Board Meeting of November 24, 1997
Statement by Matthias Meyer

NEPAL: CAS Progress Report
NEPAL: Irrigation Sector Project
NEPAL: Multimodal Transit and Trade Facilitation Project

We commend Management and Staff for the candor of the Progress Report and for its clear but rather sobering assessment of progress achieved to date. Macroeconomic stability, reflected in constant domestic inflation and better controlled balance of payment situation are positive developments. On the other hand, institutional weakness, particularly regarding management capacity, frequent changes at ministerial and lower level positions, as well as a lack of clear-cut, uniform and enforced policies are among the persistent problems hampering development process. Prospects for sustainable growth would require greater progress in key structural reform areas, improved fiscal management and greater selectivity in the public investment program. Given the track record and the persistence of coalition governments this is unlikely to happen in the near future.

On this background we agree that IDA should continue to focus on areas where it can use its leverage for policy adjustment, to concentrate on sectors that are less affected by political and administrative changes, to support projects which are simple in design, emphasize capacity building and involve beneficiaries, private sector and NGOs.

We support the Multimodal Transit and Trade Facilitation project. It is in our view a good application of IDA’s strategy to support projects that are sufficiently simple in design as to ensure timely and effective implementation. The project builds on the already improved trade relationship with neighbor countries and will further strengthen Nepal's regional trading.

Improving water resources management and rendering irrigation more productive and sustainable are crucial for improving agriculture being the engine of growth for Nepal's economy and for alleviating rural poverty. The proposed Nepal Irrigation Sector Project (NISP) clearly builds on lessons learnt and on successfully piloted approaches in several IDA supported projects, particularly with regard to user management of small irrigation schemes. However, the proposed project is more than just a scaling up of pilots. Project design and policy issues give raise to some important concerns:
1. **Water policy/sequencing**: The current subsidy levels of 85% for irrigation investments and of 90% for Operation & Maintenance costs are unsustainably high. Thus in the 1996 CAS, further lending in irrigation was made contingent upon the development and implementation of a water resources strategy, including needed changes in pricing and subsidies. Such policy is clearly not in place, and the strategy work is still at an early stage. The NISP includes a water strategy component and water policy work (i.e. review of subsidy policy, review of O&M and water charges) to be completed by year 3 of the Project. However, we miss a clear sequencing of policy and strategy work and clear targets (i.e. timing, subsidy levels). In our view, subsidy and pricing issues need to be solved quickly, whereas strategy work, based on an integrated riverbasin-wide approach is of a longer-term nature, inter alia because of the required involvement and consultation of stakeholders.

2. **Budget constraints**: Improving Operation & Maintenance of public irrigation schemes and implementing a true consumption based determination of water charges are a prerequisite for promoting stronger user cost-sharing in O&M. Nepal's current lack of investment planning and prioritization, proliferation of projects and dilution of scarce investment budgets, and the associated sustainability problems regarding Operation & Maintenance are a matter of concern. Annual incremental budget requirements for NISP would be relatively small, but on the background of ever growing claims on Nepal's development budget, any increment is problematic, unless there is a clear commitment to prioritize budget allocations. In this context, the reduced share for agriculture and irrigation in Nepal's overall development budget in FY98 raises concern as to the country's capacity to improve O&M performance.

3. **Complexity of Project design**: The sector project design is complex. It involves three implementing government agencies, central government and district level entities, a separate project structure for the SMIP component in the Eastern Region, and a set of mechanisms for coordination of strategy work, overall project implementation and of subproject implementation at the regional level. Effective project implementation, adequate linking of investments and policy development and enforcement will pose significant challenges, given the country's unstable institutional framework and the general tendency for pushing up decision making to higher levels in the hierarchy. Monitoring and supervision will have to pay particular attention to the adequate functioning of the decentralized mechanisms for subproject appraisal, approval and implementation.

4. **Productivity**: Gains from improved irrigation usually require concomitant efforts for improving agricultural productivity and marketing of agricultural outputs. In the 1996 CAS, this was at least in parts the rationale for FY97 programming of the Agricultural Technology and Dissemination Project, which subsequently slipped by one year. We would appreciate some elaboration of the likely implications of the slippage.