public-private dialogue; (iv) expansion of engagement in the financial sector through Advisory Services; and (v) establishment of a single-person field office within the World Bank office in Kathmandu. Though it remains too early to assess the long-term development contributions of these interventions, the IFC's gradual re-engagement in the context of the difficult overall investment environment has resulted in: the two GTFP investments; an investment in a domestic airline in 2008; a pipeline of investment projects in the financial sector; and a constructive dialogue with the government regarding business enabling environment issues. This approach of cautious reengagement has the potential for replication in other difficult investment climate countries.

Chapter 9
Summary Findings and Recommendations

Among the findings of this evaluation of IDA's assistance program in Nepal over the FY 2003-08, the following findings are worth highlighting.

- First, most of the economic and governance objectives targeted under the broad-based growth and good governance pillars were not achieved. Indeed, the prerequisites for effective implementation were not met and the Bank's assistance strategy was not realistic and attuned to the country circumstances (Chapter 8). Bank experience in Nepal confirms experience in other fragile states. Specifically, it shows that continuation of the Bank program and lending in a deteriorating political environment and weakening commitment to reforms does not achieve declared goals and does not serve economic development or poverty reduction.

- Second, IDA has been disengaging from the agriculture sector since the mid-1980s—a process that reached its nadir during the CAE period. The key question is whether IDA's non-delivery of the planned support to agriculture was a consequence of the increasingly intense conflict conditions in Nepal over much of the evaluation period. Views on this appear to be, at best, divided. Moreover, other development partners implemented livelihood support projects in agriculture in spite of the conflict conditions, although with varying degrees of success. Over the FY 2004-06 period, there were no active IDA projects in agriculture, including irrigation and forestry. Moreover, although the PAF targets the rural poor, it does not constitute an alternative for supporting agricultural growth. In a country where 85 percent of the population depends on agriculture for subsistence and employment, and poverty is predominantly a rural issue (and in which the Tenth Plan/PRSP had prioritized agriculture and rural growth), IDA's failure to support agriculture is a critical gap.

- Third, despite Nepal's conflict conditions and political instability, progress was made in improving basic services (primary education, essential health care, and water and sanitation) for which demand is high in the country regardless of political dividing lines. Progress was also high in reaching the poor and excluded groups, particularly in rural areas. Moreover, this progress was achieved mostly through programs implemented by central government departments (education and health) with significant strengthening of deconcentrated administration. In other sectors, such as rural water and sanitation and the PAF, the Bank supported a different approach to service delivery with a semi-autonomous Board working directly with communities through nongovernmental organizations. Although this approach was relatively successful in terms of improving sustainable access to rural water and sanitation services and in transferring resources to disadvantaged rural groups, it undermines Bank efforts to promote greater government ownership and leadership. It also undermines the Bank's state-building agenda.

- Fourth, over the past decade, Nepal made significant progress in reducing social disparities, again despite difficult country circumstances. Although the Bank strategy in this area was not specifically targeted to social inclusion but focused more on economic inclusion, the Bank contributed substantially to bringing these issues to the center of the development strategy. It did so by raising awareness and understanding, as well as supporting critical measures such as equal access to education, civil service diversity, and PAF targeting based on gender, caste, and ethnicity.

- Fifth, the Bank did not tailor its assistance strategy to country circumstances and failed to adjust when underlying assumptions were no longer valid. This undermined its effectiveness. In addition, the failure to formalize its strategy and program shifts detracted from the Board's ability to exercise oversight of country strategies and programs. The 2003 CAS explicitly recognized that, given the uncertainty in Nepal, it could be necessary to revisit the strategy. It therefore undertook to prepare a CAS Progress Report (CAS PR) some 18-24 months thence or sooner should the situation warrant. Predictably, the provisions of IDA's strategy (objectives and outcomes sought, planned lending, AAA and implementation of the pre-existing portfolio) were quickly overtaken by events. Based on the 2003 CAS, this should have triggered a formal shift to the low-case lending scenario. In addition, some Executive Directors explicitly requested a formal discussion of a CAS PR, citing a need to adjust to changing realities in the country (Oral Briefing to the Board, March 2005). Despite this, the provision of the 2003 CAS was not formally revised, nor was it even formally acknowledged as being no longer attainable. The 2007 ISN marked the first written communication to the Board on the IDA strategy for Nepal, although even that document did not depart significantly from the key elements of the 2003 CAS. Beyond the ISN, an extraordinary package was submitted to the Board in December 2007 on a no-objection basis (four new IDA grants totaling US$252.6 million, which doubled the undisbursed balance). This was preceded by a technical briefing to the Board. The package was not part of an integrated program of donor support as proposed three months earlier in an August 2007 ISN update to the Board.

Based on the analysis and findings of the evaluation, IEG recommends that IDA:

1. **Inject greater realism into the country assistance strategy and program design, retain flexibility to adjust to changing circumstances, and consult widely and continually with national stakeholders and development partners throughout program implementation.** Although the prospects for political stability and for sustaining peace look more promising today than in years past, the current government faces enormous challenges in the face of high popular expectations. In many areas, the details of the government's policy agenda and its repercussions, not to mention its feasibility, pace and exact form of implementation, are uncertain. Under such conditions, the lessons of recent history suggest a need for IDA to inject more realism into strategy and program design, and to be prepared for course corrections and maintain responsibility and accountability for signaling major shifts.

Moreover, broad consultations on a regular basis would help ensure that IDA's strategy and program remain relevant.

2. **Make agriculture and rural development the centerpiece of the assistance program.** Given the centrality of agriculture in any realistic plan to improve the lives of many of Nepal's poor and marginalized inhabitants, agricultural and rural growth, including issues of food security and malnutrition, should be placed at the heart of IDA's strategy. In parallel with the focus on economic growth in rural areas, IDA needs to step up its efforts to help increase poor and marginalized people's access to basic services (basic education, healthcare, safe water and sanitation, and roads) in rural areas, notably in the traditionally lagging regions. In striving to increase such access to basic services, the focus needs to be on delivery schemes that have worked and proved sustainable elsewhere in Nepal's rural environment. Finally, in order to have any significant impact, IDA's engagement in agriculture and rural development will need to be sustained over a long period of time, and not follow the "stop-go" patterns of the past.

3. **Design and implement a mechanism to systematically track and evaluate the impact of the Poverty Alleviation Fund on poverty, empowerment and social inclusion, and adjust its design as needed to optimize benefits to the poor and socially excluded.** The major weakness of the PAF, despite its potential as an instrument for addressing social exclusion, is that it has not had a mechanism to track the extent to which its activities are effectively addressing the various dimensions of social exclusion. Given the importance that the PAF is now assuming as an outlet for IDA funds, this shortcoming needs to be remedied as soon as possible.

4. **Support public expenditure and public finance management and other institutional reforms, preferably through policy-based lending coupled with technical assistance as needed, or SWAps (as was done in primary education and health), if the prerequisites for policy-based lending cannot be met.** In Nepal, SWAps have proven to be the most promising vehicle for achieving gradual but lasting change. If conditions for a policy-based IDA budget support do not come together, IDA could usefully explore the prospects for supporting such reforms through SWAp instruments.

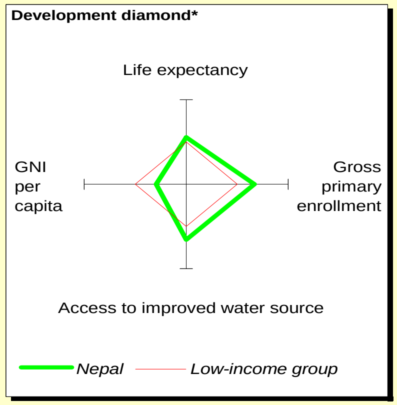
Annex A: Statistical Tables

Nepal at a glance

9/24/08

POVERTY and SOCIAL	Nepal	South Asia	Low-income
2007			
Population, mid-year *(millions)*	28.1	1,520	1,296
GNI per capita *(Atlas method, US$)*	340	880	578
GNI *(Atlas method, US$ billions)*	9.7	1,339	749
Average annual growth, 2001-07			
Population *(%)*	2.0	1.6	2.2
Labor force *(%)*	2.8	2.1	2.7
Most recent estimate (latest year available, 2001-07)			
Poverty *(% of population below national poverty line)*	31	..	..
Urban population *(% of total population)*	17	29	32
Life expectancy at birth *(years)*	63	64	57
Infant mortality *(per 1,000 live births)*	46	62	85
Child malnutrition *(% of children under 5)*	39	41	29
Access to an improved water source *(% of population)*	89	87	68
Literacy *(% of population age 15+)*	49	58	61
Gross primary enrollment *(% of school-age population)*	126	108	94
Male	129	111	100
Female	123	104	89

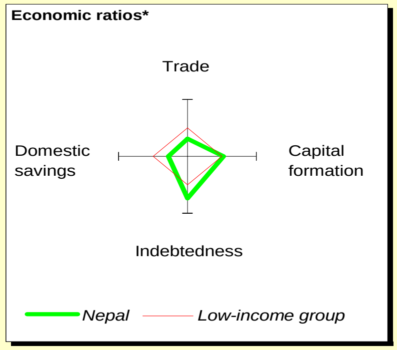
Development diamond*



KEY ECONOMIC RATIOS and LONG-TERM TRENDS	1987	1997	2006	2007
GDP *(US$ billions)*	3.0	4.9	8.9	10.2
Gross capital formation/GDP	21.2	25.3	26.0	25.3
Exports of goods and services/GDP	11.8	26.3	13.6	12.5
Gross domestic savings/GDP	12.1	14.0	7.9	9.4
Gross national savings/GDP	16.3	22.5	28.2	27.9
Current account balance/GDP	-4.7	-0.8	2.2	0.6
Interest payments/GDP	0.5	0.5	0.3	..
Total debt/GDP	33.3	49.1	38.1	..
Total debt service/exports	10.1	5.2	5.1	..
Present value of debt/GDP	..	..	24.8	..
Present value of debt/exports	..	..	81.4	..

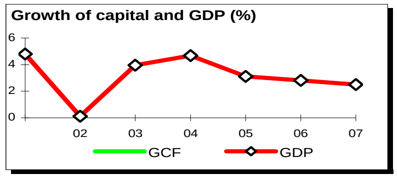
	1987-97	1997-07	2006	2007	2007-11
(average annual growth)					
GDP	5.2	3.6	2.8	2.5	4.5
GDP per capita	2.6	1.4	0.8	0.8	3.1
Exports of goods and services	..	..	..	..	..

Economic ratios*



STRUCTURE of the ECONOMY	1987	1997	2006	2007
(% of GDP)				
Agriculture	50.7	41.4	35.1	33.8
Industry	15.8	22.9	17.4	17.2
Manufacturing	6.2	9.5	7.9	7.7
Services	33.4	35.7	47.5	48.9
Household final consumption expenditure	78.8	77.1	83.3	81.9
General gov't final consumption expenditure	9.1	8.9	8.8	8.7
Imports of goods and services	20.9	37.7	31.7	28.5

Growth of capital and GDP (%)



	1987-97	1997-07	2006	2007
(average annual growth)				
Agriculture	2.9	3.4	1.8	1.0
Industry	8.1	3.5	4.5	3.9
Manufacturing	10.6	1.9	2.0	2.2
Services	6.3	3.7	3.8	2.8
Household final consumption expenditure	..	..	..	..
General gov't final consumption expenditure	..	..	..	..
Gross capital formation	..	..	..	..
Imports of goods and services	..	..	..	..

Note: 2007 data are preliminary estimates.

This table was produced from the Development Economics LDB database.

* 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.

Annex Table A2a. Nepal: Selected Economic Indicators, 1965-2007

	1965-1985	1985-2001	2002	2003	2004	2005	2006	2007	2002-2007
Growth (%)									
Real GDP per capita	0.6	2.5	-2.0	1.8	2.6	1.1	0.8	0.8	0.8
Real GDP	2.8	4.9	0.1	3.9	4.7	3.1	2.8	2.5	2.9
Population	2.2	2.4	2.1	2.1	2.0	2.0	2.0	1.7	2.0
Investments and Savings (% of GDP)									
Gross Fixed Capital Formation	16.4	19.9	19.9	20.3	19.9	25.6	20.4	21.9	21.4
Public			4.2	4.0	4.4	3.7	5.3	6.5	4.7
Private			15.7	16.4	15.5	n.a.	15.1	15.4	n.a.
Gross Domestic Savings	7.6	12.1	9.5	8.6	11.7	11.6	7.9	9.4	9.8
Fiscal Indicators (% of GDP) /1									
Revenue	6.3	9.4	11.5	12.3	11.3	11.7	10.9	12.0	11.6
Expenditure	11.3	17.0	14.8	14.3	14.9	13.8	15.9	17.7	15.2
Current	…	…	10.6	10.3	10.5	10.1	10.6	11.1	10.5
Capital	…	…	4.2	4.0	4.4	3.7	5.3	6.5	4.7
Deficit	2.5	6.0	5.7	3.7	3.0	3.2	3.8	3.6	3.8
Of which domestic financing	1.3	2.0	2.9	0.9	0.6	0.2	1.4	0.9	1.2
Public Debt	…	58.3	69.5	67.2	59.8	53.9	51.1	46.7	58.0
Public Savings	…	…	0.0	0.9	1.0	1.2	0.5	1.4	0.8
External Sector (% of GDP)									
Trade Balance	…	…	-10.8	-12.8	-12.8	-14.9	-18.1	-16.0	-14.2
Exports of goods and services	8.8	17.6	17.7	15.7	16.7	14.6	13.6	12.5	15.1
Imports of goods and services	13.6	27.9	28.5	28.5	29.5	29.5	31.7	28.5	29.4
Remittances			10.3	11.0	10.9	11.1	15.0	13.8	12.0
Current Account Balance	-2.2	-5.6	3.6	2.8	1.4	1.9	1.7	0.1	1.9
Total Reserves in Months of Imports	6.5	5.2	7.4	7.7	7.7	6.7	..	..	7.4
Money and Credit (% of GDP)									
M2	16.0	34.1	48.6	48.8	49.9	50.8	52.2	..	50.1
Domestic Credit	11.4	33.0	46.1	46.6	48.3	49.5	49.0	..	47.9
Domestic Credit to Private Sector	5.1	18.6	30.4	32.0	34.2	35.4	37.7	..	33.9
Prices and Interest Rates (%)									
Inflation, consumer prices	7.8	9.2	3.0	5.7	2.8	6.8	7.6	6.1	5.3
Lending Interest Rate	14.7	13.5	..	..	8.5	8.1	8.0	..	8.2

Source: World Bank World Development Indicators (September 2008 update) for all indicators excluding those noted.

1/ Fiscal indicators from 2002 onwards come from IMF Reports. Data for 2006, 2007 and 2008 are estimates. Data prior to 2001 from World Bank reports.

Note: GDP= gross domestic product; IMF= International Monetary Fund; M2=Money Supply.

Annex Table A2b. Nepal and Comparators: Economic and Social Indicators, 1995-2008

Indicator														Nepal	Afghanistan	Bangladesh	Bhutan	India	Pakistan	Sri Lanka	South Asia Region	Sub-Saharan Africa	Low-Income Country
	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	1995-2007									
Health and Sanitation																							
Immunization, DPT (% of children ages 12-23 months)	54.0	65.0	78.0	76.0	73.0	72.0	72.0	72.0	78.0	80.0	75.0	89.0	..	73.7	46.3	81.9	89.6	58.9	63.4	97.1	62.3	57.2	63.5
Life expectancy at birth, total (years)	57.9	..	59.4	..	..	60.5	..	61.3	..	..	62.7	63.2	..	60.8	..	61.2	61.9	63.1	63.7	73.8	62.7	49.6	55.8
Improved sanitation facilities (% of population with access)	15.0	..	..	..	..	20.0	..	..	..	..	..	27.0	..	20.7	30.7	32.0	52.0	23.0	48.7	81.0	27.5	28.6	35.0
Improved water source (% of population with access)	78.0	..	..	..	..	83.0	..	..	..	..	..	89.0	..	83.3	21.3	79.0	81.0	82.7	88.3	76.7	81.8	54.7	64.0
Mortality rate, infant (per 1,000 live births)	83.7	..	..	..	..	63.9	..	..	..	..	48.6	46.1	..	60.6	..	63.7	74.4	66.8	83.7	15.0	68.5	98.6	90.4
Population, total (in million)	21.7	22.2	22.8	23.3	23.9	24.4	25.0	25.5	26.0	26.6	27.1	27.6	28.1	24.9	..	142.3	0.6	1030.5	141.9	19.1	1381.6	691.6	1137.3
Population growth (annual %)	2.5	2.5	2.5	2.4	2.3	2.3	2.2	2.1	2.1	2.0	2.0	2.0	1.7	2.2	..	1.9	1.9	1.6	2.4	0.8	1.7	2.6	2.3
Urban population (% of total)	10.9	11.4	11.9	12.4	12.9	13.4	13.9	14.4	14.8	15.3	15.8	16.3	16.8	13.9	21.7	24.1	26.7	27.9	33.6	15.6	27.6	33.2	29.2
Education																							
Literacy rate, adult total (% of people ages 15 and above)	..	..	..	..	..	..	48.6	..	..	..	..	..	..	48.6	28.0	47.5	59.5	61.0	44.6	90.7	58.4	59.3	60.8
School enrollment, preprimary (% gross)	..	..	..	..	11.4	11.8	12.0	11.9	17.0	17.7	35.3	27.1	..	18.0	0.8	14.6	1.3	27.1	51.9	..	27.2	15.7	19.4
School enrollment, primary (% gross)	..	..	..	..	113.7	116.7	109.3	114.0	112.2	113.9	113.3	126.1	..	114.9	60.1	102.3	84.5	102.9	76.8	106.5	98.0	85.1	87.5
School enrollment, secondary (% gross)	..	..	..	..	34.0	35.3	38.3	42.0	42.8	..	45.7	43.2	..	40.2	15.7	45.6	43.3	47.0	28.7	86.4	45.6	28.0	35.3
Growth and Wealth																							
GDP growth (annual %)	3.5	5.3	5.0	3.0	4.4	6.2	4.8	0.1	3.9	4.7	3.1	2.8	2.5	3.8	11.9	5.5	8.1	7.0	4.6	5.0	6.5	4.2	4.8
GNI per capita, PPP (current international $)	660	690	720	730	760	810	850	840	870	920	960	1010	1040	835	..	916	2802	1728	1870	2844	1641	1412	1077
GNI per capita, Atlas method (current US$)	200	210	220	210	210	220	230	230	250	270	300	320	340	247	..	374	925	548	579	963	529	596	374

Annex Table A2b. Nepal and Comparators: Economic and Social Indicators, 1995-2008

Indicator														Nepal	Afghanistan	Bangladesh	Bhutan	India	Pakistan	Sri Lanka	South Asia Region	Sub-Saharan Africa	Low-Income Country
	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	1995-2007									
GDP per capita growth (annual %)	0.9	2.7	2.5	0.6	2.0	3.8	2.5	-2.0	1.8	2.6	1.1	0.8	0.8	1.6	..	3.5	6.0	5.3	2.1	4.1	4.7	1.6	2.4
Gross domestic savings (% of GDP)	15.7	14.4	14.0	13.8	13.6	15.2	11.7	9.5	8.6	11.7	11.6	7.9	9.4	12.1	-16.3	16.6	31.5	26.2	15.5	17.0	23.8	16.1	14.7
Gross fixed capital formation (% of GDP)	22.1	22.5	21.7	21.7	19.1	19.3	19.2	19.6	19.9	20.3	19.9	20.9	20.3	20.5	29.7	22.6	49.0	26.0	16.6	24.0	24.6	17.6	20.4
Production and Trade																							
Agriculture, value added (% of GDP)	41.8	41.5	41.4	39.9	41.3	40.8	37.6	38.6	37.5	37.2	36.3	35.1	33.8	38.7	42.9	23.3	27.5	22.6	24.0	17.2	22.8	17.6	29.4
Industry, value added (% of GDP)	22.8	22.9	22.9	22.5	21.8	22.1	17.8	18.1	18.1	17.9	17.7	17.4	17.2	19.9	22.6	26.1	36.4	27.1	24.8	28.0	26.8	29.7	25.4
Services, etc., value added (% of GDP)	35.5	35.6	35.7	37.6	36.9	37.0	44.6	43.3	44.3	45.0	46.0	47.7	49.1	41.4	34.5	50.5	36.1	50.3	51.2	54.7	50.4	52.7	45.1
Exports of goods and services (% of GDP)	25.0	22.8	26.3	22.8	22.8	23.3	22.6	17.7	15.7	16.7	14.6	13.6	12.5	19.7	17.4	14.7	32.0	14.8	15.6	34.8	15.5	30.8	27.1
Imports of goods and services (% of GDP)	34.5	35.6	37.7	33.9	29.7	32.4	33.2	28.5	28.5	29.5	29.5	31.7	28.5	31.8	63.9	20.7	48.5	16.5	18.3	43.1	18.0	32.1	31.8
Current account balance (% of GDP)	-8.1	-7.2	-7.9	-1.4	-1.6	-2.4	-2.7	3.6	2.8	1.4	1.9	1.7	0.1	-1.5	..	-0.4	..	-0.5	-1.8	-3.2	..	..	..
Government Finance																							
Revenue, excluding grants (% of GDP) /1	10.4	10.8	10.5	10.5	10.2	10.7	11.4	11.5	12.3	11.3	11.7	10.9	12.0	11.1	8.9	10.0	18.7	12.0	14.6	17.0	12.4	..	..
Expenditure and net lending (% of GDP) /1	16.0	17.6	16.5	16.8	15.4	15.5	17.5	17.2	16.0	14.3	14.9	14.7	15.7	16.0	20.4	9.0	18.9	15.2	17.2	22.4	15.5	..	..
Overall balance, before grants (% of GDP) /1	5.5	6.8	6.0	6.3	5.2	4.8	6.1	5.7	3.7	3.0	3.2	3.8	3.6	4.9	11.5	1.0	0.2	3.2	2.6	5.4	3.1		
Total debt service (% of GNI)	1.9	1.7	1.9	1.8	2.1	1.8	1.6	1.7	1.8	1.6	1.4	1.6	..	1.8	0.1	1.4	1.8	2.9	4.1	3.8	2.9	3.9	3.7
External debt, total (% of GNI)	54.7	52.9	49.0	54.9	59.9	52.0	45.3	49.5	50.0	46.3	39.0	37.8	..	49.3	21.1	33.9	60.0	21.0	43.5	56.7	25.7	60.1	63.4
Total reserves in months of imports	4.7	4.3	4.1	6.6	6.2	6.5	7.4	7.4	7.7	7.7	6.7	..	..	6.3	..	2.5	..	7.7	3.5	3.0	7.1	7.2	4.7
Inflation, consumer prices (annual %)	7.6	9.2	4.0	11.2	7.5	2.5	2.7	3.0	5.7	2.8	6.8	7.6	6.1	5.9	14.2	6.0	5.8	6.2	6.9	10.3	..	..	..
Official exchange rate (LCU per US$, period average)	51.9	56.7	58.0	66.0	68.2	71.1	74.9	77.9	76.1	73.7	71.4	72.8	66.4	68.1	36.1	54.4	42.5	42.5	51.9	82.7	..	..	..

Source: World Bank World Development Indicators (September 2008 update) for all indicators excluding those noted.
1/ Data for Nepal comes from IMF Reports (2006, 2007 and 2008 are estimates). Data for comparators comes from World Development Indicators.
Note: DPT= diphtheria, pertussis and tetanus; GDP= gross domestic product; GNI= gross national income; IMF= International Monetary Fund; LCU= local currency unit; PPP= purchasing power parity.

Annex Table A2c. Nepal: Poverty Trends, 1996-2006			
	1995-96	2003-04	Change
Poverty			
Poverty headcount rate	41.8	30.9	-26
Urban	21.6	9.6	-56
Rural	43.3	34.6	-20
International poverty line			
US$1 a day	33.5	24.1	-9
US$2 a day	77.6	65.8	-12
Inequality			
Gini coefficient	34.2	41.4	21
Per-capita expenditure distribution			
Bottom half of distribution (p25/p10)	1.4	1.3	-2
Top half of distribution (p90/50)	2.2	2.8	23
Inter-quartile range (p75/p25)	2.1	2.3	13
Tail of distribution (p90/p10)	4.3	5.4	27

Source: Capital Budget System and World Bank staff calculations using NLSS-I and II.

Annex Table A2d. Nepal: Government Expenditure by Sector, FY 2003-07									
	9TH PLAN FY 1998-2002 AVERAGE	TENTH PLAN/POVERTY REDUCTION STRATEGY PAPER						FY 2003-07 AVERAGE	2004/05 STRUCTURE
		FY 2002	FY 2003	FY 2004	FY 2005	FY 2006 (Estimate)	FY2007 (Budget)		
Social services	5.6	5.8	5.6	5.5	5.9	6.3	8.1	6.3	37.5
Education	2.5	3.1	2.9	2.9	3.2	3.3	3.5	3.2	19.6
Health	0.9	0.9	0.8	0.8	0.9	1	1.4	1.0	6.0
Drinking Water and Sanitation	0.6	0.5	0.5	0.5	0.4	0.5	1	0.6	3.2
Local Development	1.1	0.9	1.1	0.9	1	1	1.5	1.1	5.9
Other	0.5	0.4	0.4	0.4	0.5	0.5	0.7	0.5	3.0
Economic Services	5.9	4.9	4.1	4	4.3	4.1	5.2	4.3	24.2
Agriculture	2.0	2	1.4	1.4	1.4	1.4	1.7	1.5	8.5
Infrastructure	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.5
Transportation	1.6	1.2	0.9	0.9	0.9	0.9	1.2	1.0	5.1
Power	0.3	0.3	0.6	0.2	0.3	0.2	0.3	0.3	1.3
Other Infrastructure	1.6	1	0.9	1	1.4	0.9	1.3	1.1	5.6
Other Economic Services	0.3	0.2	0.2	0.4	0.3	0.5	0.7	0.4	3.1
General Administration	1.5	2.2	2	1.9	2	2.2	1.8	2.0	13.1
Police	1.0	1.4	1.4	1.3	1.4	1.4	1.2	1.3	8.3
Other General Administration									
Defense	0.9	1.4	1.6	1.7	2.1	2	1.6	1.8	11.8
Other	2.5	2.8	2.6	2.3	2.1	2.3	3.1	2.5	13.4
Total	16.3	17	16	15.5	16.5	16.8	19.9	16.9	100.0
Memorandum Item									
Infrastructure	3.4	2.5	2.3	2.1	2.5	2	2.8	2.3	12.0
Community-controlled Funds	0.2	0.3	0.7	0.8	1	1.1	n/a	0.9	6.7
Pro-Poor Expenditure	6.4	6.1	6	6.1	6.6	6.9	9.3	7.0	41.1

Source: Nepal Managing Public Finances for a New Nepal: A Public Finance Management Review, World Bank, July 2007.

Annex Table A2e. Nepal: Agricultural Production, 1990-2007				
	Average of Annual Growth Rate			
	1990-1995	**1996-2002**	**2003-2007**	**1990-2007**
Area Harvested (Ha)				
Barley	1.0%	-0.8%	-0.8%	-0.3%
Maize	0.9%	0.6%	1.1%	0.8%
Millet	6.0%	-0.1%	0.5%	1.9%
Mustard seed	3.8%	0.3%	0.2%	1.3%
Oilseeds, Nes	2.1%	1.7%	-0.2%	1.5%
Potatoes	3.3%	4.8%	2.6%	3.7%
Rice, paddy	1.0%	0.5%	-1.4%	0.1%
Sugar cane	6.9%	4.6%	1.5%	4.4%
Wheat	1.0%	0.8%	1.1%	0.9%
Production (thousand metric tons)				
Barley	1.9%	1.4%	-1.6%	0.6%
Maize	1.2%	2.7%	3.8%	2.6%
Millet	2.0%	1.7%	0.2%	1.4%
Mustard seed	3.8%	2.3%	1.0%	2.3%
Oilseeds, Nes	1.1%	4.3%	-2.5%	1.9%
Potatoes	4.6%	8.6%	5.8%	6.6%
Rice, paddy	2.7%	2.1%	-2.1%	1.1%
Sugar cane	8.8%	6.0%	3.0%	5.9%
Wheat	1.7%	4.9%	3.9%	3.6%
Yield (Hg/Ha)				
Barley	0.9%	2.2%	-0.8%	0.9%
Maize	0.3%	2.1%	2.7%	1.8%
Millet	-3.5%	1.9%	-0.4%	-0.4%
Mustard seed	-0.1%	2.0%	0.8%	1.0%
Oilseeds, Nes	-1.1%	3.1%	-2.3%	0.6%
Potatoes	1.4%	3.6%	3.1%	2.8%
Rice, paddy	0.6%	1.7%	-0.8%	0.6%
Sugar cane	2.0%	1.4%	1.5%	1.6%
Wheat	0.7%	4.0%	2.8%	2.7%

Source: Food and Agricultural Organization (FAO) Statistical Database (FAOSTAT) data as of 02/23/09.

Annex Table A2f. Nepal: Social Indicators Summary, 1965-2007

	1965-1985	1986-2001	2002	2003	2004	2005	2006	2007	2002-2007	South Asia Region*
Education										
Literacy rate, adult total (% of people ages 15 and above)	..	40.8	..	..	..	..	..	..	..	58.4
School enrollment, primary (% gross)	..	112.4	114.0	112.2	113.9	113.3	126.1	..	115.9	107.7
Ratio of female to male primary enrollment	..	75.8	86.2	88.1	88.0	91.2	95.4	..	89.8	93.6
Repetition rate, primary (% of total enrollment)	..	24.8	21.6	21.7	21.7	23.1	20.6	..	21.7	3.8
Public spending on education, total (% of government expenditure)	..	11.8	13.9	14.9	..	..	..	..	14.4	14.9
Health										
Life expectancy at birth, total (years)	46.4	56.8	61.3	..	..	62.7	63.2	..	62.4	64.2
Life expectancy at birth, female (years)	46.1	56.7	61.6	..	..	63.2	63.7	..	62.8	65.5
Mortality rate, infant (per 1,000 live births)	145.0	82.1	..	..	..	48.6	46.1	..	47.4	62.0
Mortality rate, under-5 (per 1,000)	215.8	115.2	..	..	..	63.1	59.4	..	61.3	83.2
Maternal mortality ratio (modeled estimate, per 100,000 live births)	..	..	..	..	..	830.0	..	..	830.0	500.0
Fertility rate, total (births per woman)	5.7	4.7	3.7	..	..	3.1	3.1	..	3.3	2.8
Adolescent fertility rate (births per 1,000 women ages 15-19)	..	125.7	122.2	..	..	117.6	116.1	..	118.6	68.1
Births attended by skilled health staff (% of total)	..	10.3	..	..	15.4	..	18.7	..	17.1	40.8
Low-birth-weight babies (% of births)	..	22.0	..	..	..	..	..	..	..	26.5
Malnutrition prevalence, height for age (% of children under 5)	75.0	58.3	..	..	..	..	49.3	..	49.3	46.9
Malnutrition prevalence, weight for age (% of children under 5)	60.8	41.4	..	..	..	..	38.8	..	38.8	41.3
Health expenditure, public (% of government expenditure)	..	6.6	9.4	8.2	8.7	8.4	..	..	8.7	3.5
Population and Poverty										
Population, total (in millions)	13.7	21.0	25.5	26.0	26.6	27.1	27.6	28.1	26.8	1520.4
Population growth (annual %)	2.2	2.4	2.1	2.1	2.0	2.0	2.0	1.7	2.0	1.4
Urban population (% of total)	5.1	10.5	14.4	14.8	15.3	15.8	16.3	16.8	15.6	29.2
Poverty headcount ratio at national poverty line (% of population)	..	41.8	..	..	30.9	..	..	..	30.9	..
Poverty headcount ratio at rural poverty line (% of rural population)	..	43.3	..	..	34.6	..	..	..	34.6	..

Poverty headcount ratio at urban poverty line (% of urban population)	..	21.6	..	..	9.6	..	..	..	9.6	..
GINI index	..	37.7	..	47.2	..	..	..	..	47.2	..

Source: World Bank World Development Indicators (September 2008 update).
* Latest year available.

Annex Table A2g. Nepal: Assets and Access to Basic Infrastructure, 1996, 2001, 2006

Asset

	NATIONAL			RURAL			URBAN		
	1996	2001	2006	1996	2001	2006	1996	2001	2006
Radio	36.5	43.5	61	34.2	41.4	59.2	59.7	61.0	69.7
Television	6.6	13.1	27.9	3.1	7.7	20.8	42.6	58.9	62.9
Telephone	1.3	2.5		0.1	0.6		14.1	18.0	
Mobile telephone			5.5			2.1			22.5
Non-mobile telephone			6.3			2.1			27.2
Bicycle	19.5	26.1	32.7	17.6	24.0	31.4	38.9	44.0	38.9

Access to Basic Infrastructure Services

	NATIONAL			RURAL			URBAN		
	1996	2001	2006	1996	2001	2006	1996	2001	2006
ELECTRICITY	17.9	24.6	51.2	12.1	17.4	43.2	78.4	85.7	90.1
IMPROVE D WATER SOURCE	63.4	72.8	81.8	61.4	71.1	80.2	84.7	86.0	89.5
IMPROVED SANITATION FACILITY	15.6	30.4	36.5	14.3	24.7	29.3	28.1	79.9	76.5

Source: 1996, 2001, and 2006 DHS Reports.

Annex Table A2h. Nepal: Selected Gender Indicators, 1996-2007 (period averages)				
	Nepal		South Asia Region	
	1996-2001	2002-2007	1996-2001	2002-2007
Fertility rate, total (births per woman)	4.2	3.3	3.4	2.9
Maternal mortality ratio (modeled estimate, per 100,000 live births)	…	830.0	…	500.0
Life expectancy at birth, total (years)	59.9	62.4	62.1	63.7
Female	60.2	62.8	62.7	64.8
Male	59.7	62.0	61.6	62.7
Literacy rate, adult total (% of people ages 15 and above)	48.6	…	…	58.4
Female	34.9	…	…	45.8
Male	62.7	…	…	70.4
School enrollment, primary (% gross)	113.2	115.9	90.3	102.6
Female	100.2	109.5	82.1	98.3
Male	125.4	121.9	97.8	106.6
Ratio of girls to boys in primary and secondary education (%)	77.5	87.5	80.3	88.0
Proportion of seats held by women in national parliament (%)	4.2	7.9	6.6	10.8

Source: World Bank: World Development Indicators (September 2008 update).

Annex Table A2i. Nepal: Governance Indicators, 1996-2007

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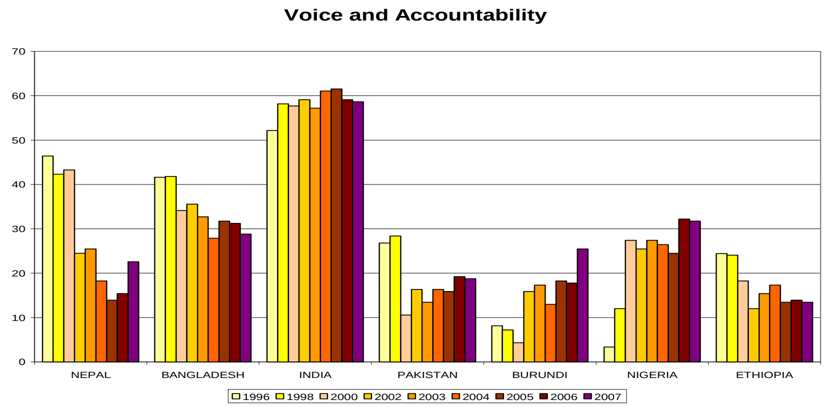
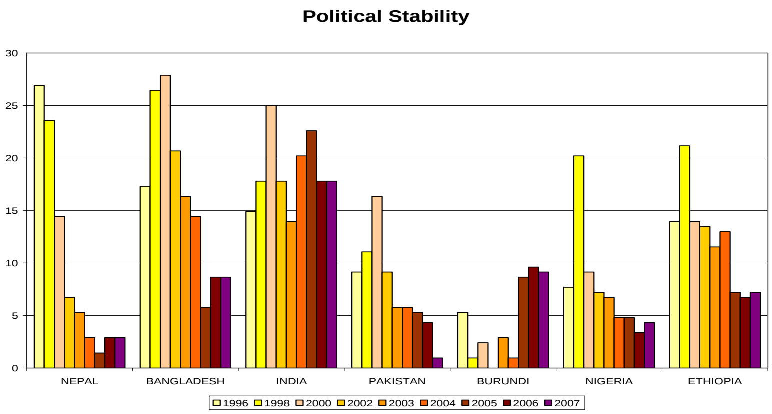
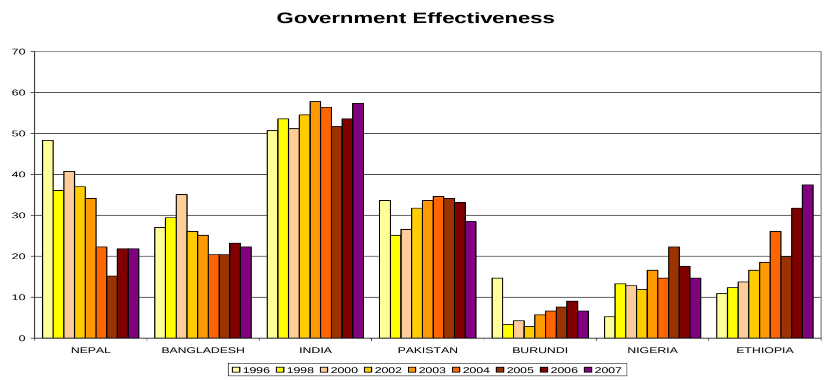
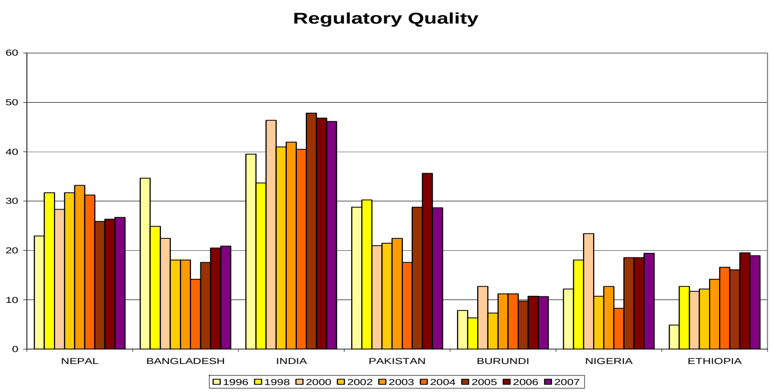
Annex Table A2j. Nepal and Comparators: Governance Indicators, 1996-2007









Annex Table A2k. Nepal: Millennium Development Goals, 1990-2007				
	1990	1995	2000	2007
Goal 1: Eradicate extreme poverty and hunger				
Employment to population ratio, 15+, total (%)	59	58	58	58
Employment to population ratio, ages 15-24, total (%)	48	47	47	44
Income share held by lowest 20%	..	7.6	..	..
Malnutrition prevalence, weight for age (% of children under 5)	..	42.9	43	38.8
Poverty headcount ratio at national poverty line (% of population)	..	41.8	..	..
Prevalence of undernourishment (% of population)	20	26	..	..
Vulnerable employment, total (% of total employment)	..	..	..	..
Goal 2: Achieve universal primary education				
Literacy rate, youth female (% of females ages 15-24)	33	..	60	..
Literacy rate, youth male (% of males ages 15-24)	68	..	81	..
Persistence to last grade of primary, total (% of cohort)	..	..	46	79
Primary completion rate, total (% of relevant age group)	51	54	66	76
Total enrollment, primary (% net)	..	..	73	..
Goal 3: Promote gender equality and empower women				
Proportion of seats held by women in national parliament (%)	6	3	6	17
Ratio of female to male enrollments in tertiary education	33	..	40	..
Ratio of female to male primary enrollment	63	..	79	95
Ratio of female to male secondary enrollment	46	..	71	89
Ratio of young literate females to males (% ages 15-24)	48	..	75	..
Share of women employed in the nonagricultural sector (% total nonagric. empl.)	..	..	15.1	..
Goal 4: Reduce child mortality				
Immunization, measles (% of children ages 12-23 months)	57	56	71	85
Mortality rate, infant (per 1,000 live births)	99	84	64	46
Mortality rate, under-5 (per 1,000)	142	118	86	59
Goal 5: Improve maternal health				
Adolescent fertility rate (births per 1,000 women ages 15-19)	..	127	124	116
Births attended by skilled health staff (% of total)	7	9	12	19
Contraceptive prevalence (% of women ages 15-49)	23	29	37	48
Maternal mortality ratio (modeled estimate, per 100,000 live births)	..	..	..	830
Pregnant women receiving prenatal care (%)	15	24	27	44
Unmet need for contraception (% of married women ages 15-49)	..	31	28	25
Goal 6: Combat HIV/AIDS, malaria, and other diseases				
Children with fever receiving antimalarial drugs (% of children under age 5 with fever)	..	..	..	..
Condom use, population ages 15-24, female (% of females ages 15-24)	..	..	..	8
Condom use, population ages 15-24, male (% of males ages 15-24)	..	..	..	24
Incidence of tuberculosis (per 100,000 people)	243	220	199	176
Prevalence of HIV, female (% ages 15-24)	..	..	..	0.3
Prevalence of HIV, total (% of population ages 15-49)	..	..	0.5	0.5
Tuberculosis cases detected under DOTS (%)	..	5	57	64
Goal 7: Ensure environmental sustainability				
Annual freshwater withdrawals, total (% of internal resources)	..	..	5.1	..
CO2 emissions (kg per PPP $ of GDP)	0.1	0.1	0.2	..
CO2 emissions (metric tons per capita)	0	0.1	0.1	..
Forest area (% of land area)	34	..	27	25
Improved sanitation facilities (% of population with access)	9	15	20	27
Improved water source (% of population with access)	72	78	83	89
Marine protected areas, (% of surface area)	..	..	..	..
Nationally protected areas (% of total land area)	..	..	..	..
Goal 8: Develop a global partnership for development				
Aid per capita (current US$)	22	20	16	19
Debt service (PPG and IMF only, % of exports of G&S, excl. workers' remittances)	14.7	7.7	7.3	9.7
Internet users (per 100 people)	0	0	0.2	1.2
Mobile phone subscribers (per 100 people)	0	0	0	4.2
Telephone mainlines (per 100 people)	0.3	0.4	1.1	2.7
Other				
Fertility rate, total (births per woman)	5.1	4.6	4	3.1
GNI per capita, Atlas method (current US$)	210	200	220	340
GNI, Atlas method (current US$) (billions)	3.9	4.4	5.4	9.7
Gross capital formation (% of GDP)	18.1	25.2	24.3	25.3
Life expectancy at birth, total (years)	54	58	61	63
Literacy rate, adult total (% of people ages 15 and above)	33	..	49	..
Population, total (millions)	19.1	21.7	24.4	28.1
Trade (% of GDP)	32.2	59.5	55.7	41

Source: World Development Indicators Database as of 02/23/09.

Note: CO2= carbon dioxide (emissions); DOTS= Tuberculosis Directly Observed Short Course; G&S= goods and services; GDP= gross domestic product;

ANNEX TABLE A2K. NEPAL: MILLENNIUM DEVELOPMENT GOALS, 1990-2007				
	1990	1995	2000	2007

HIV/AIDS= human immunodeficiency virus/acquired immune deficiency syndrome; IMF= International Monetary Fund; kg= kilogram; PPG= public and publicly-guaranteed (debt); PPP= purchasing power parity;

Annex Table A3a. Nepal: International Development Association Commitments by Sector, FY 2003-08 *(in millions US$)*							
Sector Board	FY03	FY04	FY05	FY06	FY07	FY08	Average FY03-08
Agriculture and Rural Development		15.0			43.2	150.0	34.7
Economic Policy		70.0					11.7
Education	5.0		50.0		60	60.0	29.2
Energy and Mining	75.6						12.6
Financial and Private Sector Development	16.0	75.5	3				15.8
Global Information/Communications Technology							
Health, Nutrition, and Population			50.0			50.0	16.7
Social Protection						50.0	8.3
Transport			32			42.6	12.4
Water		25.3				27.0	8.7
Total	96.6	185.8	135.0	0.0	103.2	379.6	150.0

Source: World Bank internal database as of 02/18/09.
Note: FY= fiscal year.

Annex Table A3b. Nepal: International Development Association Commitments by Sector, FY 2003-08 *(percentage of annual commitments)*							
Sector Board	FY03	FY04	FY05	FY06	FY07	FY08	Average FY03-08
Agriculture and Rural Development		7			21	72	23.1
Economic Policy		100.0					7.8
Education	3		29.0		34	34	19.4
Energy and Mining	100.0						8.4
Financial and Private Sector Development	17	80	3				10.5
Global Information/Communications Technology							
Health, Nutrition, and Population			50			50	11.1
Social Protection						100	5.6
Transport			43			57	8.3
Water		48				52	5.8
Total	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*

Source: World Bank internal database as of 02/18/09.
Note: FY= fiscal year.

Annex Table A3c. Nepal: International Development Association Disbursements by Sector, FY 2003-08 *(in US$ million)*							
Sector Board	FY03	FY04	FY05	FY06	FY07	FY08	Average FY03-08
Agriculture and Rural Development	13.8	4.0	2.1	3.9	10.7	23.6	9.7
Economic Policy	..	74.9	..	..	..	..	74.9
Education	1.9	6.2	6.8	17.6	19.7	16.5	11.4
Energy and Mining	..	0.0	0.9	3.9	9.7	6.5	4.2
Financial and Private Sector Development	..	4.9	49.6	12.0	3.5	1.1	14.2
Global Information/Communications Technology	..	3.4	6.8	2.8	1.3	2.7	3.4
Health, Nutrition, and Population		..	5.6	11.2	13.8	14.0	11.1
Social Protection	..	..	..	..	..	..	..
Transport	8.6	6.8	7.7	12.4	9.4	10.6	9.2
Water	2.9	0.7	1.3	3.2	6.8	5.8	3.4
Total	27.2	100.9	80.7	67.0	75.0	80.6	71.9

Source: World Bank internal database as of 02/18/09.
Note: FY= fiscal year.

Annex Table A3d. Nepal: Yearly Net Receipts from all Donors, 2003-07

TOTAL RECEIPTS: ODA + OOF + PRIVATE	2003	2004	2005	2006	2007	AVERAGE 2003-07
All Donors, Total	461	413	413	498	594	476
DAC Countries, Total	325	314	343	312	377	334
Multilateral Agencies, Total	136	97	69	185	209	139
Non-DAC Countries, Total	1	3	2	1	8	3
G7, Total	228	213	247	217	253	232
DAC EU Members, Total	184	171	172	153	187	173
Japan	60	56	63	40	52	54
AsDF (Asian Dev. Fund)	12	-4	16	75	60	32
IDA	79	46	16	34	44	44
United Kingdom	63	66	62	74	88	71
Germany	62	51	62	32	47	51
United States	38	35	52	62	53	48
Denmark	40	34	28	33	49	37
Norway	18	23	25	25	44	27
Switzerland	14	16	16	17	19	16
EC	16	22	10	24	25	19
Belgium	2	0	0	0	1	1
Netherlands	9	13	11	2	2	7
PRIVATE FLOWS	2003	2004	2005	2006	2007	AVERAGE 2003-07
All Donors, Total	5.5	-3.4	-2.3	-5.5	3.7	-0.4
DAC Countries, Total	5.5	-3.4	-2.3	-5.5	-0.7	-1.3
Non-DAC Countries, Total	..	..	..	..	4.3	4.3
G7, Total	9.5	-2.0	-1.1	-2.9	0.7	0.8
DAC EU Members, Total	7.9	-2.7	-2.3	-4.2	-3.7	-1.0
OTHER OFFICIAL FLOWS (OOF)	2003	2004	2005	2006	2007	AVERAGE 2003-07
All Donors, Total	-7.4	-8.4	-7.9	-7.9	-8.5	-8.0
DAC Countries, Total	-1.3	-1.4	-0.6	0.4	0.1	-0.6
Multilateral Agencies, Total	-6.1	-7.0	-7.2	-8.3	-8.6	-7.4
Non-DAC Countries, Total	..	..	..	..	..	..
G7, Total	-1.3	-1.0	0.0	0.0	-0.3	-0.5
DAC EU Members, Total	-0.8	-1.0	..	..	..	-0.9
DISBURSEMENTS - OFFICIAL DEVELOPMENT ASSISTANCE (ODA)	2003	2004	2005	2006	2007	AVERAGE 2003-07
All Donors, Total	462.93	425.09	422.93	511.77	598.4	484
DAC Countries, Total	320	318	345	318	377	336
Multilateral Agencies, Total	142	104	76	193	217	146
Non-DAC Countries, Total	1	3	2	1	4	2
G7, Total	220	216	248	220	252	231
DAC EU Members, Total	177	175	174	157	190	175
Japan	61	56	63	42	49	54
AsDF (Asian Dev. Fund)	12	-4	16	75	60	32
United Kingdom	53	66	62	75	88	69
IDA	79	46	16	34	44	44
Germany	63	53	63	33	49	52
United States	38	35	52	62	54	48
Denmark	40	34	28	33	49	37
Norway	20	23	25	25	44	28
Switzerland	14	16	16	17	19	16
EC	16	22	10	24	25	19
Netherlands	10	14	12	4	3	9
WFP	6	*10*	6	8	12	8

Source: OECD DAC online database, and Client Connection, as of 1/22/09.
Note: ASDF= Asian Development Fund; DAC= Development Assistance Committee (of the Organization for Economic Co-operation and Development); EU= European Union; G7= Group of 7 Finance Ministers of Seven Industrialized Countries including: Canada, France, Germany, Italy, Japan, United

Kingdom, and the United States); IDA= International Development Association; ODA=official development assistance; OECD= Organization for Economic Co-operation and Development; OOF=other official flows; WFP= World Food Programme .

Annex Table A4a. Nepal: Lending Program, Actual versus Planned by Pillar, FY 1999-2003

Project Title		Project ID	Proposed FY	Proposed Amount (USD mil)	Approved FY	Approved Amount (USD mil)
Pillar 1: Broad-based Economic Growth				350.0		173.7
Financial and Private Sector Development				50.0		16.0
1998 CAS, 2002 CASPR	Financial Sector Reform [/a]	P071291	2000	50.0	Dec-02	16.0
Agriculture				100.0		0.0
1998 CAS	Land Resource Management Project		2000	30.0	Dropped	
1998 CAS	Terai Groundwater Irrigation		2000	30.0	Dropped	
1998 CAS	Mahakali Irrigation III		2001	40.0	Dropped	
Transport				55.0		59.5
1998 CAS	Road Development and Maintenance II [/b]	P045052	2000	50.0	Nov-99	54.5
1998 CAS	Rural Infrastructure LIL	P045053	2000	5.0	May-99	5.0
Power				100.0		75.6
1998 CAS, 2002 CASPR	Power Development APL [/c]	P043311	1999	100.0	May-03	75.6
Telecommunications				45.0		22.6
1998 CAS	Telecommunications Sector Reform Project	P050671	2000	45.0	Dec-01	22.6
Pillar 2: Social Sector Development				70.0		12.5
Education				20.0		12.5
1998 CAS	Basic & Primary Education Project II	P040612	1999	20.0	Mar-99	12.5
Health, Nutrition and Population				30.0		0.0
1998 CAS	Population & Health II		2000	30.0	Dropped	
Water & Sanitation				20.0		0.0
2002 CASPR	Rural Water Supply & Sanitation Project --> CAS 2003	P071285	2003	20.0	CAS 2003	
Pillar 3: Social Inclusion and Targeted Programs				0		0
Pillar 4: Good Governance				0		0
Total 1999-2003				420.0		186.2

a/ Renamed Financial Sector Technical Assistance.
b/ Renamed Road Maintenance and Development.
c/ Renamed Power Sector Development.
Source: 1998 CAS and 2002 CASPR, World Bank internal database.
Note: CAS= Country Assistance Strategy; CASPR= Country Assistance Strategy Progress Report; FY= fiscal year; USD= U.S. dollars.

Annex Table A4b. Nepal: Lending Program, Actual versus Planned by Pillar, FY 2004-07

2003 Country Assistance Strategy	Project Title	Project ID	Proposed FY	Proposed Amount (USD million)	Approved FY	Approved Amount (USD million)
Pillar 1: Broad-based Economic Growth				535		180.5
Economic Policy				290		73
FY 2003 CAS	First Poverty Reduction Support Credit PRSC-I	P074685	2004	70	Nov-03	70
FY 2003 CAS	Poverty Reduction Support Credit II		2005	70	Dropped	
FY 2003 CAS	Poverty Reduction Support Credit III		2006	70	Dropped	
FY 2003 CAS	Poverty Reduction Support Credit IV		2007	70	Dropped	
FY 2003 CAS	Reform Technical Assistance/Capacity Building a/	P093294	2005	10	Jun-05	3
Financial and Private Sector Development				145		75.5
FY 2003 CAS	Financial Sector Restructuring, Phase II, FSRP	P084219	2004	70	Mar-04	75.5
FY 2003 CAS	Financial Sector Restructuring, Phase III		2006	75	Dropped	
Agriculture				30		0
FY 2003 CAS	Agriculture Sector Operation		2006	30	Delayed	
Transport				70		32
FY 2003 CAS	Rural Access Improvement & Decentralization, RAIDP	P083923	2005	30	Mar-05	32
FY 2003 CAS	Infrastructure Development		2007	40	Delayed	
Pillar 2: Social Sector Development				155		125.3
Education				75		50
FY 2003 CAS	Basic & Primary Education II (2nd Phase) b/	P074633	2004	50	Jul-05	50
FY 2003 CAS	Higher Education	P066075	2005	25	Delayed	
Health, Nutrition and Population				50		50
FY 2003 CAS	Health Sector Operation	P040613	2005	50	Sep-04	50
Water & Sanitation				30		25.3
FY 2003 CAS	Second Rural Water Supply and Sanitation, RWSSP II	P071285	2004	30	Jun-04	25.3
Pillar 3: Social Inclusion and Targeted Programs				45		40
FY 2003 CAS	Poverty Alleviation Fund LIL	P081968	2004	15	Jun-04	15
FY 2003 CAS	Poverty Alleviation Fund II c/	P080819	2006	30	Nov-06	25
Pillar 4: Good Governance				30		0
FY 2003 CAS	Decentralization Support		2007	30	Dropped	
Total CAS 2003				765		345.8

a/ Renamed Economic Reform Technical Assistance Project, ERTA.
b/ Renamed Education For All project.
c/ Delayed; PAF additional financing instead.
Source: 2003 CAS and World Bank internal database.

Notes: AF= additional financing; CAS= Country Assistance Strategy; FSRP= Financial Sector Restructuring Program; FY= fiscal year; ID= identification; ISN= Interim Strategy Note; LIL= learning and innovation loan; RAIDP= Rural Access Improvement and Decentralization Project; RWSSP= Rural Water Supply and Sanitation Project; TA=technical assistance: USD= U.S. dollars.

Annex Table A4c. Nepal: Lending Program, Actual versus Planned by Pillar, FY 2007-08

2007 INTERIM CAS	PROJECT TITLE	PROJECT ID	PROPOSED FY	PROPOSED AMOUNT (USD MILLION)	APPROVED FY	APPROVED AMOUNT (USD MILLION)
PILLAR 1: BROAD-BASED ECONOMIC GROWTH				165		110.8
Economic Policy				25		18.2
FY 2007 ISN	Development Policy Credit (ITS)		2007	30-70	Scenario not triggered	
FY 2007 ISN	Development Policy Credit (ITS)		2008	30-70	Scenario not triggered	
FY 2007 ISN	Economic Reform TA Additional Financing (ITS)		2007	5	Scenario not triggered	
FY 2007 ISN	Avian Flu Control	P100342	2007	20	Jan-07	18.2
Agriculture				*80*		*50*
FY 2007 ISN	Irrigation and Water Resource Management	P099296	2007	40	Dec-07	50
FY 2007 ISN	Agricultural Sector Operation a/ (pipelined)	P087140	2008	40	Jul-09	
Transport				30		42.6
FY 2007 ISN	Infrastructure Development b/	P095977	2008	30	Dec-07	42.6
Power				30		0
FY 2007 ISN	Community Electrification (ITS)		2008	30	Scenario not triggered	
PILLAR 2: SOCIAL SECTOR DEVELOPMENT				100		198
Education				100		120
FY 2007 ISN	Education for All Supplement	P107558	2008	40	Dec-07	60
FY 2007 ISN	Second Higher Education	P090967	2007	60	Feb-07	60
Health, Nutrition and Population				0		50
	Health Sector Operation, AF	P110731	Unplanned		May-08	50
Water & Sanitation				0		28
	Second Rural Water Supply & Sanitation, RWSSP II, AF	P110463	Unplanned		May-08	28
PILLAR 3: SOCIAL INCLUSION AND TARGETED PROGRAMS				100		150
FY 2007 ISN	Poverty Alleviation Fund II	P105860	2008	100	Dec-07	100
	Peace Support Project	P110762	Unplanned		May-08	50
PILLAR 4: GOOD GOVERNANCE				0		0
Total 2007 ISN				365		458.8

ITS: Improving Transition Scenario

a/ Renamed Agricultural Commercialization and Trade

b/ Renamed Road Sector Development

Source: 2007 ISN and World Bank internal database.

Note: *AF= additional financing; FY= fiscal year; ISN= Interim Strategy Note; RWSSP= Rural Water Supply and Sanitation; TA= technical assistance; USD= U.S. dollars.*

Annex Table A5a. Nepal: AAA Program, Actual versus Planned by Pillar, FY 1999-2003

Project Title		AAA Type	Project ID	Proposed Completion FY	Proposed Amount (USD 000s)	Delivery date FY	Approved Amount (USD 000s)
Pillar 1: Broad-based Economic Growth					1318		1862
Poverty Reduction					478		205
1998 CAS	Poverty Assessment	ESW	P015583	1999	184	Nov-98	174
1998 CAS	Country Assistance Strategy (CAS)			1999	112	Dropped	
1998 CAS	Social Dimensions of the CAS			1999	83	Dropped	
	Nepal Development Forum Note	ESW	P071544	Unplanned		Jan-02	31
2002 CASPR	Joint IDA-IMF Staff Assessment of the PRSP --> CAS 2003	PRSP	P075048	2003	25	CAS 2003	
2002 CASPR	Nepal Living Standards Survey --> CAS 2003	TA	P074678	2003/2004	75	CAS 2003	
Economic Policy					513		362
1998 CAS	Economic Update	ESW	P059877	2000	30	Feb-00	41
1998 CAS	Public Expenditure Review	ESW	P052389	1999	333	Jan-00	225
2002 CASPR	Consensus building for Public Expenditure Review			2003	15	n/a	n/a
2002 CASPR	Nepal Med Term Budget Frame/Expand Ref Phase 1 --> CAS 2003 /2	TA	P078729	2003	35	CAS 2003	
2002 CASPR	Trade and Competitiveness Study	ESW	P078719	2003	100	Jun-03	96
Financial and Private Sector Development					0		567
	Private Sector Assessment	ESW	P061033	Unplanned		Jan-01	144
	PPIAF: Nepal Telecom	TA	P069868	Unplanned		Apr-01	75
	PPIAF: Nepal Pre-CFR	TA	P073492	Unplanned		Mar-01	30
	Nepal Financial Sector Policy Dialogue	ESW	P072128	Unplanned		Jun-01	41
	NSA Financial Sector TA Credit	TA	P073382	Unplanned		Jun-01	79
	Nepal Financial Accountability Assessment	ESW	P075072	Unplanned		Jun-02	132
	Nepal Financial Sector Study	ESW	P073811	Unplanned		Oct-02	65
Agriculture					253		454
1998 CAS	Land Resource Management Study	ESW	P045939	1999	114	Nov-98	119
1998 CAS	Terai Development Options	ESW	P065442	1999	103	Jun-00	291
1998 CAS	Public Sector Role in Rural Development			2000	36	Dropped	
	TCN marketing study - Policy Note	ESW	P067844	Unplanned		Dec-00	18
	Nat Res & Decentrl. (pol dialogue)	ESW	P071576	Unplanned		Apr-01	26
Power					74		274
1998 CAS	Strategic Issues in Energy /1	ESW	P059170	1999	74	Sep-00	274
Pillar 2: Social Sector Development					324		418
Education					137		148
1998 CAS	Prior/Strategy for Education Reform	ESW	P052391	1999	137	Apr-01	148
					187		270

Annex Table A5a. Nepal: AAA Program, Actual versus Planned by Pillar, FY 1999-2003

Project Title		AAA Type	Project ID	Proposed Completion FY	Proposed Amount (USD 000s)	Delivery date FY	Approved Amount (USD 000s)
Health, Nutrition and Population							
1998 CAS	Health Issues	ESW	P039195	1999	187	Jul-99	270
Pillar 3: Social Inclusion and Targeted Programs					318		83
1998 CAS	Social Dimensions of Project Work			2000	164	Dropped	
1998 CAS	Aid Group Meeting			1999	67	Dropped	
1998 CAS	Status of Women in Nepal			1999	12	Dropped	
2002 CASPR	Poverty Alleviation Fund Policy Note	ESW	P078554	2003	75	Jan-03	83
Pillar 4: Good Governance					200		213
1998 CAS	Anti Corruption Initiative	ESW	P060012	1999	50	Jun-99	48
	Nepal- Decentralization Review	ESW	P070368	Unplanned		Oct-00	94
	Country Procurement Assessment	ESW	P070017	Unplanned		Jun-01	70
2002 CASPR	Fiscal Decentralization	ESW	P075014	2003	75	Dropped	
2002 CASPR	Decentralized Organizations --> CAS 2003	ESW	P075431	2003	75	CAS 2003	
Total 1999-2003					2,160		2,576

1/ Renamed Proposed Power Sector Development Strategy.

2/ Project approved in FY04.

Source: 1998 CAS and 2002 CASPR, World Bank internal database.

Note: AAA= Analytical and Advisory Services; CAS= Country Assistance Strategy; CASPR= Country Assistance Strategy Progress Report; CFR=Country Framework Report; NSA=New Spending Authority; IDA= International Development Association; IMF= International Monetary Fund; PPIAF=Public-Private Infrastructure Advisory Facility; PSRP= Poverty Reduction Strategy Paper; TA= technical assistance; TCN=Timber Corporation of Nepal.

Annex Table A5b. Nepal: AAA Program, Actual versus Planned by Pillar, FY 2004-07

2003 CAS	Project Title	AAA Type	Project ID	Proposed Completion FY	Proposed Amount (USD 000s)	Delivery date FY	Budget Amount (USD 000s)
Pillar 1: Broad-based Economic Growth					1,625		2,713
Poverty Reduction					550		735
FY 2003 CAS	Joint IDA-IMF Staff Assessment of the PRSP	PRSP	P075048	2003/2004	150	Oct-03	n/a
	Nepal Poverty Reduction Strategy Paper annual progress report	PRSP	P090827	Unplanned		Nov-05	n/a
	Nepal PRSP Progress report and Joint IDA-IMF staff advisory note	PRSP	P074711	Unplanned		Nov-06	n/a
FY 2003 CAS	Nepal Living Standards Survey	TA	P074678	2003/2004	200	Jun-04	207
FY 2003 CAS	Poverty Assessment	ESW	P084655	2005	200	Dec-05	528
Economic Policy					625		524
FY 2003 CAS	Country Economic Update			2006	75	n/a	n/a
	Nepal Economic Monitoring	TA	P078750	Unplanned		May-05	38
FY 2003 CAS	Development Policy Review	ESW	P084650	2004	150	Jun-04	299
FY 2003 CAS	Reform Episodes a/	ESW	P081696	2003/2004	50	Dropped	
FY 2003 CAS	Public Expenditure Analysis- Evaluating the MTEF f/	ESW	P093959	2005	100	Jun-06	12
FY 2003 CAS	Public Expenditure Analysis-The SOE sector			2005	100	n/a	n/a
FY 2003 CAS	Nepal Med Term Budget Frame/Expand Ref Phase 1	TA	P078729	2003/2005	100	Oct-04	64
	Med Term Expenditure Framework Phase 2	TA	P090582	Unplanned		May-05	21
FY 2003 CAS	Study on Labor Remittances b/	TA	P082511	2003/2004	50	Jul-03	37
	Nepal Trade Study Dissemination	TA	P084657	Unplanned		Jun-04	53
Financial and Private Sector Development					100		704
FY 2003 CAS	Nepal Legal Financial Review Policy Note c/	ESW	P088986	2006	100	Feb-05	116
	Nepal Access to Finance	ESW	P090736	Unplanned		Mar-07	418
	Nepal Corporate Governance ROSC Assessment	ESW	P094047	Unplanned		Jun-05	56
	Nepal ICR ROSC Insolvency Assessment	ESW	P094090	Unplanned		Jun-07	114
Urban Development					0		51
	Secondary Town Services Policy Note	ESW	P086422	Unplanned		Dec-04	51
Agriculture and Rural Development					225		144
FY 2003 CAS	Rural Sector Issues Note d/	ESW	P084332	2004	75	Dropped	
FY 2003 CAS	Rural Factor Market Study			2005	150	n/a	n/a
	Groundwater Legislation & Water Quality Mapping	TA	P078054	Unplanned		Nov-04	87
	Benchmarking of Sunsari Morang Irrigation Project	TA	P090976	Unplanned		May-06	57
Transport					0		74
	Nepal Transport Corridors Study	ESW	P086412	Unplanned		Aug-04	74

Annex Table A5b. Nepal: AAA Program, Actual versus Planned by Pillar, FY 2004-07

2003 CAS	Project Title	AAA Type	Project ID	Proposed Completion FY	Proposed Amount (USD 000s)	Delivery date FY	Budget Amount (USD 000s)
Environment					125		481
FY 2003 CAS	Country Environment Analysis	ESW	P078635	2005	125	Jun-07	473
	Oversight of Carbon Finance Operations; Capacity Assessment	TA	P104502	Unplanned		Jun-07	8
Pillar 2: Social Sector Development					150		0
FY 2003 CAS	Evaluation of Community Managed Schools	TA	P095391	2007	150	Delayed	
Pillar 3: Social Inclusion and Targeted Programs					430		711
	Measuring empowerment and social inclusion as key social development outcomes in bank assisted cdd projects	ESW	P077579	Unplanned		Jun-04	174
FY 2003 CAS	Social and Gender Assessment e/	ESW	P078793	2004	230	Jun-05	537
FY 2003 CAS	Re-evaluating Social and Gender Issues			2007	100	n/a	n/a
FY 2003 CAS	Updated on Child Labor			2006	100	n/a	n/a
Pillar 4: Good Governance					290		803
	Gap Analysis of Public Sector Accounting & Auditing study	ESW	P097050	Unplanned		Sep-06	46
FY 2003 CAS	Update Fiduciary Assessments g/	ESW	P097597	2007	100	May-07	280
	E-Procurement: Readiness report and Implementation plan for Nepal	ESW	P100104	Unplanned		Jun-07	40
FY 2003 CAS	Fiscal Decentralization	ESW	P075014	2003/2005	60	Dropped	
FY 2003 CAS	Decentralized Organizations	ESW	P075431	2003/2004	130	Mar-04	375
	Delineation of Responsibilities b/w Ministers and Civil Servants Note	ESW	P094508	Unplanned		Jun-07	62
Total CAS 2003					2,495		4,227

a/ Renamed Nepal Policy Reform Notes
b/ Renamed Nepal Migrant Remittances (TA)
c/ Renamed Nepal Legal financial review policy note
d/ Renamed Nepal Accelerating Rural Sector Growth
e/ Working paper: Unequal Citizen: Gender, Cast and Ethnic Exclusion in Nepal
f/ Renamed Expenditure Management - Policy Note
g/ Renamed Nepal Public Finance Management Review
Source: 2003 CAS, World Bank internal database.
Note: AAA= Analytical and Advisory Activities; CAS= Country Assistance Strategy; ESW= economic and sector work; ICR= Implementation Completion Report; IDA= International Development Association; IMF= International Monetary Fund; MTEF= Medium-Term Expenditure Framework; PRSP= Poverty Reduction Strategy Paper; ROSC= Report on the Observance of Standards and Codes; SOE= state-owned enterprise; TA= technical assistance.

Annex Table A5c. Nepal: AAA Program, Actual versus Planned by Pillar, FY 2007-08

2007 Interim CAS	Project Title	AAA Type	Project ID	Proposed Completion FY	Proposed Amount (USD 000s)	Delivery date FY	Budget Amount (USD 000s)
Pillar 1: Broad-based Economic Growth					400		31
Poverty Reduction					0		0
	PSRP support to the government of Nepal	TA	P111318	Unplanned		May-08	n/a
	NP Monitoring and Evaluation Dialogue	TA	P090826	Unplanned		Oct-11	(49)
Economic Policy					0		0
	NLTA Labor migration and migration study	TA	P108409	Unplanned		Apr-09	(48)
Financial and Private Sector Development					0		0
FY 2007 ISN	Investment Climate Assessment			2008	n/a	n/a	n/a
	Nepal Technology in Microfinance	ESW	P108967	Unplanned		Jul-08	(93)
	NP Agricultural Insurance Feasibility Study	ESW	P110459	Unplanned		Jul-08	(10)
	Nepal Secured Charges Registry	TA	P109613	Unplanned		Sep-08	(7)
Information Communications Technology					0		31
	Nepal ICT Dev for Conn and Growth	TA	P107464	Unplanned		Mar-08	31
	Infrastructure for growth initiatives	TA	P111668	Unplanned		Jun-10	(250)
Energy					200		0
FY 2007 ISN	Options for Financing Hydro Power 1/	ESW	P111244	2008	200	Apr-09	(200)
	NEA Energy Efficiency Study	ESW	P111217	Unplanned		Sep-08	(174)
	Assessment Social Impacts of Rural Energy	ESW	P111242	Unplanned		Mar-09	(200)
Environment					200		0
FY 2007 ISN	Climate Variability and Climate Change 2/	ESW	P102682	2008	200	Apr-09	(200)
Natural Disaster Management					0		0
	GFDRR-TF- Global Facility for Disaster Reduction and Recovery	ESW	P105077	Unplanned		May-09	(914)
Pillar 2: Social Sector Development					150		0
FY 2007 ISN	Financing of Education			2008	n/a	n/a	n/a
FY 2003 CAS	Evaluation of Community Managed Schools	Impact Eval.	P099792	Carried over	150	Oct-09	
Pillar 3: Social Inclusion and Targeted Programs					0		0
Social Development					0		0
	Social Inclusion Action Program	TA	P104077	Unplanned		Aug-08	(248)
Pillar 4: Good Governance					0		26
	Fiscal Federalism	TA	P081630	Unplanned		Dec-08	(154)
	MTEF/DMTEF Dialogue	TA	P110375	Unplanned		Jun-08	3
	Understanding accountability gap in urban service delivery	ESW	P108136	Unplanned		May-08	23
Total 2007 ISN*					550		57

1/ Renamed Nepal Hydro Power - Removing Barriers

2/ Renamed Nepal- Adaptation to climate variability

* Total 2007 ISN budget amount does not include the budget amount of the programs delivered after FY08

Source: 2007 ISN, World Bank internal database.

Note: AAA= Analytic and Advisory Activities; DMTEF= District-Level Medium-Term Expenditure Framework; ESW= economic and sector work; FY= fiscal year; GFDRR= Global Facility for Disaster Reduction and Recovery; ICT=information and communication technologies; ISN= Interim Strategy Note; MTEF= Medium-Term Expenditure Framework; NEA= Nepal Electricity Authority; NLTA= non-lending technical assistance; NP=Nepal; PRSP= Poverty Reduction Strategy Paper; TA= technical assistance; TF= Trust Fund; USD= U.S. dollars.

Annex Table A6. Nepal: List of IDA Projects, FY 2003-08

Project ID	Project Name	Approval FY	Sector Board	IDA Amount	Latest DO	Latest IP	Latest Risk Rating	Project Status	Date, Rev Closing	IEG Outcome	IEG Sustaina-bility*	IEG ID Impact
Active Projects												
P043311	Power Development Project	FY03	Energy and Mining	75.6	S	S	#	Active	12/31/10			
P071291	NP Financial Sector Technical Assistance	FY03	Financial and Private Sector Development	16.0	MS	MS	#	Active	12/31/11			
P071285	Rural Water Supply & Sanitation Project	FY04	Water	25.3	S	MS	#	Active	12/31/10			
P084219	Fin Sector Restructuring (Phase II)	FY04	Financial and Private Sector Development	75.5	MS	MS	#	Active	09/30/09			
P040613	Nepal Health Sector Program Project	FY05	Health, Nutrition and Population	50.0	S	MS	#	Active	07/15/10			
P074633	Education for All Project	FY05	Education	50.0	S	S	#	Active	01/31/10			
P083923	Rural Access Improve. & Decentralization	FY05	Transport	32.0	S	MS	#	Active	12/31/10			
P093294	NP Economic Reform TA	FY05	Financial and Private Sector Development	3.0	S	MS	#	Active	12/31/09			
P090967	Second Higher Education Project	FY07	Education	60.0	S	MS	#	Active	01/15/14			
P100342	Avian Flu	FY07	Agriculture and Rural Development	18.2	S	MS	#	Active	07/31/11			
P095977	Road Sector Development Project	FY08	Transport	42.6	S	S	#	Active	06/30/12			
P099296	Irrigation & Water Res Mgmt Project	FY08	Agriculture and Rural Development	50.0	S	MU	#	Active	06/30/13			
P105860	PAF II	FY08	Agriculture and Rural Development	100.0	S	S	#	Active	09/30/12			
P107558	Education for All Additional Financing	FY08	Education	60.0	#	#	#	Active	#			
P110463	Second Rural Water Sup. and San. Add. Fin	FY08	Water	27.0	#	#	#	Active	#			
P110731	NP - Health Sector Additional Financing	FY08	Health, Nutrition and Population	50.0	#	#	#	Active	#			
P110762	Peace Support Project	FY08	Social Protection	50.0	S	S	#	Active	06/30/11			
Closed Projects												
P010516	Rural Water Supply & Sanitation Project	FY97	Water	18.3	#	#	#	Closed	12/31/03	MS	Non-Evaluable	Substantia
P010509	Multimodal Transit	FY98	Transport	23.5	#	#	#	Closed	09/30/03	MU	Significant	#
P010530	Irrigation Sector Development	FY98	Agriculture and Rural Development	79.8	#	#	#	Closed	06/30/04	MS	Unlikely	Modest
P048026	AGRI RES & EXTENSION	FY98	Agriculture and Rural Development	24.3	#	#	#	Closed	09/30/02	U	Unlikely	Modest
P040612	Basic & Primary Education Project II	FY99	Education	12.5	#	#	#	Closed	07/15/04	MS	Likely	Substantia
P045053	RURAL INFRA LIL	FY99	Transport	5.0	#	#	#	Closed	07/31/03	MS	Likely	Substantia
P045052	Road Maintenance and Development	FY00	Transport	54.5	MS	S	#	Closed	06/30/07	MS	Moderate	#
P074685	Poverty Reduction Support Credit I	FY04	Economic Policy	70.0	#	#	#	Closed	11/01/04	MS	Unlikely	Modest

Source: World Bank internal database, 2/21/09.

* IEG sustainability ratings for Multimodal Transit and Road Maintenance and Development Projects are "Risk to DO". And, the original IEG sustainability rating for PRSC I is Non-Evaluable.

Note: DO= development objective; EG= FY= fiscal year; ID= identification; IDA= International Development Association; IEG= Independent Evaluation Group; IP= implementation progress; LIL= learning and innovation loan; NP= Nepal; PAF= Poverty Alleviation Fund; TA= technical assistance. R*atings:* MS= mostly satisfactory; MU= mostly unsatisfactory; S= satisfactory; U= unsatisfactory.

Annex Table A7. Nepal and Comparators: Level of ESW, FY 2003-08

	FY03	FY04	FY05	FY06	FY07	FY08	AVERAGE FY03-08
Number of Deliveries							
Nepal	3	3	5	2	7	0	3.3
Bangladesh	16	5	13	4	8	9	9.2
Pakistan	7	10	9	9	8	6	8.2
South Asia Region	66	69	84	76	62	47	67.3
Africa Region	148	167	148	148	108	120	139.8
Bank-wide	667	687	651	572	512	467	592.7
Bank Budget: Cost of ESW (in US$ thousands)							
Nepal	849	1,097	1,115	1,519	1,302	891	1,129
Bangladesh	1,563	1,571	2,472	2,648	2,829	2,643	2,288
Pakistan	2,165	3,197	4,742	4,402	2,948	3,221	3,446
South Asia Region	15,100	18,414	22,542	22,909	20,850	18,865	19,780
Africa Region	32,304	35,732	35,778	39,187	37,863	42,945	37,301
Bank-wide	150,737	154,945	158,446	169,053	162,908	187,772	163,977
Percentage of Bank Budget Cost of ESW from Country Service Budget							
Nepal	30	25	31	37	29	20	29
Bangladesh	23	21	31	25	27	22	25
Pakistan	35	38	47	35	23	29	34
South Asia Region	31	31	34	31	26	22	29
Africa Region	24	23	22	24	23	25	24
Bank-wide	29	26	27	27	26	29	27

Source: World Bank internal database, 02/23/09.

Note: ESW= economic and sector work; FY= fiscal year.

Annex Table A8. Nepal and Comparators: Bank Budget by Cost Category, FY 2003-08 *(in US$ thousands)*

	FY03	FY04	FY05	FY06	FY07	FY08	AVERAGE	SHARE (%)
NEPAL								
Project Supervision	637	782	1,148	1,312	1,517	1,756	1,192	30
Lending	842	1,602	822	715	1,014	1,235	1,038	26
AAA	849	1,097	1,115	1,519	1,302	891	1,129	28
Other	461	871	483	525	691	638	611	15
Total	2,789	4,352	3,568	4,071	4,524	4,521	3,971	100
South Asia Region								
Project Supervision	15,111	15,171	19,994	22,002	24,945	30,820	21,341	31
Lending	12,852	18,753	15,646	20,469	24,308	24,397	19,404	28
AAA	15,100	18,414	22,542	22,909	20,850	18,865	19,780	29
Other	6,253	7,491	7,673	9,487	9,857	10,170	8,489	12
Total	49,315	59,830	65,855	74,868	79,960	84,253	69,013	100
Africa Region								
Project Supervision	39,668	42,031	49,773	52,398	53,259	60,882	49,668	32
Lending	33,390	45,947	40,164	39,626	38,486	37,002	39,103	25
AAA	32,304	35,732	35,778	39,187	37,863	42,945	37,301	24
Other	26,642	30,782	34,734	30,451	32,717	31,564	31,148	20
Total	132,004	154,491	160,448	161,662	162,325	172,394	157,221	100
BANKWIDE								
Project Supervision	160,059	166,807	177,915	189,741	198,723	216,974	185,037	31
Lending	119,962	156,262	151,319	155,280	148,834	146,774	146,405	24
AAA	150,737	154,945	158,446	169,053	162,908	187,772	163,977	27
Other	92,296	107,463	101,473	104,678	106,331	106,194	103,073	17
Total	523,054	585,478	589,152	618,751	616,797	657,714	598,491	100

Source: World Bank internal database. 2/23/09.
Note: AAA= Analytic and Advisory Services; FY= fiscal year.

Annex Table A9. Nepal: World Bank's Senior Management, FY 2003-08

YEAR	VICE PRESIDENT	COUNTRY DIRECTOR
2003	Mieko Nishimizu	Kenichi Ohashi
2004	Praful C. Patel	Kenichi Ohashi
2005	Praful C. Patel	Kenichi Ohashi
2006	Praful C. Patel	Kenichi Ohashi
2007	Praful C. Patel	Kenichi Ohashi
2008	Praful C. Patel	Susan Goldmark

Source: World Bank Directory
Note: FY= fiscal year.

Annex B: Poverty and Social Development Outcomes

Nepal experienced significant general improvements in economic and human development between 1995/96 and 2003/04. There are indications that this trend continued beyond the latter years despite a politically difficult and conflict-ridden environment.

1. Income poverty declined from 42 percent in 1995/96 to 31 percent in 2003/04, with the decline in rates affecting rural as well as urban areas.

The incidence of poverty[51] declined dramatically from 42 percent in 1995/96 to 31 percent in 2003/04. Progress occurred both in rural and urban areas, although it was much greater in urban areas. The poverty incidence fell from 21.6 percent in 1995-96 in urban areas to 6.6 percent in 2003-04 and from 42.3 percent in rural areas on 1995-96 to 34.6 percent in 2003-04. Nepal's urbanization rate is the highest in South Asia, although the rural population still represented 86 percent of Nepal's total population in 2001 Census.

Both internal factors (macroeconomic stability, economic and financial sector reforms, better public expenditure management) and external factors (an increase in remittances from 3 percent of GDP in 1995-96 to 12 percent in 2003-04) underlay this unexpectedly strong development outcome.

The decline in poverty was driven by growth in per capita consumption expenditure and income which, in turn, was driven by increases in remittances, higher agricultural wages, increased connectivity, urbanization, and a decline in the dependency ratio.

Remittances increased dramatically. More than one million Nepalese were working abroad in 2003-04. Most migrants work in India, but an increasing number now go to the Persian Gulf or East Asia, where they earn much more than in South Asia. The increase in remittances is responsible for one-third to one-half of the overall reduction in the headcount poverty rate between 1995-96 and 2003-04.

2. Human poverty was estimated at 38 percent in 2005

Human poverty[52] incidence (focusing on the most deprived in multiple dimensions of poverty) was estimated l at 38.1 percent in 2005. Unfortunately there is no time series for this measure of poverty. However, it is based on the same primary indicators (life expectancy, adult literacy, population with improved water source, children underweight for age, and standard of living) as the Human Development Index (HDI). We can infer from continued progress in the HDI that the incidence of human poverty continued to decline over the recent years.

3. Health and education outcomes improved particularly for girls and people living in remote areas.

- Nepal's HDI[53] improved steadily since 1975, although the pace of improvement declined after 1990, and was the lowest over the 2000-05 period (table B.1, annex B). Strikingly, Nepal has made greater progress than would be expected based regarding its economic and income growth. As a result, whereas in 1975, Nepal had an HDI of 0.3 which was lower than the average HDI for sub-Saharan African countries (0.4). It was slightly higher in 2005.

Table B.6 Nepal Human Development Index and Human Poverty Incidence

	1975	1980	1985	1990	1995	2000	2005
Human Development Index	0.301	0.338	0.380	0.427	0.469	0.502	0.534
Human Poverty Incidence (percent)							38.1

Source Human Development Report 2007/2008, Fighting Climate Change: Human Solidarity in a Divided World, UNDP.

- **Education outcomes have improved over the last decade**. Net primary and secondary enrollment rates have increased significantly between 1995-96 and 2003-04, and the gap between boys and girls has declined. Over the CAE period, net primary enrollment rate continued to decline and the gender gap has been largely eliminated in primary education[54] (Table B.2). Completion rates among children who were ever-enrolled in school increased from 1995-96 to 2003-04, and girls are now on a par with rates for ever-enrolled boys. Since 2004, the rate of participation to Grade 5 continued to improve from 76 to 81 in 2008.

- **Nepal has made significant improvements in the health status of its people**. Major declines in child mortality and improvements in the detection and treatment of tuberculosis have helped to increase life expectancy at birth to 61 in 2001 from 59.2 in 1996.[55] According to the National Demographic Health Surveys (DHS, 1996, 2001, and 2006), the infant, child and maternal mortality rates all declined significantly over the past decade and the CAE review period (table B.3).

- **Access and use of improved water sources improved significantly.** It has increased from 64 percent of the population in 1996 to 74 percent in 2001, to 80 percent in 2006 (DHSs). It has increased from 61 percent in 1996 to 71 percent in 2001 and 80 percent in 2006 in rural areas. Access to improved sanitary facilities improved dramatically for urban populations over the 1996-2001 period and deteriorated somewhat subsequently. For rural populations, the progress was steady but much more modest and the rate of progress declined over the 2001-06 period compared to the 1996-2001 period (table B.3).

Table B.7 Nepal Education Outcomes, 1995/96–2208 *(in percentages)*

	1995-96[a)]	2003-04[a)]	2004[b)]	2008[b)]
NET PRIMARY AND SECONDARY ENROLLMENT RATES				
Primary				
All	56.8	72.4	84.2	91.9

Gender gap	*69.6*	*85.9*	*87.0*	*97.0*
Lower secondary				
All	19.1	29.0		
Gender gap	*61.4*	*84.9*		
Secondary				
All	9.3	15.1		
Gender gap	*46.5*	*79.8*		
COMPLETION RATES				
All ever-enrolled children 11-13	29	37		
Gender gap	*83.9*	*97.3*		
All ever-enrolled children 14-17	71	79		
Gender gap	*85.3*	*98.7*		
Survival rate to grade 5			76.4	81.1

Source: a) Resilience Amidst Conflict, an Assessment of Poverty in Nepal, 1995-96 and 2003-04, World Bank, September 2006. b) Joint Evaluation of Nepal Education For All 2004–09, March 2009.

Table B.8 Nepal: Health, Water, and Sanitation Outcomes, 1996, 2001, and 2006

	1996	2001	2006
Health			
Infant mortality (per 1,000 live births)	76	64	48
Under-5 child mortality (per 1,000 live births)	118	91	61
Maternal mortality rate (per 100,000 live births)	539	n.a.	281
Life expectancy	59.2	61	63.2
Water and Sanitation			
Access to improved water source (safe drinking water)	63.4	72.8	81.8
Rural	61.4	71.1	80.2
Urban	84.7	86.0	89.5
Access to improved sanitary facilities	15.6	30.4	36.5
Rural	14.3	24.7	29.3
Urban	28.1	79.9	76.5

Source: Demographic Health Surveys.

4. Income inequalities increased but disparities in access to basic services declined.

- Though income growth was high between 1995-96 and 2003-04, with real average per-capita expenditures growing on average by 4.5 percent per year, the increase was greatest for the higher expenditure groups. These patterns of growth were driven by increasing returns to human and physical assets. As low-income groups lacked these assets, income inequality worsened, with the Gini coefficient increasing from 34.2 to 41.4 during this period. Most of the increase in inequality occurred because the gap between the middle class and the rich class grew. Inequality increased along the expenditure distribution, except at the bottom. Most of the increase was concentrated in the upper half of the expenditure distribution.

- Considerable progress was made in improving access to primary education for girls, Dalits, and disadvantaged Janajati groups. The proportion of girls 15–49 completing fifth grade doubled from 17 percent in 1996 to 35 percent in 2006, and the gap with boys decreased significantly. The ratio of girls to boys age 15–49 who completed fifth grade increased from 0.38 in 1996 to 0.45 in 2001 and 0.56 in 2006 (Nepal DHS data). Between 1996 and 2006, the percentage of girls currently attending school rose from 57 percent to 87 percent. Gender equity in school attendance increased in all wealth quintiles over the same period.

- Significant progress has been achieved in reaching underserved populations. For a large number of health outcomes and health care services utilization, inequalities based on gender, caste, and ethnicity have been significantly reduced.

- The greatest improvement in access to safe drinking water occurred among the poorest, and by 2006 access to safe water was equally distributed across wealth quintiles. Use of improved sanitary facilities increased somewhat over time both overall and among the poorest. However, improvements in sanitation lag behind improvements made in increasing access to safe water. In 1996, 16 percent of the population had access to improved sanitation, with no one in the two poorest quintiles using improved sanitation in 1996 and 2001. By 2006, 36 percent used improved facilities. Among the wealthiest, the corresponding figure was 94 percent and, compelling only 3 percent among the poorest.

Annex C: Political Developments in Nepal During the Evaluation Period

Progressive Suspension of Democracy and Emergence of a Three-Way Conflict

<u>From monarchy to multiparty democracy</u>. For most of its modern history, Nepal was ruled by a hereditary monarch. It briefly experimented with multiparty democracy in 1959–1960. A constitutional monarchy and multiparty democracy were established in 1991. After a short period of optimism, it became increasingly evident that the new political order was unstable with frequent turnover in administrations, and problems with patronage and corruption. A succession of governments (a total of eight between November 1994 and October 2002) was unable to achieve any real headway in addressing the country's continuing economic underdevelopment and deep-seated social inequalities.

<u>A decade of Maoist Insurgency.</u> Against this backdrop and ostensibly in response to it, an armed insurgency led by Nepali Maoists began in February 1996. The start of the insurgency followed a split in the Communist Party of Nepal (CPN) into two factions, the CPN (Maoists) and the CPN (Unified Marxist-Leninists). The CPN (Maoists) faction vowed to resort to armed struggle, judging the then-prevailing political order incapable of furthering its goals. The insurgency was initially concentrated in the most remote and least developed areas of Nepal (the Rolpa and Rukum districts in the mid-Western region). It began as a low-intensity conflict, and gradually developed into a full military conflict between the Maoist fighters and the government security forces, spreading to all parts of the country (see maps in Annex C which illustrate how the geographical range of the conflict changed over time, as well as how the intensity of the conflict varied by district).

In the initial years of the insurgency, the government used the then-prevailing law and order framework to address the security problem. But the intensity of the conflict escalated sharply after the government declared a state of emergency in November 2001, and the Royal Nepal Army was mobilized to counter the insurgency. Most parts of rural Nepal progressively fell under the control of Maoist guerillas, although district headquarters remained mostly under the control of the state.

<u>Suspension of Democracy</u>. In May 2002, the King dissolved parliament and began appointing prime ministers by royal decree, and sidelining the mainstream political parties. In addition, the mandates of the elected District Development Committees (DDCs) and Village Development Committees (VDCs) were allowed to expire in 2002. As government instability grew (three governments were successively in office between October 2002 and February 2005) and insecurity continued, the King formally suspended the remaining trappings of democratic rule and assumed absolute power in February 2005. The so-called "royal coup" included placing party leaders under house arrest, suspending key constitutional rights, and declaring a heightened state of emergency, including a strict curfew and communications restrictions. With these events, the conflict in effect became a three-party one, involving the Palace and the Army, the CPN (Maoists), and the unarmed

civilian mainstream (non-royalist) political parties. The period in the immediate wake of the royal coup witnessed widespread human rights abuses and growing risks of a humanitarian crisis as the conflict took devolved into direct military clashes with greater fallout on the population.

Transition to a Fragile Peace

Profound dissatisfaction with the King's autocratic rule and deep-rooted desire for peace and democracy among the population spawned an activist Pro-Democracy Movement. This forced the King to reinstate the Parliament and appoint an interim prime minister in April 2006. Formation of the Pro-Democracy Movement came in two steps. First, the non-royalist mainstream political parties came together in the Seven-Party Alliance (SPA) in mid-2005. Then in November 2005, the SPA and the CPN (Maoists) formed an alliance against the King.

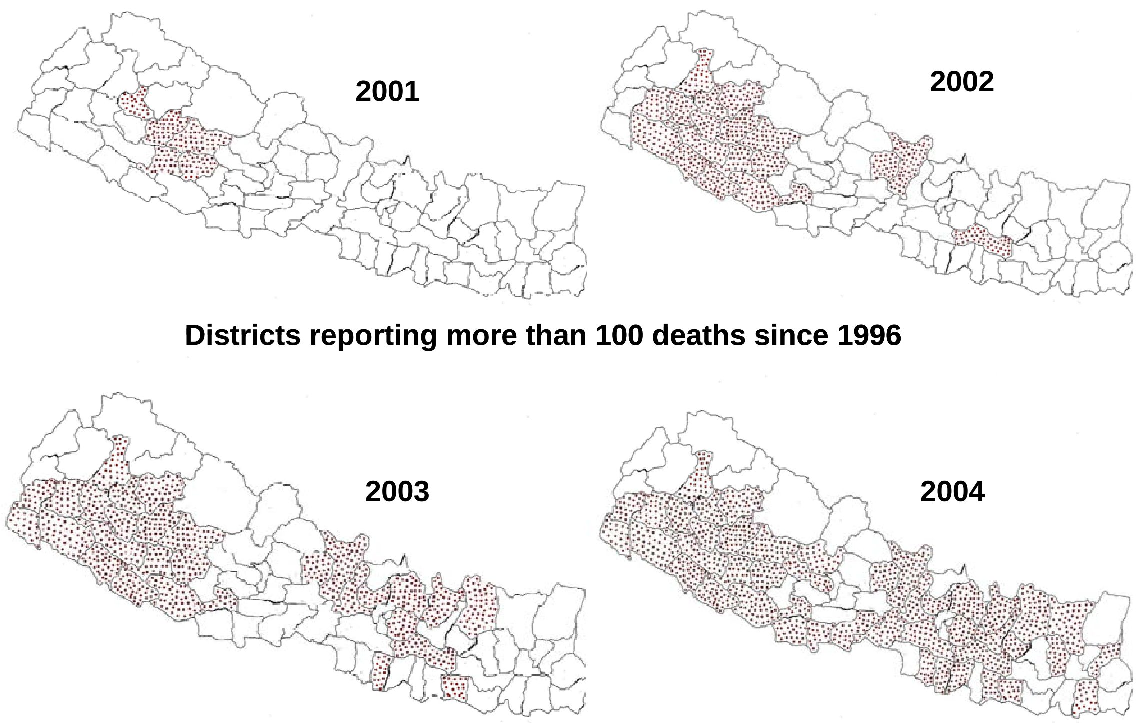
After the SPA and the Maoists signed a Comprehensive Peace Agreement (CPA) in November 2006, the Maoists joined the coalition government and the interim Parliament. The 2007 Interim Constitution, enacted following the political settlement with the Maoists, was contested by the Madhesis[56] the day after its promulgation. The Madhesis constitute about a third of the Nepal's population and nurse a long-standing grievance of exclusion from public life. After long negotiations, the coalition government signed a deal with the United Madhesh Democratic Front in February 2008. This provided the Terai region with considerable autonomy, reserving a greater proportion of seats in the Constituent Assembly for Madhesi representatives, integrating Madhesi militias into the Nepali Army, and advancing Madhesi and minorities in the civil service. A separate deal was signed with the Federal Republican National Front on March 1, 2008. However, armed groups left out of the negotiations have continued to carry out killings, bombings, and abductions, and have threatened further violence.

After two postponements, the elections for a Constituent Assembly (CA) to serve as a transitional legislative body (and to be tasked with drafting a new constitution for the country) were finally held in April 2008. The CPN (Maoists), which won a plurality of seats (220 out of 601) but failed to get an outright majority, is leading a transition coalition government formed in August 2008. The first meeting of the newly-elected CA abolished the 239-year-old monarchy and proclaimed the Federal Democratic Republic of Nepal.

Despite successful elections and a lasting military ceasefire, Nepal's peace process remains fragile and continues to face severe tests. Ten months after the elections, the constitution-writing process is finally getting underway. Nevertheless, major parts of the CPA (such as the integration of former Maoist guerilla commanders into the Nepali army) remain unimplemented. At the same time, lawlessness remains rife and public security alarmingly weak. The consensus underlying the peace process has frayed, relationships between the parties to the CPA are increasingly acrimonious, and fundamental elements of the deal are being challenged.

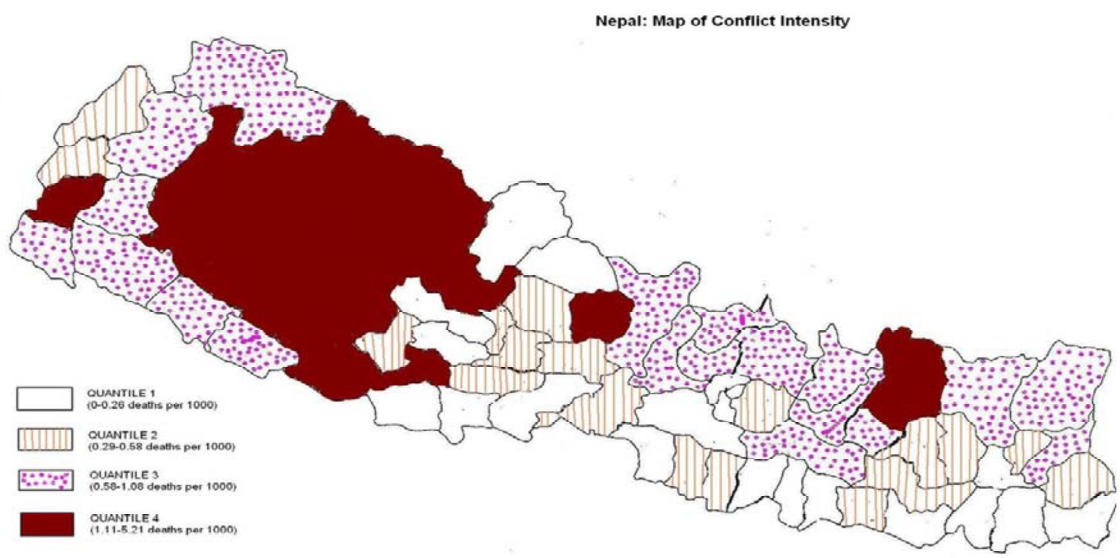
Annex D

Annex Figure D1. Nepal: Geographical Spread of Conflict over time, 2001-04



Source: Poverty, Social Divisons, and Conflict in Nepal, World Bank Policy Research Working Paper 4228, May 2007

Annex Figure D2. Nepal: Map of Conflict Intensity, 2001-04



Source: Poverty, Social Divisons, and Conflict in Nepal, World Bank Policy Research Working Paper 4228, May 2007

Annex E: Nepal's PRSP Weaknesses Reflected in IDA's Assistance Strategy

Given IDA's close association with the PRSP preparation, and the backdrop of conflict in which Nepal's first PRSP was developed, it is worth noting that some weaknesses in the PRSP were carried over into the Bank assistance strategy.

The PRSP was appropriately geared toward Nepal's longer-term development and poverty reduction goals. Overall, Nepal's PRSP was satisfactory in content and process given the country circumstances. Its analysis of past performance and current challenges was critical and credible, and the proposed policies and reforms—pursuit of broad-based economic growth, improved provision of basic services, targeted programs to address exclusion, and actions to improve governance—were appropriate and necessary to address Nepal's longer-term development and poverty reduction challenges. A World Bank analysis of conflict sensitivity in conflict-affected countries praised the initial consultation process in Nepal and the PRSP's emphasis on the need for rural growth—both of which had the potential to reduce conflict.

Limited conflict analysis. The PRSP considered conflict issues in its poverty diagnostic and recognized the interaction between these issues and poverty. However, no specific conflict analysis supported the discussion of the implications of the conflict for the development and poverty reduction strategy, both in terms of formulation and implementation. In addition, there was little exploration of exactly how conflict and poverty interact. Although the PRSP noted the structural factors that contributed to both persistent poverty and conflict, and indicated that past efforts to address these factors had largely failed, it did not take up the reasons for these failures. The reason was mainly the lack of political will to address the issues among the government and bureaucratic elite. According to a number of observers, Nepal's main problem has been the lack of commitment and effort by those in power to implement a development agenda that meets the needs of the poor and the marginalized. An unstable political system, a patriarchal governance structure, and a civil service subject to rapid turnover obstructed efforts to mitigate conflict, and were also were key constraints on pro-poor initiatives in development interventions. In addition, the PRSP did not address human rights, one of the main issues of conflict dynamics.

There was a lack of prioritization on tangible results mutually compatible with conflict-resolution and poverty reduction. Given the state of Nepal's conflict at the time, the PRSP could have focused more on tangible results that are mutually compatible with conflict resolution and poverty reduction. Also a shift from policy reforms to impact results could have been more strongly prioritized. The poverty focus in the design and implementation arrangements of PRSP programs was often weak, and understanding of the cross-cutting sectoral dimensions of poverty was limited. Most importantly, the structure and working culture of the National Planning Commission did not demonstrate the capacity to approach poverty through the lens of social exclusion (including gender, caste, class, regional, and institutional discrimination). Also, the lack of public awareness, consultation, and involvement in setting priorities encouraged a perception that vested interests were prevailing in the selection and funding of programs.

There was limited government ownership. The PRSP's quality, particularly its clarity of analysis, was due at least in part to the Bank-recruited (and DFID-funded) consultant who helped write the final version. This is not to say that the document did not reflect the views of the National Planning Commission (the department which led the process). However, it does raise questions about ownership, and the degree to which the government was willing to accept the implicit criticisms within the PRSP in order to gain access to financing by the World Bank (the planned US$70m first Poverty Reduction Support Credit that was approved at the same time) and the IMF (a three–year PRGF arrangement approved by the Executive Board on November 19, 2003, and ended in November 2007).

Limited government legitimacy and country circumstances were not conducive to effective implementation. Finally, by the time the PRSP was approved, questions about the legitimacy of the government and its policies were rife. Since October 2002, the King had been choosing prime ministers (there were three changes of government in the 28 months before the 2005 royal coup). Although there had been a good consultation process in the early stages, by the time the PRSP was finalized, no democratic institutions remained to endorse it. The State of Emergency declared in October 2002 and the 2005 royal coup paralyzed all systems of democratic governance and called into question the legitimacy of the PRSP. Moreover, in the deteriorating conditions marked by growing disruption, violence, insecurity, lawlessness, the PRSP became effectively obsolete.

The shortcomings of the PRSP were reflected in IDA's assistance strategy:

- Although the Bank's strategy acknowledged the existence and impact of the conflict, it did not take into account the implications for the government and its capacity to implement planned policies, reforms, and programs. In addition, as in the PRSP, the Bank did not identify the reasons for past failures that contributed to the conflict. Therefore, it did not propose an adequate and realistic alternative with a better chance of success.
- The Bank strategy, like the PRSP, was not realistic for the country circumstances. Unless a tremendous improvement of the country situation was assumed, a number of the proposed policies and reforms would be impossible to implement in the prevailing environment characterized by violence, disruption, insecurity, lawlessness, a much reduced State presence, and a governance vacuum in rural areas. Without tackling the endemic instability that characterizes Nepal, the poverty-focused goals of the CAS and PRSP could not be achieved. The Bank simply avoided the conflict issue or treated it as a negative externality.
- There was a heavy reliance on a very few reform-minded technocrats (mostly in the Ministry of Finance and National Planning Commission and one or two line ministries) who were remote from the situation on the ground and wielded little power. With limited country ownership of the PRSP reforms, policies, and programs to be supported by the Bank, it was a very risky bet.

Annex F: List of People Interviewed

Government of Nepal

Office of the Prime Minister and Council of Ministries

Bhoj Raj Ghimire, Chief Secretary
Bimal P. Koirala, former Chief Secretary
Ganga Dutta Avasthi, Secretary, Local Self Government and Decentralization Division

National Planning Commission

Piamber Sharma, Deputy Chairman
Balananda Poudel, Joint Secretary
Shankar P. Sharma, former Vice Chair
Jagadish Pokharel, former Vice Chair
Champak P. Pokharel, former Member for Finance; Team Leader of Tenth Plan/PRSP
Dilli Raj Khanal, former Member, National Planning Commission, now Center for Policy Research

Ministry of Finance

Rameshwore Khanal, Secretary
Bhanu P. Acharya, former Secretary
Vidhyadhar Mallik, former Secretary
Mr. Bimal Wagle, Privatization Unit
Kailash Raj Pokhrel, Under Secretary, Foreign Aid Coordination Division
Lal Shankar Ghimire, Under Secretary, Office of the Finance Comptroller General
Krishna Gyawali, Head, Office of the Finance Comptroller General
Kailash Raj Pokhrel, Under Secretary, Foreign Aid Coordination Division
Deep Basnyat, Acting Finance Comptroller General and Public Expenditure Financial Accountability (FEFA)

Ministry of Agriculture and Cooperatives

Purushotam P. Mainali Jt., Secretary Planning Division, Agro-business Promotion Division

Ministry of Education

Balaram Paudel, Secretary
Lava Deo Awasthi, Undersecretary
Janardan Nepal, Director, Department of Education
Chuman Singh Basnyat, retired Secretary
Shivraj Lohani, retired Secretary, Ministry of Education, now Director, Research Inputs and Development Action

N. Karmacharya, Training Officer, National Curriculum and Education Department

MINISTRY OF HEALTH AND POPULATION

Dirgha Singh Bam, Secretary
Yogendra Gauchan, Under Secretary (Finance)
Kapil Dev Ghimire, Joint Secretary
Baburam Marasini, Project Coordinator, Health Sector Program
Robert Dimmons, Team Leader, Health Sector Reform Support Programme, RTI International
Damodar Adhikari, Deputy Team Leader, Health Sector Reform Support Programme

MINISTRY OF WATER RESOURCES

Mr. Anup K. Upadhyay, Secretary
Mahendra Nath Aryal, former Secretary

MINISTRY OF LOCAL DEVELOPMENT

Mahesh Dahal, Joint Secretary
Khem Raj Nepal, former Secretary

MINISTRY OF PEACE AND RECONSTRUCTION

Madhav P. Ghimire, Secretary

MINISTRY OF LAW AND JUSTICE

Suresh Pradhan, Director of Public Procurement Monitoring Office
Shakti Shrestha, former Project Coordinator of Public Procurement Reform Project

CENTRAL BANK

Deependra Purush Dhakal, former Governor
Bir Bikram Rayamajhi, Deputy Governor

COMMISSION FOR THE INVESTIGATION OF ABUSE OF AUTHORITY

Surya Nath Upadhyay, former Chief Commissioner
Lalit Man Limbu, Acting Chief Commissioner

OFFICE OF THE AUDITOR-GENERAL

Bachchu Ram Dahal, Acting Auditor General
Bishnu Bhahadur KC, former Auditor General
Sushil Pant, former Attorney General

Poverty Alleviation Fund

Ram P. Yadav, Vice-Chairman
Mohan Man Sainju, former Chair
Raj Babu Shrestha, Executive Director
Bhola M. Shrestha, Livestock and Veterinary Consultant

Constituent Assembly

Narayan Khadka, Hon’ble Member, former Vice Chair, National Planning Commission
Tilak Rawal, Hon’ble Member, former Governor, Central Bank
Minendra Rijal, Hon’ble Member, former member, National Planning Commission
Ram Sharan Mahat, Hon'ble Member, former Finance Minister
Prakash Chandra Lohani, Hon’ble Member, former Finance Minister
Bharat Mohan Adhikary, Hon’ble Member, former Finance Minister
Krishna Prasad Sapkota, Hon’ble Member, former President, ADDCN
Prakash Sharan Mahat, Hon'ble Member, former Member, National Planning Commission

Public Accounts Committee (PAC)

Som Bahadur Thapa, Secretary

Public Service Commission

Tirtha Man Shakya, Chairman,

Private Sector

Biswajit Ghosh, Director of Finance, Surya Enterprises Private Limited
Sujeev Shakya, President, Tara Management Private Ltd.
Laju Pradhan, Executive Office Manager, Tara Management Private Ltd.
Siddha Raj Pant, Deputy Team Leader, Tara Management Private Ltd.
Prabhakar S.J.B. Rana, Chairman Emeritus, Soaltee Group
Rajendra Kabra, Arrowtech
Lochan Gyawali, Narayani Group
Basu Deb Ram Joshi, Chief Executive Officer, Nepal Bangladesh Bank, Ltd
Mr. Suraj Vaidya, Acting President, Federation of Nepalese Chambers of Commerce and Industry (FNCCI)
Narendra K Basnyat, Vice President, Confederation of Nepalese Industries
Jagadiswar Shrestha, Joint Secretary, Chief, Special Economic Zone Project
Narendra Prajapati. General Manager, Bhote Koshi Power Company Ltd.
O. B. Chhetri, Vice President, Bhote Koshi Power Company Ltd.
Khilanath Dahal, Co-President, General Federation of Nepalese Trade Unions
Bishnu Rimal, Vice Chairman, General Federation of Nepalese Trade Unions

Financial Sector

Bir Bikram Rayamajhi, Deputy Governor, Nepal Rastra Bank
Ashish Garg, Credit Officer, Nepal Rastriya Banijya Bank
Sanjay Bahadur Shah, Chairman, Bank of Kathmandu
Udhay Upadhyay, Chief Operating Officer, Bank of Kathmandu
Manish K. Singh, Company Secretary, Bank of Kathmandu
Anil Ratna Tuladhar, Head, ITD, Bank of Kathmandu
Anand Pandey, Head, Business Bank, Bank of Kathmandu
Bikas Khanal, Head, Credit Risk Management, Bank of Kathmandu
Anil Chandra Adhikary, Credit Information Bureau
Himalaya S. Rana, Chairman, Himalayan Bank Ltd.
Ashoke Rana, Chief Executive Officer, Himalayan Bank
Purshuram Chettri, Chief Executive Officer, Bank of Asia
Ratna Raj Bajracharya, Chief Executive Officer, Nepal Credit and Commerce Bank
Sashin Joshi, Chief Executive Officer, Nepal Industrial and Commercial Bank and Acting President of Nepal Banker's Association
Sujit Mudul, Chief Executive Officer, Standard Chartered Bank
Anil Shah, Chief Executive Officer, Nabil Bank
Upendra Poudel, Chief Executive Officer, Nepal Merchant Bank
Tejhari Ghimire, Chief Executive Officer, Center for Micro-Finance Nepal
Harihar Dev Pant, Chairperson and Chief Executive Officer, Nirdhan Utthan Bank Ltd.

Agriculture sector

Madhusudan P. Upadhyay, Senior Scientist, Nepal Agricultural Research Council
Ganga Jang Thapa, Executive Officer, National Trust for Nature Conservation.

Education

Association of Community Managed Schools
Arbinda Lal Bhomi, Professor, Center for Educational Research and Development
Mohan Gyanwali, President, Nepal Teachers' Association
Mahendra Joshi, Chairman, Community Schools National Network
Balaram Timalsina, District Education Officer of Charikot
Kamal Krishna Joshi, Chairman, University Grants Commission
Madhav Sharma, Vice Chancellor, Tribhuvan University
Kedar Mathema, retired chancellor, Tribhuvan University
Tirtha Raj Khaniya, Professor, Tribhuvan University
K P. Malla, retired Professor, Tribhuvan University
Bishwambhar Pyakurel, Tribhuvan University
Purush Bajracharya, Professor, Tribhuvan University

Journalists

Bijay Ghimire, Kantipur
Prem Khanal, Chief Reporter, Business Bureau, The Kathmandu Post
Keshav Poudel, Spotlight

Madan Lamsal, New Business Age Magazine/Arthik Abhiyan
Kiran Nepal, Himal
Rajendra Dahal, Chairman, Nepal Press Council
Pushpa Adhikari, former Director, Sagarmatha TV
Madan Lamsal, Director, Infotiser

Civil Society

Damodar P. Gautam, President, Transparency International Nepal
Mr. Aashish Thapa, Executive Director, Transparency International Nepal
Prithivi Raj Ligal, Chairman, Policy Research and Development, Nepal
Shreekrishna Upadhyay, Executive Director, Support Activities for Poor Producers of Nepal
Hari Krishna Upadhyay, Founder Chairperson, Central for Environmental and Agricultural Policy Research, Extension and Development
Bal Gopal Vaidya, Chairman, New Era
Ajay Dixit, Interdisciplinary Analysts
Kedar Khadka, Treasurer and Programme Director of GG and Anti-corruption, Department of Pro Public
Bijay K.C., Dean, South Asian Institute of Management
Pasang Sherpa, Chairman, Nepal Federation of Indigenous Nationalities
Om Gurung, Advisor and former Chairman, Nepal Federation of Indigenous Nationalities
Ms. Chhaya Jha, Director, Human Resource Development Centre

Other

Madhav Prasad Ghimire, Senior Advisor to the Executive Director for Nepal

Development Partners

Asian Development Bank (ADB)

Ki Hee Rue, Head, PMU
Raju Tuladhar, Senior Programs Officer
Ki Hee Ryu, Head, Portfolio Management Unit, Resident Mission
Govinda P. Gewali, Senior Project Implementation Officer
Komal Karki, Project Implementation Officer, Transport
Bikash Sharma, Rural Energy Specialist (Nepal)
Krishna Panday, Officer
Huban Bajracharya, Officer

Danish International Development Agency (DANIDA)

Keshar Man Sthapit, Watershed Development Specialist, former staff

Danish Embassy

Ove Larsen, Counselor
Shiva Bushal, Education Specialist

U.K. Department for International Development (DFID)

Matthew Greenslade, Head, Inclusive Economic Growth Team, Nepal
Simon Lucas, Adviser, Growth and Infrastructure, Land and Agricultural Policy
Nick Leader, Economic Advisor
Mark Segal, former Senior Conflict Advisor for Nepal

German Technical Cooperation (GTZ)

Surendra Raj Shrestha, Coordinator, Local and Regional Economic Development,
GB Banjara, Coordinator, Private Sector Promotion
Roshan Shrestha, Adviser, Micro Finance and Community Mobilization

International Monetary Fund (IMF)

Brian Aitken, Mission Chief for Nepal, International Monetary Fund, Washington D.C.
Alexander Pitt, Resident Representative, International Monetary Fund (IMF), Kathmandu

Japanese International Cooperation Agency (JICA)

Narendra Kumar Gurung, Senior Program Officer, Nepal Office

Swiss Agency for Development and Cooperation (SDC)

Jean-Marc Clavel, Country Director, Nepal
Elisabeth von Capeller, First Secretary (Development) and Deputy Country Director, Nepal

United Nations Children's Fund (UNICEF)

Purushottam Acharya, ECD specialist
United States Agency for International Development (USAID)
Susan B. MacIntyre, Regional Adviser, South Asia, Office of US Foreign Disaster Assistance, Nepal

World Bank

Praful Patel, former Vice-President, South Asia
Kenichi Ohashi, former Country Director, Nepal
Susan Goldmark, Country Director, Nepal
Hans-Martin Boehmer, Former Country Director for Nepal
Shanta Devarajan, former Chief Economist, South Asia Region
Deborah Bateman, former Country Program Coordinator, Nepal
Rajib Upadhya, Senior External Affairs Officer, External Affairs Unit, Nepal
Hassan Zaman, Lead Economist, Nepal
Roshan Bajracharya, Senior Economist, Economic Policy and Poverty Sector
Hisanobu Shishido, Senior Economist, Economic Policy and Poverty Sector
Gabi Afram, Financial Economist, Financial and PSD Sector Unit

Lynn Bennett, Anthropologist, Gender and Social Exclusion, Nepal
Adolfo Brizzi, Sector Manager, Agriculture and Rural Development,
Shyam S. Ranjitkar, Senior Irrigation Engineer, Agriculture and Rural Development
Gayatri Acharya, Senior Economist and Sector Coordinator, Agriculture and Rural Development
Nagavalli Annamalai, Task Manager, Second Financial Sector Project, Nepal
Tenzin D. Norbhu, Senior ICT Policy Specialist,
Surendra Joshi, Senior Transport Specialist, Transport
Narayan D. Sharma, Consultant, Transport
Tashi Tenzing, Senior Sanitary Engineer, Urban, Water and Sanitation
Rajendra Dhoj Joshi, Senior Education Specialist, South Asia Human Development Sector
Nastu Sharma, Public Health Specialist, South Asia Human Development Sector
Tirtha Rana, former Senior Health Specialist, South Asia Human Development Sector
Venkatesh Sundararam, Senior Economist, South Asia Human Development Sector
Mohan Arya, Consultant, South Asia Human Development Sector
Ian Bannon, former Task Manager, Poverty Alleviation Fund Project, Nepal
Geeta Sethi, former Task Manager, Poverty Alleviation Fund Project, Nepal
Navin Ray, former Lead Economist, Decentralization, Social Development Department
Vikram Menon, Senior Public Sector Specialist, Governance and Public Sector, Nepal
Bigyan Pradhan, Senior Financial Management Specialist, Financial Management Unit
Irina Niederberger, Senior Operations Officer, South Asia Enterprise Development Facility, International Finance Corporation
Jan Walliser, former OPCS
Per Wam, Conflict-Sensitive PRSP Program, SDV

Annex G: Guide to IEGWB's Country Assistance Evaluation Methodology

This methodological note describes the key elements of IEGWB's country assistance evaluation (CAE) methodology.[57]

CAEs rate the outcomes of Bank assistance programs, not the Clients' overall development progress

A Bank assistance program needs to be assessed on how well it meets its particular objectives, which are typically a subset of the client's development objectives. If a Bank assistance program is large in relation to the client's total development effort, the program outcome will be similar to the client's overall development progress. However, most Bank assistance programs provide only a fraction of the total resources devoted to a client's development by donors, stakeholders, and the government itself. In CAEs, IEGWB rates only the outcome of the Bank's program, not the client's overall development outcome, although the latter is clearly relevant for judging the program's outcome.

The experience gained in CAEs confirms that Bank program outcomes sometimes diverge significantly from the Client's overall development progress. CAEs have identified Bank assistance programs which had:

- Satisfactory outcomes matched by good client development
- Unsatisfactory outcomes with clients that achieved good overall development results, notwithstanding the weak Bank program and
- Satisfactory outcomes with clients that did not achieve satisfactory overall results during the period of program implementation.

Assessments of the development assistance program outcome and the Bank's performance are not the same.

By the same token, an unsatisfactory Bank assistance program outcome does not always mean that Bank performance was also unsatisfactory, and *vice-versa*. This becomes clearer once we consider that the Bank's contribution to the outcome of its assistance program is only part of the story. The assistance program's outcome is determined by the *joint* impact of four agents: (a) the client; (b) the Bank; (c) partners and other stakeholders; and (d) exogenous forces (e.g., events of nature, international economic shocks, etc.). Under the right circumstances, a negative contribution from any one agent might overwhelm the positive contributions from the other three, and lead to an unsatisfactory outcome.

IEGWB measures Bank performance primarily on the basis of contributory actions the Bank directly controlled. Judgments regarding Bank performance typically consider: (i) the relevance and implementation of the strategy; (ii) the design and supervision of the Bank's lending interventions, the scope, quality and follow-up of diagnostic work and other analytic and advisory activities; (iii) the consistency of the Bank's lending with its nonlending work and with its safeguard policies and; (iv) the Bank's partnership activities.

Rating Assistance Program Outcome

In rating the outcome (expected development impact) of an assistance program, IEGWB gauges the extent to which major strategic objectives were relevant and achieved, without any shortcomings. In other words: Did the Bank do the right thing, and did it do it right? Programs typically express their goals in terms of higher-order objectives, such as poverty reduction. The CAS may also establish intermediate goals, such as improved targeting of social services or promotion of integrated rural development, and specify how they are expected to contribute toward achieving the higher-order objective. IEGWB's task, then, is to validate whether the intermediate objectives were the right ones, whether they produced satisfactory net benefits, and whether the results chain specified in the CAS was valid. Where causal linkages were not fully specified in the CAS, it is the evaluator's task to reconstruct this causal chain from the available evidence, and assess relevance, efficacy, and outcome with reference to the intermediate and higher-order objectives.

For each of the main objectives, the CAE evaluates the relevance of the objective, the relevance of the Bank's strategy toward meeting the objective, including the balance between lending and nonlending instruments, the efficacy with which the strategy was implemented, and the results achieved. This is done in two steps. The first is a top-down review of whether the Bank's program achieved a particular Bank objective or planned outcome and had a substantive impact on the country's development. The second step is a bottom-up review of the Bank's products and services (lending, analytical and advisory services.

Highly Satisfactory:	The assistance program achieved at least acceptable progress toward all major relevant objectives, and had best practice development impact on one or more of them. No major shortcomings were identified.
Satisfactory:	The assistance program achieved acceptable progress toward all major relevant objectives. No best practice achievements or major shortcomings were identified.
Moderately Satisfactory:	The assistance program achieved acceptable progress toward most of its major relevant objectives. No major shortcomings were identified.

Moderately Unsatisfactory:	The assistance program did not make acceptable progress toward most of its major relevant objectives, or made acceptable progress on all of them, but either; (a) did not take into adequate account a key development constraint or; (b) produced a major shortcoming, such as a safeguard violation.
Unsatisfactory:	The assistance program did not make acceptable progress toward most of its major relevant objectives, and either; (a) did not take into adequate account a key development constraint or; (b) produced a major shortcoming, such as a safeguard violation.
Highly Unsatisfactory:	The assistance program did not make acceptable progress toward any of its major relevant objectives. It did not take into adequate account a key development constraint, and also produced at least one major shortcoming, such as a safeguard violation.

The **institutional development impact (IDI)** can be rated at the project level as: *high*, *substantial*, *modest*, or *negligible*. IDI measures the extent to which the program bolstered the Client's ability to make more efficient, equitable and sustainable use of its human, financial, and natural resources. Examples of areas included in judging the institutional development impact of the program are the:

- Soundness of economic management
- Structure of the public sector, and, in particular, the civil service
- I Institutional soundness of the financial sector
- Soundness of legal, regulatory, and judicial systems
- Extent of monitoring and evaluation systems
- Effectiveness of aid coordination
- Degree of financial accountability
- Extent of building NGO capacity and
- Level of social and environmental capital.

IEG is, however, increasingly factoring IDI impact ratings into program outcome ratings, rather than rating them separately.

Sustainability can be rated at the project level as *highly likely*, *likely*, *unlikely*, *highly unlikely*, or, if available information is insufficient, *non-evaluable*. Sustainability measures the resilience to risk of the development benefits of the country assistance program over time, taking into account eight factors:

- Technical resilience
- Financial resilience (including policies on cost recovery)
- Economic resilience
- Social support (including conditions subject to safeguard policies)
- Environmental resilience
- Ownership by governments and other key stakeholders
- Institutional support (including a supportive legal/regulatory framework, and organizational and management effectiveness); and, resilience to exogenous effects,

such as international economic shocks or changes in the political and security environments.

At the program level, IEG is increasingly factoring sustainability into program outcome ratings, rather than rating them separately.

Risk to Development Outcome. According to the 2006 harmonized guidelines, sustainability has been replaced with a "risk to development outcome," defined as the risk, at the time of evaluation, that development outcomes (or expected outcomes) will not be maintained (or realized). The risk to development outcome can be rated at the project level as *high, significant, moderate, negligible to low, non-evaluable.*

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ENDNOTES

Nepal: Summary of World Bank Program Ratings

[1] The goals of Bank assistance may be distinct from those of the client country's own development objectives, although the two are usually consistent.

[2] The Bank program outcome subratings and overall rating assess the extent to which the Bank program achieved the results targeted in the relevant strategy document(s) and/or the documents for individual operations. They do not attempt to assess the extent to which the client country was satisfied with the Bank's program, nor do they try to measure the extent (in an absolute sense) to which the program contributed to the country's development. Equally, they are not synonymous with Bank performance.

Chapter 1

3. The fiscal years of both Nepal and the World Bank run from July 1 through June 30.

4. As Nepal was IDA-eligible throughout the review period (and remains so today), this report follows common usage by referring interchangeably to IDA and the (World) Bank.

5. For a more detailed account of political developments over the period, see annex C – Political Developments in Nepal during the Evaluation Period.

6. The seven parties were Nepali Congress, Nepali Congress (Democratic), CPN (Unified Marxist-Leninist), Nepal Workers and Peasants Party, Nepal Goodwill Party (Anandi Dev), United Left Front, and People's Front. (Note that the ULF is itself an alliance of three parties, so that the SPA label is not quite accurate.) Taken together, these seven parties accounted for 194 of 205 seats contested and allocated in the 1999 legislative elections. The only party with a significant number of seats that was not represented in the SPA was the Monarchist Rashtriya Prajatantra Party.

7. Inhabitants of the Terai region of southern Nepal, also commonly known as the Madhesh, are referred to as Madhesis, and constitute approximately one-third of Nepal's population. The Terai region has relatively good infrastructure, agriculture, industrial development, and access to India across the open border, making it crucial to the economy and an area of great political importance.

8. One-third to one-half of the poverty reduction is attributed to the dramatic rise in workers' remittances over the period. With an estimated 1 million workers abroad in 2004 (primarily in India, the Gulf, and East Asia), remittance inflows soared from less than 3 percent of GDP in 1995/96 to 12percent in 2003/04. The share of households receiving remittances also increased to 32 percent from 24 percent over the same period. The increase in remittances is estimated to be responsible for more than one-half (6.2 percentage points) of the overall reduction in poverty headcount between 1995/96 and 2003/04. After 2004, the share of remittances in the GDP further increased to 16 percent (US$1.4 billion) in 2007.

9. This compares with a GNI per capita averaging US$880 in South Asia and US$578 in low-income countries.

Chapter 2

10. Since 2000, the Asian Development Bank (ADB) and the Japan Bank for International Cooperation (JBIC), the Bank, and the government have been carrying out Joint Country Portfolio Performance Reviews.

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11. These efforts built on the selective focus on outcomes embodied in the first Immediate Action Plan (IAP). Beginning in June 2002, institutional capacity constraints related to reform implementation were recognized in an innovative annual action plan, known as the IAP. The IAP consisted of a selective set of "must do" activities derived from the PRS reform agenda. It was used to hold ministries and departments accountable for promised actions. Five IAPs were prepared over the evaluation period (fiscal years 2003-07), each covering the four PRS pillars. Despite the success associated with the earlier IAPs, the process lost momentum with wavering political focus on reform implementation and was ultimately discontinued.

12. This process was initiated in the aftermath of the Royal coup but was slowed by government concerns regarding the terminology and definitions involved, and resistance to Nepal being labeled a Fragile State. Formal government approval came only in late February 2006, and shortly thereafter continuation of the process was pre-empted by the fall of the royal government in April 2006. At that point, the donor community took the position that the government needed to focus on conflict resolution, and the process was discontinued.

13. Nepal's CPIA was raised from 3.0 in 1999 to 3.1 in 2000 and 3.5 in 2001 and was kept around 3.5 for the reminder of the evaluation period.

14. March 2005, December 2005, and August 2006.

15. In particular, the Executive Directors referred to evidence showing that continuation of the Bank program in countries with deteriorating political environments and weakening commitment to reforms does not achieve declared goals, and does not serve the objectives of improved economic performance or poverty reduction.

16. These included: (i) bypassing involvement of national institutions; (ii) directing resources through local-level agencies that were closer to the ultimate beneficiaries; (iii) working at the national level through specialized Project Implementation Units outside the public administration or within nongovernmental organizations; (iv) setting conditions at sectoral or national level with little government ownership; and (v) introducing new ideas without ensuring that they were grounded in the realities and institutions of Nepal.

17. CIDA, Danida, DFID, the European Commission, Finland, GTZ (Germany), JICA (Japan), Norad (Norway) SDC (Switzerland) and SNV (Netherlands). AusAid (Australia) joined in 2005.

18. A modified version of the BOGs was adopted by the United Nations system and the Association of International Nongovernmental Organizations (NGOs). The process of adopting the BOGs was driven by DFID, GTZ, and SDC. All donors were invited to sign up, but several declined. The international financial institutions, including the Bank, felt they could not sign without endorsement from the government. USAID objected to the implicit equality of treatment between the parties to the conflict and declined to join (at that time the United States was providing military assistance to the government to fight the Maoist Insurgency). The BOGs Donor Group met periodically to review the operating environment and after the royal coup, when communications were cut, the BOGs Group became the principal forum for sharing information on operational development issues and risks. The BOGs were eventually formally accepted by both sides, by the government in July 2005 and by the Maoists in December 2005.

19. The IMF-supported program expired in November 2007 and discussions on a follow-up program have been inconclusive.

20. For instance, DFID analyzed the key constraints to growth and inclusive development. USAID conducted an economic growth assessment based on its guide to economic growth in post-conflict countries and a specific growth assessment for agriculture, a key sector for development and poverty reduction in Nepal.

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21. The Bank submitted an extraordinary package to the Board in December 2007 on a no-objection basis (four new IDA grants totaling US$252.6 million, which doubled the undisbursed balance).

Chapter 3

22. In fiscal 2007, the Commission for the Investigation of Abuse of Authority (CIAA) brought charges against the Central Bank Governor regarding alleged improper payments associated with an IDA project. After 13 months, IDA completed its investigation, clearing the Governor of culpability. However, the impact of the charges has been to sideline the Governor, who as of end September 2008 had not been replaced. This raised doubts in the minds of Nepalese financial regulators about the ultimate effectiveness of vigorously pursuing large and often well-connected willful defaulters, as the Governor had been known for, and leaving the exercise of the Central Bank's regulatory authority in limbo.

23. A new Central Bank Governor was appointed in December 2008, after the CAE mission in September. Also the licensing of new institutions was stopped.

24. Exogenous factors benefiting the project outcomes included trade policy reforms that increased agricultural exports, contributed to commodity market deregulation (that encouraged private sector participation and investments, particularly for fertilizer), and upgraded and extended road networks that improved access for inputs and marketing. From Project Performance Assessment Report No. 44438, Nepal Irrigation Sector Project, June 30, 2008.

Chapter 4

25. In principle, since 2002, the management of all government-funded schools is supervised by a School Managed Committee. The "formally transferred" schools refer to government-funded schools for which the School Managed Committee has entered in a formal agreement with the District Education Officers that stipulates the respective parties' responsibilities. In exchange for more responsibilities and autonomy (hire and pay temporary teachers, review annual school performance, control school finance, mobilize additional resources, distribute textbooks and scholarships, nominate teachers for training, and prepare school improvement plans), these communities receive a grant of approximately US$1,200 and eligibility for a menu of additional supporting grants.

26. Moreover, given the delays in implementing this policy during the CAE period, the bulk of the transfers occurred recently. It may be premature to assess the full impact of the policy.

27. As reported in *An Assessment of the Implementation of the Tenth Plan/PRSP, PRSP Review 2005/06*, Government of Nepal/National Planning Commission, December 2006; *Joint Evaluation of Nepal's Education for All 2004-2009*, Norad, Evaluation Department, March 2009; *National Assessment of Grade-5 Students,* Government of Nepal, Department of Education, June 2008; "Empowering the 'local' through education? Exploring Community-Managed Schooling in Nepal," Stephen Carney, Min Bista, and Jytte Agergaard, *Oxford Review of Education*, Vol. 33, No. 5, November 2007, pp. 611-628.

28. The Bank's strategy in education over the CAE review period was mostly based on the July 2001 *Nepal Priorities and Strategies for Education Reform* and the April 2000 *Nepal Public Expenditure Review*. It is notable that the Bank's assistance strategy in education was not revised to reflect the deterioration ofdevelopment space in Nepal as the conflict intensified and there was increased political instability.

29. The first Higher Education Project was approved in December 1993, and closed in November 2001.

30. *Health Sector Strategy: An Agenda for Reform*, Ministry of Health, Nepal, October 2004.

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31. An independent "Review of Nepal Health Sector Programme: A Background Document for the Mid-Term Review," Mick Foster, John Quinley, Raghav Regmi and Binjwala Shrestha, November 2007.

32. Although the private sector has contributed, the bulk of the work came from the public sector. The public sector has been entirely responsible for immunization, Vitamin A distribution, and de-worming. It also has led campaigns to change the care of newborns, and is responsible for about half of child visits to health service providers, including about half of treatments for pneumonia.

33. There has been a shift in the population in the Far Western region from 9 percent in 1996 to 14 percent in 2006 and the population has become poorer (the percentage of households members falling into the lowest wealth quintile in the Far Western region increased dramatically from 11.6 percent in 1996 to 25.3 percent in 2006, as measured by a DHS wealth index based on households assets).

34. *Evaluation of Decentralization Process*, Nepal Health Sector Program, 2007.

35. IDA's first Population and Family Health Project was closed in 2000. The successor Health Sector Project was approved in September 2004 and became effective in February 2005.

36. Contraceptive prevalence rate increased from 35.4 percent in 2001 to 44.2 percent in 2006 against a target of 47 percent in June 2009. Skilled birth attendance increased from 12.9 percent in 2001 to 18.7 in 2006 (target 35 percent). Full immunization rates improved from 72 percent in 2001 to 88.6 percent in 2006 (target 85 percent). Knowledge of one correct method of preventing HIV/AIDs increased from 37.6 and 50.8 percent respectively for women and men in 2001 to 58.3 and 81.1 respectively in 2006 (target 75 and 85 percent).

37. After the second popular movement of April 2006, there has been a growing expectation among the Nepal is for better and more inclusive social services. Demand for free health care is an important one. Despite the continuous universal policy debate on whether free primary health care should be targeted to the poor or provided free of charge for all, the 2007 Interim Constitution recognizes access to health care as a citizen's fundamental right and includes a provision that primary health care be made free of charge. The Three Year Interim Plan (2007-10) also emphasized the need for equitable distribution of resources and quality health services to be focused on more needy people, the poor and marginalized groups in particular. In this political context, the government's first attempts toward free health care, which was introduced in December 2006, include emergency and inpatient services free for "the disadvantaged, destitute, underserved, elderly, people living with physical and psychological disability, and Female Community Health Volunteers," at district and primary health care centers. In October 2007, the government extended free essential health care services to all health and sub-health posts from January 2008.

38. They include the United Nations Children's Fund (UNICEF), United Nations Population Fund (UNFPA), USAID, World Health Organization (WHO), The Global Fund to Fight AIDS, Tuberculosis and Malaria (GFATM), Norwegian Association of Heart and Lung Patients/ Netherlands Leprosy Relief (LHL/NLR), German Agency for Technical Cooperation (GTZ), GAVI Alliance, KfW Entwicklungsbank, the Swiss Agency for Development and Cooperation (SDC), and other development partners.

Chapter 5

39. Johnson, Kiersten and Sarah E.K. Bradley. 2008. *Trends in Economic Differentials in Population and Health Outcomes: Further Analysis of the 2006 Nepal Demographic and Health Survey.* Calverton, Maryland, USA: Macro International Inc.

40. Norad. 2009. *Joint Evaluation of Nepal's Education for All 2004-2009 Sector Program.* Evaluation Department.

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41. Relative poverty: among beneficiary members in PAF Community Organizations (COs), 67.9 percent fall in the hardcore poor category (food sufficiency less than 3 months is among the criteria fixed by community), and 24 percent in the medium poor category (food sufficiency more than 3 months, but less than 6 months). Ethnicity: CO member households are 36 percent Dalit, 29 percent Janajati, 2 percent Muslim, 27 percent Brahmin/Chhetri and 6 percent other ethnicities. With regard to key positions (such as President, Treasurer, Secretary), 43 percent are held by Dalit, 28 percent by Janajati, 2 percent by Muslims, 22 percent by Brahmans/Chettris, and 4 percent by other ethnicities. Gender: some 68 percent of CO members and 57 percent of key position holders are female (as per data provided by the PAF Task Team Leader).

42. As noted in the PAF II PAD, "in PAF I communities have had discretion as to how to manage the funds received, with a number of them choosing to revolve the funds within their group." All communities visited by the IEG team have chosen to revolve the funds.

43. As of August 16, 2008, the PAF had registered 8,592 COs, and signed agreements with 7,885. It had supported 7,691 income-generating activities amounting to NPR 3,061 million and 1,510 community infrastructure activities amounting to NPR 600 million.

44. In both the Sri Lanka and the Pakistan Poverty Alleviation Funds, no targeted microcredit was permitted. Both Bank-supported projects only supported the strengthening of microcredit agencies. In the Andhra Pradesh District Poverty Reduction Initiatives Project, the PAD explicitly prohibited the "cash grants or loans to individuals or groups."

45. "Projects should be careful to clearly separate the administration of grants for public goods from grants for productive assets. They should also separate the administration of a loan program for productive assets from a grant program for productive assets. The institutional arrangements, including staffing, need to be separated, because the eligibility criteria and operational guidelines will be quite different. If they are not separated, there is a significant risk that both staff and beneficiaries will be confused, leading to failure of the intervention. Several issues complicate the provision of grants to acquire privately owned assets. First, they may be a temporary fix, unless the project is designed carefully and managed and monitored well. For example, a project may provide the asset as a grant, but fail to plan for the maintenance of the asset, or for the other costs of operating the asset." See Bank Webpage on Livelihood Projects - http://www.worldbank.org/rurallivelihoods.

46. Hobley, Mary and Bimala Rai Raudyal. 2008. "Study of Income Generating Activities in Kapilvastu and Ramechhap Districts, Nepal." Prepared for Swiss Development Cooperation. "The group-based approaches to poverty identification and decision-making make it easier for the project to provide services. It is a highly managerial approach to development rather than a transformational approach. It is a high-risk strategy in terms of ensuring that poor households have their voices heard, rather than being interpreted by others. This is a particular problem for the most marginalized households. Experience from elsewhere indicates that group-based approaches are not the most appropriate for the most marginalized and often end up either in their lack of representation or inappropriate support being provided. In both study wards there was evidence of self-exclusion of poor households from groups, so their voices have no chance of being heard."

47 In Kapilvastu, all hard core poor members of the community had opted for goat rearing business and among them some had reared 12, some 13 and some up to 19 goats from the 3 initial numbers of goats. But, it has been reported that everyone had to bear huge loss because all reared goats died because of endemic disease. In comparison, buffalo rearing proved to be beneficial to some extent. Vegetable farming could have been profitable but markets were very far. Some found carrying costs of vegetables to the market very high and some found that money received from sales of vegetable even did not cover the production cost, as result they have to leave the products in the farm itself.

48. Information derived from the Public Service Commission from 1999-2001.

Chapter 7

49. By 2007, 80 percent of public investment projects were labeled P1, or "high priority," in an effort to secure funding regardless of their development merits.

50. See "Study of Income Generating Activities Kapilvastu and Ramechhap Districts, Nepal," Hobley, Mary and Bimala Paudyal, March 2008.

Annex B

51. Poverty lines derived from the 1995-96 and 2003-04 Nepal Living Standards Survey (NLSS-I and NLSS-II) data; Resilience Amidst Conflict: An Assessment of Poverty in Nepal, 1995-96 and 2003-04, World Bank.

52. The Human Poverty Index calculated by the UNDP for developing countries focuses on the proportion of people living below a threshold along the same dimensions of human development as the Human Development Index—that is, living a long and healthy life, having access to education, and a decent standard of living.

53. The Human Development Index (HDI) is a composite index measuring average achievement in three basic dimensions of human development—a long and healthy life, knowledge and a decent standard of living; Human Development Report 2007/2008, Fighting Climate Change: Human Solidarity in a Divided World, UNDP.

54. It should be noted that because public schools are funded according to the number of children enrolled, administrative data on enrollment rates probably overestimate actual rates. Moreover, administrative data do not take into account actual attendance.

55. Life expectancy was estimated at 63.2 years in 2006.

Annex C

[56] Inhabitants of the Terai region of southern Nepal, also commonly known as the Madhesh, are referred to as Madhesis. The Terai has relatively good infrastructure, agriculture, industrial development, and access to India across the open border, making it crucial to the economy and an area of great political importance.

Annex H

[57] In this note, *assistance program* refers to products and services generated in support of the economic development of a client country over a specified period of time, and *client* refers to the country that receives the benefits of that program.