

IDA AT WORK

Nepal: Building a Peaceful, Prosperous and Just New Nepal

Nepal is a country at a crossroads. Nepal's decade-long conflict formally ended in November 2006 and the country is now in transition from conflict to peace and from a monarchy to a republic. This moment in history creates welcome opportunities for a country that remains one of the poorest in South Asia, poorer than many Sub-Saharan African countries, with a GDP per capita of US\$470 in 2009.

The next few years are critical as Nepal manages its transition while confronting long-standing development challenges at a time of global economic downturn. The International Development Association (IDA), the World Bank's fund for the world's poorest countries, supports Nepal at this delicate juncture. As of July 2009, IDA commitments in Nepal totaled US\$872.4 million. IDA also manages seven recipient-executed trust funds with net commitments of US\$30.81 million. Bank assistance will remain flexible in order to respond to opportunities as they arise.

Country Indicators	1997-98	2002-03	Most recent
GDP growth (%)	2.9	4.0	4.7 (2008)
Per capita GDP (US\$)	207	261	470 (2008)
Total expenditure (% of GDP)	16.9	14.8	20.0 (2008)
Deficit financing after grants (% of GDP)	5.2	1.4	4.0 (2008)
Net domestic borrowing(as % of GDP)	1.5	1.3	1.8 (2008)
Official remittances (as % of GDP)	2.3	11.0	17.4 (2008)*
Net primary school enrollment (%)	69.6	82.3	91.9 (2008/09)
Under-5 child mortality (per 1,000 live births)	118	91	61 (2006)
Population with access to improved water sources (%)	65-70	70-75	75-80
Population (millions)	23.3	26.0	28.1

Sources: Central Statistics Bureau, Nepal Rastra Bank, Bank Staff Estimates, Ministry of Physical Planning and Works, World Bank WDI and GDF Database

*This figure excludes all remittances from India and other informal flows. Including these flows, remittances are estimated to easily exceed 20 percent of GDP. Many estimates are above 25 percent.

COUNTRY ACHIEVEMENTS

Nepal is a country at an “open moment” in its history.

Nepal’s decade-long conflict formally ended in November 2006 and the country is now in transition from conflict to peace and from a monarchy to a republic. In 2008, the country voted in a Constituent Assembly (CA), abolished a feudal monarchy, named a President, elected a Prime Minister, formed a coalition government, and set about the task of writing a new Constitution by 2010, with a new round of elections planned for 2011. Former insurgents, Maoists, became the largest party in the CA but fell short of majority.

The new Nepal is expected to take on a federal character, with significant devolution of decision-making powers from the center to local levels of the government. The next few years are critical as Nepal manages transition while confronting long-standing development challenges at a time of global economic downturn. Already the first coalition government of the republic led by Maoists fell and a new 22-party coalition government, which excludes Maoists, has been established. The key challenge facing the government will be to rebuild the legitimacy of the state, maintain law and order, and deliver benefits to those excluded and to society at large.

Enormous economic challenges remain as growth remains low.

The World Bank ranks Nepal at 195th out of 210 countries in terms of Gross National Income per capita (Atlas methodology, 2008). The country largely missed benefiting from the robust growth of its two neighbors, India and China. Nepal’s economy has, however,

shown significant resilience during the recent civil conflict, with annual growth averaging 3.1 percent between fiscal years (FY) 2002-2007, made possible through stable macro-economic management based on a prudent fiscal stance—strong spending pressures notwithstanding. This laid the ground for GDP growth to rebound to 4.7 percent in FY2008 as peace arrived. The rebound was also aided by good weather, a buoyant regional setting, and higher tourist arrivals.

However, FY2009 growth is estimated to be less than 4 percent. Major adverse factors include political uncertainties, low agricultural growth, slow capital budget implementation, long and frequent power outages, and security problems such as strikes and highway blockades. The global recession is affecting Nepal in a limited way so far. Tourist arrivals are down slightly and exports are not growing, but remittances continue to grow, albeit at a slower rate than earlier.

Political uncertainty, law and order problems, uncertainty regarding private property rights, and more generally, a business climate not friendly to investors, are hindering private investment. Limited job opportunities in the country are driving many to seek work abroad resulting in large inflows of remittances.

Remittances have a problematic impact.

At above 20 percent of GDP in 2009, officially recorded remittances (excluding informal flows and flows from India) are growing more slowly but are still 30 percent above the last year’s level in dollar term. Higher liquidity on account of remittances combined with supply bottlenecks due to security problems as well as cartels for some key commodities, are keeping prices high—12-month inflation remains 12 percent.

Nepal's balance of payments continues to be in surplus, despite a chronic trade deficit, thanks to the high amount of remittances. Households are increasing expenditures because of these inflows, and poverty incidence has declined significantly. At the same time, remittances are increasing the economy's vulnerability through (i) high dependence on foreign labor markets and (ii) erosion of both external competitiveness and incentives to invest in tradable activities. To take on these challenges, the government needs to address law and order problems and improve the investment climate. (Nepal ranked 111 out of 181 economies in terms of ease of doing business in the 2009 *Doing Business* survey.)

Nepal has made considerable progress toward reducing poverty.

On the social side, achievements are many. Over the last decade Nepal has made considerable progress toward reducing poverty, with the headcount poverty rate falling from 42 percent in FY1996 to 31 percent in FY2004—in large part thanks to remittances. While there are wide discrepancies depending on geographic location, ethnicity, caste and gender, progress on a number of social indicators has been impressive:

- Net primary enrollment in schools has increased from 82 percent in 2002 to 92 percent in 2008. Gender parity ratio in primary education improved from 0.66 in 1995 to 0.98 in 2008.
- The maternal mortality rate was halved from 538 in 1996 to 281 in 2006. The infant mortality rate dropped from 79 in 1996 to 48 in 2006. Full immunization coverage rose from 43 percent to 83 percent during the same period.
- The coverage of potable water rose from 71 percent in 2002 to 77 percent in 2006.

Some of these successes, however, create new challenges, such as meeting the “bulge” of children entering secondary education. Old challenges also remain such as high malnutrition rates among children. In addition, inequality has risen to the highest level in South Asia mostly because wages of skilled workers and professionals rose fast. This seems to be a result of a shift in demand as higher remittances support increased consumption of modern services—such as finance and information technology. While higher remunerations for people who have gained skills through education and training are desirable (encouraging new generations to seek education), higher inequality presents a difficult challenge for policymakers.

IDA CONTRIBUTIONS

Poverty reduction is the main objective underlying IDA's activities in Nepal. IDA assists Nepal in its development with IDA funds and analytical and advisory work. As of July 7, 2009, the Nepal portfolio consisted of 16 active IDA projects and seven recipient-executed trust funds with net commitments of US\$872.4 million and US\$30.81 million respectively.

IDA's program over the next 2 years (June 2009-June 2011) as outlined in the Interim Strategy Note (ISN), builds on the areas which have shown to be the most robust during conflict and which are well suited to Nepalese modalities of implementation. The overarching goal of the ISN is to promote the complementary processes of peace and development (see box).

Foundations for a New Nepal

IDA's Interim Strategy rests on three pillars:

- (i) promoting capable state structures and systems and fostering accountable institutions which addresses the cluster of challenges in adapting and constructing the public systems, institutions and capacities needed for the new Nepal;
- (ii) laying the foundation for sustainable, inclusive and equitable economic growth which focuses on over-coming constraints in the productive sector in terms of job-creation, productivity, connectivity and sustainability;
- (iii) and enhancing equitable access to the benefits of growth, services and social inclusion which concentrates on expanding and honing social programs to increase opportunities and wellbeing, especially for the poor and excluded.

The over-arching goal is to help Nepal consolidate peace—the essential underpinning of development and poverty reduction—along with social inclusion.

The broader governance and anti-corruption agenda is part of the focus on building the new state. IDA will support efforts to enhance transparency and accountability and strengthen citizens' voice and engagement. This will include "demand" side approaches to building good governance from bottom-up and "supply" side capacity building of public agencies to respond effectively to the emerging demands. Social accountability tools and other non-lending technical assistance will be the core program in this area and will be largely supported by IDA-managed Governance Partnership Facility and other donor trust funds.

IDA support is helping overcome constraints to growth.

Financial sector. World Bank-financed projects are helping improve the supervisory functions of the central bank and stem the losses at the two of the largest public sector banks.

Infrastructure. IDA has been supporting Nepal's Rural Water Supply and Sanitation sector since 1996. The ongoing Rural Water Supply and Sanitation Project (RWSSP) accords priority to service delivery in remote, rural areas and takes extra pains to ensure social inclusion, particularly with respect to indigenous peoples, Dalits and disadvantaged groups. Supported by 589 schemes completed so far, access to clean water in rural areas has increased from 77 to 85 percent of the population while access to sanitation has risen from 46 to 56 percent between 2007 and 2009. RWSSP now covers 74 of Nepal's 75 districts. Schemes completed thus far serve over 430,000 people with improved water supply and over 55,000 households with new latrines. Clean water and better hygiene have helped reduce diarrheal disease morbidity among young children by at least 10 percent.

In the roads sector, a project is improving rural transport infrastructure and services and enhancing people's access to social services and economic opportunities. A survey of five completed first-year roads (three in hills and two in Terai), has found that motorized and non-motorized trips by beneficiaries have increased by more than 20 percent; travel times have dropped from an average of 2.6 hours to 32 minutes—a 79 percent saving in time.

Another Bank-financed project is increasing access to electricity for the population in rural areas, while promoting the development of Nepal's hydropower potential in a sustainable and environmentally sound manner, and encouraging private participation to improve efficiency in the power sector. The steady expansion of community-managed micro-hydro systems has so far resulted in coverage of about 40,000 households in 40 of 51 districts that have micro-hydro potential. These systems serve as entry points for holistic and sustainable development in rural areas as they generate local employment in electricity-based enterprises, help protect the environment, and provide quality lighting for children to study at night.

To accelerate human development, IDA's assistance to Nepal has focused on improving the access to education and health care.

Education. With funding and technical assistance from IDA, Nepal has moved toward community management of schools and improved the access to education. More than 8,300 schools have so far chosen a transfer to community management. At this rate, the goal of achieving community management for all public schools by 2015 appears attainable. Net enrollment at the primary level rose from 83.5 percent in 2003 to 91.8 percent in 2008. Gender parity improved from 83 percent to 98 percent during the same period.

Health. IDA is also providing funding and advice to the government on its long-term health strategy and program as well as the devolution of sub-health posts to local communities. A total of 676 health posts and 3,134 sub-health posts have been established since 1991. However, in the Mountain Region, 4 out of 10 individuals still have to travel

1 to 4 hours to reach the nearest health or sub-health post. In the Hill Region, 3 out of 10 individuals have to travel 1 to 4 hours to reach the nearest health or sub-health post. Continuing with the sector-wide approach, the health sector program intends to expand access to, and increase the use of, essential health care services. Currently IDA, DFID, and AusAID are pooling funds to support this goal.

Social inclusion. To help Nepal achieve its goals of social inclusion, IDA is working with the government and other development partners on strengthening the policy dialogue to reach out to marginalized groups. Specifically, community-based projects, such as the Rural Water and Sanitation project and the Poverty Alleviation Fund have started to focus on issues of inclusion more vigorously. A Food Price Crisis Response Program was approved in 2008 to support immediate social safety net measures to ensure food for vulnerable households in food insecure districts as well as longer-term measures to raise agricultural yields and consequently the production of staples.

IDA's strategy is focusing on consolidating the peace process and helping the government prepare for important post-conflict work. IDA-financed Emergency Peace Support project supports the government in fulfilling the commitments made under the Comprehensive Peace Agreement, including support to the families of those killed in the conflict. A specific screening tool—or "peace filter"—has been developed to use in the selection, design and implementation of operations. The intention is to proactively seek opportunities to promote social harmony, build social capital and sustain and create jobs, as well as identify and mitigate potential sources of conflict.

PARTNERSHIPS

A large number of donors are active in Nepal and program coordination remains challenging. The Ministry of Finance meets with donors periodically to share information and promote coordination. In addition, donors meet frequently to exchange information and agree on joint approaches. At the operational level, coordination efforts are being consolidated and expanded. Joint portfolio reviews occur with the government and include action plans to improve performance. Sector-wide approaches are operating in health and education sectors where a few donors pool their funds. IDA's Nepal country team also coordinates closely with the IMF team.

During the preparation of the recent Interim Strategy Note, the IDA team undertook consultations with a broad range of stakeholders in different regions of the country. The participants attending consultations in Pokhara, Biratnagar, and Nepalgunj included representatives from community organizations, political leaders, civil society, program personnel and others. The group in Kathmandu included the private sector, government, civil society, academia, international and local NGOs, politicians, youth and donor agencies. As it implements its interim strategy, IDA is planning to expand its outreach to civil society groups and strengthen its public information services beyond Kathmandu.

CHALLENGES AHEAD

Recent improvements notwithstanding, the following issues need the government's and development partners' attention.

- Life expectancy at birth has increased, but at 63 years, it remains lower than its neighboring South Asian countries. Infant mortality rates are still among the highest in the region.
- Due to still high maternal mortality, women's life expectancy is lower than men's.
- On literacy, gender disparities are common; only 26 percent of Nepal's women are literate compared to 62 percent of men.
- Population growth has led to fragmented land holdings and depletion of forest products upon which much of the rural population depends for its livelihood.

To sustain poverty reduction, Nepal faces the dual challenges of accelerating domestic growth and sharing this growth more broadly across the population. Policies to achieve these ends will help all citizens of Nepal—including groups that have been traditionally excluded. But such policies will not be sufficient to rapidly improve the well-being of disadvantaged groups—the policies need to be accompanied by efforts to build human and social capital among the excluded groups.

Nepal is facing several transitions including: moving from conflict to peace, defining a new republic state and “rules of the game” in the post-monarchy era, and transforming the social and economic relations. The fact that these are being faced simultaneously increases the challenges and associated risks.

Additional challenges are emerging. The law and order situation remains difficult with regional, ethnic, and political tensions. Frequent unrest and strikes in the Tarai region are hurting economic activity and livelihoods. High dependence on remittances makes

Nepal vulnerable to a reversal of fortunes which could fuel unrest. The impact of the global crisis may hurt exports, tourist arrivals, and remittances. So far, all indicators are holding up.

IDA's future role in Nepal.

IDA will continue to enter into new commitments for a number of projects, many built on robust community engagement and others strengthening the foundations for future sustained growth. Strong dialogue, backed by analytical work carried out not just with the government, but also with a broad range of stakeholders, will continue, especially on the issues of inclusion, state building, and growth. Bank assistance will remain flexible in order to respond to opportunities as they arise.

IDA faces substantial risks working in Nepal and its program is designed to take those risks into account. To manage and mitigate the risks, the program is kept selective, simple and flexible. It builds on existing strengths and successful projects (for example, community management approach) and applies the 'do no harm' principle. IDA is also working closely with development partners on the development of joint approaches to deal with the fluid and complex country situation. At the same time, IDA's own capacity to deal with fiduciary and other risks is being strengthened.

However, given the transitional nature of the country, not all of the risks can be mitigated, and significant political, social and economic risks remain. If any such risks are realized, IDA program will be adjusted accordingly.

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