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AN ASSESSMENT OF THE Implementation of the Tenth Plan (PRSP)

Second Progress Report

ON THE ROAD TO FREEDOM FROM POVERTY

NATIONAL PLANNING COMMISSION
Singh Durbar, Kathmandu, Nepal
June 2005

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Preface

The Poverty Reduction Strategy/Tenth Plan progress report in your hands is testimony of the silent development efforts that have been taking place in Nepal after 2002/03. The outcomes underscore the appropriateness of the development approach and also make a strong case for redoubling efforts to bring about meaningful changes in the lives of the people at the grassroots. The fact that Nepal has made considerable progress on PRSP implementation despite the violent insurgency in which development programs were carried out is also an indication of the resilience and potential to bounce-back to higher performance levels in the event of an improvement in the ground situation.

The achievements made so far have resulted from the efforts of many development actors: government and its agencies, non-governmental organizations, community organizations and settlement level user groups and their constituents—the men and women of Nepal. The other important actors that have assisted the change process are the development partners, whose support has been instrumental in translating our visions into programs and outputs. I congratulate all of you for your efforts, and restate the government's commitment to the roadmap provided by the PRSP and the Millennium Development Goals (MDGs) as strategy to attain our development objectives.

Nepal is undergoing through the most difficult time in history. The nine-year-old insurgency and continued political uncertainty pose the most difficult challenge to development. Our challenge is to be able to overcome the obstacles and ensure that development activities can continue, because by addressing to the basic needs of the people, we may also be able to set the stage for long-term conflict resolution. Therefore, we have no choice but to continue our development efforts because therein lies our opportunity to address the age-old inequalities and grievances, which are also said to fuel the violent insurgency.

Our ability to progress as a nation depends on how soon we can develop our villages, and ensuring equal opportunities to every one irrespective of caste, class, ethnicity or religious beliefs and language groups. The road ahead is not easy, but what is now certain is that we are heading in the right direction.

I would like to thank all those who provided valuable contributions to prepare this progress report. Further, I appreciate the support provided by UNDP to produce this report, and all development partners for their contribution towards institutionalisation of the Poverty Monitoring and Analysis System—the basis of this report. I further hope all stakeholders will continuously engage and support further institutionalisation of this process.

Dr. Shankar P. Sharma
Vice-Chairman, National Planning Commission

Abbreviations

AGO	Office of the Auditor General
AMIS	Agency Managet Irrigation System
APP	Agriculture Perspective Plan
APPSP	Agriculture Perspective Plan Support Programs
ARI	Acute Respiratory Infection
AsDB	Asian Development Bank
ASYCUDA	Automated System of Custom Data
CBS	Central Bureau of Statistics
CEAPRED	Center for Environmental and Agricultural Policy Research, Extension and Development
CGISP	Community Ground Water Irrigation Sector Programme
CIAA	Commission for Investigation of Abuse of Authority
CPR	Contraceptive Prevalence Rate
DADF	District Agricultural Development Fund
DDC	District Development Committee
DEF	District Extension Fund
DFID	Department for International Development
DPP	District Periodic Plan
DPT	Diptheria, Pertusis and Tetanus
EPI	Expanded Programme On Immunisation
FCGO	Financial Comptroller General's Office
FY	Fiscal Year (mid-July to mid-July)
GDP	Gross Domestic Product
HDR	Human Development Report
HMG/N	His Majesty's Government of Nepal
HMIS	Health Management Information System
IAP	Immediate Action Plan
IDA	International Development Agency
IDE	International Development Enterprises
IMF	International Monetary Fund
LIF	Local Initiatives Fund
LSGA	Local Self-Governance Act
MDGs	Millennium Development Goals
MIS	Management Information System
MOAC	Ministry of Agriculture and Cooperatives
MOES	Ministry of Education and Sports
MOF	Ministry of Finance
MTEF	Medium Term Expenditure Framework
NBL	Nepal Bank Limited
NDA	Net Domestic Assets
NDHS	Nepal Demographic and Health Survey
NER	Net Enrolment Rate
NFHS	Nepal Family Health Survey

NGO	Non-Government Organization
NLSS	Nepal Living Standards Survey
NPA	Non-performing Assets
NPBT	Net Profit before Tax
NPC	National Planning Commission
NRB	Nepal Rastra Bank
NTFPs	Non-Timber Forest Products
NTIP	New Technology Irrigation Programs
NVC	National Vigilance Centre
PAC	Public Accounts Committee
PAF	Poverty Alleviation Fund
PAN	Permanent Account Numbers
PMAS	Poverty Monitoring and Analysis System
PRGF	Poverty Reduction and Growth Facility
PRSC	Poverty Reduction Support Credit
PRSP	Poverty Reduction Strategy Paper
PRS	Poverty Reduction Strategy
RBB	Ratriya Banijya Bank
Rs.	Nepalese Rupee
SAPPROS	Support Activities for Poor Producers of Nepal
SEZ	Special Economic Zone
SIMI	Small Irrigation and Marketing Initiatives
SRN	Strategic Road Network
SWAP	Sectorwide Approach Program
VAT	Value Added Tax
VDC	Village Development Committee
WB	World Bank
WUA	Water Users Association

SECTION I

Introduction

Background

Nepal's Poverty Reduction Strategy (PRS) is also its Tenth Plan. The government began implementing the five-year Plan in the Fiscal Year 2002/03. This is the annual progress review for the Fiscal Year 2003/04. PRS implementation in the 2002/03 was reviewed in May 2004, and the results were discussed at the Nepal Development Forum (NDF).

The implementation of the Poverty Reduction Strategy Paper (PRSP) began in an extremely adverse political and economic environment. The insurgency had begun to escalate amid political instability and the economy had contracted in 2001/02. The economy recovered, compared to 2001/02, while the larger socio-political environment remained fluid and tentative. Insulating the economy from uncertainties and maintaining progress in attaining the PRSP targets, therefore remains a major challenge. Nepal's basic economic indicators have improved in the past two years and although still short of the ideal, they remain at acceptable levels. It was possible to attain and maintain the growth levels because of stringent fiscal and monetary discipline, and enhanced efforts to reduce poverty through improvements in governance, corruption control, and continued implementation of targeted and quick-yielding programs in areas affected by the insurgency.

Organisation of the Report

The report is divided into 12 sections. Sections I and II include an overview of poverty in Nepal, the key elements of the Poverty Reduction Strategy and also discuss its linkages with the Millennium Development Goals (MDGs). Section III discusses some of the key macroeconomic indicators and achievements. Section IV sums up government efforts to realign public expenditure management for supporting the PRSP goals. Achievements by sectors, including the treatment of crosscutting themes such as gender and social exclusion, environment, decentralization, participation, and the mobilization of CBOs and

BOX 1: Distinct features of the PRS (Tenth Plan)

- The Tenth Plan is Nepal's Poverty Reduction Strategy Paper (PRSP).
- It recognises the role of local bodies, community organisations and NGOs in development and reflects the government's commitment to decentralization and functional devolution.
- It uses modern planning tools and the logical framework to define institutional tasks and responsibilities, being done for the first time in the history of periodic planning in Nepal.
- It has clearly defined priorities: P1, P2 & P3 projects and clear-cut allocation/ disbursement commitments.
- It has extensive M&E provisions, including a commitment for annual poverty monitoring, and—also for the first time in Nepal—process monitoring.

the private sector, are documented in sections V to VII. Section VIII reports performance in terms of institutional reforms and governance improvements and Section IX discusses strategies in conflict-affected areas. Section X comprises an analysis of the system to track progress and Section XI discusses resource needs and issues about aid harmonisation. The conclusions of the review are presented in Section XII.

SECTION II

Key National Objectives and Strategies

THE NATIONAL SITUATION

Nepal's economic growth was in accordance with the global and regional trends. Continued stability and growth in the Indian economy helped anchor the Nepalese economy, which has recovered after contracting by 0.6 percent in 2001/02. Political instability and continued violence caused development to slowdown throughout the review period, resulting in:

- Damage of development infrastructure,
- Low private sector investment,
- Slow government spending on development,
- Mergers and closures of financial, industrial and service establishments,
- Disruption of work of I/NGOs, community organisations and other development partners,
- Disruption of production, trade and transport by frequent closures, and
- General insecurity in both urban and rural areas.

The most affected economic sectors are trade, industry, tourism and construction. Annual tourist arrivals remained at almost one-half of the roughly 500,000 tourists in 1998/99, and tourism income declined by more than a quarter.

Political instability and the resulting protests and *bandhas* (general strikes) remained throughout the review period, disturbing government efforts to take necessary measures to restore peace and create a climate for re-energizing economic activities. Besides, Nepal faces other development challenges, which include:

- Structural challenges, such as low factor productivity compared to other South Asian countries and low resource availability.
- High contribution of agriculture to the GDP, while agricultural productivity remains dependent on factors not fully controllable. These include productivity loss caused by low quality fertilizers, seasonal irrigation and high dependence on the monsoon, displacement of domestic goods by cheap and low quality imports, lack of adequate market access (rural roads), and continued production for subsistence rather than market.
- Low domestic savings.
- High reliance on exports that in turn rely on concessionary agreements and quotas, rather than on competitive goods.
- Declining public and private sector investments.
- Weak project planning and management resulting in low absorptive capacity.
- Weak financial sector and regulatory oversight.
- Inefficient public enterprises, and
- High dependence on foreign aid.

Poverty Profile

The Nepal Living Standards Survey 1995/1996 (NLSS-1996) had reported a poverty incidence (head count estimate) of 42 percent. It was highest—as high as 72 percent—in the Far-western Hill and Mountain regions. The Tenth Plan/PRSP goals were set based on the end-2001/02 estimate of poverty, which was about 38 percent.

The NLSS 2003/04 reported a decline in poverty incidence by 11 percentage points from 42 to 31 percent. It also showed higher poverty levels in rural areas. However, the rural-urban disparities are still alarming: NLSS 2003/04 reported rural poverty at 35 percent compared to 10 percent in urban areas (only 3% in urban areas of Kathmandu Valley). By development region, the incidence of poverty is lowest in the Central Development Region (27%) and highest in the Mid-Western Development Region (45%). There are smaller proportion of population below the poverty line in the Tarai and more in the Hill and Mountain regions (For details see: Annex 2).

Nepal's poverty is explained by many factors—high illiteracy, poor health and low sanitation, low food grain productivity, high child malnutrition, poor access to basic services and inequities resulting from a tradition-driven social structure.

Among the population groups, poverty is highest among people of the so-called "lower" castes and indigenous groups. The NLSS 2003/04 reported major improvements in living standards and access to basic services (Box-2).

BOX 2: Poverty profile: NLSS-I and NLSS-II

Percentage of HH reporting less than adequate	NLSS-I	NLSS-II
Food consumption	50.9	31.2
Housing	64.1	40.6
Clothing	57.6	35.6
Health care	58.7	28.3
Schooling	45.4	21.4
Total income	72.6	67.0
Adult literacy, Total	35.6	48.0
(15 +) F	19.4	33.8
M	53.5	64.5
NER in primary school		
Total	57.0	72.4
Female	46.0	66.9
Male	67.0	77.9
Children fully immunized	36.0	59.4
Access to electricity	14.1	37.2
Access to piped water	32.8	43.9
Access to toilet facility	21.6	38.7
Household access to facility within 30 minutes		
Primary school	88.4	91.4
Health post/hospital	44.8	61.8
Agriculture centre	24.5	31.9
Commercial banks	20.7	27.8
Paved road	24.2	37.2
Motorable road	58.0	67.6

A comparison of data of NLSS I and II reveals major improvements in the people's access to basic services. The nominal per capita consumption has grown from Rs. 6,802 in 1995/96 to Rs. 15,848 in 2003/04. The nominal per capita consumption of the poorest population quintile has also increased from Rs. 2,571 to Rs. 4,913 during the same period. The share of non-farm household income has grown from 22 percent in 1995/96 to 28 percent in 2003/04. Remittances were a major factor contributing to increases in non-farm income and per capita consumption. In 2003/04, 31.9 percent households were receiving remittances, up from 23.4 percent in 1995/96.

Both the Rural Household Survey, 2001 (RHS) and the NLSS-II report significant improvements in the living standards of the people, suggesting a substantial decline in the poverty level.

However, the findings are still being analysed to better understand poverty in terms of rural/urban, regional, sectoral and caste/ethnic distribution. But the NLSS II indicators support the RHS estimates. Among factors contributing to poverty reduction were increased remittances, higher wages (including agriculture) and increased urbanisation. The population living in urban areas has doubled between the two NLSS rounds. The wages are higher in urban areas, which have also contributed towards reducing rural poverty and improving living standards.

The following explain the improvement in living standards between NLSS-I and NLSS-II:

- Real GDP grew by about 5 percent per year between 1996 and 2001, which combined with a decline in population growth and average household size, caused per capita and household income to grow.
- Agricultural growth remained at about 3.9 percent during the review period: it was higher than population growth (2.1 %), resulting in increased per capita food availability.
- Crop diversification and the shift towards high value crops, off-season vegetables, meat and eggs, horticulture products, etc., contributed to increasing income of rural farm households even though the two surveys do not show increases in real agricultural incomes of rural households. This could have resulted from decline in relative prices of agricultural products.
- Growth in remittances, by more than 30 percent per year, and the increase in the number of households receiving remittances (from 23.4% in 1995/96 to 31.9% in 2003/04).
- Improved employment opportunities in the services sector, and
- Social sector improvements resulting from increased government spending on health, education and drinking water programs, and higher general awareness about the services available.

Poverty reduction could have been sharper, and sustained, and it could also have influenced other economic sectors, if the general environment had been normal. The insurgency and political uncertainty negated some of the achievements and PRS implementation will remain influenced by the general political and economic environments.

The Tenth Plan/ PRSP: The original goal of the PRSP/Tenth Plan was to reduce poverty from 38 percent in 2001/02 to 30 percent by 2006/07. The Plan is founded on an inter-related, four-pillar development strategy (Box-3). The first strategy aims to achieve high and sustained broad-based growth through a

BOX 3: PRSP pillars

- High broad-based and sustained economic growth.
- Improvement in access and quality of infrastructure, social and economic services in rural areas.
- Greater social and economic inclusion of poor men and women from all groups including Dalit and disadvantaged Janajati groups through mainstream as well as targeted programs, and
- Good governance to improve service delivery, efficiency, transparency and accountability.

combination of approaches. These include promoting faster non-agricultural growth by creating an investment-friendly environment through adherence to liberal economic policy and focusing on agricultural growth to raise income, employment and food security in rural areas. The PRS seeks to maintain macroeconomic stability through structural and policy reforms in key areas that influence—directly and indirectly—the attainment of poverty reduction targets and the Millennium Development Goals (MDGs).

The second PRS strategy focuses on improving access to and quality of infrastructures as well as social and economic services. Better roads, reliable electricity and communications facilities are needed not only for achieving high and sustained growth but also for ensuring effective service delivery to rural populations.

The third PRS pillar aims to improve access across all sectors and programs for socially excluded groups such as Dalits, Janjatis, Muslims and women and to provide safety nets for vulnerable groups, including children, senior citizens and widows and those displaced by the conflict. There is a strong focus on the importance and role women can play in development, and on measures to assure that they and other excluded groups have access to education, health services and economic opportunities needed to help them overcome poverty and make greater contribution towards increasing national productivity.

The fourth PRSP strategy aims at creating a simple, transparent, responsive and accountable government to cater to all in an equitable and efficient manner. The actions envisaged include downsizing government by devolving more functions to local bodies and involving local communities in development activities, encouraging Community Organizations (COs), Non-Government Organizations (NGOs), and international NGOs in community awareness and mobilization; income generating activities and service delivery; encouraging private sector investment for employment generation, streamlining the planning and budgeting system and improving resource mobilisation.

PRSP and the Millennium Development Goals (MDGs)

Nepal endorsed the Millennium Declaration in September 2000 and has committed to work towards achieving the MDGs by 2015. The MDGs set quantitative poverty reduction targets and specific goals in health, education, gender equality, the environment and other aspects of Human Development, measured in terms of outcome and impact indicators. Several studies suggest that the linkages between public expenditure and sectoral outcomes remain weak and need to be enhanced through economically sound pro-poor policies backed by strong accountable institutions to implement the programs.

The MDGs may not be attained by Nepal unless the on-going efforts are sustained and implemented through the 12th Plan period or for two more periodic plans. Most of the MDG-related indicators are incorporated in the PRSP and some specific targets are also compatible with the Millennium Development Goals. There were doubts about whether Nepal would be able to attain the MDGs by 2015 in almost every category except the drinking water sector during the early years of the Tenth Plan. It is also clear that women, Dalits and disadvantaged Janajatis account for a majority of those currently not reached by social services. Therefore, bringing these groups into the development mainstream is key to attaining the MDGs. In primary education for example, girls from the Dalit and disadvantaged Janajati households make up most of the out-of-school children. These groups have to be brought into the system if the education MDG is to be attained. Targets and achievements for selected MDG indicators are given in Table 2.1.

Based on available data, progress on the net enrolment ratio and people with access to safe drinking water is encouraging, even though there have been reports about the deterioration in service quality. Similarly, even though NLSS-II results show significant improvements in the poverty head count, poverty levels in some population groups—rural Hill Janajatis and pockets in the Hill and Mountain regions throughout the country—appears to have increased. Achieving the poverty reduction goal therefore would require restoring economic growth at least to levels attained during the second half of the 1990s, and reducing income inequality. There are also possibilities of Nepal being able to attain some other goals and targets, including those related to child health and primary education.

Net Enrolment Rate (NER) at the primary level may remain slightly short of the MDG target but achieving completion of the primary cycle target remains a distant possibility. Meeting the NER goal requires increased efforts to target children from very poor families, Dalits, disadvantaged Janajati groups and girls. The attainment

TABLE 2.1: Target and performance on the MDGs

Goal	Base Period 1990/95	Base period of the 10th Plan (2001/02)	10th Plan target@ (2006/07)		MDG target (2015)	Progress 2003/04	Targets: 12th Plan
			Normal case	Lower case			
Infant mortality rate per 1000 births	107	64.2	45	47	26	64.2^{+}	
Under 5 mortality per 1000 births	197	91.2	72		54	91.2^{+}	34.4
Maternal mortality ratio per 100,000 live births	539	415	300	315	145	NA	250
Literacy rate 15 + yrs (%)		44*	63	61	100	48.2	100
Female literacy rate 15+ yrs (%)		35.6	55	53	100	34.7	100
Net enrolment in primary school (%)	64	80.4	90	89	100	84.2	100
Access to safe drinking water facility (%)		71.6	85	83	100	73.0	100
Children under 5 malnourished (%)	57**	48.3			28		
Head count poverty (%)	42	38	30	33	21	30.8	10

@ The 10th Plan has two scenarios: normal case (peace) and lower case (continued conflict). * Adult literacy rate has been revised from 49. 2% as mentioned in the 10th Plan to 44 percent by MOES. ** estimated from linear trend. + refers to 2001/02.
Sources: The 10th Plan, NFHS 1996, NDHS 2001, NLSS II 2004, MDG Progress Report 2002, and reporting of the MOES.

of many other goals depends on the ability to attain the third goal of the MDGs, and therefore narrowing the gender gap is of utmost importance.

However, the progress made in the 1990s towards attaining MDGs remains threatened by the conflict. Restoring peace and allowing the economy to function at levels it did during the second half of the 1990s are therefore prerequisites for attaining the universal goals.

Effective poverty reduction requires continuous economic growth, which is possible through technological advancement and capital accumulation, including human and social capital. The MDGs, being ends in themselves, are integral to the poverty reduction goals. Every society desires reduced hunger, gender equality, improved health and better education, etc. The achievement of the goals in these areas is also equivalent to capital inputs that can re-energize economic growth and lead to greater overall well-being. Healthier, better educated workers and improved water, sanitation and infrastructures can help to raise output per capita. Therefore, investing for achieving the MDGs is part of the overall capital accumulation and empowerment process.

Political uncertainty and conflict have affected service delivery and hampered the efforts towards building the social capital discussed in the preceding paragraph. Overcoming the difficulties resulting from the general environment can be possible by devising and implementing non-conventional approaches for service delivery and direct income transfers, which has been the approach HMG/N has adopted. For example, after 2001/02 Nepal has devolved five tasks (primary education, management of health posts, maintenance of rural roads, agriculture and livestock extension services and postal services) to local bodies and communities, and plans to devolve more functions.

Since underdevelopment continues to feed the conflict and development cannot wait until the violence is over, the government has shifted its approach to include working directly with communities, in addition to forming partnerships with local institutions. The devolution process began with transfer of management responsibility of primary schools, sub-health posts and agriculture and livestock extension services. The government is also transferring responsibility for building local infrastructures, such as small irrigation schemes, rural drinking water systems and rural roads, to local bodies and community organisations. HMG/N will continue to rely on rapid devolution of functions to local bodies and communities and implement programs through participation as a strategy to ensure continuity to activities aimed at attaining the MDGs.

Recent Initiatives on the MDGs

Most of the indicators and targets of the MDGs are included in the Tenth Plan. However, in order to ensure focused realisation of the goals, the government is undertaking a needs assessment exercise and also preparing the second MDG progress report. The MDG needs assessment exercise encompasses five sectors—primary education, child and maternal mortality, communicable diseases, drinking water and sanitation, and rural roads and electrification and is expected to help identify interventions and estimate resources necessary for meeting the MDGs. Similarly, the MDGs progress report will assess performance regarding all the MDGs and the policy environment, and recommend policy options needed for achieving the goals.

SECTION III

The Path To Recovery

SUSTAINING MACROECONOMIC STABILITY

Macroeconomic performance has been positive—albeit on the lower side—during the years of PRS implementation. The decline in output in 2001/02 made way for annual growth of 3 to 4 percent during the first two years of the PRSP/Tenth Plan. Inflation remains under control—below 5 percent per year. The budget deficit shrank reflecting buoyant revenue collection and controlled expenditures while current account deficit widened, reflecting increased imports. Significant inflows of external assistance and remittances helped to increase foreign exchange reserves.

The achievements are significant given the challenges faced by the economy that were compounded by the fluid political situation and the insurgency. HMG/N has taken various measures to maintain macroeconomic stability. These include prudent domestic borrowing, strict fiscal discipline, tight monetary control and implementation of financial sector reforms. Other reforms aim at making the economic environment investor-friendly.

Macroeconomic developments: The economy contracted by 0.6 percent in 2001/02. GDP growth recovered to 3.2 percent in 2002/03 and 3.3 percent in 2003/04. The preliminary forecast of economic growth is about 2.5 percent for 2004/05. Overall, GDP growth remains lower than that targeted for the Plan period.

On average, agricultural sector growth was 3.9 percent during the review period (Table 3.1). However, agriculture still remains dependent on the monsoon. The non-agriculture sector rebounded from a contraction (1.9 percent) in 2001/02 to growth by 3.1 percent in 2003/04. Manufacturing grew by 1.7 percent in 2003/04, and construction by just 0.2 percent. These sectors have been badly affected by the economic and political uncertainties.

TABLE 3.1: Macroeconomic performance indicators, 1999/00-2004/05

	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05*
ECONOMIC GROWTH						
Real GDP growth	6.1	5.6	-0.6	3.2	3.4	2.5
Agriculture	4.9	5.5	2.2	2.5	3.9	2.8
Non-agriculture	6.8	4.5	-1.9	3.2	3.1	2.3
Real per capita GDP growth rate	3.8	3.4	-2.8	1.0	1.3	
INVESTMENT AND SAVINGS (% OF GDP)						
Total investment	24.3	24.1	24.1	26.0	27.3	
Private investment (including change in stock)	17.3	16.5	16.6	19.1	20.8	
National savings	18.6	19.0	16.4	15.5	15.1	
Domestic savings	15.2	15.3	12.1	11.9	12.5	
GOVERNMENT FINANCES (% of GDP)						
Revenue	11.3	11.9	11.9	12.3	12.6	13.8
Expenditure	17.5	19.5	18.9	18.4	18.6	21.5
Regular	9.1	10.5	11.5	12.1	12.0	
Development	8.4	9.0	6.4	6.4	6.6	
Budget deficit	-4.6	-6.0	-5.4	-3.6	-3.7	-4.9
Foreign aid	4.6	4.6	3.4	3.9	3.7	6.0
Grants	1.5	1.6	1.6	2.5	2.3	2.9
Loans	3.1	3.0	1.8	1.0	2.2	3.2
Domestic borrowing	1.5	3.0	3.6	2.6	1.5	1.7
BALANCE OF PAYMENTS						
Export value	13.1	13.6	11.1	11.0	10.7	
Import value	28.6	28.2	25.4	27.3	28.1	
Current account balance before grants	-5.3	-2.0	-4.3	-2.6	- 2.4	
Net aid disbursements	5.1	4.2	3.4	4.1		
Gross foreign exchange reserves		25.6	25.1	23.8	26.2	
MONETARY DATA						
Broad money growth	21.8	15.2	4.5	9.8	11.8	12.5
Domestic credit growth	17.2	18.6	10.4	10.2	9.5	9.8
Net foreign assets	23.8	9.1	0.7	3.4	21.0	15.5
Inflation	3.4	2.5	2.9	4.8	4.1	4.3

** Projected; Sources: Various publications of NPC, CBS, and NRB*

Investment (including stock) has increased, compared to the pre-Tenth Plan levels (24% of GDP), reflecting mainly accumulation of stock. Public investment (development spending) has declined by about 3-percentage points in terms of GDP, reflecting disruptions caused by the insurgency and also the rationalization of expenditures and better-targeting. Private investment grew from 17 percent of GDP in 2001/02 to 21 percent in 2003/04 while domestic savings rose slightly, by 0.5 percentage points (in GDP terms) during 2003/04. Generally, low economic growth caused the downturn in savings.

Fiscal development: The reduction in the budget deficit (from 5.4% of GDP in 2001/02 to 3.7% in 2003/04, Table 3.1 and Annex 3) is due to two factors, one of which was improvement in revenue. Revenue collection rose from 11.9 percent of GDP in 2001/02 to 12.6 percent in 2003/04.

Implementation of Automated System of Custom Data (ASYCUDA) at major custom points, mandatory Value Added Tax (VAT) and Permanent Account Numbers (PAN) registrations and income taxes, and implementation of three-year custom reforms program resulted in an increase in the number of effective tax payers. Another factor that explains the lower budget deficit is the decline in development spending (around 6-7% of GDP), resulting from implementation difficulties caused by the security situation, and the rationalization of spending through the Medium Term Expenditure Framework (MTEF).

The security situation caused regular expenditures to grow from 11.5 percent of GDP in 2001/02 to 12.0 percent in 2003/04. However, increased revenue, savings resulting from rationalization of development spending and revenue growth covered the increase in recurrent spending. Therefore pressure on domestic borrowing remained low–borrowing declined in GDP terms after 2001/02 aiding to improve fiscal balance.

Trade and balance of payments: Both domestic as well as foreign trade were affected severely between 2001 and 2004, despite improvements in the external environment. Low exports and higher imports caused the trade balance to grow to about 18.6 percent of GDP in 2003/04, from about 14.3 percent in 2001/02.

Export declined from 11.1 percent of GDP in 2001/02 to 10.7 percent in 2003/04. The phasing out of quotas in the U.S. and the inability to develop new markets could further lower readymade garment exports in 2004/05. The export of all major commodities dipped (about 20% for garments, about 9% for pashmina, 14% for woollen carpets), even though there was some recovery in 2003/04. Nepal exported goods and services 82 countries in 2003/04 and total exports reached Rs. 55.2 billion in 2003/04–an increase by about 18 percent, from Rs. 46.9 billion in 2001/2002. HMG/N seeks to enhance Foreign Direct

TABLE 3.2: Macroeconomic performance and projections (Rs million)

Description	2001/02 Base Year	2002/03 Actual	2003/04 Rev. Est.	2004/05 Allocation	2005/06 Projection	2006/07 Projection
Government revenue	50445	56230	62227	73920	79480	89140
Total expenditure	80072	84006	92107	115289	124540	131014
Regular expenditure	48590	54973	59302		71618	73025
Development expenditure	31482	29033	32805		52922	57989
Recurrent expenditure	-	52090	56720	70098	66129	67784
Capital expenditure (including principal repayment)	-	31916	35387	45191	58411	63230
Revenue surplus	1855	1257	2925		7862	16115
Government revenue recurrent expenditure	-	4140	5507	3822	13351	21356
Budgetary deficit	22941	16437	18423	26018	28110	24824
Total foreign aid	14385	15885	22568	32310	35250	35420
Grant	6686	11339	11457	15351	16950	17050
Loan	7699	4546	11111	16959	18300	18370
Domestic borrowings	8000	8880	7312	9060	9810	6454
Cash balance (- surplus)	7242	3011	0	0	0	0
Total domestic borrowings	15242	11891	7312	9060	9810	6454
Narrow money supply (M1)	77156	83754	93969	99767	111340	124812
Broad money supply (M2)	223988	245911	256987	309291	351052	400552
Total domestic credit (at current prices)	207323	228444	251090	274661	302673	337484
Net foreign assets (at current prices)	8842	91407	108801	127701	148774	174802
CPI (1994/95 =100)	142.1	148.9	155	161.7	168.9	176.8
Export	46945	50761	55228	57051	62186	68715
Import	107387	121053	132910	151047	172194	196645
Current account balance	18161	11615	14598	17086	18111	19198
Remittances	47536	54203	58588	68903	78549	89939
Balance of payments (-deficit)	-3343	4364	16001	17378	17725	18257
Gross foreign exchange reserves	105901	108229	130201	138293	151431	167331
GDP (at factor cost)	405632	435531	472424	511980	558563	616120
Agricultural GDP	160144	171104	183357	197475	213866	232472
Non-agricultural GDP	245863	265968	290519	314505	344697	383648
GDP (at market prices)	422676	456201	495336	536627	585870	646411
Key ratios						
Government revenue	11.93	12.33	12.56	13.77	13.57	13.79
Total expenditure	18.94	18.41	18.59	21.48	21.26	20.27
Regular expenditure	11.50	12.05	11.97	0.00	12.22	11.30
Development expenditure	7.45	6.36	6.62	0.00	9.03	8.97
Recurrent expenditure	-	11.42	11.45	13.06	11.29	10.49
Capital expenditure	-	7.00	7.14	8.42	9.97	9.78
Budget deficit	5.43	3.60	3.72	4.85	4.80	3.84
Foreign aid	3.40	3.48	4.56	6.02	6.02	5.48
Grant	1.58	2.49	2.31	2.86	2.89	2.64
Loan	1.82	1.00	2.24	3.16	3.12	2.84
Domestic borrowing	1.89	1.95	1.48	1.69	1.67	1.00
Cash balance (- surplus)	1.71	0.66	0.00	0.00	0.00	0.00
Total domestic borrowings	3.61	2.61	1.48	1.69	1.67	1.00

Source: Various Reports of NPC, MOF and NRB

Investment (FDI) by designating a Special Economic Zone (SEZ), and an ordinance to the effect has been prepared. Imports rose from Rs.107.4 billion to Rs.132.9 billion during the same period.

The current account deficit has been reduced, from 4.3 percent of GDP in 2001/02, to 2.4 in 2003/04. The reduction resulted from significant growth in remittances–every 11th Nepalese male is working abroad and sending money home. The gain from remittances was somewhat offset by a widening trade deficit and a decline in services receipts (mainly due to a decline in tourist arrivals and receipts from tourism). Overall, the balance of payments (also including foreign direct investment and loans to government) recorded a surplus except for the year 2001/02. The total foreign exchange reserve in 2003/04 was 26.2 percent of GDP, sufficient to cover 11.2 months of imports.

Inflation and exchange rate: The period between 2001/02 and 2003/04 was one of tight monetary management. This helped contain annual inflation at around 4 percent. Exchange rate vis-à-vis the US dollar showed a decelerating trend during the review period, and eventually stabilized at about NRs71: US$1 and real exchange rate remained at acceptable levels.

Broad money doubled from 4.5 percent in 2001/02 to 9.8 percent in 2002/03, and increased to 11.8 percent in 2003/04. Domestic credit recorded about 10 percent annual growth in the years 2002/03 and 2003/04. The share of private sector credit was maintained at 68 percent of the total. Government overdraft from the banking sector has been brought down to zero and there was a budget surplus of Rs.1.7 billion. The credit volume grew owing to increased private sector demand while government demand for credit remained low owing to "savings" in terms of unspent development expenditure.

Foreign Employment: National income has been more dynamic than the GDP owing to growth in remittances which rose sharply from about Rs. 48 billion in 2000/01 to Rs. 59 billion in 2003/04. The Census (2001) reported more than 762,000 people working abroad, most of them in India. The government encourages foreign employment by providing essential services such as training, job opportunity information, travel documents, and safety arrangements, made bilaterally or through special measures.

The number of workers heading abroad for foreign employment has been increasing over the years, and it increased from 104, 739 in 2001/02 to 106, 660 in 2003/04. In spite of the incident of August 2004 against mapower companies, the number

TABLE 3.3: Nepalese workers in different countries (Excluding India)

Country	2001/02	2002/03	2003/04	2004/05*
Malaysia	52,926	43,812	45,760	52,125
Qatar	19,895	26,880	24,128	32,418
Saudi Arabia	21,094	17,990	16,875	10,335
U.A.E.	8,411	12,650	12,760	9,331
Kuwait	378	907	3194	1562
Baharain	695	818	606	222
Hong Kong	482	564	672	154
S. Korea	131	712	1324	324
Oman	96	44	73	285
Israel	16	55	433	568
Brunai	132	239	131	-
Japan	26	28	55	-
Others	457	356	649	114
Total	104,739	105,055	106,660	107,438
(Women)	(N.A.)	(N.A.)	(892)	(446)

** As of April 2005*

Source: Department of Labour and Employment Promotion.

of workers reached to about 107,438 during the first 10 months of 2004/05. Since 2003/04, the government began encouraging women to seek foreign employment: During 2003/04-2004/05, 1,338 women began jobs abroad, mainly in Hong Kong and Israel (Table 3.3).

Poverty Reduction and Growth Facility (PRGF): A full-fledged PRSP made Nepal eligible for both the Poverty Reduction and Growth Facility (PRGF) with the International Monetary Fund (IMF) and Poverty Reduction Support Credit (PRSC) from the World Bank (WB). Nepal entered agreements for the PRGF and the PRSC in November 2003. The PRGF allows to access credit from IMF equivalent to US$ 73.9 million, of which the first tranche of US$10.6 million was drawn in November 2003. Under the PRSC, Nepal obtained US$ 75 million as soft loan from the IDA.

The main elements of the PRGF-supported program are–sound macroeconomic management, better expenditure prioritisation and enhanced efficiency, structural reform in major economic sectors, and improved governance. PRGF emphasizes these reforms for attaining sustained growth and enhancing the pro-poor budget focus. Under PRGF, Nepal has several benchmarks to attain, including adjustment in prices of government-controlled products, fiscal and financial adjustments, and implementation of financial sector reforms. Besides, the government has also committed to sectoral and structural reforms, aggressive privatisation of public enterprises and institutional reforms including capacity enhancement of the NRB for supervising and monitoring financial institutions.

The IMF was largely satisfied with PRGF implementation in the first year of the Plan but had some reservations on performance in the second year. Nepal adjusted prices of petroleum products in mid-2004 (and again in January 2005) and raised the VAT rates to narrow down the gap between commitments and performance.

Poverty Reduction Support Credit (PRSC): The preparation and implementation of a credible PRS made Nepal eligible for the annual PRSC (budget support) from the World Bank. The PRSC I (US$ 75 million) sought to support reforms to expedite PRSP implementation. PRSC I emphasized creating fiscal space for, and improving the effectiveness of growth-enhancing public investments and measures for improving the investment climate and the credit helped to scale up service delivery by accelerating devolution of management authority of primary schools and health posts to communities. It was also instrumental in promoting social inclusion by helping raise the effectiveness of targeted programs, improve access to schooling for excluded groups and encourage affirmative actions in public service. On governance, the PRSC thrust was on raising the effectiveness of the civil service; strengthening anti-corruption and accountability institutions, and improving financial management and procurement practices.

Prudent fiscal and monetary policies have helped spur economic growth, contain inflation and maintain a comfortable level of reserves. The progress in fiscal management includes reforms in public spending, streamlining of tax policies and improvement in tax administration. The reforms in public expenditure management are being deepened by focussing spending on pro-poor activities. Other PRSC supported reforms include the establishment of the Roads Board (an autonomous entity to fund road maintenance), rationalization of petroleum pricing and enhanced devolution of management of schools and health posts to local committees, and special programs for supporting development of Dalits and disadvantaged Janajatis. Overall, the reforms supported by PRSC have been satisfactory but slow.

Public Debt Management

HMG/N has begun a program to strengthen public debt mobilisation with assistance from the Asian Development Bank (AsDB). State-of-the-art computer software (CS-DRMS 2000+) has been installed at the MOF, FCGO and NRB for recording and producing information required for public debt management. Staffs at these agencies have also been trained on the use of the software. The government has also prepared a macro modelling framework for continuous debt sustainability analysis.

SECTION IV

Public Expenditure Management

Low outcome of public expenditure in ensuring better service delivery, improving governance and accountability had remained a major concern for many years. The government has undertaken a wide range of policy actions to address the problem, most important of which is public expenditure reform.

Managing public expenditure is not only about improving spending allocations. It is more about accountability for resource use in terms of results and outputs. The Medium Term Expenditure Framework (MTEF) helps to improve budget process and outcomes through greater clarity in objectives, predictability in allocations, comprehensive coverage and transparency in uses of funds.

Medium Term Expenditure Framework in Nepal

The Public Expenditure Reform Commission (2000) recommended several measures to focus planning and budget allocation to outputs by formulating and implementing the MTEF. Following that, the government introduced several measures to anchor the Poverty Reduction Strategy (PRS), maintain fiscal discipline and to prioritise and align resources for poverty reduction. The MTEF was introduced in 2002/03—initially in five sectors and later expanded to include the entire development budget. In addition to serving as an expenditure framework to strengthen budget implementation, the MTEF process has been useful to introduce the following reforms:

- to ensure predictability, all activities are prioritised and priority activities (P1 activities) are fully funded
- to enable differential funding of activities, the fund release system has been changed to ensure that priority activities receive one third of the budget in the beginning of the year, while others received one-sixth
- to ensure accountability, further fund releases are based on performance
- to reduce fungibility of allocated expenditures, line ministry secretaries have been barred from making fund transfers in budget lines as was the practice; and
- to address the concerns of capacity, the Immediate Action Plan (IAP)—a "must" complete annualised list of actions–has been implemented alongside broader expenditure reforms.

BOX 4: MTEF classifications

MTEF was used to classify development budget/expenditure into two categories—priority and strategy. The priority category was further classified as P1, P2, P3 and N priority-wise. The strategy, on the other hand, was further classified into five heads, as follows:

- 01 - High, sustainable and broad-based annual growth rate
- 02 - Social sector and infrastructure development
- 03 - Social inclusion/ targeted programs
- 04 - Good governance, and
- 07 - General administration.

The deepening and widening of the MTEF process has continued. Stepping in the fourth year of PRS implementation, the government has completed unit costing in several sectors, classified the budget into current and capital expenditure and has continued refining the prioritisation criteria. Sectoral activities have been strengthened by aligning prioritised resource allocations with outcomes, and training government officials. HMG/N has also instituted a practice of screening new projects with a pro-poor bias.

All of the aforesaid actions and reforms—measured against benchmarks agreed in advance with the NPC—have helped maintain fiscal discipline, even while being faced by rising security expenditures, and to increase pro-poor spending. The reforms have resulted in increased donor confidence, reflected in the government's ability to secure two sector-wide approach programs (SWAPs) and budget support. The SWAPs and budget support have reinforced the performance orientation of HMG/N because the flexible financing option has shifted the responsibility of proper use of resources on government and the line ministries because replenishment is contingent of effective use.

MTEF and Fiscal Performance

Public expenditure reforms have helped to maintain aggregate fiscal discipline. HMG/N has been successful at managing competing claims on resources to avoid unsustainably large fiscal deficits. In the mid-1990s, domestic borrowing averaged 1.8 percent of GDP. In the same period, the government mobilized foreign financing equivalent to 5.1 percent of GDP and added domestic resources to maintain development spending at 9.1 percent of GDP. It was able to finance the total expenditure (18% of GDP) despite the low revenue base (11% of GDP), made possible by limiting regular expenditure to nine percent of GDP.

The escalation of the conflict in 2001 increased pressure on fiscal management. Using the MTEF as a response measure, the government was able to maintain total expenditure close to 19 percent of GDP during 2001/02- 2003/04; efforts to increase tax collection also netted a revenue increase of 1.8 percent of GDP during the same period. The implementation of the PRS alongside expenditure reforms anchored in the MTEF helped to cushion the pressure of security expenditure on aggregate spending, while simultaneously helping to raise allocations to PRS priority areas.

The aforesaid approach has resulted in some visible gains. Revenue as percentage of GDP has increased to 13 percent and, given Nepal's dependence on external assistance, HMG/N has been relatively successful at restoring donor confidence through the reform actions. Concessional foreign financing obtained as a result rose from 3.4 percent of GDP in 2001/02 to 3.7 percent in 2003/04; it is projected to grow to six percent in 2004/05. The resource availability has allowed government to reduce domestic borrowing, which has declined from 3.6 percent of GDP in 2001/02 to 1.5 percent in 2004. HMG/N aims to reduce domestic borrowing from 1.7 percent in 2004/2005 to 0.7 percent in 2006/07 by increasing revenue to cover the fiscal gap (see Annex 3).

Budget Realism

Budgetary performance has improved over the past three years, resulting in a narrower gap between budget and actual performance—the deviation of total expenditure from allocation declined from 20 percent in 2002 to 11 percent in 2004. The budget has become more realistic, aided by the elimination of several hundred marginal projects and changes in budget formulation by anchoring it to fund availability and legislation of the overdraft limit.

Although classification of the budget from 'regular' and 'development' to 'recurrent' and 'capital' has enhanced transparency and aided proper costing of activities, budget formulation still remains input driven—and not outcome-oriented (and backed by resources). Implementation shortfalls resulting from gaps in the realisation of committed donor funds and underperformance of activities—resulting from normal delays or the insurgency—remain concerns because low capital formation can constrain future growth. The table 4.1 shows that the budget has become more realistic despite the conflict-induced gap between allocations and expenditures for development. What is notable is that the government has performed well in areas where the security situation was not an obstacle.

TABLE 4.1: Budgetary performance (2001/02 to 2003/04) (Rs in billion)

	2001/02			2002/03			2003/04			2004/05
	Budget	Actual	%Achieved	Budget	Actual	%Achieved	Budget	Actual	%Achieved	Budget Est.
Total expenditure	99.8	80.1	80.2	96.1	84.6	88.0	102.4	92.1	89.9	111.7*
Regular	49.3	48.6	98.6	57.4	55.0	95.8	60.5	59.3	98.0	64.5
Development	50.5	31.5	62.4	38.7	29.0	74.9	41.9	32.8	78.1	47.2
Financing										
Revenue	60.3	50.4	83.6	57.2	56.2	98.2	62.2	62.2	100.0	70.3*
Foreign aid	30.5	14.4	47.2	27.0	15.9	58.9	28.3	22.6	79.9	32.3
Domestic borrowing	9.0	8.0	88.9	12.0	8.9	74.2	11.8	7.3	61.9	9.1

* As per the additional budget provision made in January 2005, the total budget increased to 115.3 billion and revenue increased to 73.9 billion.

Project size and composition: PRS implementation has enabled the government to streamline and scrub the portfolio, and tightly align spending with priorities. As recommended by Public Expenditure Review Commission (PERC), the government deleted over 70 projects in 2001/02. An additional 203 projects were dropped following PRS implementation in 2002/03 and has maintained projects at a manageable level (Table 4.2). The rationalisation of projects helped to nearly double the per project budget allocation. Improvements in the overall budgeting framework and linkages with the priorities justified an increase in development expenditure in the fiscal year 2004/05.

TABLE 4.2: Development budget and trends

	Fiscal Year 1999/00	2000/01	2001/02	2002/03	2003/04	2004/05
Development Budget (Rs.billion)	41.85	48.11	50.47	38.68	41.85	47.20
Number of projects	681	715	637	434	443	454
Allocation per project (Rs. million)	61.45	67.29	79.73	89.12	94.47	103.97

Source: PRSP and Budget Documents.

TABLE 4.3: Allocation by priority classification in the MTEF, 2002/03 to 2004/05 (%)

FY		Development Budget			Regular budget		
		P1	P2	P3	P1	P2	P3
2001/02	Allocation	58.7	34.3	7.0	93.8	3.5	2.7
	Actual	55.3	38.6	6.1	94.7	3.1	2.2
2002/03	Allocation	71.0	25.5	3.4	91.8	5.2	3.0
	Actual	68.6	27.6	3.8	94.1	4.9	1.0
2003/04	Allocation	75.8	20.5	3.7	90.3	5.5	4.2
	Actual	77.6	18.4	4.0	93.1	5.5	1.4
2004/05	Allocation	76.0	21.3	2.7	92.5	5.1	2.4
Trend (%)	Allocation (2001/02 to 2004/05)	5.7	-4.4	-1.3	-0.5	0.5	0.0
	Actual (2001/02 to 2003/04)	11.2	-10.1	-1.1	-0.8	1.2	-0.4

Source: Budget speeches for FY 2001/02 to 2004/05 and MTEF

Inter-Sectoral Allocation

Social sector investment is important for reducing poverty in rural areas. Government efforts to prioritise and realign programs and activities in line with the PRS goals have also brought about changes in the inter-sectoral composition of the development budget. The share of the social sectors–education, health, drinking water and local development–has grown from about 37 percent of actual development expenditure in 20001/02 to 42 percent in 2002/03; and to 47 percent in 2004/05. Within this group, the share of education has grown from 8.8 percent to 13.3 percent, health from 6.0 percent to 9.6 percent, drinking water from 5.6 percent to 7.6 percent and local development remained constant at about 13 percent (Table 4.4).

The implementation modality of social sector projects has shifted to allow increased decentralization and involvement of local beneficiaries in program execution in order to make them more participatory and inclusive. Increased allocations in both education and health resulted from two Sector-wide Approach programs. HMG/N plans to gradually reduce spending on the economic sector to create space for private investors and to remain more focused on increasing social sector investment. However, much of the reduction in the economic sector so far, except communication, resulted from completion of large projects like the Kali Gandaki and slow implementation of others like Middle Marshyangdi Hydroelectric Project and the Melamchi Drinking Water Project. Although investments in the economic sector tend to be linked to project life cycles, the inability to design programs with linkages to sectoral and PRS goals is also reason for the lower funding levels. The government is working to reverse the investment trend in the economic sector through the formulation of 'business plans' (refined sectoral strategies).

TABLE 4.4: Composition of development expenditure, 1999/00-2004/05

	FY99/00	FY00/01	FY01/02	FY02/03	FY03/04 Budget	FY04/05 Budget
Percentage share (%)						
Social services	39.08	34.73	36.62	41.98	42.01	47.42
Education	8.11	7.51	8.75	9.40	10.36	13.26
Health	6.70	5.32	5.96	5.58	7.23	9.56
Drinking water	7.63	6.49	5.55	6.93	8.26	7.56
Local development	13.03	12.48	13.20	18.14	12.90	13.01
Other social services	3.61	2.92	3.16	1.93	3.25	4.00
Economic services	25.62	23.48	26.26	21.50	24.31	22.08
Agriculture	6.58	6.28	8.14	6.31	5.25	5.36
Irrigation	9.59	10.67	9.98	7.36	6.44	6.57
Forestry	1.63	1.29	2.00	2.15	1.50	1.42
Other economic services	7.81	5.23	6.14	5.68	11.12	8.73
Infrastructure	33.12	33.49	29.17	32.20	31.45	28.28
Roads/ transportation	14.79	14.45	14.35	12.83	12.89	11.99
Communication	0.89	0.66	0.86	5.93	2.03	2.84
Electricity (power)	17.44	18.38	13.96	13.44	16.54	13.45
Others	2.19	8.31	7.94	4.32	2.22	2.22
Total	100.00	100.00	100.00	100.00	100.00	100.00
Memo Item:						
Pro-poor spending (% of total)	32.80	34.00	36.70	40.40	42.40	n.a.

Source: Budget documents, MTEF

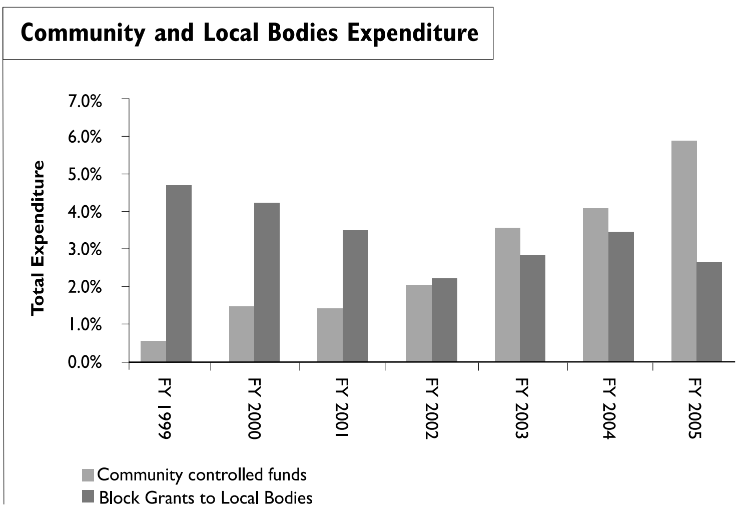
Decentralised public expenditure: In rural areas improvement in living standards can be achieved only if the beneficiaries participate in development, and there is accountability and transparency of spending through democratic governance. The fiscal decentralisation measures underway are the first steps toward the direction. The budget allocated to districts has nearly doubled, and the emphasis on capital spending in the districts is higher compared to central level projects (Table 4.5). It must, however, be acknowledged that the insurgency has affected absorption capacity. There is therefore the need to design more activities for implementation by local bodies through people's participation in order to 'insure' activities against possible disruption, especially in the insurgency-affected areas.

The increased efforts of HMG/N to devolve activities and funds to communities have resulted as response to the threats of the insurgency on development. The government strongly believes that service delivery can be enhanced only if communities are empowered to control development activities. Prior to the

TABLE 4.5: Central and district level expenditure, 1999/00-2004/05 (Rs million)

Budget	2002/03	2003/04	2004/05	Trend	Growth rate (%)
Total budget	84572	92107	115290	13559	16.0
Central level	76275	83443	102509	11317	14.8
District level	7731	8665	12781	2525	32.7
Recurrent cost	52090	56720	82602	7759	14.9
Capital cost	22356	24469	32688	4611	20.6

implementation of the PRS, communities controlled less than 1.5 percent of the total expenditure. It increased to 4 percent in 2003/04, and the allocation for 2004/05 was raised further to 6 percent of the total budget. The amount of money controlled and spent by communities has surpassed the block grant spending by local bodies since 2003/04. The experience so far suggests that truly community-owned development initiatives are more likely to be pro-



Sources: Ministry of Finance

tected by the people compared with projects where the ownership levels and participation are lower than the ideal. In many of the truly community-owned and managed programs, the people have managed to negotiate the 'development space' needed to continue activities, suggesting that the approach has greater resilience and could therefore be useful to duplicate for giving continuity to development despite the insurgency.

SECTION V

Broad-Based Growth Performance

ACCELERATING AGRICULTURAL GROWTH

The PRSP seeks to attain broad-based and sustainable agricultural growth by modernising agriculture to enhance productivity, food security, promote agribusiness and empower farmers. The Agriculture Perspective Plan (APP), 1995, is the main strategy for agricultural development. It envisages diversification and commercialisation of agriculture by enhancing the following outputs: cereal production in the Tarai and production of fruits, high value crops including NTFPs, and livestock in the Hills and Mountain regions.

The goals are to be achieved by managing key inputs: need-based research and extension, improved fertilizer supply, controlled year-round irrigation, linkage of potential production pockets and markets through rural agricultural roads and expansion of rural electrification. APP implementation was initially constrained by funding difficulties. The PRSP renewed government commitment to the APP because both agriculture and rural development are high priorities for poverty reduction. The Tenth Plan builds on the APP with emphasis on progressive private sector involvement in input and output marketing, commercialisation of agriculture, strategic and coordinated provision of critical public infrastructure and services with stakeholder participation, partnership with private providers including NGOs, and devolution of rural services.

A new institutional approach, the District Agricultural Development Fund (DADF), has been initiated in 20 districts under the DFID-supported Agriculture Perspective Plan Support Program (APPSP). The districts for APPSP were selected using the poverty and deprivation index as basis. The DADF has two fund sub-components—District Extension Fund (DEF) and Local Initiatives Fund (LIF).

BOX 5: APPSP update

As of May 2005 proposals of 140 service providers and 798 farmer groups are funded under the DADF. These projects provide agriculture extension services to over 36,000 farm families in the program districts. The DEF projects comprise mainly of cattle-raising, goat-raising, piggery, seasonal and off-season vegetable production, orchard establishment, bee keeping, provision of veterinary services and market development. Likewise, the majority of LIF projects comprise goat raising and vegetable production combined with small irrigation (treadle pump, sprinklers, etc.). The beneficiaries of the DADF projects included 37 % janjaties, 30% Dalits and 33% others. About 35% of the DADF beneficiaries are women. Early experiences indicate that DADF modality can be responsive, productive and efficient to deliver agriculture extension services.

An APP Implementation Plan is being prepared under the guidance of the NPC. The goal is to reorient the agricultural sector to create more responsive, productive and efficient services for the rural poor. There are, however, several reforms that need to be completed in order to fulfil WTO and SAFTA membership commitments.

The MOAC has 32 P1 and 10 P2 projects in 2004/05. Five of the P1 projects—Agriculture/Livestock Extension Program, APP Monitoring, APPSP, Crop Diversification Project and Small Irrigation Special Program—have been allocated Rs.2.52 billion, or 43 percent of the development budget allocated to the sector. Some of the main activities in the agriculture sector are:

- Mobilization of the private sector and NGOs as partner service providers on a contract basis
- Monitoring, quality control and regulation of inputs supplied by the private sector
- Transfer of subsidies in the form of grants on goods and services of public nature
- Transfer of extension services to local bodies and veterinary services to the private sector
- Conversion of agricultural farms/stations into resource centres
- Promotion of cooperative and contract farming
- Development of market centres, and

- Integration of irrigation and micro-irrigation with agricultural intensification for mainstreaming women and disadvantaged groups.

Irrigation

Irrigation is a key input for increasing agricultural productivity, especially in Nepal where rainfall is highly erratic. Both the APP and PRSP emphasise irrigation as key to raising household income and food security in rural areas. Roughly 43 percent of Nepal's net cultivated area of 2.64 million hectares has access to irrigation, largely "flooding systems" that provide only seasonal irrigation and benefit mainly large farmers. About 465,000 hectare of land has year-round irrigation facility. As a consequence, and in conjunction with delays in availability of other inputs, agricultural productivity remains low and highly dependent on rainfall. The major objectives in irrigation are to develop new infrastructures capable of providing controlled year-round irrigation, to attain sustainable management of existing Farmer Managed Irrigation Systems, and to support non-conventional irrigation methods in order to enable the poor to benefit.

The new irrigation policy implemented since 2003 seeks to empower Water Users' Associations (WUAs) to operate and manage their own systems, and to involve local bodies in development and management of small and medium operations. The Department of Irrigation (DOI) is fine tuning the strategy and aims to have a "Business Plan" ready for implementation in 2005/06.

There was a setback in ground water irrigation (mainly through Shallow Tube Wells) after subsidies were withdrawn during the early years of PRS implementation. The Community Groundwater Irrigation Support Program (CGISP), a major initiative to promote shallow tube well irrigation in Tarai, is expected to bring a turnaround in agricultural production. Preliminary estimates show additional 5,175 ha of land was irrigated using DTW and STW in 2003/04.

The irrigation sector had 17 P1, 14 P2 and 1 P3 projects in 2004/05 and development budget of about Rs.2.2 billion. Five projects, the Operation and Maintenance of existing AMIS, Bagmati Irrigation Project, Praganna Irrigation Project, CGISP and Babai Irrigation Project shared nearly 56 percent of the budget.

For the first time in Nepal, the DOI has begun planning implementation of non-conventional irrigation schemes using mostly micro technologies that are both pro-poor and environment-friendly. A New Technology Irrigation

Program (NTIP) has been established to promote the new initiatives. NTIP aims at facilitating irrigation of an additional 10,000 ha of land within the Tenth Plan period, starting in 2005. The government has completed a feasibility study to promote non-conventional micro-irrigation technologies, which prior to this, was largely promoted by I/NGOs.

Another significant development in micro-irrigation promotion is the implementation of the Small Irrigation and Marketing Initiatives (SIMI) project jointly by Winrock International, IDE, SAPPROS and CEAPRED in 2003. SIMI aims at providing integrated agricultural services with irrigation as entry-point to about 27,000 households in 7 districts of the West and Mid-western Development Regions.

Roads For Development

The road sub-sector objective of the PRSP is to develop and manage a cost effective transport network to support the socio-economic development efforts. The growth targets are to be met by expanding the road network to improve access between rural areas and market centres, and enhancing the management of existing assets (including maintenance). An additional 540 km of roads were built in two years after PRSP implementation began. Additionally, in December 2004 the government transferred 300 km of roads to the DDCs.

Maintenance: The government has established an autonomous Roads Board and Road Fund to provide stable funding for road maintenance from user fees. In 2003/04, the Board received Rs.220 million from fuel levy; it is expected to grow to Rs.363 million in 2004/05 and to Rs.400 million in 2005/06. It has also made provisions to ensure sufficient budget allocations for the maintenance of the Strategic Road Network (SRN).

Expansion of strategic roads: The PRSP aims to complete road construction to connect 10 district headquarters that are not connected with the national network. But, progress has been slow in districts affected by the conflict; construction had to be abandoned in some areas owing to the security situation. The 'savings' from disrupted construction was diverted for upgrading fair weather roads and this action is expected to remain focussed on the PRSP objective of providing efficient nationwide road services. In 2003/04, 140 kilometres of additional rural roads were built, in addition to rural roads initiated and built by local communities.

Private sector participation: The participation of the private sector is essential for meeting the transport needs cost effectively. The government has enacted an ordinance to facilitate Build-Own-Operate-Transfer (BOOT) contracts. The response from the private sector remains to be tested. The government is strengthening the BOOT cell to assess construction risks and to conduct studies on geological and traffic conditions, regulatory framework and the security situation, which it believes are needed to improve conditions for attracting private investment.

Institutional reforms: The government has carried out several reforms to enhance the technical and managerial capacity of the Department of Roads (DOR). They include updating policies and design standards, establishing and operating modern IT-based financial and data management systems and working on a road map for efficient institutional transformation. The government plans to devise a performance-based incentive system within the DOR to facilitate its transformation into an efficient agency for road building and supervision.

Road-building during the conflict: The conflict has become a major operational concern for expanding road construction in remote areas. The risks associated with project implementation increased after the escalation of the conflict, and the areas most-affected are those where there is greater need to build roads and increase development assistance. The government is building a major road, connecting Surkhet and Jumla, which is targeted to be completed by 2005/06. This road will link the Karnali Zone, comprising districts with the lowest social and economic indicators, with the rest of Nepal paving the way for enhancing development in the region. The Surkhet-Jumla road is a priority government project that is being built through a participatory approach involving the local community.

Power to the People

Easy access to electricity can create the conditions for involving people in other development activities. Per capita electricity consumption is also a measure of general well-being. Nepal's hydropower generation potential is one of the highest in the world but the indicators for electricity use are still much lower than the ideal. Electricity is available to about 40 percent of the population.

Nepal's installed hydro-generation capacity was 584 megawatts in 2001/02. Of this, 546 megawatts (MW) is connected to the Nepal Integrated Power System

BOX 6: Karnali's road to development

The 232-km Surkhet-Jumla Road has the potential to emerge as a developmental catalyst for districts in the Mid and Far-western Development Regions, which are also the most deprived. Upon completion, it will connect Surkhet, Dailekh, Kalikot and Jumla districts of Bheri and Karnali zones and provide direct and indirect benefits to people of Achham, Bajura, Mugu, Jajarkot and other remote mountain districts.

The construction was frequently disrupted by violence, following which the local people prepared a 40-point statement to explain to the insurgents why road-building should be allowed to continue. The 232-km road has been divided into sections, and user groups have been given the responsibility to build the different sections. The involvement of local communities has helped address many of the implementation level problems.

Some lessons learnt from involving communities in road-building are: (i) communities commit themselves to the tasks that address their needs and contribute to project implementation, (ii) community involvement helps to resolve local conflicts and implementation hold-ups and can also help to devise new ways to continue work even in insecure environments; and (iii) development cannot wait for the conflict to be resolved and community involvement can create the conditions needed to ensure continuity to development programs.

(NIPS) and the rest is non-grid based, including private-sector promoted micro projects that contribute about 7.5 MW. The hydro-generation capacity reached 609 megawatt in 2003/04. The Census (2001) reported that 39.4 percent households use electricity as a source of lighting.

HMG/N aims to address structural anomalies in access to electric power through a pro-poor approach, incorporated in its long-term vision (1997-2017), by expanding efficient power generation and distribution in rural areas. There are 13 P1, 4 P2 and 3 P3 projects in the power sector in 2004/05 and a development budget allocation of Rs.6.14 billion. Five projects, the Middle Marshyangdi, Reinforcement and Distribution System Improvement, Community and other Rural Electrification, Kaligandaki A and Kailali-Kanchanpur Rural Electrification, share 82 percent of the allocation. In 2003/04 micro-hydroelectric projects added 498 kilowatts of electricity to the national total, which is expected to increase by another 1500 kilowatts in 2004/05.

Pro-Poor Forestry

Nepal has about 4.27 million hectares of land under forest, which is more than that used for agriculture (3.09 million ha). The forestry sector can therefore make major contribution towards improving livelihoods and reducing poverty. The PRSP thrust on forestry is to promote community and leasehold forestry program. The government had transferred 8,271 ha of forest area to community user groups compared to 4,378 ha in 2001/02. Other pro-poor activities in the forestry sector are:

- Promotion of herbs and other Non Timber Forest Products (NTFPs)
- Soil conservation in Churia range, and
- Bio-diversity and watershed conservation.

The leasehold forestry program aims to enhance equity in the distribution of forest resources. About 401 user groups comprising 2,719 poor and disadvantaged households were formed between 2002/03 and 2003/04. In 2003/04 the households were leased additional 1,210 ha of degraded forest land that they are to manage and use for poverty reduction. The leasehold forestry program has been very effective at reducing poverty. A study by the FAO reveals that about 80 percent of the poor engaged in the program have elevated their status to the "non-poor" category.

There are 16 P1, 12 P2 and 6 P3 projects in the forestry sector in FY 2004/05. The sector has a total development budget allocation of Rs.0.7 billion.

Non-Agricultural Growth

Growth in the non-agriculture sector–contributing about 60 percent of GDP– is very important for meeting and maintaining growth targets set by the PRSP. The Tenth Plan emphasizes continuation of a private sector policy that is liberal, transparent and supportive of a market-driven economy through broad policy reforms, and continued efforts to reform the financial sector. The non-agricultural sector includes manufacturing, trade and tourism as well as the services sector and real estate.

Activities in the non-agriculture sector are mostly private-sector led. However, there are some key sectors such as electricity, telecom, drinking water and, to an extent, the financial sector, where the public sector dominates. The conflict, political instability and weak external and domestic demand have constrained non-agricultural growth. Low spending on development and a general slowdown of economic activities caused domestic demand to shrink. HMG/N has attempted to implement several measures, including BOOT contracts to solicit private participation in infrastructure building, opening up to international airlines, eliminating monopolies of key public enterprises and facilitating private sector development through improvements in the regulatory environment and accounting standards.

Public sector reforms: Nepal has begun dismantling public monopolies and introducing competition. A joint-venture private operator has been allowed to provide basic telephone services in Kathmandu and another private operator has begun work to provide telecom services in 534 VDCs in the Eastern Development Region. The Nepal Telecommunications Corporation was converted into Nepal Telecom, a public company, in April 2004. A private operator has also been licensed to provide mobile telephone services.

The government has a policy to promote private investment for building small and medium scale power projects. The Power Development Fund was established in 2003 to finance such investments. The Nepal Electricity Authority (NEA) has also begun decentralising electricity sales and distribution in accordance with a new government policy allowing communities and cooperatives to distribute power in rural areas.

The government has hired a Nepal-India joint venture company to manage the Inland Container Depot at Birgunj and has approved a new policy to allow the private sector to import and sell petroleum products. The BOOT Ordinance 2003 provides a basis for involving private sector in infrastructure building. The government is also working on handing over the Kathmandu operations of the Nepal Water Supply Corporation to a private operator.

Besides dismantling public monopolies and encouraging private sector investment in sectors traditionally dominated by government, since 2002/03, the government has been devolving a number of tasks and functions to local bodies and community organizations. Several semi-independent funds–the Drinking Water Fund Board, Road Maintenance Fund Board and the Poverty Alleviation Fund–have also been established to 'contract out' service delivery functions to entities with relevant expertise, with the government taking on the role of monitoring performance to make the agencies accountable for the services provided.

Public enterprises: Public enterprise reform has been a sensitive issue and has never been easy. The government has revitalised privatisation by preparing a list of companies to be leased, liquidated or converted into public limited companies to be run under performance contracts. Among major privatisations completed so far are the sale of shares of the Butwal Power Company and the leasing of the Bhaktapur Brick Factory. Similarly, the Handicrafts Emporium, Nepal Coal, Hetauda Textiles, Nepal Transport Corporation and Birgunj Sugar Mill have been liquidated. The Nepal Telecommunication Corporation has been converted into Nepal Telecom, a public limited company. The evaluation of the assets and liabilities of the Royal Nepal Airlines Corporation (RNAC), as first step towards converting it into a company, is underway. The government has begun management improvements of public enterprises, including two large cement factories at Udaypur and Hetauda, through performance contracts.

Financial sector reforms: Nepal's financial sector is very weak and lacks competitiveness. In the past, the government made attempts to inject fresh capital in publicly-owned companies and to introduce expertise by opening up the sector to foreign joint ventures. However, the sector remains dominated by two-government owned and semi owned-commercial banks that account for almost one-half of the total transaction volume. Both of these banks are in serious trouble, as their Non Performing Assets exceed the acceptable limit.

The government has been implementing a financial sector reform program since July 2002 to address the weaknesses of the sector, which even though not directly pro-poor has a direct bearing on the larger economic environment that in turn influences economic growth and poverty reduction. The reform objectives include making the two problematic banks financially sound through improved accounting and auditing standards and loan recovery, strengthen the monitoring and regulatory capacity of the central bank and the legislative and institutional framework, and to eventually restructure and privatise the banks. The reforms also include restructuring the state-owned Nepal Industrial Development Corporation, an industrial financing institution, and the Agriculture Development Bank, both of which face serious financial problems.

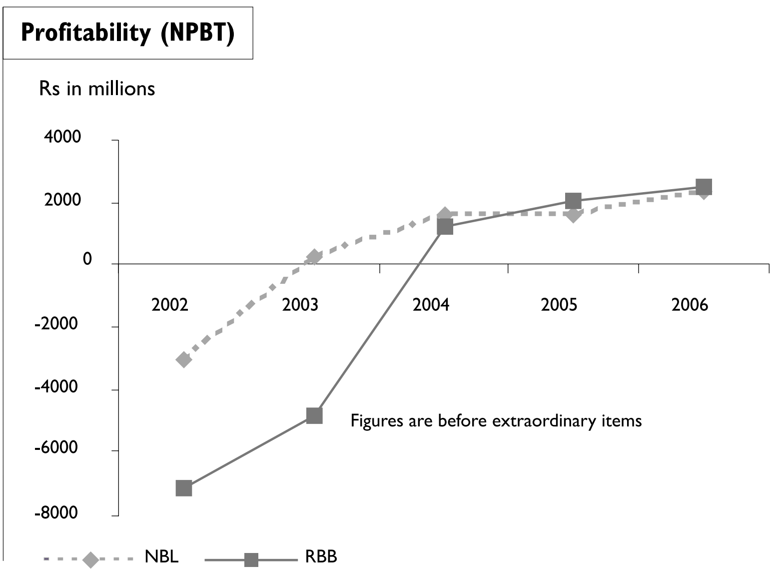
International consultants were hired to manage the two banks and implement the reforms during the transition. The new managements have undertaken a series of measures to improve performance. The two banks, Nepal Bank Limited and the Rashtriya Banijya Bank had operating losses of over Rs. 2 billion and Rs. 7 billion respectively when the reforms were started. Both the banks have reported operating profits. In summary, the reforms have helped to check the speed at which the two banks were failing but they still have large stocks of non-performing assets. The reforms have also resulted in progress in terms of rationalising the workforce, financial disclosure, credit appraisal mechanisms, improved revenue and cost controls.

The banking sector also has a new legislative framework that grants greater independence to the central bank and empowers it to better perform its regulatory functions. The central bank has also introduced new accounting standards in the financial sector.

BOX 7: Banking on NBL and RBB reforms

Nepal began reforming two troubled banks, Nepal Bank Limited (NBL) and the Rashtriya Banijya Bank (RBB) in July 2002 and January 2003 respectively. It began with the takeover and placement of external managers at the two banks by the central bank. In 2003/04 the two banks were short of the target for reducing the NPA but had made significant debt recovery efforts. In mid-January 2005, NBL had recovered about Rs.4.7 billion in cash and the RBB, Rs.5.2 billion. NPA levels at the banks remain above 50 percent (of their assets) even though the provisioning is adequate.

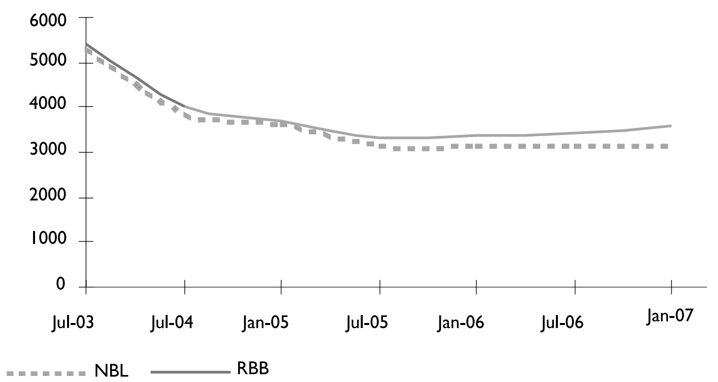
The two management teams have had difficulties dealing with delaying tactics employed by large wilful defaulters who have tended to use the court system to frustrate



debt recovery attempts. This remains a very serious concern because it threatens the entire financial reform program. Business and revenue growth, and improved operating efficiency, have helped NBL and RBB to perform better than their profitability targets in 2003/04. Better interest collection on loans, lower interest payments on deposits and significant reduction in overhead costs have contributed to the profitability.

Other factors are write-back of provisions that were not required after collection of some fully provided debts, and in case of NBL, sales of its stock at the Standard Chartered Bank Nepal. These actions have improved the net worth of the two banks, which, however, is still negative. Staff efficiency levels have also improved but were short of the target set for 2003/04. The process to rationalise staff comprised implementation of two phases of the Voluntary Retirement Scheme (VRS) in 2003/04. The first VRS phase was very successful and the second one less so.

Staff Level



The modernisation of the banks was somewhat slower than anticipated due to unanticipated delays in procurement of computers and time taken to run trials of new software. Data validation and inadequacy of staff training were major barriers to fully computerising the operations. Improved financial disclosure is the other major achievement. The banks have significantly improved the audit of their books, which are now completed within six months–compared to several years in the past–and provisional accounts are published within a month.

The indicators discussed above underscore both the timeliness and effectiveness of the financial sector reform agenda, and especially the actions undertaken at two banks. The government, however, would like to enhance the pace of the reforms. To facilitate this, it has initiated steps to help the banks with debt recovery–which has remained the major stumbling block.

SECTION VI

Social Sector Performance

EDUCATION

Providing all children complete primary education of good quality is highest priority in the education sector. The six major goals of the Education for All (EFA) program guide the basic and primary education sector. The goals are expanding early childhood development; ensuring access for all children; meeting the learning needs of all children including indigenous peoples and linguistic minorities; reducing adult illiteracy; eliminating gender disparity; and improving all aspects of quality education.

Improving access to primary education for disadvantaged children and the education quality are two major challenges that have to be overcome in order to meet the MDG of achieving universal primary education of good quality. The two main strategies adopted by the PRSP for overcoming the challenge are decentralization of school management including transfer of management to communities, and scholarships targeted to children from disadvantaged communities. Expanding teachers' training, improving curricula and teaching materials, and strengthening school monitoring and supervision are the other strategies. The government has begun to provide grants to schools—both block grants and those earmarked for specific activities—to enable them to improve service delivery by covering non-salary recurrent costs in addition to the salaries. The funding of unaided schools through block grants represents another

BOX 8: Community schools

Responding to the widespread public discontent on the performance of public schools, in 2001 the Parliament adopted the Seventh Amendment of the Education Act. One of its provisions was to rename public schools as community schools, which also paved the way for transferring schools to communities. In 2002, the government issued directives for the transfer of schools to management by communities, and subsequently the Immediate Action Plan 2002 set a target for transferring 100 primary schools for community management by the end of 2002/03. This initiative generated intense public debate and despite significant resistance from different interest groups, the government went ahead with the reform. Up to mid-July 2004 the government had transferred over 1,500 schools to communities. Schools managed by communities have also established a network, Community School National Network, with a view to promote the interests of such schools as well as to assist in the improvement of their performance. A baseline survey of community-managed schools, primarily to evaluate their performance, is underway.

significant step towards enhancing equity in access to school education. Above everything else, the transfer of schools to community management—to improve service delivery—is among the boldest developmental reforms ever attempted in Nepal.

There are 7 P1, 7 P2 and 4 P3 projects in FY 2004/05 with Rs.6.3 billion development budget in the education sector. The major P1 projects include EFA, Secondary Education Support Program, Teacher Education Project, Secondary Education, and the New EFA.

Achievements: Some results achieved in two years of PRSP implementation include an increase in the number of primary schools and trained teachers, and increases in the number of primary schools handed over to local management (Table 6.1).

TABLE 6.1: Major accomplishments: Education

Indicator	2001/02	2002/03	2003/04	Change (% or % points) in 2003/04
Number of primary school	25,194	26,638	26,858	0.8
Net enrolment rate of primary school	81.1	82.4	84	1.6
Number of certified teachers	NA	27,875	120,988	334.0
Pupils completing primary education (%)	60.0	67.7	69.0	1.3
Primary teachers trained (%)	15	15	31	16.0
Number of schools transferred to local communities	-	90	1,500	1566.7
Number of community learning centres	20	40	52	30.0
Number of people completing adult education	23,942	26,733	39,262	46.9
Number of girls in primary schools receiving scholarship	151,568	120,742	224,656	86.1
Schools with latrines for girls	7,613	9,741	10,633	9.1

Source: Administrative records of MOES, HMG/N

Significant increase has been recorded in the certification process. The number of certified teachers increased from 27,875 in 2002/03 to 120,988 in 2003/4 and the number of primary school transfers increased from 90 in 2002/03 to 1,500 in 2003/04. Likewise, the number of girl students receiving scholarships rose from 120,742 to 224,656 during the same period. The number of females completing adult education is also growing significantly.

Implementation of a sector wide approach in the basic and primary education sub-sector is another major achievement. The new funding and project implementation modality has helped to improve coordination of donor assistance by firmly anchoring it to national policies and plans, and existing administrative structure and procedures.

Health

High population growth, low life expectancy, high burden of diseases, premature mortality and inadequate health care remain major impediments to poverty reduction and attaining faster economic growth. The reforms being implemented are aimed at improving the health of all, especially that of vulnerable groups who depend on manual labour for subsistence. The health objectives and strategies of the PRSP are also designed to contribute to the attainment of the MDGs.

Policy measures: The Second Long Term Health Plan 1997 to 2017 (SLTHP) provides the road map for investments in the sector. The objective is to have "a health system in which there is equitable access to coordinated quality health care services in rural and urban areas, characterized by: self-reliance, full community participation, decentralization, gender sensitivity, effective and efficient management, and private and NGO sector participation in the provision and financing of health services resulting in improved health status of the population".

The main policy thrusts in within the PRSP and SLTHP framework are: a) implementing a MTEF to allocate the health budget in terms of three prioritised services, with the first priority to Essential Health Care Services (EHCS). Key elements of the strategy are: (i) ensuring provision of essential health care services (EHCS); (ii) decentralizing management of service delivery; (iii) promoting public-private partnerships (PPP); and (iv) improving sector management and the provision, deployment, utilization and efficiency of health inputs. The government has also prepared a plan to implement the Health Sector Strategy which defines actions to be taken and programs to be undertaken upto July 2009. The Nepal Health Sector Program Implementation Plan (NHSP-IP, 2004-2009) will be reviewed in 2006/07 and the outcome will be used to adjust programming to better support the Eleventh Plan that will come into implementation in July 2007.

Achievements: An important policy-reform achievement is the shift to sector-wide planning and management as envisaged by the Health Sector Strategy, which also outlines major reform areas for program and sector management. The strategy was developed in collaboration with a wide range of stakeholders including 11 development partners (UN agencies and multilateral agencies: WHO, UNICEF, UNFPA, ILO, The World Bank, and bilateral agencies-DFID, USAID, GTZ, KFW, Japan, SDC and AUSAID). All development partners have endorsed the government proposal to scale up harmonization through joint planning, programming, reviewing and monitoring of interventions in the sector.

Another government policy allows it to provide maternity benefits to women and incentives to service providers and health institutions assisting during childbirth. The policy is expected to result in safer motherhood, especially because it is backed by the decision to train Mother and Child Care Workers and upgrade them to Assistant Nurse Midwifes and place them at sub-health posts.

The government has also pursued a policy to decentralise management of health facilities by putting communities in charge of the institutions. HMG/N has handed over 1,114 sub-health posts in 25 districts (Table 6.2). The management responsibility of two health posts and one primary health care centre has also been devolved. Some of the outcomes of the devolution have been increased ownership by local communities, improved problem-solving, enhanced monitoring, quicker decision-making, greater transparency and improved financial management. The benefits, however, have not been reported in all districts owing to area-specific implementation weaknesses which the government has taken up on a case-by-case basis. HMG/N has also expanded the Community Drug Program to 25 districts–full coverage at public health facilities in 12 districts (except district hospitals) and partial coverage in 13 (30-50%).

The government remains committed to increase public spending on health. Most of the essential public health care programs are classified as P1 under the MTEF and donor funding on P1 programs remains high. MOH is implementing 21 P1, 12 P2 and 5 P3 projects in 2004/05 with an allocation of Rs.4.4 billion.

BOX 9: Basic health indicators

There has been an increase in availability of health facilities compared to that of Ninth Plan period resulting in decrease in travel time to reach the facilities. According to NLSS II 2004 access to health posts and hospitals within 30 minutes of travel has increased significantly–62 percent households compared to 45 percent in 1996. However, the number of health facilities has declined from 4,429 in 2001/02 to 4,408 in 2002/03 and 4,401 in 2003/04 (HMIS reports). The reduction reflects the number of facilities destroyed or damaged in the conflict.

Child health: The incidence of diarrhea in children under-5 is 222 per 1,000, a reduction resulted from wide use of oral re-hydration solutions, improved water supply and sanitation and hygienic practices. Diarrhea used to be Nepal's number one childhood killer. According to the HMIS 2003/04, acute respiratory infection (ARI) and pneumonia are now the major killers of children: The under-5 ARI incidence is 344 per 1,000. The NLSS II reported DPT-3 coverage at over 90 percent–78% in the Far Western Development Region and 85% in the Midwestern Region. Overall, according to NLSS II, DPT 3 coverage has increased from 36% in 1996 to 60% in 2004.

Maternal health: The maternal health indicators (HMIS 2003/04) show that only 18% of the deliveries are assisted by health workers, and only 9.9 percent deliver babies at health institutions. On average pregnant mothers make two antenatal visits to health institutions and the provision of basic and comprehensive obstetric care remains low. The use of family planning devices and methods has reached 40 percent, ranging from 28 to 46 percent by regions, and lowest in the Far Western districts.

TABLE 6.2: Major accomplishments: Health

Indicator	2001/02	2002/03	2003/04	Change in (% or % points) 2003/04
Number of health institutions	4,429	4,408	4,401	(-)1.0
Number of sub-health post transferred	-	468	1,114	138.0
Women receiving at least 4 ANC visits (%)	37.9	36.8	43.6	6.8
Women receiving adequate PNC visits (%)	14.4	18.8	28.3	9.5
One year olds receiving DPT3 (%)	80.3	86.2	90.3	4.1
Births by skilled attendants (%)	15.0	16.1	18.0	1.9
National health expenditure per capita	1,102	1,251	1,351	8.0
Contraceptive prevalence rate (%)	38.9	37.8	40.2	7.0
Malnourished women (%)	15.4	14.0	12.8	(-) 1.2
Pregnant women receiving iron tablets (%)	57	68	88	20.0
Number of TB cases detected	70,189	71,114	70,514	(-) 1.0
Number of malaria cases detected (per 10,000 population)	5.7	5.2	3.3	(-) 1.9
Number of malaria cases treated (per 10,000 population)	4.4	5.2	3.2	(-) 39.0

Source: Ministry of Health, (HMIS 2003/04)

The government is also introducing special programs in 25 districts with low Human Development Indices (less than 0.400, national value 0.471), many of which are also affected by the conflict. Anecdotal evidences also suggest that the insurgency may not have affected health service delivery–one indication of that it the ability of government to satisfactorily carry out national campaigns against measles, polio, and Vitamin A supplementation and de-worming.

Drinking Water and Sanitation

Unsafe drinking water and poor sanitation are reasons for high incidence of communicable diseases in Nepal. The PRSP/Tenth Plan seeks to increase access of deprived communities to safe drinking water and basic sanitation (See Box 10). The aim is to raise drinking water supply coverage to 85 percent and sanitation by 50 percent by the end of the Plan period. HMG/N hopes to achieve the goal through decentralized demand driven approaches and the involvement of NGOs/CBOs and other support organizations to plan and implement schemes demanded by local communities. The communities will then be responsible for the operation and management of the schemes.

Two policy decisions have been taken to facilitate changes in the drinking water and sanitation sector:

(i) Revision of the National Water Supply and Sanitation Policy, 1998, clearly defining the roles and responsibilities of different stakeholders including local bodies, community organizations and beneficiaries in planning and upkeeping of water supply and sanitation services; and

(ii) Abolition of district offices of the Department of Water Supply and Sanitation (DWSS) and their reorganization as 'facilitator' and 'monitor' of small projects, and 'planner' and 'implementer' of larger schemes.

The following activities are planned and/or are underway in the sector:

- Revision of sector policy for defining roles and responsibility of different actors
- Enhancing the autonomy of the Rural Water Supply and Sanitation Fund Board
- Making sanitation an inalienable component of new drinking water projects and appending the sanitation component on old schemes
- Involving communities in the management of the drinking water schemes
- Implementing cost recovery mechanisms

- Developing national water quality standard/guidelines and strengthening water quality monitoring (this was inspired by reports of high arsenic concentration, above safe level or 50 ppb; tests of most Tarai tube wells have been completed and unsafe wells have been marked), and
- Reducing water supply losses in Kathmandu Valley and other municipalities by 4 percent annually.

The DWSS is implementing 16 P1, 8 P2 and 1 P3 projects with a total development budget of Rs.3.42 billion in 2004/05. The major P1 projects are Melamchi Water Supply Project, Kathmandu Valley Water Supply Management Preparation Committee, Small Town Water Supply and Sanitation Project and the Community Based Water Supply and Sanitation Project. These projects share 74 percent of the sector's development budget.

The drinking water and sanitation sector is expected to achieve and even exceed the sectoral MDG. The population with access to potable water has increased from 72 percent at the beginning of the Tenth Plan, to 73 percent in 2003/04 (Table 6.3). The major sectoral concerns are the rehabilitation of the

TABLE 6.3: Major accomplishments: Drinking water and sanitation

Indicator	2001/02	2002/03	2003/04	Change (% points) in 2003/04
Population with access to drinking water (%)	71.6	72.8	73.0	0.2
Unaccounted for water	40	38	NA	-
Households with sanitation facility (%)	20	26	39	13.0

Source: Ministry of Physical Planning and Works

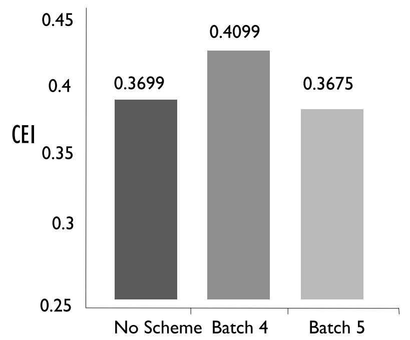
old schemes and difficulties of maintaining water quality caused by increasing salinity of ground water and arsenic levels in the Tarai and poor service delivery. Both progress and coverage in sanitation remain low. The reasons for low coverage are lumping of the sanitation budget with drinking water and the low priority accorded by rural households to toilet construction and use.

BOX 10: nclusion in rural water supply and sanitation

The Rural Water Supply and Sanitation Fund Board (RWSSFB) is a semi-autonomous body that funds and supervises NGOs to help communities form Water User Groups to build, manage and maintain their own water systems. It is one of the government's main approaches to attain the MDG targets for delivery of drinking water. The RWSSFB fully recognizes the central role women play in supplying their families with water for drinking and domestic use. Accordingly, its first project set inclusion and empowerment of women as a key objective.

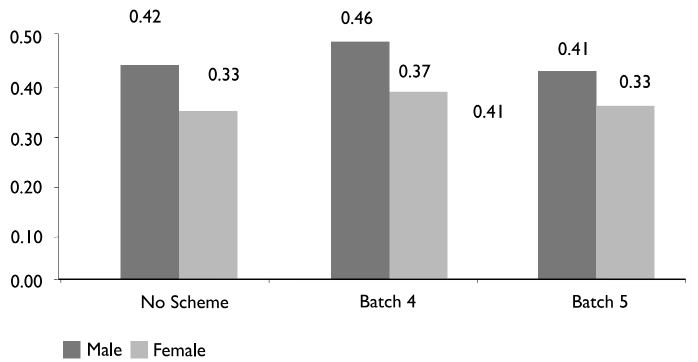
A recent empirical study of 1 man and 1 woman from 1,000 households in 60 villages (20 Batch 4 villages where the RWSS I intervention had been completed, 20 Batch 5 villages where it was just beginning and 20 control villages) confirmed that 20 Batch 4 villages served by interventions supported by the Fund Board had higher overall (male and female) empowerment and inclusion levels than the other 40 villages (See: Figure 6.1).

Figure 6.1 Average Combined Empowerment and Inclusion Index



The study also looked at males and females separately and found that it was not just men who were empowered–the women were significantly more empowered and included (See: Figure 6.2).An earlier study by the Fund Board of MIS data (disaggregated by caste and ethnicity) had revealed that Brahman/Chhetri house-

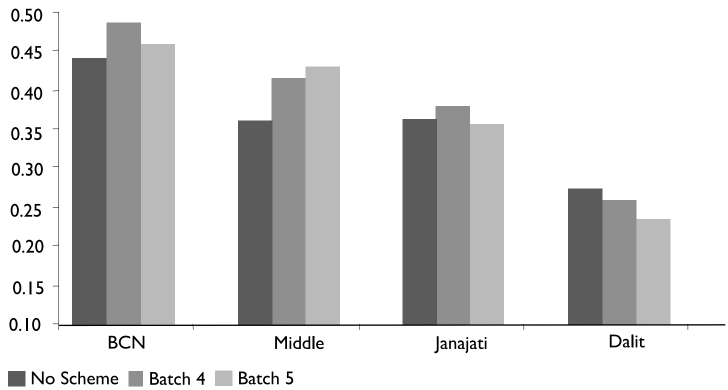
Figure 6.2 Average Combined Empowerment and Inclusion Index by Gender



holds were getting more access to the RWSS systems than their proportional share in the population compared to Dalits and disadvantaged Janajatis. The recent study reported similar findings: The increases in empowerment and inclusion levels in the Batch 4 communities where

RWSS had worked had gone almost entirely to Brahman, Chhetri and Newar men and women. The empowerment and inclusion of Janajati villagers was not statistically significant. There was also no increase in empowerment and inclusion levels of the Dalits (See Figure 6.3).

Figure 6.3 Average Combined Empowerment and Inclusion Index by Caste/Ethnicity



By the time the Fund Board learned of the findings, it had already taken a number of specific measures to improve outreach to Janajatis and Dalits. One major action was requiring "social mapping" of the catchment area to be served by a water system, and setting up a monitoring system to ensure that the caste/ethnic profile of households served by the RWSS system reflected the profile of households in the map. The Fund Board has also published information brochures in seven Janajati languages to ensure that everyone had information on how to apply for a scheme. The Fund Board believes these measures and the greater awareness of its staff and NGO personnel will ensure increased empowerment and inclusion of Dalits and Janajatis when the Batch 5 study is completed. Figures 1, 2 and 3 (clockwise): (1) Comparison of villages with and without RWSS intervention, (2) empowerment and inclusion by gender, and (3) empowerment and inclusion by caste/ethnicity.

SECTION VII

Performance In Social Inclusion And Targeted Programs

Inclusion

The NLSS II data reveal that certain caste, ethnic and religious groups–particularly the Hill Janajatis (exclusive of Newars and Thakalis), Dalits and Muslims have poverty levels well above the national average. Additionally, women, people living in remote areas, the very poor, as well as many marginal and small farmers living in difficult circumstances face additional barriers in getting access to social services and economic opportunity.

The recognition of this fact in the Plan is reflected in the third PRSP pillar on social inclusion and the targeted programs. Implicit in the Tenth Plan is the recognition that Mid- and Far-western Development Regions are the most disadvantaged areas, and women, Dalit and Janajatis (indigenous groups) are the most disadvantaged groups. These groups require not only special programs, but even more importantly, they require the government to look at all mainstream programs to identify barriers in access and develop mechanisms to overcome the obstacles. The core idea of the inclusion pillar is that while targeted programs are essential to reach the excluded, a truly level playing field requires that these groups have equal access to mainstream programs as well–and the full weight of the budget allocated to these programs.

Who Are Excluded?

Women: Nepalese women have historically faced discrimination due to the male-centred social structures that prevail in almost all of the country's diverse ethnic and caste groups. Women have lower outcomes than their male counterparts on almost all indicators of poverty. Realising this, several efforts have been initiated under the Tenth Plan to improve the situation of women, including legislation to correct laws that discriminate against women.

Dalits and Janajatis (indigenous groups): The National Foundation for Development of Indigenous Nationalities (NFDIN) was established by law in 2002. It has taken on the implementation of a number of special programs (such as the Chepang Development Program) and special scholarship programs for disadvantaged Janajati groups. The NFDIN also keeps watch to ensure that Janajati needs and interests are reflected in national policies and programs. The National Dalit Commission was established under an executive order in 2002. Since the Ninth Plan, national scholarships have been provided exclusively to Dalit students for study from primary to higher levels. In addition, a total of 65 income and skill oriented projects are being implemented for the welfare of Dalit households. The LSGA has made provisions for the nomination the Janajati and Dalit representatives in local bodies. Notwithstanding these efforts, much more needs to be done to eliminate economic and social discrimination against Dalits, and to bring both Dalit and Janajati groups into the development mainstream.

Remote areas: Most of the poor live in remote areas and are difficult to reach even by the targeted programs. These are also areas where the insurgency has more influence, mainly because their remoteness has made it difficult to fully secure the regions. The greater insecurity—both real and perceived—has added to the difficulties in implementing development programs. Despite the difficulties, HMG/N has managed to implement some infrastructure projects in parts of the Mid- and Far-western Development Regions, which may have also contributed to reducing poverty—reported by NLSS II—in the regions.

Targeted Programs And Safety Nets

There are about 32 targeted programs under implementation. The programs are designed to address issues of social inclusion, poverty reduction, participation, service delivery, gender balance and equity and focus on reaching women, Dalits, disadvantaged Janajati groups and those living below the poverty line.

The policy initiatives taken to improve the program performance, efficiency and targeting are:

- Basing sector activities on poverty mapping
- Developing framework for addressing the problems of deprived communities/regions
- Increasing grants to local bodies on the basis of district poverty index
- Strengthening social mobilization
- Using PAF to support NGO/CBO activities to supplement and complement targeted programs
- Designing special mechanisms for monitoring output/input indicators for targeted groups
- Assisting overseas employment
- Providing special incentives to girls in education,
- Eliminating legal discrimination, and
- Introducing affirmative action in public services.

The implementation modality of targeted programs has changed—from the traditional welfare-oriented approach to social mobilization. The programs and projects based on social mobilization include activities such as formation and development of groups, saving mobilization, skill development, and construction of small infrastructures. The targeted programs are complemented by a safety-net initiative, which includes providing special allowances to widows above the age of 60 years, senior citizens above age 75 and setting up old-age homes. In order to promote representation of women, Dalits and Janajatis in the civil service, HMG/N conducted coaching classes for these groups to enhance their capacity so as to compete in the civil service examination.

The nature of the targeted programs and safety nets differ because of the diversity of needs. In general, the programs can be grouped into the following broad categories:

(i) Geographical and sectoral targeted programs which include construction of infrastructures and local development initiatives; and

(ii) Group-based targeted programs, which include the following:

- provision of subsidy
- programs focusing on capability development through improvements in HDI
- programs offering income generating opportunities
- food for work program
- skill oriented training
- programs focused on particular subjects, based on comparative advantage, and
- programs aimed at increasing access (of the poor) to productive resources.

TABLE 7.1: Budget allocation for selected Targeted Programs (Rs million)

	2002/03			2003/04		
	Allocation	Actual	%	Allocation	Actual	%
Rehabilitation of bonded-labour	15.0	14.6	97.3	10.0	9.8	98.0
Women development	264.4	100.2	37.9	212.0	121.8	57.5
Women's income generation (Jagriti)	50.0	47.0	94.0	50.0	43.4	86.8
Leasehold forestry	50.0	49.1	98.2	55.4	52.8	95.3
Food for education	498.3	318.4	63.9	575.4	395.0	68.6
Women education	180.5	176.0	97.5	158.1	139.5	88.2
National scholarship	81.7	71.1	87.0	81.7	81.7	100.0
Ethnic group development	24.8	13.2	53.2	29.8	29.8	100.0
Deprived group development	11.3	11.2	99.1	29.8	11.3	37.9
Western Tarai poverty reduction	121.1	94.2	77.8	98.4	75.1	76.3
Western Hill poverty reduction	36.0	8.4	23.3	60.0	44.0	73.3
Remote area development	70.8	69.8	98.6	167.9	122.8	73.1
Poverty Alleviation Fund	170.2	58.1	34.1	400.0	213.9	53.5
Selected targeted expenditure	1574.1	1031.3	65.9	1928.5	1340.9	69.5
Total targeted expenditure	1762.9	1309.2	83.2	2405.5	1777.7	73.9
Total development expenditure	38679.7	29030.0	75.1	41845.0	32810.0	78.4
Ratio of targeted to development expenditure	4.6	4.5		5.7	5.4	

Source: Budget and FCGO data

The Ministry of Women, Children and Social Welfare (MOWCSW) is implementing about 26 percent targeted programs but its share in the total budget is only a little over 6 percent. The Ministry of Education and Sports (MOES) has about 17 percent of the targeted programs but commands about a third of the budget. The apparent discrepancy suggests that the size and scope of the programs differ. There has been a 79 percent increase in terms of allocation to targeted programs, up from Rs1.67 billion in 2000/01 Rs. 2.97 billion in 2003/04. In addition to the public resource allocation, some donors, I/NGOs have also channelised resources to implement various targeted and social inclusion programs.

The average ratio of total expenditures to total allocations for all targeted programs is around 74 percent (Table 7.1). Among the three ministries implementing targeted programs, the Ministry of Agriculture and Cooperatives (MOAC) spent the highest amounts allocated in 2002/03, compared to the MOES and the MLD. Rehabilitation of Freed Bonded Labour and Career Development Program is implemented by Ministry of Land Reform and Management in Dang, Banke, Bardiya, Kailali and Kanchanpur districts. In 2000 there were about 18,400 bonded labourers in those districts. About 11,613 ha of land has been distributed to landless families at the rate of 0.17 ha per household.

MONITORING TARGETED PROGRAMS

A separate mechanism for monitoring targeted programs is being finalised (further details appear in the Chapter X) at the NPC. The mechanism was first piloted in two targeted programs– Free Text Book and National Scholarship Program. Some highlights of the monitoring results are given in Box 11.

BOX 11: Some feedback on the Free Textbook and National Scholarship programs

- The mismatch between academic year and fiscal year delays the flow of authority and funds.
- Annual budget allocation for free textbook program has declined by almost a quarter in the recent years despite the growing number of primary school students.
- There are frequent changes in the allocation modality, which hampers smooth book distribution.
- Coupon system of distribution was more effective for timely delivery of the complete set of textbooks.
- The book distribution under the bill repayment system is self-targeting, as the better-off households do not seek reimbursement.
- Textbooks are not available for purchase throughout the year because of the monopoly in production and distribution.
- The targeting mechanism for scholarships is good, but there are errors of exclusion because all disadvantaged castes of the Tarai are not included in the targeting definition, and
- The allocation for the scholarships is increasing but it is still inadequate; the amount is also low in view of the increase in prices.

BEYOND TARGETED PROGRAMS TO INCLUSIVE MAINSTREAM PROGRAMS

Table 7.2 shows budget allocated to development programs in terms of the four PRSP pillars. If the social inclusion and targeted programs pillar is understood to mean the 32 targeted programs, then only a little over seven percent of the development budget was allocated to the area in 2003/04. The inability of the government to

TABLE 7.2: Development expenditure classified by strategic pillars of PRS (2003/04)

Strategic pillar	Amount Rs '000	% of total
High, sustained and broad-based economic growth	17,472,450	41.76
Social sectors and rural infrastructure development	16,297,136	38.95
Targeted programs	2,979,150	7.12
Good governance	5,096,264	12.18
Total	41,845,000	100

Source: Annual Development Program of 2003/04, National Planning Commission, HMGN, 2003 finalise a better targeting mechanism tied to actual outputs for target groups determined under a verifiable mechanism explains the low allocation. The PRSP's social inclusion pillar strategy also involves initiatives aimed at bringing about structural changes to facilitate inclusion in the mainstream programs. The aim is to ensure that all mainstream programs are designed and implemented in ways that recognize the barriers some citizens face in getting access, and build mechanisms and incentive structures to help overcome those barriers during implementation.

Evaluation of Targeted Programs

A joint staff assessment of Nepal's PRS by the World Bank and IMF suggested four improvements. One was the need to further elaborate pro-poor rural strategies to ensure social inclusion through changes in the way in which public services are delivered. The aggregate contribution of targeted programs to poverty reduction also remains short of expectations, owing mainly to scattered implementation, weak monitoring and evaluation, non-replication of effective programs and poor targeting. Another weakness has been the inability to exclude the 'not-poor' from targeted programs and weaknesses in service delivery.

SECTION VIII

Performance In Institutional Reforms And Governance

Good governance is the critical fourth pillar of the PRSP. Improving governance is important for achieving all the outcomes envisaged by the Tenth Plan. The governance improvement approaches include ensuring accountability, controlling leakages, and increasing inclusion and stakeholder participation. These are to be attained by enhancing the efficiency of the civil service and deepening decentralization, including fiscal devolution.

Civil Service Reforms

HMG/N has typically had an imbalance between professional and support staff and a highly centralised bureaucracy. Increasing decentralization and devolution of authority to local bodies and community organizations has necessitated the re-definition of conventional bureaucratic roles and functions, and even downsizing. The PRSP rightsizing objective was to reduce/eliminate 7,500 positions in the bureaucracy by 2003, of which 7,000 reductions were done in 2002/03. The government has begun training workers on M&E and the use of computers to assist the bureaucracy to adapt to its changing role within decentralisation now taking place.

Other problems in the bureaucracy include low remuneration for work, excessive political interference and inappropriate skills and staffing. Organising communities to demand services is desired at the client/beneficiary levels, while increased debate on public policy are desired at the centre, taking care to ensure non-interference in day-to-day program implementation.

The government has undertaken various measures to make the civil service efficient, responsive, accountable and transparent. One is raising the remuneration of government employees to match the costs of living, revising the package periodically, and establishing and implementing reward and punishment mechanisms. Nepal's civil service salaries and benefits remain the lowest in South Asia.

Other reforms include the computerisation of the personnel information system (PIS) of public employees, preparation of a governance road map, establishment of governance reform units at key ministries and re-organisation of some HMG/N agencies into autonomous organisations, etc. The government has prepared a draft Governance Act and is finalising an amendment of the Civil Service Act. HMG/N has also begun implementing an Internet-based Personnel Information System that is being extended beyond the Ministry of General Administration (MOGA). A new law for procurement has also been drafted. However, much still remains to be done towards creating an "ideal" bureaucracy, especially in terms of fair representation of women and Janajatis.

The accountability mechanism of the executive has traditionally had an imbalance between authority held by the Ministers and the government secretaries. The new law seeks to clarify the roles of the political leader and secretary and also establish an accountability system. The new law also seeks to make secretaries responsible for managing government employees.

There is now an understanding in the government that true decentralization involves more than a provisioning role (allocation, monitoring and regulation). HMG/N believes that decentralisation is about giving actual production responsibility to others such as the private sector, CBOs and NGOs that have greater flexibility and institutional arrangements for optimising outputs, which is what now guides public policy.

Decentralization

Decentralization is the key crosscutting element of the PRSP. In general, the decentralization efforts were constrained during the review period, because of the absence of elected authorities both in Parliament and at the local levels.

The preparation of District Periodic Plans (DPP) in 52 districts is one positive beginning towards decentralisation. The central budgetary allocations are aligned with the district plans and sectoral ministries have been directed to be guided by DPP priorities. Fifty-four districts have prepared Citizen's Charters and 11 have begun publishing notices on job opportunities.

Sectoral and block grants (share of budget implemented by local bodies) were raised by 25 percent in 2004/05 compared to 2003/04 and new areas have been opened up to enable local bodies enhance their revenue. The government also implemented capacity enhancement training programs to support staff development at the local level—such training included about 578 VDC secretaries up to mid-July 2004. The government has set up Management Information Systems, Geographical Information Systems and accounting systems at 60 DDC offices to facilitate planning and implementation of local programs. The analysis of public expenditure (for years 2002/03 to 2004/05) by local bodies shows that it grew by nearly 33 percent in terms of allocation/expenditure compared to the 15 percent increase in central level activities. This is a modest move towards fiscal decentralization even though it remains to be determined if the VDCs are actually using the funds or not. Many laws and regulations still conflict and contradict the provisions of the LSGA, 1999; following ten such laws were submitted for amendment in 2003/04:

- Local Administration Act 1971
- Film (Production, Show and Distribution) Act 1969
- Sports Development Act 1991
- Consumer Protection Act 1997
- Statistics Act 1958
- Construction Business Act 1998
- Environment Protection Act 1996
- Animal Health and Livestock Services Act 1998
- Animal Slaughtering House Act 1998
- Disaster (Relief) Act 1982

Another major decentralization initiative of the Tenth Plan has been the transfer of management of basic facilities such as primary schools and health posts to local communities. The government has drafted a human resources development plan and is discussing proposals for setting up Local Service Commissions as measures to enable local bodies to handle their new functions effectively.

Corruption Control

Effective corruption control remains a major national challenge and also a concern of Nepal's development partners. Corruption control is vital for improving effectiveness of public spending and service delivery. HMG/N has implemented various measures to control corruption besides re-vitalising the bureaucratic control mechanisms.

The Judicial Commission for Property Investigation was instituted in April 2002 to investigate assets of politicians and officials in public office after 1990. The Commission for the Investigation of Abuse of Authority (CIAA) initiated judicial action against public officials suspected of having amassed wealth disproportionate to verifiable sources of income. Table 8.1 summarises the activities and outcomes of actions taken by the CIAA.

TABLE 8.1: CIAA activities and outcomes, 2000/01 to 2003/04

Particulars	2001/02	2002/03	2003/04
Number of complaints received	2,000	3,687	3,732
Number of cases filed/registered	61	147	98
Number of cases adjudicated		55	129
Number of full convictions		43	120
Number of partial convictions		4	-

Source: Administrative records of CIAA

Other measures taken to control leakages include the establishment of the National Vigilance Centre (NVC) under the Office of the Prime Minister in late 2002, and the institution of mandatory public auditing for controlling misuse of resources at the project level. These measures and other legislative reforms, have contributed towards reducing the high levels of impunity for corruption.

The CIAA also performs a preventive role by sharing and disseminating information, publishing posters, pamphlets, booklets, newsletters and so on. It also organises interaction programs with government and non-governmental organisations to discuss ways to curb corruption.

SECTION IX

The Conflict And The Development Response

The conflict in Nepal has continued to affect PRSP implementation, especially because some of the badly affected regions are also those where social exclusion is more pronounced. Generally, the areas affected badly by the conflict are also those that lag behind the national average in terms of poverty incidence and development. By 2001, the insurgency that began in early 1996 in a handful of districts in the Mid-western and Central regions had a reported presence in almost every district. The conflict intensified after the PRSP implementation began and remains a major obstacle to generating and maintaining high growth needed for reducing poverty.

Nothing justifies the violence and inhumanity that has been associated with the insurgency. Continued violence threatens not only to impede the achievement of the PRS, but also to arrest and reverse the progress. The PRSP incorporates strategies needed to address what are now said to be some of the "root causes" of the conflict but the ability to implement programs to attain desired outcomes depends on the peace and security situation. HMG/N believes equitable development and equal sharing of benefits can result in long-term conflict resolution and lasting peace.

Nepal is implementing its PRS in a very difficult development environment. The outcomes would therefore be influenced by how the conflict and the government's efforts to restore peace and security evolve. Some of the possible scenarios are:

- Continued violence and government efforts to restore peace and security could cause difficulties in PRSP implementation, delaying outcomes of efforts aimed at addressing the historical inequalities said to be fuelling the conflict
- Enhanced efforts to maintain security could contribute towards creating a climate conducive for PRSP implementation and pave way for revitalising and speeding up development programs leading to long-term peace, stability, and economic wellbeing, and
- Nepal may need to devise special mechanisms to cope with continued violence in order to be able to continue delivery of basic services for preventing regression of progress made in the first three years of PRS implementation. This scenario may demand higher investment towards ensuring security of all stakeholders working to reduce poverty and restore peace.

The government attempted to resolve the conflict through negotiations twice (August-November 2001 and January-August 2003) and this is its preferred way towards resolution. However, the efforts did not lead to desired results while implementation of development activities remained very difficult, especially because violence limited the reach of government institutions. The difficulties associated with traditional implementation methods have led HMG/N to increasingly rely on newer modalities, especially one which puts communities in the centre, as drivers of development.

Development cannot wait until the conflict is resolved and Nepal also has no choice but to continue implementing the PRS by making adaptations to suit the situation as it unfolds. The ability to implement the PRS could help win the confidence of the people and wean away those that may have resorted to supporting violence as a means to achieve development goals, towards supporting HMG/N's efforts to reduce poverty and restore peace and security.

One approach to ensure continuation of PRS implementation is to transfer basic development functions and decisions to the people, and re-orient government and its agencies to take on the role of facilitators of the processes rather than implementers. Experience so far shows that it is difficult even for the insurgents to go against the wishes of the people when the poor and the deprived take true charge of their development. The PRS recognises the validity of the modality, which, however, remains to be adequately reflected in various hierarchies of development governance.

The challenge now is to stretch every rupee available for development to produce the maximum possible impact because therein lies the opportunity to influence long-term conflict resolution and restoration of lasting peace. The ability of the government to pursue this development approach is contingent on the continued availability of resources, and additional flexibility, in order to be able to match resources to the needs—as they emerge.

The approaches used for implementing programs in conflict-affected areas include involving local communities and NGOs and CBOs for delivering public services in participatory ways. HMG/N plans to implement more projects relying on bottom-up planning and beneficiary participation, and those that use labour-intensive and environment-friendly techniques. Such programs are typically owned and implemented by local communities assisted by government agencies, NGOs and CBOs.

The government also implemented the Integrated Security and Development Program (ISDP) to continue development in the conflict-affected areas. The ISDP was designed to provide a security umbrella for carrying out development activities in areas where service delivery had been disrupted by violence. The Poverty Alleviation Fund (PAF) also envisages large-scale, community-owned and driven interventions for poverty reduction to address the root causes of conflict, mainly exclusion and the resulting deprivation. In December 2004 the PAF had approved 54 projects in 168 village development committees (VDCs) of six districts. HMG/N has also instituted a flexible Immediate Relief Fund (IRF) to address the humanitarian needs that could emerge if the conflict continues or escalates.

SECTION X

Tracking Mechanisms And Learning

Continuous monitoring of poverty is essential for a sound poverty reduction strategy. Monitoring is needed to gen-erate information and provide feedback for refining policy, monitor progress on investments and to ensure accountability. At the most basic level, the system for poverty monitoring and analysis must focus on the dynamics of poverty and the outcomes—or relate the inputs (budget) and outcomes (PRS achievements). The government has instituted a separate section for continuous monitoring at the NPC. The functions of this section would be to facilitate policy refinement, monitor progress and ensure accountability through timely analyses and information dissemination.

HMG/N has three major poverty monitoring mechanisms: The Poverty Monitoring and Analysis System (PMAS), Health Management Information System (HMIS) and the Education Management Information System (EMIS). In addition to these, it also conducts periodic national surveys to analyse impact of policies and investments across a range of sectors and programs. In order to further streamline monitoring and better manage the information generated, the government has decided to conduct the following surveys at different intervals for generating data needed to monitor poverty. Accordingly, HMG/N plans to maintain the following schedule for surveys:

- National Living Standard Surveys and the Nepal Demographic and Health Survey, once every 2.5 years
- Health Management Information System and the Education Management Information System, annual, and
- Public Expenditure Tracking Survey, annual.

Poverty Monitoring and Analysis System

The PMAS was instituted as part of the PRSP implementation process. The main objective of the PMAS is to coordinate, consolidate, harmonize and analyse data from existing poverty monitoring systems (discussed above) and communicate results in a manner that continuously help to refine the policy process. The PMAS stresses on:

- Implementation (or input/output) monitoring
- Outcome or well-being monitoring
- Impact assessment
- Poverty management information system, and
- Communication/advocacy.

Implementation Monitoring

Implementation monitoring relies primarily on input and output indicators and intermediate process indicators. The aim is to: a) monitor budget allocations of all priority programs and policies; b) monitor process/activity indicators of the policies and programs; and, c) monitoring the level of achievement of outputs of main PRS policies and programs.

The government has refined the mid-term budget review process and has also completed "Public Expenditure Tracking (PET)' surveys in health, education, and the works and transport sectors. These surveys enable tracking of resource flows to spending units. EIMS and HMIS annual reports provide facility-level data for the two sectors. Additionally, HMG/N's performance-based budget release system also captures progress in all Priority-1 programs.

Outcome Monitoring

Outcome monitoring tracks changes in overall well-being or impacts over time. The goal is not to attribute outcomes to specific programs or policies but to focus on impact indicators, or a subset of closely related indicators. Well-being monitoring has a number of objectives: assess overall performance with respect to living conditions; assess relative performance of different geographical regions, districts, VDCs and socio-economic groups; and facilitate analysis of the causes and changes in the poverty situation. In order to generate survey data for this type of monitoring, HMG/N has decided to streamline household surveys and rely primarily on the NLSS and NDHS conducted at the interval of five years.

The PMAS incorporates data from the different surveys and monitoring systems and continuously refines the monitoring indicators, using inputs from different ministries. Also included are intermediate indicators sourced from administrative records, including management information systems at the ministries, national accounts and price data from the central bank.

Impact Assessment

Impact analysis establishes linkages between outcomes/ impacts and the programs being monitored. Impact analysis has two main objectives:

- to assess the effect of a specific policy, program/ project on poverty or some other well-being outcome, and
- to assess the efficiency of different policies/programs in achieving a given well-being outcome, i.e. could other policies or programs have improved well-being at lower cost?

In 2003/04, an impact assessment survey was conducted in Siraha district. Some major findings of the Survey is given in Box 12.

BOX 12: Impact assessment conducted in Siraha District

Highlights of findings of an impact assessment study in Siraha District of programs in four sectors—education, health, drinking water and agriculture:

- Growth in productivity was higher for sugarcane, potato and livestock products.
- Public agencies had a monopoly in extension services whereas the input market was dominated by the private sector.
- There was encouraging achievement in EPI coverage, nutritional status of children, and CPR rate, but the outcome was poor in terms of ARI, diarrhoea and kala-azar control.
- Among children of the survey settlements, 58% were going to public schools, 14% to private schools and the rest were not attending school.
- More than two-fifths of highly food insecure (food sufficiency up to three months) families were not sending children to school.
- "Economic problem" was the main reason for school dropout.
- Access to education, health services and drinking water had improved.
- Targeting Dalits was more effective in the education sector but the magnitude of support was small.
- There was low participation of beneficiaries in the development programs. The participation of Dalits and religious groups was found higher in drinking water projects.

Participatory monitoring: Participatory monitoring at different levels complements the macro-monitoring systems. HMG/N will institutionalise participatory monitoring as part of the PMAS to ensure greater accountability at all levels, and also to facilitate quick interventions for making necessary corrections. The participatory monitoring tools include citizens' report cards, social audits, budget reviews by civil society groups and parliamentary reviews of program and policy performance. HMG/N is developing a participatory poverty monitoring mechanism, using appropriate tools, in order to take into account the voice of the people.

Poverty Management Information System (PMIS)

The PMAS is to grow into a central repository of all data on poverty in Nepal. The data on PMAS would be accessible through the Poverty Management Information System (PMIS), which would link all major databases relevant to poverty monitoring. The main objective of PMIS is to assist decision-making by: (i) providing instant access to relevant, correct information on poverty, (ii) making existing information coherent, compatible and consistent, (iii) serving as a flexible and evolving mechanism for data storage and analysis, and (iv) ensuring data access while continuously generating information through greater control and monitoring functions.

However, before developing a complex and integrated PMIS, Nepal Info, an easy-to-use CD-ROM with MDG, PRSP and other indicators–maintained by CBS–is to be expanded and disseminated. The Nepal Info is a database software tool that features a comprehensive set of social development indicators selected to monitor the PRSP, MDGs and other key development parameters.

Nepal Info provides information for poverty monitoring and thus helps in operationalising and institutionalising the PMAS for effective monitoring of PRSP and MDGs indicators. Nepal Info database is updated annually with information on MDGs for global as well as local level monitoring systems. Additional PRSP indicators and some other prioritised indicators as identified by the Nepal Info Technical Committee are added and updated annually. Nepal Info 2 was released at the end of 2004. This latest version of Nepal Info contains information on 73 PRSP indicators and 94 other prioritised indicators. Additional steps have also been taken to develop a training package on

Nepal Info to train key personnel of line ministries and civil society in the use of data.

Monitoring Mechanism for Targeted Programs

Building upon the government's monitoring and analysis system, a mechanism has been developed in order to determine: (i) whether the budget spent on the targeted programs and projects reaches the final service delivery institutions, and (ii) whether the output and services of such programs reach disadvantaged areas/groups, including women and Dalits. The mechanism was piloted in two districts to monitor the free textbook distribution program and national scholarship program, and is being finalised.

District Poverty Monitoring and Analysis System (DPMAS)

The DPMAS was drafted in 2003, and was shared with different stakeholders both at local and national levels in 2004. Regional workshops were held to share DPMAS with the district level stakeholders of all 75 districts. It has been refined based on the comments received from the stakeholders.

Results-based Management and Monitoring

The government has adopted the Results-based Management (RBM) as a monitoring approach to improve development effectiveness. RBM is a management tool that provides a coherent framework for planning, implementation, monitoring and learning. RBM moves the attention from inputs and activities to

BOX 13: Results-based Management

HMG/N has developed and adopted the RBM. The main elements include strategic planning and prioritization in the PRSP/Tenth Plan, annual budgeting based on the medium-term expenditure framework (MTEF), the Poverty Monitoring and Analysis System (PMAS), the Immediate Action Plan (which identifies activities to be given priority attention for implementation), and Sector Business Plans (which are being developed to make priorities, formulate objectives, specify resource needs, identify targets, set timeframes, and define risks). The RBM will be further refined and integrated at sectoral and local levels.

results and impacts. It emphasises effectiveness in service delivery while focusing on transparency and participation. It also helps clarify goals and objectives; systems aimed to provide measures of performance and results; a learning culture grounded in evaluation; beneficiary participation at all stages of program design and implementation; clear accountabilities in a decentralized framework; and builds links between planning, resource allocation and results.

SECTION XI

Resource Needs And Aid Harmonization

Resource Needs

There was a slowdown in development spending after PRSP implementation began—owing mainly to external factors including the conflict. The spending levels have increased compared to previous fiscal years but the overall level still remains low. Investment in development is critical for attaining the PRS goals and therefore the need to maintain fairly high and predictable expenditure levels.

The ability to increase spending depends on the peace and security situation and implementation level efficiencies. The government's ability and flexibility to increase spending on development remains constrained by increasing recurrent expenditure and debt servicing obligations—the pressure of which was offset to some extent by low levels of development spending—causing it to rely on external sources of financing. The conflict also continues to pressure government finances, causing more resources to be spent for maintaining peace and security. The progress towards attaining MDGs remains slow and Nepal may be able to achieve the goals, only if it can substantially increase investments on related programs. Additional resources are needed for the following reasons:

- To plug the investment gaps of the past years of PRS implementation and attain the levels envisaged by the Tenth Plan by 2006/07, and to be able to raise investments on areas related to attaining the MDGs
- To rebuild/ repair infrastructures damaged during the conflict; and
- To be able to fund new, quick-yielding projects/ programs that could also contribute to conflict-resolution.

The ongoing MDG needs assessment exercise will identify the resource requirements and gaps. Table 11.1 shows the gap between estimated investment requirements for the remaining years of the Tenth Plan and the anticipated government

TABLE 11.1: Projected expenditures and financing for 2005/06-2006/07 *(Rs. billion)*

Expenditure/source	2005/06	2006/07	Total
Projected total expenditure	133.5	153.8	287.3
Regular	68.5	72.5	141
Development (Capital)	65	81.3	146.3
Projected sources of financing	133.5	153.8	287.3
Revenue	85.5	99.6	185.1
Domestic Borrowing	9.5	9	18.5
Foreign Financing	38.5	45.2	83.7

Source: An assessment of Tenth Plan (PRSP) implementation, May 2004.

revenues. The estimate of investment required—based on the assumption of normalcy—suggests that the government would need Rs.84 billion in foreign financing in order to meet the targeted expenditures during the remaining two years of the Tenth Plan. However, because development financing levels are contingent on the ability to spend, the actual levels needed may be lower.

Foreign financing increased slightly in 2003/04 to reach about Rs22 billion; the need may be slightly higher in 2005/06—assuming that the ground situation changes for the better—and increase proportionately with advances made on restoring peace and security. Based on the aforesaid estimates of foreign financing, development spending could be around Rs.40 billion in 2005/06 and Rs45 billion in 2006/07. The other issue of financing is less the willingness of partners to contribute to the development process, but the availability of quick financing when it is needed (for example, funds for quick interventions if there is a dramatic change in the peace and security situation).

AID HARMONIZATION

Nepal began planned development in the 1950s. Early foreign aid tended to be influenced more by the global political priorities and less by the needs of recipients, despite all the good intentions associated with development assistance. Aid became less political over time but remained constrained by weak institutional capacity to manage and administer assistance at the recipient end. In order to increase aid effectiveness, many donors tried to design programs bypassing government institutions causing aid to become a 'donor business', which remained so until about the end of the millennium.

In 2002 Nepal prepared a Foreign Aid Policy anchored on the premise that the government should set the development vision, framework and priorities and development partners should fit into the arrangement using the PRSP and the MTEF as reference. The policy was presented at the Nepal Development Forum (NDF) 2002 where the development partners endorsed the fundamental policy thrust. Several donors have already aligned their assistance strategies and programs with the PRSP and the specific allocation decisions remain integrated to an extent with the MTEF. To overcome the weak integration with the MTEF, the government proposed an aid integration process at the NDF, 2004, and its logic for integration and harmonisation was endorsed by the donors. HMG/N is now beginning to implement the idea, even though effective integration could be delayed owing to a number of factors including the nature of aid programs, the immediate impact on allocation, and the time needed by donors to make preparations for the modality shift.

The move towards integration and harmonisation can end the unpredictability of resources and help increase the effectiveness of aid—which has remained a major donor concern. The PRSP has been accepted as the larger framework to guide investment in development. Aid harmonisation and its resultant benefits in terms of resource predictability, program-wide support rather than project specific investments and a clearly focused investment framework (PRSP) can therefore support the attainment of the development goals and increase aid effectiveness. Gains can also result from lower transaction costs, resulting from a monitoring and reporting framework acceptable to all, and better alignment of assistance with national priorities.

The move towards harmonising aid began with the Rome Declaration on Harmonization (February, 2003), necessitated largely by two major concerns:
- The high transaction costs resulting from a large number of donor-funded projects with different policies, procedures, and reporting and accounting requirements, and
- The lack of country ownership and leadership in development causing it to be donor driven.

At the NDF 2004 Nepal proposed harmonization at three levels:
- Overall program level, or aligning aid with HMG's priorities
- Individual program level or aligning aid with HMG's sectoral policies, and
- Financial modality level or aligning aid with HMG's financing system.

The NDF 2004 also endorsed the National Action Plan for Harmonisation, a two-year rolling plan that is reviewed annually. The action plan is expected to serve as road map in the move towards greater harmonization through actions to respond to both outstanding as well as emerging foreign assistance management issues. The plan also includes guidelines to steer sectoral actions.

Nepal is the only country in South Asia that has a fully operational PRS, MTEF and an Immediate Action Plan. Together, these instruments address most of the implementation-related concerns, including monitoring and evaluation, and reporting. Nepal's annual budget has been aligned with the PRS and the IAP provides the basis for implementing and monitoring reforms on an annual basis. The PRS outcome therefore depends on effective aid harmonisation, a process which has already begun in terms of increased and considerable coordination among the development partners.

As a group, Nepal's development partners have endorsed and strongly supported the PRSP, MTEF prioritisation and the annualised reforms being implemented on the basis of the IAP. The progress in devolution of functions in basic service delivery, including health and education, to communities is another success story that has accompanied changes in the policy regime. The government has also instituted a mechanism for greater coordination between HMG/N agencies and donors. HMG/N's coordination mechanisms include reviews by the Ministerial Development Action Committee (MDAC) and the National Development Action Committee (NDAC); the development partners also meet regularly in sectoral working groups to discuss and review progress.

The government is fully committed to continuously enhance its outcome focus, developing clear sectoral strategies and pursuing rigorous prioritisation using the MTEF. It has also continuously broadened and deepened coverage of the MTEF—it now covers the entire budget. To make expenses more realistic and comparable internationally, in 2004/05 Nepal began classifying spending as recurrent and capital expenditures. The government is finalising business plans of selected sectors for aid-integration, and has continuously fine tuned the MTEF by rationalising the budget envelope. It expects development partners to fit into the framework, especially upon completion of the business plans.

The slow progress towards the attainment of MDGs calls for scaling-up actions in all sectors. Traditional service-delivery mechanisms do not work in the context of the conflict, which continuously poses new challenges. Nepal has no choice but to continue implementing development programs, which in turn depends on continuous support from the development partners. Effective aid harmonization and predictable donor support are therefore very critical in Nepal's quest to attain both the PRSP objectives and the Millennium Development Goals.

SECTION XII

Conclusions

The mid-period achievements of the PRSP/Tenth Plan are generally satisfactory, given the difficult development environment resulting from the violent conflict, which escalated at around the same time that PRSP implementation began. Nepal's macro level indicators remain stable and HMG/N remains fully committed to take all measures that would be necessary to sustain the stability.

The gains made in PRSP implementation so far are not self-sustaining and would therefore need concerted efforts to prevent reversal. The Human Development Report 2004 has called on Nepal to continue bolder reforms and development measures. A prerequisite for being able to do so is restoration of peace and security. The government has no option but to ensure continuity to development because the inequalities in Nepalese society will continue to grow as long as they are left unaddressed. Continued conflict can also result in greater damages on development infrastructures and delay further the recovery process.

The possibility of long-term conflict resolution and establishment of lasting peace lies in the ability of the government to deliver unhindered services and ensure inclusive development. The key for implementing these actions would be to devolve more and more tasks and functions to local bodies and community organizations and encourage the widest possible participation of stakeholders during implementation. The way forward is empowering people by putting them in charge of their development, with government, donors and other agencies playing a supportive role.

The government acknowledges that there is a gap between what is planned and what actually takes place on the ground, resulting from the transitional contingencies. The donors, therefore, need step back and let government take fuller charge of development and support its efforts through more cost-effective modalities, of which moving towards aid harmonisation is one. The absence of elected local bodies has impeded the mobilisation of people and their participation in development resulting in a slowdown in local level service delivery. The situation is expected to change over time and the policy reforms, including devolution efforts now underway are expected to change—for ever—the manner in which services have traditionally been delivered.

Restoring an environment conducive to enhanced participation by stakeholders at all levels is urgent, especially in the context of devolution of management functions to communities for bringing greater efficiencies in rural education, health care, agriculture and livestock extension services and for building rural infrastructures. These efforts need to be backed up with predictable flow of funds and strong monitoring of expenditures. These measures can take Nepal closer towards attaining the objectives of the PRSP, and the longer-term Millennium Development Goals, notwithstanding the unanticipated obstacles that may have to be overcome in the process as long as the conflict remains unresolved.

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ANNEXES

ANNEX 1:	Poverty monitoring: Key indicators				
Sector/Theme	Outcome/Impact Indicators	Intermediate Indicators	2001/02	2002/03	2003/04
Income/ Consumption Poverty	■ Population below poverty line	■ Percentage of population below poverty line	38	-	30.85
		■ Share of poorest quintile in national consumption	-	-	6
		■ Gini coefficient	0.341	-	0.414
Economic Growth	■ Faster Economic Growth	■ Overall GDP growth (real) % p.a.	-0.6	3.2	3.5
		■ Agriculture (real) % p.a.	2.2	2.5	3.9
		■ Non-agriculture (real) % p.a.	-1.9	3.2	3.1
		■ Per capita income growth (real) % p.a.	-2.8	1.0	1.3
Macro Economic Stability	■ Fiscal Balance	■ Revenue/GDP ratio (%)	11.9	12.3	12.6
		■ Development Exp./Total Exp. ratio (%)	39.4	34.4	26.6 Y
		■ Development Exp./GDP ratio (%)	6.4	6.4	6.6 #
		■ Domestic borrowing/ GDP ratio (%)	3.6	2.6	1.5
	■ Balance of payments	■ Exports/GDP ratio (%)	11.1	11.0	10.7
		■ Workers' remittances/ GDP (%)	11.3	11.9	12.6
		■ Gross reserves (Rs billion)	105.9	108.2	130.2
		■ Current account balance (Rs. billion)	18.16	11.61	14.60
	■ Monetary Stability	■ Broad money growth (%) p.a.	4.5	9.8	11.8
		■ Domestic credit growth (%) p.a.	10.4	10.2	9.5
	■ Inflation	■ Consumer prices (%) p.a.	2.9	4.8	4.1
	■ Efficiency of public spending	■ Prioritization (P1, P2, P3) in place (%)	NS	P_1=59 P_2=33 P_3=8	P_1=72.5 P_2=23.3 P_3=4.2
		■ Budget release to P1 against allocation to P1 (%)	NS	73	91
		■ Reporting of outputs for P1 projects done for every trimester	✓	✓	✓
		■ Number of enterprises privatized/liquidated	1	7	1 completed 8 underway
		■ Proportion of pro-poor spending to total spending (%)	-	-	-
	■ Health of Financial Sector Institutions	■ Capital adequacy ratio	12	11	11
		■ Non-performing assets ratio	30.4	28.8	28.9
		■ Completion of on-site inspection (number) of commercial banks			
		- Corporate Level	7	7	9
		- Branch Level	30	26	24

Y = *Capital expenditure / Total expenditure*
# = *Capital expenditure / GDP ratio*

ANNEX 1: Poverty monitoring: Key indicators

Sector/Theme	Outcome/Impact Indicators	Intermediate Indicators	2001/02	2002/03	2003/04
Agriculture	■ Food security	■ Number of districts served by NFC	32	31	30
		■ Quantity of food sold (mt.)	8,213	5,693	6,100
	■ Overall agricultural growth	■ Length of rural roads (km)	2,361	905	840
		■ Number of VDCs electrified **C**	1,600	1,800	2,000
		■ Number of public market collection centers / market yards	31	33	750
		■ Agricultural credit (ADB/N only; Rs in million)	7,110	7,669	10,151
		■ Area under irrigation (ha.) **C**	937,722	985,546	1,128,000
		■ Use of chemical fertilizer (mt.)	193,154	172,270	161,316
	■ Crop production	■ No. of functioning farmers groups **C**	7,508	9,383	11,272
		■ Improved seeds (mt.)	2,654	2,574	5,751
		■ Number of pocket programs	1,897	1,967	1,967
		■ Crop/horticulture credit (Rs million)	2,028	2,222	2,024
	■ Livestock production	■ Number of livestock farmers' groups	6,623	6,954	6,965
		■ Number of Artificially Inseminated (AI)	53,641	52,049	44,344
		■ Production of milk (mt.)	1,158,780	1,195,931	1,238,000
		■ Numbers of pocket programs	455	455	807
		■ Livestock credit (Rs. million)	1,570	1,634	1,597
		■ Meat /Egg production (mt.)	737,060	761,250	783,760
Irrigation	■ Area under year round irrigation	■ Number and hectare of STW,DTW			
		STW	-/9,969	657/1,905	1,430/4,855
		DTW	-/29,586	44/1,592	8/320
		■ Surface irrigation schemes with conjunctive use of STW/DTW (Number & ha.)	-	16/3,071	17/6,851
		■ Area under year round irrigation (ha.)	-	-	465,402
	■ Management transfer to WUAs.	■ Number of rehabilitated and handed over schemes	5	50	-
Power	■ Percentage of population with electricity services.	■ Installed capacity (mw) **C**	584	606	609
		■ Percentage of system losses (%)	24.6	23.6	22.9
		■ Households electrified (%) **C**	40	43	48
	■ Increased Rural consumption	■ Per capita rural electricity consumption	-	-	-
		■ Number of VDCs covered **C**	1,600	1,800	2,000

C = *cummulative*

ANNEX 1: Poverty monitoring: Key indicators

Sector/Theme	Outcome/Impact Indicators	Intermediate Indicators	2001/02	2002/03	2003/04
Forestry and Soil Conservation	■ Area under intense forest coverage	■ Area under community forest (ha) **C**	1,028,473	1,062,823	1,065,000
		■ Area under leasehold forest (ha.) **C**	4,378	7,061	8,271
		■ Number of households under leasehold forest **C**	9,070	10,027	13,706
		■ Area under national parks/ protected area (% of total land)	18	18.3	18.3
		■ Areas under forest cover including shrub land (%)	39.6	39.6	39.6
		■ No. of community forest users group (CFUGs)	-	-	13,125
		■ Women participation in CFUGs (%)	-	-	24
		■ No. of leasehold forest users groups (LFUGs)	-	-	2,102
		■ Women participation in LFUGs (%)	-	-	28.3
	■ Income from forestry	■ Income generated by FUGs (CFUGs only; Rs. in million)	129	124	-
Industry, Trade and Tourism	■ Expansion of industrial production	■ Growth rate (%) p.a.			
		- Industry	-9.8	2.0	1.7
		- Services	-0.4	3.5	3.3
		■ Share in GDP			
		- Industry	8.6	8.4	8.2
		- Services	52.0	52.5	53.1
		■ Credit to industrial and services sectors	-	-	-
		■ FDI (Rs million)	1,210	1,771	2,713
		- Additional employment	3,731	3,572	2,128
	■ Additional employment in SMEs	■ Number of training course and trainees	-/14,272	139/13,615	118/13,259
		■ Number of industries registered			
		-Total	9,890	5,225	6,035
		-Cottage & Small	-	5,116	5,958
		-Medium & Large	-	109	77
		■ Additional employment generated	-	-	-
	■ Trade Promotion	■ Average Tariff rates (%)	12.9	11.5	10.7
		■ Number of trade and industrial fairs	11	7	16
Labour	■ Remittances	■ Number of Nepali workers employed overseas	104,739	105,055	106,660
		■ Proportion of skilled migrant workers	-	-	-

C = *cummulative*

ANNEX 1: Poverty monitoring: Key indicators

Sector/Theme	Outcome/Impact Indicators	Intermediate Indicators	2001/02	2002/03	2003/04
Tourism	■ Tourism Contribution	■ Number of tourist arrivals			
		- total	275,468	338,132	210,535 #
		- by air	218,660	275,438	167,413
		- by road	56,808	62,694	41,322
		■ Number of promotional activities outside Nepal	19	22	-
		■ Number of seats available on international flights (per week)	7,994	6,884	-
		■ Length of stay of tourists (days)	12	7.9	9.5
		■ Number of flights outside Kathmandu (per week)	-	70	-
		■ Number of beds available outside Kathmandu	13,666	14,795	-
		■ Number of star hotels **C**	104	108	108
		■ Foreign exchange earning from tourism (Rs million)	7,799	11,747.7	18,147.4
		■ Share of tourism in GDP	2.5	2.6	2.8
Roads	■ Increased road access	■ Number of district HQs connected	60	61	61
		■ BOT projects (selected)	-	10	-
	■ Reduced transport costs	■ Length of additional road constructed (km)	283	306	234
Environment	■ Environment Improvement	■ Proportion of traditional fuel in total energy use	87.4	87.4	86.8
		■ Energy per capita use (Ton. of oil equivalent)	-	-	-
Decentralization	■ Improved service delivery	■ Number of service delivery facilities transferred to local bodies			
		- Agriculture extension (Districts) **C**	NS	75	75
		- Health facilities **C**	NS	468	1,114
		- Rural roads	-	-	-
		- Primary and secondary schools **C**	NS	90	1,500
		■ Number of local body officials trained	-	-	578
		■ Number of districts completing and updating DPPs	-	52	52
		■ Number of districts (DDC) with Citizen Charters	-	43	54
		■ Proportion of conditional grant in total development budget (%)	1.6	2.1	2.0

C = *cummulative*

ANNEX 1: Poverty monitoring: Key indicators

Sector/Theme	Outcome/Impact Indicators	Intermediate Indicators	2001/02	2002/03	2003/04
Information and Communication	■ Telephone penetration per thousand inhabitants	■ Private sector entry **C**	-	1	2
		■ Number of new telephone lines **C**	219,000	422,183	608,084
		■ Number of VDCs with telephone facility **C**	1,761	1,761	1,959
	■ Access to radio/TV services	■ Coverage (% of population) radio and television services	90/50	90/60	90/62
		■ Number of new television and radio providers (to increase intensity)			
		- Radio **C**	-	30	56
		- Television **C**	2	3	5
Education	■ Improved Access	■ Number of primary schools **C**	25,194	26,638	26,858
		■ Net primary enrolment rate	81.1	82.4	84
		■ Proportion of population within 1/2 hours walk to primary schools	-	-	91.4
	■ Quality of Education	■ Number of certified teachers **C**	NA	27,875	120,988
		■ Percentage of pupil completing primary level	60	67.7	69
		■ Share of age 5 children in school	-	-	-
		■ Primary teachers trained (%)	15	15	31
		■ Secondary teachers trained (%)	-	46.2	48
		■ Proportion of vacant teachers' positions	-	-	Not vacant
		■ Number of schools transferred to communities **C**	NS	90	1500
		■ Primary cycle completion	-	-	50.4
	■ Adult literacy (15+)	■ Number of community learning centres	20	40	52
		■ Adult literacy rate	44	-	48
		■ Share of adult education expenditure in total education expenditure (%)	0.9	0.5	0.5
	■ Female adult literacy (15+)	■ Number of programs for women literacy (class)	1,400	1,600	1,745
		■ Adult female literacy rate	-	-	33.8
		■ Number of people completing adult education	23,942	26,733	39,262
	■ Girls' enrolment	■ Share of female teachers in primary schools (%)	21.4	22.1	21.1
		■ Number of girl students receiving scholarships (primary schools)	151,568	120,742	224,656
		■ Schools having separate latrines for girls **C**	7,613	9,741	10,633

C = *cummulative*

ANNEX 1:	Poverty monitoring: Key indicators				
Sector/Theme	Outcome/Impact Indicators	Intermediate Indicators	2001/02	2002/03	2003/04
Health	■ Access to health	■ Number of primary health centres , health posts, sub-health post and district hospitals	4,429	4,408	4,401
		■ Number of sub-health posts transferred **C**	NS	468	1,114
		■ Proportion of population within 30 minutes walk to health facilities/outreach clinics	-	-	62
	■ Improved Quality	■ Expenditure on medicine for health centres (Rs.)	80,000	80,000	80,000
		■ Number of health facilities where 15 of the most essential drugs are available	-	1568	-
	■ Infant mortality rate	■ Percentage of women receiving at least 4 ANC visits	37.9	36.8	43.6
		■ Percentage of women receiving adequate PNC (post natal care) visits	14.4	18.8	28.3
		■ Infant mortality rate (per thousand live births)	64	-	-
	■ Child mortality rate	■ Percentage of one year olds receiving DPT3 against target diseases	80.3	86.2	90.3
		■ Child mortality rate (Per thousand)	91	-	-
	■ Maternal mortality rate	■ Percentage of births by skilled attendants	15	16.1	18.0
	■ Improvement in General Health	■ National health expenditure/per capita	1102	1251	1,351
		■ Number of health centres, PHC and hospitals upgraded.	4	1	-
	■ Reduced population growth	■ Condom use by 15-49 year olds	3.2	2.2	2.4
		■ Contraceptive prevalence rate	38.9	37.8	40.02
	■ Incidence ofTB/ Malaria	■ Number of TB and Malaria cases detection and treatment - Detection - TB	70,189	71,190	70,514
		- Mal.(per 10,000 population)	5.73	5.23	3.30
		- Treatment - Mal. (per 10,000 population)	4.41	5.20	3.20
	■ Incidence of anemic cases	■ Proportion of malnourished	15.4	14	12.8
		■ Percentage of pregnant women receiving iron tablets	57	68	88

C = *cummulative*

ANNEX 1: Poverty monitoring: Key indicators

Sector/Theme	Outcome/Impact Indicators	Intermediate Indicators	2001/02	2002/03	2003/04
Drinking Water and Sanitation	■ Access to safe and sustainable drinking water	■ Proportion of population served with access to safe drinking water	71.6	72.8	73
		■ Proportion of unaccounted for water (%)	40	38	-
	■ Incidence of water-borne and water washed diseases	■ Proportion of households with sanitation facilities %	20	26.2	39
Social Inclusion and Targeted programs	■ HDI of Far-West and Mid-West development regions	■ Budget allocation for Far west/ Mid west regions (Rs. million)	5,013.3	3,869.5	4,368.1
		■ Grants allocation to DDCs bodies on poverty based formula (Rs in million)	810	810	842.5
		■ Number of districts covered by PAF	-	-	6
	■ Access to education of women, Dalits and Janajatis	■ Number of Women, Dalits, Janajatis benefited from scholarships and training	-	-	
		■ NumberWomen, Dalits and Janajatis receiving scholarships for higher education			
		- Women	403	403	-
		- Dalits	-	-	-
		- Janajatis	-	-	-
		■ Ratio of girls to boys in primary levels	-	-	-
	■ Proportion of women, Dalits and Janajatis in political activities and public positions	■ Number of women, Dalits and Janjatis in teaching	-	-	
		■ Number of Women, Dalits and Janjatis in civil service			
		- Women **C**	8,008	-	8,042
		- Dalits	-	-	-
		- Janajatis	-	-	-
Governance Civil Service Reform	■ Rightsizing bureaucracy	■ Number of positions abolished **C**	-	7000	7160
	■ Percentage of women, ethnic and disadvantaged groups in civil service	■ Number of applications from women, ethnic and disadvantaged groups:			
		-Women	21,247	25,174	16,014
		-Dalits	135	1,028	810
		-Janajatis	3,199	29,030	21,423
Anti-corruption	■ Corruption cases reduced	■ Number of corruption cases: Registered/filed	61	147	98
		Adjudicated	-	55	129
		Convicted (fully)	-	43	120
		Convicted (partially)	-	4	-
Human Rights	■ Reduced human rights violations	■ Number of human rights complaints filed/registered.	-	483	1,083

C = *cummulative*
* *Provisional Estimates.*
NA= Not Applicable.
NS= Not Started.

ANNEX 2: Poverty situation by regions

Area	Number of Poor (Percent)		Depth of Poverty (Percent)		Severity of Poverty (Percent)	
	1995/96	2003/04	1995/96	2003/04	1995/96	2003/04
Nepal	41.8	30.8	100.0	100.0	100.0	100.0
Urban Area	21.6	9.6	3.6	4.7	6.9	15.0
Rural Area	43.3	34.6	96.4	95.3	93.1	85.0
Survey Areas/Domains						
Urban Area of Kathmandu Valley	4.3	3.3	0.3	0.6	2.6	5.4
Other Urban Area	31.6	13.0	3.3	4.1	4.4	9.7
Rural West Mountain/Hill	55.0	37.4	32.7	23.6	24.8	19.4
Rural East Mountain/Hill	36.1	42.9	19.4	29.4	22.4	21.1
Rural West Tarai	46.1	38.1	18.4	18.9	16.7	15.3
Rural East Tarai	37.2	24.9	25.9	23.5	29.1	29.1
Development Region						
Eastern Region	38.9	29.3	21.0	23.4	22.5	24.7
Central Region	32.5	27.1	26.9	32.2	34.6	36.6
Western Region	38.6	27.1	18.7	16.7	20.3	18.9
Mid-Western Region	59.9	44.8	18.5	17.7	12.9	12.2
Far-Western Region	63.9	41.0	14.8	9.9	9.7	7.5
Geographical Areas						
Mountain	57.0	32.6	10.7	7.5	7.9	7.1
Hill	40.7	34.5	41.9	47.1	43.0	42.1
Tarai	40.3	27.6	47.4	45.4	49.2	50.8

(Rs. million)

ANNEX 3: Government resources, expenditure and other macro variables at current prices

Description	2001/02 Base year	2002/03 Actual	2003/04 Revised Estimates	2004/05 Allocation	2005/06 Projection	2006/07 Projection
Government revenue	50445	56230	62227	70320	79480	89140
Total expenditure	80072	84006	92107	111690	124540	131014
Regular expenditure	48590	54973	59302	64488	71618	73025
Development expenditure	31482	29033	32805	47202	52922	57989
Recurrent expenditure	-	52090	56720	67608	66129	67784
Capital expenditure (including principal repayment)	-	31916	35387	44082	58411	63230
Revenue surplus	1855	1257	2925	5832	7862	16115
Government revenue-recurrent expenditure	-	4140	5507	2712	13351	21356
Budgetary deficit	22941	16437	18423	26019	28110	24824
Total foreign aid	14385	15885	22568	32310	35250	35420
Grant	6686	11339	11457	15351	16950	17050
Loan	7699	4546	11111	16959	18300	18370
Domestic borrowings	8000	8880	7312	9060	9810	6454
Cash balance (-surplus)	7242	3011	0	0	0	0
Total domestic borrowings	15242	11891	7312	9060	9810	6454
Monetary Survey						
Narrow money supply (M1)	77156	83754	90287	99767	111340	124812
Broad money supply (M2)	223988	245911	274931	309291	351052	400552
Total domestic credit growth (at current prices)	207323	228444	250190	274661	302673	337484
Gross foreign exchange reserves	106996	109306	127341	138293	151431	167331
GDP (at market price)	422301	454935	494882	536627	585870	646411
As a % of GDP						
Government revenue	11.95	12.36	12.57	13.10	13.57	13.79
Total expenditure	18.96	18.47	18.61	20.81	21.26	20.27
Regular expenditure	11.51	12.08	11.98	12.02	12.22	11.30
Development expenditure	7.45	6.38	6.63	8.80	9.03	8.97
Recurrent expenditure	0.00	11.45	11.46	12.60	11.29	10.49
Capital expenditure	0.00	7.02	7.15	8.21	9.97	9.78
Budget deficit	5.43	3.61	3.72	4.85	4.80	3.84
Foreign aid	3.41	3.49	4.56	6.02	6.02	5.48
Grant	1.58	2.49	2.32	2.86	2.89	2.64
Loan	1.82	1.00	2.25	3.16	3.12	2.84
Domestic borrowing	1.89	1.95	1.48	1.69	1.67	1.00
Cash balance (-surplus)	1.71	0.66	0.00	0.00	0.00	0.00
Total domestic borrowings	3.61	2.61	1.48	1.69	1.67	1.00

Source: MTEF III

Note: Some figures presented in Table 4.3 may not resemble that of this annex because Table 4.3 has latest available data.

His Majesty's Government of Nepal
National Planning Commission
Singh Durbar, Kathmandu, Nepal
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