

## **PIN100**

### **Nepal CAS**

#### **Public Information Notice**

#### **World Bank Board Discusses Country Assistance Strategy for Nepal**

On November 18, 2003, the World Bank's Board of Executive Directors discussed the International Development Association's (IDA) Country Assistance Strategy (CAS) for Nepal. The last full CAS was discussed in December 1998 and a Progress Report was discussed in December 2002. At the same time, the Board discussed the Poverty Reduction Strategy (PRS) of His Majesty's Government of Nepal (HMGN), and the Joint Staff Assessment (JSA) carried out by IDA and the International Monetary Fund (IMF). The Bank's Board also approved the first Poverty Reduction Strategy Credit (PRSC) for Nepal in the amount of US\$70 million.

#### **Country Context**

In recent months, the political landscape in Nepal has continued to be extraordinarily unstable. While a cease-fire was announced in January 2003 and three rounds of peace talks were held, the insurgents declared a unilateral withdrawal from the cease-fire agreement in late-August. Furthermore, the Government appointed by the King in October 2002 and led by Prime Minister Lokendra Bahadur Chand, resigned in late-May 2003 in part due to a standoff that had developed with the political parties agitating for the restoration of Parliament and formation of an all-party Government. A second interim Government—headed by Prime Minister Surya Bahadur Thapa—was appointed, resulting in Nepal's twelfth Prime Minister in the last seven years and the fifth since the 1999 elections.

On the economic front, there are currently signs of a modest recovery underway, with growth in FY02/03 estimated at above 2 percent. This follows an economic decline in FY01/02 that hit manufacturing and tourism particularly hard, due to slow growth in Europe and the US, exacerbated by disruptions caused by the insurgency situation (garments), market saturation (carpets), and inadequate quality control and standards (carpets and pashmina). GDP per capita remains extremely low—approximately US\$230—and as such, poverty (largely a rural phenomena) persists and is compounded by significant ethnic and caste-based disparities. As a result, Nepal faces considerable challenges on many fronts.

Nonetheless, despite the instability and uncertainty, important—and often quite innovative—reforms have emerged over the past two years and the reform process is picking up momentum. For example:

- To prevent a possible financial sector crisis, an important initial step toward reform was taken by putting the two ailing commercial banks under external management teams;
- A Medium Term Expenditure Framework (MTEF) was introduced to rationalize the development budget and instill the discipline of a hard budget constraint;
- Responding to the urgent need to improve public service delivery, primary education and primary health care facilities are being transferred to community management;

- To ensure implementation of priority reforms, an Immediate Action Plan (IAP) has been extremely effective; and
- A highly visible anti-corruption drive has been started by the Commission for Investigation of Abuse of Authority (CIAA).

The recently completed Poverty Reduction Strategy—the Executive Summary of the Tenth Five-Year Plan—has established reducing the overall poverty ratio from about 40 percent to 30 percent by the end of the plan period (FY06/07) as its key target. In addition, a number of other important development targets have been established. The PRS breaks from the past plans in a number of significant ways, including explicitly identifying social exclusion as a fundamental development challenge, recognizing the constrained fiscal situation and weak implementation capacity, and placing the PRS in a realistic framework of fiscal and institutional implementation abilities (i.e., the MTEF and IAP). Stressing decentralization, rationalization of central government functions, and transparency, the PRS is built around four pillars: (i) broad-based economic growth; (ii) social sector development; (iii) social inclusion; and (iv) good governance.

### **World Bank Strategy**

The World Bank’s strategy will build on the achievements under the 1998 CAS—which were to facilitate the beginnings of determined reform efforts—and support the Nepali-led reform process in a significant span and depth. Backed by a successful process of supporting the reform dynamics, the strategy supports key elements under each of the PRS pillars and continues to focus on governance—by bringing resources to grassroots levels and improving development effectiveness—along with an increased emphasis on growth and inclusion. The CAS is “outcomes-based” and has established 26 specific outcomes as the key targets for the FY04-FY07 period.

The proposed program of financial assistance from IDA would likely be anchored each year in a PRSC to support implementation of the PRS. This would be complemented by an average of three investment or sectoral operations per year to support key programs in the focus areas. Lending would be accompanied by a strong non-lending analytical program, with a particular focus on helping to prioritize future policy reform areas. Given Nepal’s low income level, it qualifies for a portion of the IDA assistance on a grant basis. IDA grant funds are likely to be used for social sector projects—i.e., in health, education or rural water—or for technical assistance.

The private sector arm of the Bank—the International Finance Corporation (IFC)—will focus on providing technical assistance for small and medium enterprises (SMEs) through the South Asia Enterprise Development Facility (SEDF), while the Multilateral Investment Guarantee Agency (MIGA) will continue to support foreign direct investments into Nepal as they present themselves.