



# Country Partnership Strategy

---

September 2019

## Nepal, 2020–2024 —Promoting Connectivity, Devolved Services, and Resilience

Distribution of this document is restricted until it has been endorsed by the Board of Directors. Following such endorsement, ADB will disclose the document to the public in accordance with ADB's Access to Information Policy.

Asian Development Bank



## CURRENCY EQUIVALENTS

(as of 6 September 2019)

Currency unit	–	Nepalese rupee/s (NRe/NRs)
1.00	=	\$0.0087
\$1.00	=	NRs 114.95

## ABBREVIATIONS

ADB	–	Asian Development Bank
COL	–	concessional OCR lending
CPS	–	country partnership strategy
GDP	–	gross domestic product
GESI	–	gender equality and social inclusion
PFM	–	public financial management
SASEC	–	South Asia Subregional Economic Cooperation
SNG	–	subnational government
SSDP	–	Schools Sector Development Plan
TA	–	technical assistance
TVET	–	technical and vocational education and training

## NOTES

- (i) The fiscal year (FY) of the Government of Nepal ends in mid-July. “FY” before a calendar year denotes the year in which the fiscal year ends, e.g., FY2019 ends on 16 July 2019.
- (ii) In this report, “\$” refers to United States dollars.

<b>Vice-President</b>	Shixin Chen, Operations 1
<b>Director General</b>	Hun Kim, South Asia Department (SARD)
<b>Director</b>	Mukhtor Khamudkhanov, Country Director, Nepal Resident Mission (NRM), SARD
<b>Team leader</b>	Sharad Bhandari, Principal Economist, NRM, SARD
<b>Team members</b>	Bhupendra Bhatt, Senior Project Officer (Transport), NRM, SARD Narendra Chand, Senior Procurement Officer, NRM, SARD Johan Georget, Transport Specialist, SARD Smita Gyawali, Senior Project Officer (Education), NRM, SARD Pratish Halady, Principal Public–Private Partnership Specialist, Office of Public–Private Partnership Binita Shah Khadka, Senior External Relations Officer, NRM, SARD Manbar Singh Khadka, Economics Officer, NRM, SARD Pushkar Manandhar, Project Officer (Energy), NRM, SARD Neelina Nakarmi, Economic Analyst, NRM, SARD Anjan Panday, Senior Programs Officer, NRM, SARD Naresh Pradhan, Project Officer (Transport), NRM, SARD Shreejana Rajbhandari, Programs Analyst, NRM, SARD Arun Rana, Senior Project Officer, NRM, SARD Rachana Shrestha, Senior Public Management Officer, NRM, SARD Deepak Singh, Senior Environment Officer, NRM, SARD Lei Lei Song, Regional Economic Advisor, SARD Suman Subba, Senior Social Development Officer (Gender), NRM, SARD Laxmi Subedi, Senior Social Development Officer (Safeguards), NRM, SARD Sonali Tang, Principal Investment Specialist, Private Sector Operations Department Malika KC (Thapa), Operations Assistant, NRM, SARD Rudi Van Dael, Senior Portfolio Management Specialist, NRM, SARD Vivian Wooldridge, Urban Development Specialist, SARD
<b>Peer reviewers</b>	Joven Balbosa, Advisor, Southeast Asia Department Dominic Mellor, Senior Investment Specialist, Private Sector Operations Department

In preparing any country partnership strategy, financing any project, or by making any designation of or reference to a particular territory or geographic area in this document, the Asian Development Bank does not intend to make any judgments as to the legal or other status of any territory or area.

## CONTENTS

	<b>Page</b>
COUNTRY AT A GLANCE	
I. COUNTRY PARTNERSHIP STRATEGY SNAPSHOT	1
II. COUNTRY DEVELOPMENT CONTEXT	2
III. COUNTRY STRATEGY FRAMEWORK	7
A. Lessons from Previous Strategy	7
B. National Development Strategy	8
C. Role of Development Partners	8
D. ADB's Strategic Objectives and Operational Priorities	9
E. Priorities for Knowledge Support	13
IV. STRATEGY IMPLEMENTATION	13
A. Indicative Resource Parameters	13
B. Implementation Priorities	14
C. Monitoring of Results	15
D. Risks	15
APPENDIXES	
1. Country Partnership Strategy Results Framework	16
2. Country Knowledge Plan	18
3. List of Linked Documents	22



## COUNTRY AT A GLANCE

<b>Economic</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019<sup>1</sup></b>
GDP (\$ billion, current)	21.4	21.2	25.2	29.0	30.7
GDP per capita (\$, current)	763.6	745.2	873.5	993.9	1036.5
GNI per capita (\$, atlas method)	780.0	770.0	850.0	960.0	...
GDP growth (% , in constant prices)	3.3	0.6	8.2	6.7	7.1
Agriculture	1.1	0.2	5.2	2.8	5.0
Industry	1.4	(6.4)	12.4	9.6	8.1
Services	4.6	2.4	8.1	7.2	7.3
Gross fixed investment (% of GDP)	28.0	28.7	31.4	34.7	36.9
Gross domestic saving (% of GDP)	9.2	4.1	13.4	17.8	20.5
Consumer price index (annual % change)	7.2	9.9	4.5	4.2	4.6
Liquidity (M2) (annual % change)	19.9	19.5	15.5	19.4	15.8
Overall fiscal surplus (deficit) (% of GDP)	0.8	1.3	(3.2)	(6.7)	(5.1)
Merchandise trade balance (% of GDP)	(31.1)	(30.3)	(33.5)	(37.5)	(37.1)
Current account balance (% of GDP)	5.1	6.2	(0.4)	(8.2)	(7.7)
External debt service (% of exports of goods and services)	8.1	9.9	10.8	8.3	8.2
External debt (% of GDP)	16.1	17.3	15.5	17.3	17.0

<b>Poverty and Social</b>	<b>2006</b>	<b>Latest</b>
Population (million)	24.8	29.2 [2018]
Population growth (annual % change)	1.2	1.4 [2017]
Maternal mortality ratio (per 100,000 live births)	281.0 [2005]	239.0 [2018]
Infant mortality rate (below 1 year/per 1,000 live births)	48.0 [2005]	28.4 [2016]
Life expectancy at birth (years)	62.0 [2001]	69.7 [2018]
Adult literacy (%)	48.0 [2004]	66.8 [2017]
Primary school gross enrollment (%)	122.0 [2004]	118.5 [2017]
Child malnutrition (% below 5 years old)	49.0	36.0 [2016]
Population below poverty line (%)	30.9 [2004]	18.7 [2018]
Population with access to safe water (%)	82.5	92.7 [2017]
Population with access to sanitation (%)	24.5	87.6 [2017]

<b>Environment</b>	<b>Latest</b>
Carbon dioxide emissions (kiloton)	8,031 [2014]
Carbon dioxide emissions per capita (tons)	0.3 [2014]
Forest area (million hectares)	3.6 [2016]
Urban population (% of total population) <sup>2</sup>	59.9 [2018]

<b>ADB Portfolio (active loans and ADF grants)<sup>3</sup></b>	<b>As of 31 December, 2018</b>
Total number of loans and ADF grants	49 (36 projects)
Sovereign	49 (36 projects)
Nonsovereign	0
Total loan and ADF grant amount (\$ million) <sup>4</sup>	2,809.4
Sovereign	2,809.4
Nonsovereign	0
Disbursements {sovereign}	
Disbursed amount, total (\$ million, 2018)	246.7
Disbursed amount, excluding PBL (\$ million, 2018)	246.7
Disbursement ratio, excluding PBL (%)	17.5

... = not available, ( ) = negative, [ ] = latest year for which data are available, ADB = Asian Development Bank, ADF = Asian Development Fund, GDP = gross domestic product, GNI = gross national income, M2 = broad money, OCR = ordinary capital resources, PBL = policy-based lending.

<sup>1</sup> Preliminary estimates of GDP by the Central Bureau of Statistics.

<sup>2</sup> Based on the administrative classification of 293 urban municipalities in 2017, 59.9% of the total population was living in urban areas in 2018.

<sup>3</sup> Covers ADF and OCR financing for projects and programs, including policy-based lending, unless otherwise stated, and excludes cofinancing.

<sup>4</sup> Net of droppages and cancellation.

Sources: Central Bureau of Statistics; National Planning Commission; Nepal Rastra Bank; World Development Indicators database. <http://data.worldbank.org/data-catalog/world-development-indicators> (accessed 1 July 2019).





## I. COUNTRY PARTNERSHIP STRATEGY SNAPSHOT

1. **Key development challenges.** Nepal's economy rebounded from the 2015 earthquakes and the 2015–2016 trade disruptions to grow at an average annual rate of 7.3% during FY2017–FY2019. The move to a federal governance system mandated by the 2015 constitution should lead to greater accountability and better public services. Because of the increased political stability since the 2017 elections, the prospects for sustained rapid growth have increased. Nepal has reduced overall poverty significantly, but poverty rates vary by gender, social groups, and regions. A sizeable proportion of the population is vulnerable to poverty. Large infrastructure gaps, reflecting several decades of low investment, impede connectivity, raise costs for businesses, and deter private sector investment, competitiveness, exports, growth, and job creation. Weak institutional capacity at the federal and especially the subnational levels poses challenges to the transition to the federal system. Unplanned growth in urban areas and haphazard construction of roads in rural areas are exerting pressure on the natural environment, including the rivers, and exacerbating the risks from climate change and natural hazards.

2. **Government's strategy.** Under the 15th plan for FY2020–FY2024, the government aims for Nepal to graduate from least-developed country status by 2022. By 2030, it expects Nepal to be comfortably in the ranks of middle-income countries and to achieve the Sustainable Development Goals.<sup>1</sup> The 15<sup>th</sup> plan prioritizes an investment-friendly environment; effective implementation of the federal governance system; large investments in infrastructure, building human capital, and raising productivity in agriculture and industry; preservation of the environment; and increased resilience to natural hazards and climate change to achieve high and equitable national income and economic and social justice.

3. **ADB's strategic objectives and priorities.** The Nepal country partnership strategy (CPS), 2020–2024 of the Asian Development Bank (ADB) has three objectives: (i) improved infrastructure for private sector-led growth, (ii) improved access to devolved services, and (iii) environmental sustainability and resilience. ADB will support renewable energy, road and air transport, logistics, and trade facilitation to strengthen domestic, regional, and international connectivity; reduce the costs of production and trade for businesses; and attract private investment. Improved access to devolved services will entail assistance for (i) the development of cities and urban municipalities, (ii) quality education and employment-oriented skills development, and (iii) increased agriculture productivity and commercialization to augment rural incomes. These will be targeted to benefit women and disadvantaged social groups. ADB will support integrated water resource management, as well as the formulation and implementation of policies and plans, for stronger resilience and environmental sustainability. ADB will assist with policy reforms for devolved service delivery, including subnational public financial management (PFM); and sector reforms in agriculture, air transport, and water supply. Knowledge solutions and development of institutional capacity, especially at subnational levels, will be emphasized.

4. **Alignment with Strategy 2030.** Consistent with ADB's Strategy 2030, ADB's sovereign and nonsovereign support will be tailored to the needs of a low-income, landlocked, and mountainous country, based on the country's priorities.<sup>2</sup> ADB's assistance to Nepal will comprise selected components of the Strategy 2030's seven operational priorities. Development assistance constitutes a large portion of Nepal's public capital expenditures. In each of the priority areas, ADB will collaborate with development partners on complementary solutions to development

---

<sup>1</sup> The 15th plan targets per capita gross domestic product of \$2,634–\$3,089 by 2030.

<sup>2</sup> ADB. 2018. *Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific*. Manila.

challenges. Consistent with Strategy 2030, ADB will retain some flexibility in its Nepal program given the dynamic country context.

5. **ADB's value addition.** ADB is one of Nepal's largest, longstanding, and trusted development partners. During the CPS period, ADB will seek concessional and commercial cofinancing to leverage its own assistance in order to address Nepal's large resource requirements. ADB's support will include knowledge products and services, investments, policy and institutional reforms, capacity development, and policy dialogue. ADB will help mainstream gender equality and social inclusion (GESI), as well as resilience and environmental sustainability, in development programs and projects, including those supported by ADB. Innovative technologies appropriate to Nepal will be assessed and promoted to enhance the efficiency and quality of service delivery. To promote the sustainability of benefits, ADB will assist with reforms and capacity development in priority areas, such as PFM for service delivery, tariff adjustments, asset management, and operation and maintenance.

## II. COUNTRY DEVELOPMENT CONTEXT

6. Nepal is a landlocked, mountainous country located between the large and fast-growing economies of the People's Republic of China to the north and India to the east, west, and south. It is classified as a low-income, least-developed country.<sup>3</sup> The country has substantial natural resources, including water, fertile (albeit limited) land in a variety of climatic zones, and rich biodiversity. Nepal has a diverse culture with a rich heritage. Its population is young: the working age population (15–64 years old) has been increasing more quickly than the total population since 1992 and is expected to continue to do so until 2047. This provides a demographic window of opportunity for growth and development.

7. The country underwent significant political changes since 1990, culminating in a new constitution promulgated in September 2015, which established Nepal as a federal democratic republic.<sup>4</sup> The federal structure comprises a federal (central) government, 7 provincial governments, and 753 local governments (6 metropolitan cities, 11 sub-metropolitan cities, 276 urban municipalities, and 460 rural municipalities). Federal, provincial, and local elections were held successfully in 2017. The ruling party's majority in the federal parliament, six of the seven provincial assemblies, and most municipal councils has raised prospects of greater political stability and accelerated economic and social development.<sup>5</sup>

8. **Rapid poverty reduction.** The poverty rate fell from 41.8% of the population in 1996 to 30.9% in 2004 and 25.2% in 2011, even with a significant increase in the national poverty line.<sup>6</sup> The poverty rate was an estimated 18.7% in FY2018.<sup>7</sup> At the international poverty line of \$1.90

<sup>3</sup> For FY2020, the World Bank classifies low-income economies as those with gross national income per capita of \$1025 or less in 2018. The United Nations defines least-developed countries as low-income countries confronting severe structural impediments to sustainable development. More details along with data sources are available in the Inclusive and Sustainable Growth Assessment (available from the list of linked documents in Appendix 3).

<sup>4</sup> Groups in the southern plains (Terai), bordering India, protested some provisions in the constitution, contributing to a disruption in trade and supply during September 2015–February 2016.

<sup>5</sup> In Province 2, the alliance of Rastriya Janata Party and Federal Socialist Forum Nepal has a majority.

<sup>6</sup> Government of Nepal, Central Bureau of Statistics. 2012. *Poverty in Nepal 2010/11*. Kathmandu; and Government of Nepal, Central Bureau of Statistics. 2005. *Poverty Trends in Nepal (1995–96 and 2003–04)*. Kathmandu. The national poverty line was increased from NRs7,696 per capita per year in 2004 to NRs19,261 in 2011.

<sup>7</sup> Government of Nepal, National Planning Commission. 2019. *Fifteenth Plan (FY2020–FY2024): Approach Paper*. Kathmandu (in Nepali). The actual rate will be available after the new National Living Standard Survey is completed in 2020. The last survey was completed in 2011.

per day (2011 purchasing power parity), the poverty rate fell from 62% in 1995 to 15% in 2010.<sup>8</sup> The declining poverty rates were accompanied by reductions in overall inequality. The Gini coefficient dropped from 35.2 in 1995 to 32.8 in 2010. Multidimensional poverty also more than halved from 59.2% to 28.6% from 2006 to 2014.<sup>9</sup> The country has made significant progress in many areas, including education, health, water supply, and sanitation, as reflected in the substantial or full achievement of most of the Millennium Development Goals.

9. **Disparities in poverty and vulnerability.** Poverty rates differ significantly by gender and social groups, by rural versus urban areas, by ecological belt, and by provinces. Women lack equitable access to, and control over, productive resources such as land, credit, and technology. In 2017, the literacy rate for men 15 years and older was 77.8%; for women, it was 57.2%. Although significant legal reforms have been adopted, discrimination against women and some social groups remains a barrier to their empowerment.<sup>10</sup> Some of these groups, such as the Dalits, Madhesis, Muslims, and indigenous Janajatis, experience multiple levels of exclusion based on income, gender, caste, ethnicity, and location. The incidence of poverty in rural areas, where 81% of the population lived in 2011, was about twice as high as in urban areas. Using a higher threshold for the international poverty line of \$3.20 per day (2011 purchasing power parity), the poverty rate was 51% in 2010, indicating that about 36% of the population was clustered just above the \$1.90 per day poverty line and are vulnerable to poverty.

10. **Broader economic base required to sustain growth.** The economy recovered strongly from the twin shocks of the 2015 earthquakes and the 2015–2016 trade disruptions, and the momentum has been maintained. Economic growth improved to 7.3% per year on average during FY2017–FY2019 compared with an annual average of 3.3% during FY2014–FY2016. In the next 5 years, the challenge will be to lay a stronger foundation for sustained economic growth of at least 7%–8% to provide jobs for the young and growing labor force.

11. Nepal's economic structure has been slow to change (footnote 3). The share of agriculture in GDP and employment remains large. The economy depends heavily on informal services, and relies on remittances from workers who have left for employment abroad. Remittances helped sustain consumption, finance imports, and alleviate poverty. However, at 25% of gross domestic product (GDP) in FY2019, remittances are already high and have contributed to higher domestic wages, rising domestic prices, and—combined with low productivity—weak economic competitiveness. The performance of exports, particularly of goods, has been lackluster.<sup>11</sup> Nepal has the potential to increase the production and exports of goods and services, including high-value agriculture and agro-processing, textiles and garments, footwear, hydropower, tourism, and information and communication technology services.

12. The country's landlocked and mountainous topography raises costs of production, trade, and transactions; contributes to low productivity and economic competitiveness; and limits the

<sup>8</sup> World Development Indicators Online. <http://data.worldbank.org/data-catalog/world-development-indicators> (accessed 1 July 2019).

<sup>9</sup> Government of Nepal, National Planning Commission. 2018. *Nepal–Multidimensional Poverty Index: Analysis toward Action*. Kathmandu. The multidimensional poverty index measures the multiple deprivations that poor people face in the areas of education, health, and living standards.

<sup>10</sup> ADB. 2019. *Nepal: Gender Equality and Social Inclusion Diagnostic of Selected Sectors* (Draft). Kathmandu.

<sup>11</sup> Merchandise exports fell from a high of 15.8% of GDP in FY2001 to 3.3% in FY2019, while imports rose from 28.6% of GDP to 40.3% during that period. Services exports were more stable, declining from 6.8% of GDP in FY2001 to 5.4% in FY2019; imports rose from 4.6% to 5.9% during that period.

benefits from proximity to large and fast-growing markets.<sup>12</sup> To realize the country's potential, Nepal will need a sustained increase in the quality and quantity of investment in infrastructure and services.<sup>13</sup> Public debt at around 30% of GDP in FY2019 is low and leaves room to increase public investment.<sup>14</sup> However, execution of capital expenditures is weak, and foreign direct investment remains low at an annual average of 0.5% of GDP during FY2016–FY2019.

13. **Inadequate infrastructure.** The lack of quality infrastructure is one of the main impediments to attracting private investment.<sup>15</sup> Despite improvement in the electricity supply since 2016, Nepal is yet to realize its hydropower potential for domestic energy security and exports.<sup>16</sup> Access to electricity has increased, but consumption is low at 146.5 kilowatt-hours per capita in 2014 (footnote 8).<sup>17</sup> Domestic demand for electricity is higher than generation capacity, especially during the dry season; the gap is filled with imports from India. Lack of transmission infrastructure hinders investment in the development of new generation capacity, including by independent power producers, as well as cross-border trade. The existing infrastructure is also not adequate to reliably deliver power to consumers.

14. Poor road transport connectivity means that businesses cannot acquire inputs and take their products and services to markets efficiently; people cannot access markets, schools, health posts and hospitals, places of employment, and government services easily; and tourists cannot reach their destinations safely and predictably. Road density is low at 479 kilometers per square kilometer.<sup>18</sup> The deterioration of roads, particularly during the monsoon season, and an increase in vehicles contribute to increased fatalities.

15. Air transport services are limited. The capacity of Tribhuvan International Airport in Kathmandu, the only international airport, is already stretched with 4.3 million international and 2.8 million domestic passengers in 2018, constraining air travel and tourism as well as transport of high-value cargo.<sup>19</sup> Trade facilitation is improving but requires further progress for goods and services to be competitive in international markets. Among logistics indicators, Nepal's ease of arranging competitively priced international shipments is the weakest relative to other countries, followed by the quality of infrastructure (roads, access to ports, railroads, and information and communication technology) and the efficiency of border clearance processes.<sup>20</sup>

16. **Improving, yet weak, business environment.** Apart from inadequate infrastructure, the regulatory framework, although improving, is not yet favorable for a vibrant, competitive private

<sup>12</sup> In 2018 Nepal ranked 109<sup>th</sup> out of 140 countries in global competitiveness, compared with 58 for India, 85 for Sri Lanka, and 103 for Bangladesh. World Economic Forum. 2018. *The Global Competitiveness Report 2018*. Geneva.

<sup>13</sup> During FY2001–FY2016, private fixed investment averaged 17.8% of GDP while public fixed investment averaged 4.2% of GDP. Public fixed investment increased to 7.6% of GDP in FY2017–FY2019 partly because post-earthquake reconstruction accelerated. Private investment also rose to 26.7% of GDP as the adverse effects of the earthquakes and trade disruption tapered off and reflecting better electricity supply and expectations of greater political stability.

<sup>14</sup> The risk of debt distress is assessed to be low. International Monetary Fund. 2019. *Nepal–Staff Report for the 2018 Article IV Consultation*. Washington DC.

<sup>15</sup> Nepal ranked 117<sup>th</sup> of 140 countries in the provision of infrastructure (footnote 12).

<sup>16</sup> Potential commercially exploitable hydropower generation is estimated to be 40,000 megawatts compared with current installed capacity of 1,021 megawatts in FY2018.

<sup>17</sup> Electricity consumption per capita was 320 kilowatt hours in Bhutan, 531 in Sri Lanka, and 805 in India.

<sup>18</sup> ADB staff estimates. Road density was 256 kilometers per square kilometer in Bhutan, 1,664 in India, 1,739 in Sri Lanka, and 1,836 in Bangladesh.

<sup>19</sup> The Gautam Buddha and Pokhara airports are also being upgraded to international airports after completion.

<sup>20</sup> In the 2018 Logistics Performance Index, Nepal ranked 114<sup>th</sup> of 160 countries, better than Mongolia (130) and Bhutan (149) but worse than Lao People's Democratic Republic (82) among landlocked Asian countries. <https://lpi.worldbank.org/international/global> (accessed 11 March 2019).

sector and growth of businesses. Small and medium-sized enterprises account for more than 99% of the formal private sector; only 18% of the firms employ more than 20 people.<sup>21</sup> Anticompetitive practices in transport and other sectors dampen the vibrancy and potential contribution of the private sector to the economy.<sup>22</sup> Among the factors comprising the ease of doing business index, Nepal ranked 148th on “dealing with construction permits,” 137th on “getting electricity,” 158th on “paying taxes,” and 137th on “enforcing contracts”—worse than its overall rank of 110th for ease of doing business.<sup>23</sup> The regulatory challenges for foreign investors are particularly onerous. The government is reforming legal and regulatory frameworks to attract domestic and foreign private investment.<sup>24</sup>

17. **Weak institutional capacity.** Weak institutional capacity is pervasive, especially in subnational governments (SNGs) that were only recently established.<sup>25</sup> The 2015 constitution devolved several functions, such as provision of services related to primary and secondary education, agriculture, rural development, irrigation, water supply and sanitation, urban infrastructure, primarily to provincial and local governments. Some of these are shared by federal, provincial, and local governments depending on whether they cross jurisdictions and the size of the project or program.

18. To clarify the responsibilities of the three levels of government and to ensure consistency among them, existing acts and regulations are being amended and new ones are being enacted. Necessary staff in the SNGs (including deployment of staff from the federal government) are being recruited to carry out these functions, but this process has not been concluded. The SNGs rely on sharing of revenues (about 3% of GDP in FY2019) and fiscal transfers (about 7.9% of GDP in FY2019) from the federal government to fulfill their mandates until they can further develop their own sources of revenues. Measures needed to improve resource use and service delivery in the SNGs include (i) a stronger link between planning and budgeting, (ii) credible accounting and reporting, (iii) better internal controls of expenditures, (iv) more robust procurement, and (v) more effective project management.

19. **Urban areas under stress.** The urban population increased 3.2% per year on average during 2000–2017, rising from 13.4% of the population to 19.7% as people moved to cities in search of opportunities (footnote 8). With the establishment of 293 urban centers, 59.9% of the total population (based on the administrative classification of municipalities) was living in urban areas in FY2018 (footnote 7). Unplanned growth and deficiencies in basic urban services have compromised the livability of cities. Initiatives to proactively manage growth resulting from

<sup>21</sup> The World Bank Group. 2018. *Creating Markets in Nepal: Country Private Sector Diagnostic*. Washington, D.C.

<sup>22</sup> In April 2018, the government ended the practice of registering transport operator committees and associations as nongovernment organizations (which enabled them to collude to prevent entry of new firms) and required them to incorporate as a company. In 2017, the government stepped up its monitoring of retail trade units and acted against firms that were operating against the 2007 competition promotion law.

<sup>23</sup> Nepal’s rank in the ease of doing business index was 108 of 185 countries in 2013. The rank in the 2019 report was 110 of 190 countries, suggesting that the business environment did not improve much relative to other countries during the period. [www.doingbusiness.org](http://www.doingbusiness.org) (accessed 24 February 2019).

<sup>24</sup> These include passage in March 2019 of (i) the new foreign investment and technology transfer act, which included a single window for clearances to establish foreign companies; (ii) the public–private partnership and investment act, which clarifies the responsibilities of various agencies to facilitate domestic and foreign investment through public–private partnerships; and (iii) regulatory guidelines to address the hedging of foreign currency risks in infrastructure projects. In July 2019, Nepal Rastra Bank, the central bank, raised the cap on interest rates for external commercial borrowing by domestic banks, increasing their scope for external borrowing.

<sup>25</sup> ADB. 2019. *Country Situational Analysis of Governance and Institutional Challenges and Risks in the Federal Context*. Kathmandu.

increasing urbanization and motorization have been limited. Urban transport planning remains insufficiently coordinated and requires stronger institutional arrangements.

20. Access to basic water supply has increased, but the quantity, quality, and reliability are inadequate.<sup>26</sup> Poor water supply disproportionately affects women, who are forced to spend more time fetching and treating water and caring for those who fall ill from contaminated water. These duties take away time from income-generating activities for women and from studying for school-aged girls. Sanitation facilities are inadequate, which adversely affect women, marginalized groups, and children particularly. About 52% of urban households have septic tanks and only 15% have sewer connections. Much of the waste seeps into the ground or is discharged into rivers. Waterlogging is severe in the Terai, particularly in the monsoon season. Inadequate solid waste management systems contribute to the clogging of drains with garbage. Public awareness on sanitation and related environmental and health risks is lacking.

21. **Inadequate access to quality education and skills.** While gender parity has been achieved in student enrollments at all levels of school education, enrollments drop off by 50% after each level.<sup>27</sup> With the poor quality of public schools, enrollments in private schools have been rising.<sup>28</sup> In 2018, only 4.3% of students in public schools achieved grades of 3.2 or better (out of a maximum of 4.0) in Secondary Education Examination compared with 40.8% in private schools. The school and technical and vocational education and training (TVET) systems need to (i) expand access further, (ii) upgrade facilities and equipment, (iii) increase availability of qualified teachers especially in science and technology, (iv) use interactive teaching methods, and (v) strengthen school-based management. TVET curricula are outdated with low relevance to current labor force needs and limited employer involvement. The inadequate capacity to provide affordable and quality public school education and TVET means that many young people, especially women and those from disadvantaged groups, are unable to equip themselves adequately for the future.

22. **Low agriculture productivity, nascent commercialization, and rural underdevelopment.** With many people, including the poor, living in rural areas and engaged in agriculture, higher agriculture productivity and better rural connectivity are required to increase competitiveness of agriculture and agribusinesses, farm (and nonfarm) incomes, and food security. Factors affecting agriculture productivity include (i) lack of year-round irrigation, (ii) poor irrigation systems and water management, (iii) land fragmentation, and (iv) lack of quality inputs and technologies. About 54% of arable land (1.47 million hectares) is irrigated and only one-third of the irrigated area has year-round irrigation. Inefficient land-use policies, inadequate rural connectivity, and limited access to finance constrain commercial farming. Access to finance is limited for micro, small, and medium-sized enterprises, especially in rural areas and for enterprises led by women.<sup>29</sup> Access to finance for these enterprises is constrained by inadequate and unreliable credit information system, the reliance of financial institutions on fixed assets (mainly land) for collateral, and limited outreach of banks in rural areas.

---

<sup>26</sup> In 2017, water supply coverage in urban areas included piped water (51.7%), covered well (2.4%), handpump and/or tube well (36.5%), and open well (2.5%).

<sup>27</sup> In 2016, the net enrollment ratio was 97% in primary education (grades 1–5), dropping to 18% in higher secondary education (grades 11–12).

<sup>28</sup> For example, enrollments in primary education in private schools rose from 14.0% in 2012 to 17.6% in 2017. Source: UNESCO Institute of Statistics. <http://data.uis.unesco.org/#> (accessed 7 August 2019).

<sup>29</sup> In the 2013 World Bank enterprise survey, 40% of firms cited access to finance as a major constraint, compared with 23% in Bangladesh and 15% in India (footnote 21).

23. **Unsustainable use of natural capital and risks from climate change and natural hazards.** Unplanned growth is exerting pressure on the country's natural environment. Urban areas are characterized by rapid population growth and density, excessive groundwater extraction, air and river pollution, and conversion of fertile arable land and groundwater recharge areas into built-up areas. With the designation of new urban areas in the federal system, these challenges could be exacerbated without adequate planning. In rural areas, unplanned construction of substandard roads contributes to deforestation, soil erosion, and landslides. Nepal contributes only 0.027% to global greenhouse gas emissions but is highly vulnerable to the impacts of climate change.<sup>30</sup> The country ranked 4th of 124 countries in the Climate Risk Index for 2017 and 11th among 181 countries on average during 1998–2017.<sup>31</sup> Nepal is vulnerable to seismic risks, and its monsoon climate and mountainous topography leave it highly prone to weather-induced hazards such as landslides, floods, and droughts. The country's vulnerability is exacerbated by weak planning and coordination; rudimentary early warning systems; insufficient preparedness for disaster risk; and inadequate relief, recovery, and reconstruction capacity.

### III. COUNTRY STRATEGY FRAMEWORK

#### A. Lessons from Previous Strategy

24. The review of ADB assistance to Nepal from 2013 to mid-2018, and its validation by ADB's Independent Evaluation Department, suggest that a strategic and targeted focus on faster and sustained growth, increased inclusiveness, resilience and sustainability, and regional cooperation and integration continue to be important.<sup>32</sup> With greater political stability, the prospects for private sector development and investment have improved. The change from a unitary to a federal government structure requires support to facilitate the transition and to strengthen SNGs' institutional capacity for the delivery of the basic services under their jurisdiction.

25. The review and its validation recommended that ADB ensure that ongoing and new operations take the federal system into account and provide strategic support in key intergovernmental subsystems to facilitate the transition. ADB should focus more intensively on institutional development and governance reforms, and match project scale and complexity to government capacities. Prospects for ADB to support private sector development, public–private partnerships, and nonsovereign operations are expected to improve. Considering Nepal's large and diverse needs and ADB's limited resources, ADB should continue to be selective in its support. The bank should also deepen coordination and collaboration with other development partners in support of different levels of government in the federal structure. ADB should try to attract more grant cofinancing. In addition, ADB should continue to focus on implementation efficiency including strict adherence to project readiness criteria, intensive consultations, and support for procurement, overall project management, and institutional capacity especially in the SNGs. The capacity of ADB's resident mission should be maintained so that it can play a meaningful role in policy dialogue and project processing as well as implementation. This CPS takes into account these lessons and recommendations from the final review and its validation (Section III.D).

<sup>30</sup> Government of Nepal, Ministry of Population and Environment. 2016. *Intended Nationally Determined Contributions*. Kathmandu.

<sup>31</sup> D. Eckstein et. al. 2019. *Global Climate Risk Index 2019: Who Suffers Most from Extreme Weather Events? Weather-Related Loss Events in 2017 and 1998 to 2017*. Bonn: Germanwatch.

<sup>32</sup> ADB. 2018. *Country Partnership Final Review: Nepal, 2013–mid-2018*. Manila; and ADB. 2019. *Validation Report - Nepal: Validation of the Country Partnership Strategy Final Review, 2013–mid-2018*. Manila. The validation report rated ADB's operations in Nepal during the CPS period "successful on the borderline".



## B. National Development Strategy

26. The government's 15th plan for FY2020–FY2024 is consistent with (i) its long-term vision of “prosperous Nepal, happy Nepali”; (ii) its aim for the country to graduate from least-developed country status by 2022; (iii) its aim for Nepal to be comfortably in the ranks of middle-income countries by 2030 (footnote 1); and (iv) achievement of the Sustainable Development Goals (SDGs) (footnote 7). The plan's objectives include high and equitable national income; economic and social justice and poverty reduction; human capital development; universal, affordable, and modern infrastructure for connectivity (including urban and rural infrastructure); high and sustainable production and productivity (including increased agriculture productivity); healthy and balanced ecosystem (including resilience to climate change and natural hazards); and good governance. The plan calls for smooth implementation of the federal system of governance based on cooperation, coexistence, and coordination. An investment-friendly environment is to be created for the private sector, which is expected to invest, compete, and contribute to the country's development.

27. The plan targets average annual GDP growth of 10.1% during the 5-year period, resulting in an increase in per capita income to \$1,595 by FY2024. The income poverty rate is to be reduced to 11% and the multidimensional poverty rate to 13%; the Gini coefficient of inequality is to drop to 0.29; and the gender development index is to be raised from 0.925 to 0.963. The plan will require investment totaling 39.1% of GDP annually, on average. The public sector is expected to provide 39% of the total investments (15.2% of GDP) and the private sector, including cooperatives, 61% (23.8% of GDP).

28. The 2017 voluntary national review of the SDGs noted the progress made with the Millennium Development Goals and outlined the mechanisms to mainstream the SDGs into the national plan.<sup>33</sup> The main challenges are to mainstream them in the planning and budgeting systems of SNGs, compile the necessary data to monitor progress, and generate adequate resources to achieve them.

29. During ADB's consultations with SNGs, civil society, and the private sector, the participants stressed the importance of infrastructure and economic development to provide decent jobs, inclusiveness in the provision of opportunities, resilience to a changing climate with more frequent extreme weather events, and preservation of the environment.<sup>34</sup> Provincial and local governments were eager to have the necessary legal framework and staffing in place to allow them to carry out their mandates. Civil society and the private sector underscored the challenges in timely delivery of quality services by the federal, provincial, and local governments.

## C. Role of Development Partners

30. Development assistance makes up a large share of government financing.<sup>35</sup> In FY2018, official development assistance totaled \$1.6 billion, equivalent to 17.3% of total government

<sup>33</sup> Government of Nepal, National Planning Commission. 2017. *National Review of Sustainable Development Goals*. Kathmandu; Government of Nepal, National Planning Commission. 2017. *Nepal: Sustainable Development Goals—Status and Roadmap: 2016–2030*. Kathmandu.

<sup>34</sup> Consultations were held in each of the seven provinces, with 379 participants from provincial and local governments, and 176 participants representing civil society, the private sector, and academic institutes. Of the 555 participants, 21.3% were women.

<sup>35</sup> Several partners are supporting Nepal in its development initiatives. Development Coordination Matrix (accessible from the list of linked documents in Appendix 3).



expenditures, 61.8% of capital expenditures, and 5.5% of GDP. ADB disbursed \$292 million in FY2018, the second-largest amount among Nepal's development partners.<sup>36</sup> ADB supports the development of critical infrastructure, human capital development, and commercialization of agriculture with priority investments and capacity development in five key sectors: energy; transport; water and other urban infrastructure and services; education, including a sector-wide approach to the government's Schools Sector Development Plan (SSDP), skills, and post-earthquake reconstruction of disaster-resilient schools; and agriculture.

31. The World Bank provides budget support for reforms in PFM, finance sector development, the business climate, and the energy sector. Its assistance also includes post-earthquake housing reconstruction, education (including the SSDP) and skills, road transport, health, and agriculture.<sup>37</sup> The United Kingdom assists with health, local development, post-earthquake reconstruction of housing, skills development, economic reforms, PFM, security and justice, and access to finance. The United States Agency for International Development provides support for health, education, schools reconstruction, forests, energy, environment, agriculture and livelihoods, local development, PFM, and financial reforms. The European Union supports peace and reconstruction, health, education (including the SSDP) and skills, energy, local development, PFM, social protection, trade, climate change program, and agriculture. The Japan International Cooperation Agency assists with energy, transport, post-earthquake reconstruction, water supply, agriculture, and education. The United Nations country team supports agriculture, education and skills, health, social protection, water supply and sanitation, post-earthquake reconstruction, access to finance, and access to justice.

32. ADB consults with partners on policy and strategic issues at the monthly International Development Partners Group meetings of ambassadors and heads of agencies and missions. Several working groups on sectors and themes provide a platform for ADB and partners to coordinate on their respective operations. These groups include energy; agriculture and food security; education; federalism; water, sanitation, and hygiene; GESI; disaster risk management; governance; economic growth; and private sector development. ADB also consults closely with civil society, the media, and the private sector to provide information on ADB operations and solicit feedback. Nongovernment organizations are engaged to implement components of ADB projects where they are best suited to do so.

33. As of 30 June 2019, ADB's ongoing investment portfolio in Nepal of \$2.8 billion included \$138.7 million in cofinancing from development partners and trust funds administered by ADB, and \$921.9 million in collaborative (parallel) cofinancing. ADB's technical assistance (TA) portfolio included \$25.4 million from ADB and \$11.3 million in cofinancing for policy advice, capacity development, and knowledge solutions.

#### **D. ADB's Strategic Objectives and Operational Priorities**

34. ADB's strategic objectives during 2020–2024 are to promote (i) improved infrastructure for private sector-led growth, (ii) improved access to devolved services, and (iii) environmental sustainability and resilience. The objectives and priority areas of support will help address some of the critical challenges in the next 5 years in line with the government's 15th plan for FY2020–FY2024. These include sustained growth and job creation with greater and more competitive

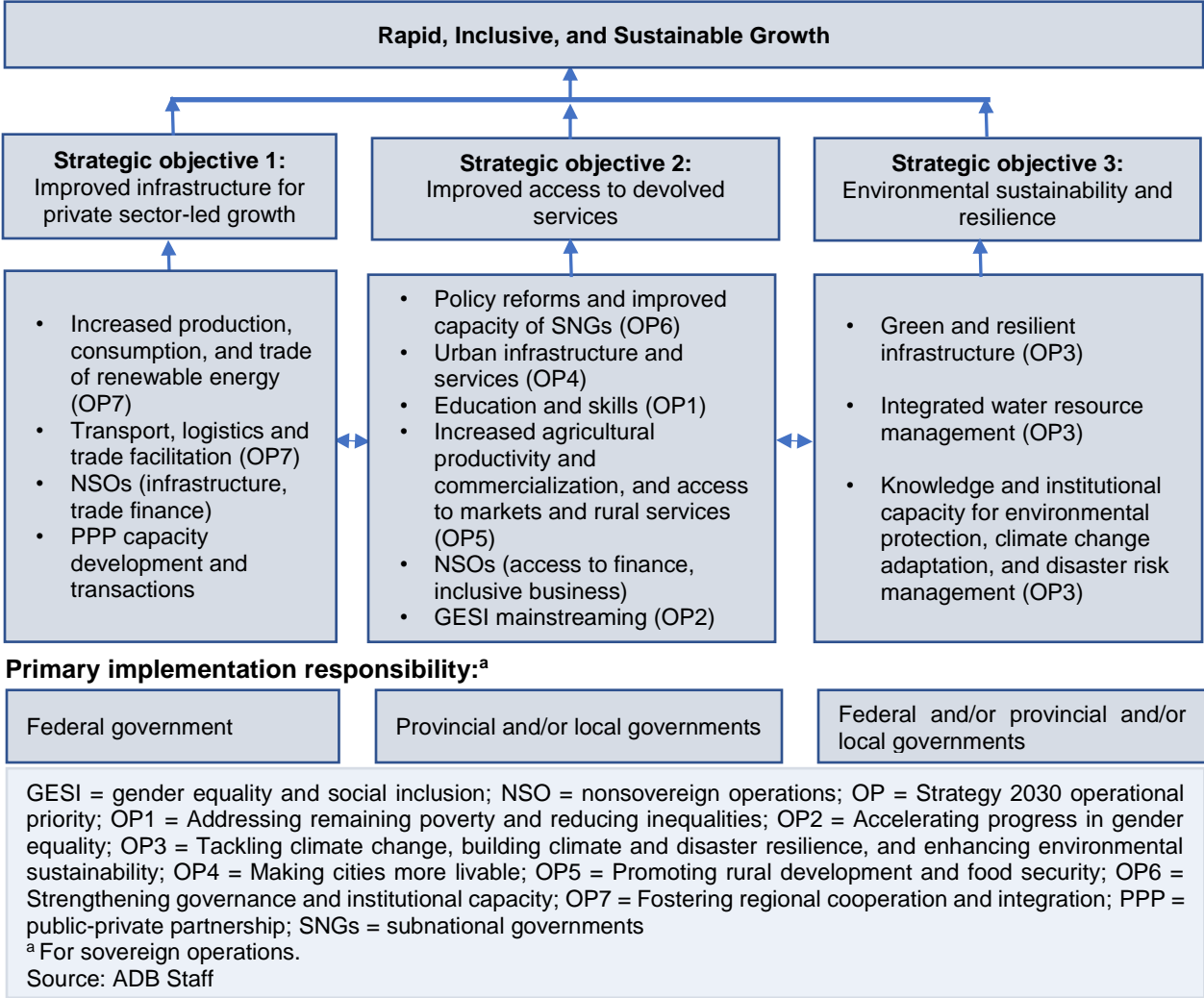
<sup>36</sup> Government of Nepal, Ministry of Finance, International Economic Cooperation Coordination Division. 2018. *Development Cooperation Report*. Kathmandu.

<sup>37</sup> Based on disbursements presented in Development Cooperation Report for FY2017 and FY2018. This paragraph includes some of the major activities of some of the partners and is not meant to be comprehensive.

participation of the private sector; increased availability of, and more equitable access to, basic services through the federal system of governance; stronger resilience to natural hazards that occur periodically; and sustainable use of natural resources.

35. **Alignment with Strategy 2030.** Consistent with ADB’s Strategy 2030, ADB’s support will be tailored to the needs of a low-income, landlocked, and mountainous country, reflecting the government’s priorities (footnote 2). ADB will be selective in supporting areas under the seven Strategy 2030 operational priorities, with some flexibility given the dynamic county context, based on country demand for ADB assistance, resource availability, ADB’s experience, and complementarity with support of other development partners. The CPS framework is presented in Figure 1.

**Figure 1: Focus Areas of ADB’s Nepal Country Partnership Strategy, 2020–2024**



**1. Infrastructure for Private Sector-Led Growth**

36. ADB will focus on improving the availability, reliability, and sustainability of hydropower and other renewable energy to (i) reduce production costs for businesses; (ii) attract private sector investment, including from independent power producers, and promote competition; (iii) increase

energy trade, particularly exports; and (iv) improve household welfare. ADB will contribute to sustainable and resilient transport infrastructure, logistics, and trade facilitation to improve domestic and cross-border connectivity. This will reduce trade and distribution costs for firms; provide people easier access to markets, places of employment, and social and government services; and enable tourists to reach their destinations safely and predictably. ADB's assistance will foster regional cooperation and integration under the South Asia Subregional Economic Cooperation (SASEC) and other regional cooperation platforms.

37. ADB will support (i) energy sector reforms and competitive market development with a focus on building the capacity of the Nepal Electricity Authority and the Nepal Electricity Regulatory Commission to apply cost-recovery principles for the sector's financial sustainability; (ii) infrastructure development (generation from storage-type hydropower projects, transmission lines and substations to evacuate power and facilitate cross-border trade, and distribution systems to expand reliable provision of electricity); (iii) energy efficiency; (iv) an enabling environment for cross-border power trading by facilitating policy dialogue among members of SASEC and other regional organizations; and (v) capacity development of counterpart agencies.

38. ADB will also assist with (i) the improvement and expansion of the strategic road network; (ii) the improvement of Tribhuvan International Airport's infrastructure and operational capacity, together with reforms to enhance operational and regulatory accountability of the Civil Aviation Authority of Nepal to increase air safety; and (iii) trade facilitation, including customs procedures and logistics such as the Electronic Cargo Tracking System, to facilitate the movement of goods coming from third countries through India into Nepal under SASEC and other regional platforms. ADB will continue to support institutional capacity building in the transport sector, including preparation of transport plans and projects; stronger road safety; sustainable asset management and maintenance planning; performance monitoring; and transport management.

39. ADB is exploring private sector operations for long-term lending for infrastructure development, such as electricity generation from hydropower and other renewable sources. ADB's nonsovereign operations will also seek to provide access to longer-term funding to support investments in other priority sectors (para. 44). ADB will consider supporting and partnering with providers of business support services. ADB's Trade Finance Program will continue to help close market gaps for trade finance by providing banks with guarantees and loans to support cross-border trade. ADB will also provide support to small and medium-sized enterprises through the Supply Chain Finance Program by assuming corporate risk for trade payables and receivables to support domestic and cross-border trade. ADB will be ready to assist with upstream reforms and capacity development for public-private partnerships of relevant agencies. It will explore opportunities for public-private partnership transactions, primarily in infrastructure, through its transaction advisory services and the Asia Pacific Project Preparation Facility.

## **2. Improved Access to Devolved Services**

40. In line with the government's 15th plan, ADB's priority areas of support will include (i) policy and institutional reforms for service delivery by SNGs, (ii) urban development, (iii) human capital development, (iv) high and sustainable agricultural production and productivity, and (v) increased access to finance. ADB will provide most of the assistance in areas that are primarily under the jurisdiction of SNGs and that will be targeted to benefit women and disadvantaged social groups. ADB will assist with mainstreaming GESI in government projects and programs. ADB will also support the SNGs in localizing the SDGs, compiling the necessary data for monitoring, and generating progress reports. In infrastructure, ADB will support designs that are inclusive and green. At construction sites, a safe work environment for women will be promoted.

Targeted assistance to reduce discrimination against women and marginalized groups will be explored.

41. ADB will support upstream policy reforms and improved capacity of SNGs to manage resources, plan, budget, prepare, and implement projects and programs. For cities in Kathmandu Valley and some other cities and urban municipalities, ADB will help (i) provide quality infrastructure services including water supply, sanitation, solid waste management, drainage, and urban transport; (ii) institutional reforms and capacity building of cities, municipalities, and water user and sanitation committees; and (iii) integrated planning to promote livability, realize their potential as centers of growth, and strengthen rural–urban connectivity. Urban water supply and sanitation projects will include subsidized services for the poor and participation of women and marginalized communities in decision-making.

42. ADB's support for education and skills will focus on access and quality of school education, and skills relevant to jobs in the local labor markets in municipalities and provinces. ADB will help promote GESI in completion rates and employability. The bank will support (i) SNGs in planning and managing education; (ii) stronger school- and community-based management; (iii) the professional development of teachers through training, including in mathematics, science, and English; and (iv) the expansion of the number of model schools and upgrading of the most successful ones into showcase science and technology high schools, partly to raise the profile of public education. For skills, ADB will help with accrediting institutions and programs, development of a system for licensing instructors, curriculum reform with the involvement of industry and enterprises, and establishment of one exemplary institute in each province.

43. ADB will help increase agriculture productivity and commercialization, and assist with improved access to agricultural markets and rural services with support for (i) reforms to improve food safety and agriculture commercialization, (ii) rural connectivity, (iii) irrigation, (iv) better access to finance for farmers and businesses, (v) stronger and more efficient agricultural value chains, and (vi) off-grid electricity. These activities will directly benefit rural areas where most of the poor live, thus helping to narrow the urban–rural divide. Increasing access of women and marginalized groups to infrastructure and services would reduce the burden and time involved in managing their livelihoods.

44. ADB's nonsovereign operations will explore ways to scale up business models and technology solutions to increase their impacts, focusing on gender equity, agriculture, inclusive finance, and climate change adaptation. ADB's nonsovereign operations will also support increased access to finance for priority sectors, including agriculture, tourism, and small and cottage industries, in line with defined government priorities. ADB's Microfinance Risk Participation and Guarantee Program will identify opportunities for TA to build a robust microfinance sector for Nepal. Aimed at both the microfinance institutions and commercial banks, the TA will support product design and operational risk management, while ensuring adoption of client-protection principles and fair lending practices. In addition, ADB's nonsovereign operations will explore direct support to strong agribusiness companies to boost productivity and include small farmers in efficient value chains.

### **3. Environmental Sustainability and Resilience**

45. ADB will help mainstream climate change and disaster risk reduction, along with environmental sustainability, in development activities with support to (i) build green, resilient infrastructure such as flood-resistant roads in the Terai and all-weather roads in the hills; (ii) implement integrated water resources management; (iii) manage surface and groundwater

resources, particularly in the agriculture sector; and (iv) enhance knowledge and capacity for management of the environment, climate change adaptation, and disaster risks. These activities, coupled with ADB's assistance for renewable energy and energy efficiency, agriculture practices that are resilient to climate change, and sustainable transport and urban services, will help Nepal implement its intended nationally determined contributions (footnote 30).

46. ADB's support will help increase the resilience of communities in the Terai to flood risks from major river basins with improved infrastructure for flood control and protection, stronger capacity for flood forecasting and early warning, and better preparedness. Stormwater drainage in Terai cities will be strengthened to alleviate flooding. ADB will promote the establishment and operationalization of river basin management systems. ADB will continue to assist with disaster-resilient retrofitting and reconstruction of schools damaged by the 2015 earthquakes, ensuring that children can learn in a safe environment. The capacity of local municipalities and school management committees to design, build, operate, and maintain disaster-resilient schools will be improved. Community-based disaster risk management plans will be developed in line with local governments' development plans and budgets that integrate disaster risk information. ADB will also support a comprehensive approach to disaster risk financing and post-disaster budget execution capabilities.

## **E. Priorities for Knowledge Support**

47. ADB's knowledge support will focus on (i) policy advisory services with diagnostic studies and assessments of good practice models, including the feasibility of new technologies, appropriate for Nepal; (ii) planning and implementation mechanisms for inclusive and sustainable delivery of quality infrastructure and social services, especially at the subnational levels; and (iii) capacity development of relevant stakeholders (Appendix 2). ADB will facilitate sharing of knowledge and experiences through SASEC and other platforms.<sup>38</sup> The country director of ADB's Nepal Resident Mission, as the country knowledge plan's custodian, will ensure proactive coordination across ADB departments in line with the "One ADB" approach, and with partners, to deliver knowledge solutions.

48. ADB will coordinate with a variety of stakeholders, including the private sector and civil society, and development partners to identify evolving needs, and generate knowledge solutions to emerging development challenges. ADB will continue its partnership with the Capacity Development Resource Center at the Nepal Administrative Staff College to deliver training, especially to SNG agencies, on procurement, financial management, environment and social safeguards, environment impact assessment, and GESI. ADB will disseminate knowledge gained from its operations through print, digital, and social media.

## **IV. STRATEGY IMPLEMENTATION**

### **A. Indicative Resource Parameters**

49. Nepal, a group A developing member country, is eligible for concessional ordinary capital resources lending (COL).<sup>39</sup> The indicative resources available for commitment in 2020–2022 are \$1,364 million: \$1,304 million from the country performance-based allocation and \$60 million from

<sup>38</sup> These will be through regional TA implemented by ADB.

<sup>39</sup> ADB. 2008. *Review of the 1998 Graduation Policy of the Asian Development Bank*. Manila; and ADB. 1998. *A Graduation Policy for ADB's DMCs. Corrigendum 1*. Manila.

the Disaster Risk Reduction (DRR) financing mechanism (\$40.0 million in COL allocation and \$20.0 million in grants).<sup>40</sup> The final allocation will depend on available resources and the outcome of the 2020 country performance assessment. Funding from other sources, including the regional COL pool, regular ordinary capital resources for eligible projects, and cofinancing from trust funds and development partners, will be explored. ADB will continue to seek cofinancing from partners for investments and TA to generate synergies in areas of mutual interest. Grants provided by partners are particularly important to support activities for which the government prefers not to borrow, including institutional capacity development, GESI, and climate change adaptation. With the prospects of a better business climate, ADB will also explore leveraging commercial financing in its nonsovereign operations. The cost-sharing arrangement during 2020–2024 envisages a ceiling of 80% for the loan portfolio and up to 85% for the nonlending portfolio, similar to the current limits.<sup>41</sup> The 2018 debt distress classification assessed Nepal as being at low risk of debt distress (footnote 14). The staffing of Nepal Resident Mission will be adjusted as necessary in line with business needs.

## B. Implementation Priorities

50. **Modalities.** ADB's support will be delivered through a mix of modalities, including policy-based loans, results-based loans, stand-alone projects, sector development programs, multitranche financing facilities, TA, and policy dialogue. ADB will support policy and institutional reforms in agriculture, air transport, devolved service delivery, and water supply through policy-based loans or sector development programs. TA will be provided for institutional reforms and capacity development in all areas of engagement, especially to SNGs.

51. **Integrated solutions.** With better prospects for private investment, ADB's nonsovereign operations will provide additional impetus to achieve the CPS objectives with investments and TA to support priority areas. ADB is also exploring the issuance of bonds denominated in Nepalese rupee initially in the offshore market to mitigate currency risk for the country, attract international investors to Nepal, and to serve as a benchmark for other issuers. In its sovereign operations, institutional reforms and capacity development of SNGs to deliver services and sustain their benefits with adequate mechanisms for operation and maintenance will be an important part of ADB support. Close coordination among sectors, such as to improve rural connectivity, irrigation, finance, access to electricity, and other components of a value chain, would provide synergistic benefits. ADB will also promote integrated water resource management to facilitate sustainable development of hydropower, irrigation, water supply, and wastewater treatment.

52. **Innovation.** ADB will promote appropriate innovative technologies in its projects and programs to enhance the efficiency, quality, and sustainability of service delivery. ADB will promote (i) the use of information and communication technology in the delivery of services; (ii) the use of supervisory control and data acquisition systems as well as smart meters in the provision of electricity and water supply in cities and municipalities, and supervisory control and data acquisition systems and prepaid meters in irrigation systems; (iii) geographic information systems for planning and management in municipalities; (iv) low-cost, open-source technologies that can increase schools' access to e-learning to complement teaching even in areas with poor internet connection; (v) the development of open online courses for selected TVET courses; (vi) intelligent traffic systems to improve road safety, and performance-based maintenance contracts

---

<sup>40</sup> Resources from the DRR financing mechanism include \$10 million in COL and \$5 million in grants from the 2019 allocation.

<sup>41</sup> Actual cost-sharing parameters will be determined based on project-specific considerations and justified during a project's economic and financial due diligence.

to strengthen road asset management; and (vii) bioengineered and nature-based flood-risk management solutions, as well as high-resolution mapping of communities at risk of flooding, to prepare them better in the event of disasters.

53. **Efficient portfolio implementation.** Contract awards and disbursements in ADB's Nepal portfolio have improved since 2016.<sup>42</sup> The key challenges in portfolio implementation include (i) inadequate capacity in government counterpart agencies; (ii) slow procurement; (iii) weak performance of contractors and consultants coupled with poor performance management; and (iv) safeguards-related issues, such as land acquisition, right-of-way arrangements, and environmental clearance. To address these challenges, ADB will continue to focus on high project readiness, close monitoring with regular portfolio and project reviews, capacity development of counterpart agencies, and policy dialogue to improve portfolio performance. Staff from the resident mission will be closely involved in the conceptualization, design, and implementation of projects so that the local context is adequately taken into account.

### C. Monitoring of Results

54. The CPS results framework includes indicators and targets for the priority areas that are aligned with government priorities (Appendix 1). Most of the indicators are drawn from the government's 15th plan. ADB, together with counterpart agencies, will monitor results annually through regular project, TA, and portfolio reviews to track progress. These results will be inputs in defining future country programs to ensure they remain aligned with government priorities. Updates to the results framework, as necessary, and the program of assistance will be reflected in the annual country operations business plan.

### D. Risks

55. The transition to a federal structure is ongoing with (i) the formulation of laws and regulations to clarify mandates of the federal government and SNGs; (ii) provision of adequate staffing in SNGs; and (iii) allocation of financial resources to SNGs, which will have to rely on fiscal transfers until their revenue mobilization capacity improves. During the transition, significant challenges will include inadequate systems, procedures, and capacity for PFM, planning, procurement, and implementation of programs and projects.

56. ADB will mitigate risks by supporting reforms and capacity development through policy loans, projects, and TA for the federal government and SNGs. ADB will assist with reforms, including for PFM and procurement, in the transition to federalism and with the development of capacity to plan, assess, prepare, and implement projects and programs. These activities will include measures to improve resource management in SNGs; procurement; environmental and social safeguards; gender and social inclusion; and effective contract, financial, and overall project management. ADB will assess the institutional arrangements and capacity to carry out the projects and programs it finances and will develop robust measures to mitigate the risks.

---

<sup>42</sup> Contract awards were 32%–37% of the net loan amount during 2016–2018, higher than those of ADB. The disbursement ratio rose from 15.4% in 2016 to 23.3% in 2017 but fell to 17.5% in 2018, partly reflecting the necessary transition to a federal structure of governance. The disbursement ratio was higher than that of ADB in 2017 but was slightly lower than the 19.9% for ADB in 2018.

## COUNTRY PARTNERSHIP STRATEGY RESULTS FRAMEWORK

Country Development Impact Indicators with which the CPS Is Aligned				
<ol style="list-style-type: none"> <li>1. Proportion of population living below the national poverty line: 11.0% by 2024 from 18.7% in 2018</li> <li>2. Multidimensional poverty rate: 13.0% by 2024 from 28.6% in 2018</li> <li>3. Gross fixed investment averages 39.1% of GDP in FY2020–FY2024 from 32.0% in FY2015–FY2019</li> <li>4. Average annual GDP growth of 10.1% in FY2020–FY2024 from 5.2% in FY2015–FY2019</li> <li>5. Gini coefficient of inequality: 0.29 in 2024 from 0.31 in 2018</li> </ol>				
CPS Strategic Objectives	Priority Areas	Key Outcomes that ADB Contributes to	Outcome Indicators	CPS Resources
Improved infrastructure for private sector-led growth	Renewable energy (aligned with OP7: Fostering regional cooperation and integration)	Greater availability, reliability, and trade of renewable energy	Electricity consumption (kWh per capita) increased to 500 in 2024 (2018 baseline: 230)  Electricity system losses reduced to 16.0% in 2024 (2018 baseline: 20.5%)	<b>Ongoing portfolio:</b> As of 31 December 2018  Sovereign loan and grant projects Number: 36 Amount: \$2.8 billion  Nonsovereign projects Number: 0 Amount: \$0  <b>Planned operations and contribution (3-year pipeline as per latest COBP):</b>  <b>Sovereign</b> Lending \$1,915 million of COL for 2020–2022  Grants \$20 million from DRR financing mechanism  <b>Technical assistance</b> Nonlending (estimated \$4.7 million per year on average)
	Transport infrastructure, logistics, and trade facilitation for domestic and international connectivity (aligned with OP7: Fostering regional cooperation and integration)	More reliable, sustainable and resilient transport  Improved logistics and trade facilitation	Score in the infrastructure component of the logistics performance index improved to 2.75 by 2024 (2018 baseline: 2.19)  International air passengers increased 25% by 2024 (2018 baseline: 4.34 million)  Score in the customs component of the logistics performance index improved to 2.90 by 2024 (2018 baseline: 2.29)	
Improved access to devolved services	Policy reforms and capacity development of subnational governments for service delivery (aligned with OP6: Strengthening governance and institutional capacity)	Policy reforms and improved capacity of subnational governments to plan, budget, prepare, and implement projects and programs	Subnational Public Expenditure and Financial Accountability score for Budget Classification improved to C and for Quality and Timeliness of Annual Financial Statements improved to C+ by 2024 (2015 baseline: D and D+)  Percentile rank of governance effectiveness index improved to 25.00 by 2024 (2017 baseline: 18.75)  GESI-responsive budgeting implemented in at least 25 subnational governments (2018 baseline: 0)	<b>Sovereign</b> Lending \$1,915 million of COL for 2020–2022  Grants \$20 million from DRR financing mechanism  <b>Technical assistance</b> Nonlending (estimated \$4.7 million per year on average)
	Urban development (aligned with OP4: Making cities more livable)	Improved urban infrastructure services  Improved planning for cities and urban municipalities	Access to piped water supply in urban areas increased to 62.0% in 2024 (2017 baseline: 51.7%)  Sanitation coverage in urban areas increased to 98.0% in 2024 (2017 baseline: 91.9%)  27 of 293 metropolitan and sub-metropolitan cities and urban municipalities have implemented an integrated urban development plan by 2024 (2018 baseline: 0)	



CPS Strategic Objectives	Priority Areas	Key Outcomes that ADB Contributes to	Outcome Indicators	CPS Resources
	Education and skills (aligned with OP1: Addressing remaining poverty and reducing inequalities)	Enhanced access to, and quality of, school education	Net enrollment rate in secondary education (9–12) increased to 63.0% (male: 64.0%, female: 63.0%) in 2024 (2018 baseline: 43.4% [male: 47%, female: 46%])  Cohort survival rate from grade 1 to 10 increased to 64% (male: 63%, female: 65%) in 2024 (2018 baseline: 58% [male: 57%, female: 59%])	
	High agricultural productivity and commercialization (aligned with OP5: Promoting rural development and food security)	Employment-oriented TVET enhanced	TVET qualifications (diplomas, TSLCs) increased to 60,000 (male: 31,000; female: 29,000) in 2024 (2018 baseline: 47,851 [male: 28,563; female: 19,288])	
		Increased agricultural productivity and commercialization	Irrigated land expanded to 1.77 million hectares by 2024 (2018 baseline: 1.47 million hectares)  Productivity of primary crops increased to 4.00 metric tons per hectare (2018 baseline: 2.97 metric tons per hectare)  Agriculture exports increased by an average 7% per year during 2020–2024 (2018 baseline: \$225 million)	
		Improved access to agricultural markets and rural services	Population who live within 30 minutes' walk to transportation facilities increased to 85.0% in 2024 (2018 baseline: 78.9%)	
Environmental sustainability and resilience	Environmental sustainability, and climate change and disaster risk reduction (aligned with OP3: Tackling climate change, building climate and disaster resilience, and enhancing environmental sustainability)	Resilience to climate change and disaster risks increased  Integrated water resources management strengthened  Knowledge and institutional capacity for environmental protection, climate change adaptation, and disaster risk management enhanced	Flood forecasting and early warning system operationalized in 17 river basins by 2024 (2018 baseline: 10)  River basin office or organization operational in at least 1 river basin by 2024 (2018 baseline: 0)  Safeguards policies updated and safeguards units for environment, climate change adaptation, and disaster risk management operationalized in at least 10 federal and subnational implementing agencies by 2024 (2018 baseline: 3)	

ADB = Asian Development Bank, COBP = country operations business plan, COL = concessional OCR lending, CPS = country partnership strategy, DRR = Disaster Risk Reduction, FY = fiscal year, GDP = gross domestic product, kWh = kilowatt-hour, MW = megawatt, OCR = ordinary capital resources, OP = operational priority, TSLC = technical school leaving certificate, TVET = technical and vocational education and training.

Sources: Government of Nepal, National Planning Commission. 2019. *Fifteenth Plan (FY2020–FY2024): Approach Paper*. Kathmandu (in Nepali); ADB staff estimates.

## COUNTRY KNOWLEDGE PLAN

### A. Knowledge Needs

1. The Asian Development Bank (ADB) undertook an inclusive and sustainable growth assessment to inform ADB's country partnership strategy (CPS), 2020–2024.<sup>1</sup> The assessment identified three major impediments to inclusive and sustainable growth: (i) infrastructure gaps that are deterring private investment and growth, (ii) inequitable access to services that are devolved to subnational governments (SNGs) under the country's 2015 constitution, and (iii) risks to environmental sustainability and vulnerability to climate change and natural hazards. The assessment also highlighted weak governance and institutional capacity, partly reflecting the transition to a federal governance system and devolution of certain functions, such as education, urban development, and agriculture, to SNGs.

2. To ensure that knowledge solutions and country operations are strongly linked, some of the knowledge gaps and plausible solutions have been identified to address operational issues and challenges in ADB's support to priority areas in Nepal (Table A1).

**Table A1: Knowledge Gaps in ADB Operations in Nepal**

CPS Objective: Priority Area for ADB Support	Selected Knowledge Gaps
<b>Improved Infrastructure for Private Sector-Led Growth: Renewable energy</b>	<ul style="list-style-type: none"> <li>(i) Institutional development and strengthening of Nepal Electricity Regulatory Commission</li> <li>(ii) Financial sustainability of Nepal Electricity Authority (e.g., asset management, tariff adjustments)</li> <li>(iii) Diagnostic studies on competitiveness of power trade with neighbors</li> <li>(iv) Feasibility of technologies (e.g., smart grid), implementation strategies, and financing plan</li> <li>(v) GESI guidelines and their implementation plans in energy and transport sectors</li> </ul>
<b>Improved Infrastructure for Private Sector-Led Growth: Transport, logistics, and trade facilitation</b>	<ul style="list-style-type: none"> <li>(i) Appropriate institutional structure and/or arrangements and capacity in federal context</li> <li>(ii) Transport master plan</li> <li>(iii) Institutional development and strengthening of new regulatory bodies (civil aviation), Public Transport Authority, and Road Safety Council</li> <li>(iv) Cross-border trade facilitation initiatives</li> </ul>
<b>Improved Access to Devolved Services: Policy reforms and improved capacity of subnational governments</b>	<ul style="list-style-type: none"> <li>(i) Subnational Public Expenditure and Financial Accountability survey</li> <li>(ii) Localizing Sustainable Development Goals</li> <li>(iii) GESI-responsive planning and budgeting</li> </ul>
<b>Improved Access to Devolved Services: Improved planning and infrastructure services for livable cities and urban municipalities</b>	<ul style="list-style-type: none"> <li>(i) Enhancing operational efficiency and sustainability of water supply (e.g., asset management, tariff adjustments)</li> <li>(ii) Graduating water users' committees to a sustainable structure</li> <li>(iii) Urban masterplans and implementing mechanisms</li> <li>(iv) PFM in urban municipalities—implementation strategy and plan</li> <li>(v) Best practices, business models, analytical study, mechanisms for public–private partnership on solid waste management, wastewater treatment, and sanitation</li> <li>(vi) Implementation of GESI in urban municipalities</li> </ul>
<b>Improved Access to Devolved Services:</b>	<ul style="list-style-type: none"> <li>(i) Implementation strategies and plans of policies and programs to improve quality of school education and skills development in SNGs</li> <li>(ii) Technical support to prepare relevant acts, regulations, and policies</li> </ul>

<sup>1</sup> ADB. 2019. *Inclusive and Sustainable Growth Assessment*. Nepal. (accessible from the list of linked documents in Appendix 3)

CPS Objective: Priority Area for ADB Support	Selected Knowledge Gaps
<b>Education and skills development</b>	(iii) Institutional strengthening of SNGs to undertake devolved sector functions and improve accountability (iv) Identify potential synergies among general education and TVET
<b>Improved Access to Devolved Services: Increased agricultural productivity and commercialization, and access to markets and rural services</b>	(i) Implementation plan of Agriculture Development Strategy, particularly by SNGs (ii) Modalities for land pooling and/or zoning to facilitate commercial and leasehold farming (iii) Nepal's comparative advantage in international trade (iv) Optimal institutional arrangements and resource requirements of SNGs to deliver their constitutional mandate in the sector
<b>Environmental sustainability and resilience: Knowledge and institutional capacity for environmental protection, climate change adaptation, and disaster risk management enhanced</b>	(i) Country Environment Note for Nepal based on Country Integrated Diagnostic on Environment and Natural Resources (ii) Safety manual, procedural guidelines, and environmental guidelines for urban sector (iii) Implications of climate change on water resources and agriculture (iv) Environmental and economic implications of rural road construction (v) School disaster risk management plan (vi) Institutional assessments of SNGs for disaster risk management (vii) Strategies for disaster risk financing (viii) Review of land acquisition and forest clearance procedures in the energy and transport sectors (ix) Integrated flood risk management in river basins (x) Implementing guidelines for national pollution control strategy and action plan

ADB = Asian Development Bank, GESI = gender equality and social inclusion, PFM = public financial management, SNG = subnational government, TVET = technical and vocational education and training.

Source: ADB staff.

3. ADB's experience in Nepal suggests that some of the challenges will include (i) poor accessibility and quality of basic infrastructure; (ii) weak investment climate for the private sector; (iii) implementation delays in projects for various reasons, including inadequate project preparedness and poor contract and project management; and (iv) necessary changes in institutional arrangements and operations under the new federal system.<sup>2</sup> Incorporation of sustainability mechanisms in ADB operations, including climate change and disaster risk-resilient project designs, well-coordinated policy reforms, and effective communication and coordination during project design and implementation are some of the lessons. The transition from a unitary to a federal system of governance remains challenging as several laws have yet to be formulated or enacted, SNGs have inadequate and unskilled human resources, institutional capacity is weak, and knowledge gaps persist in executing their functions.

## B. Scope of ADB's Planned Knowledge Operations

4. Knowledge work in Nepal will be guided by ADB's Knowledge Management Action Plan (KMAP).<sup>3</sup> Generation and dissemination of knowledge from ADB operations in Nepal, as well as application of knowledge in designing ADB operations in the country, will be an integral part of the new CPS. In line with the KMAP, the new CPS acknowledges that knowledge solutions are a key driver of change and add value to Nepal's development by combining finance, knowledge, and partnerships. ADB will provide suitable knowledge services that consider the country context and facilitate learning from within Nepal as well as from other countries. ADB will facilitate sharing

<sup>2</sup> ADB. 2018. *Final Review: Nepal Country Partnership Strategy, 2013–mid-2018*. Manila.

<sup>3</sup> The Knowledge Management Action Plan is based on the knowledge needs articulated in Strategy 2030 and connects the knowledge work inherent in the seven operational priority plans, private sector operations, and sector and thematic groups.

of knowledge and experience from other countries through SASEC and other platforms. ADB will also support application of appropriate technologies and innovative solutions to Nepal's development needs, through projects and programs, based on assessments and pilots. The knowledge work will be undertaken in close coordination with relevant divisions in the South Asia Department, Private Sector Operations Department, Economic Research and Regional Cooperation Department, and the sector and thematic groups in Sustainable Development and Climate Change Department, in line with the One-ADB approach underscored by Strategy 2030. The country director of ADB's Nepal Resident Mission, as the country knowledge plan's custodian, will ensure proactive coordination across ADB departments and with partners. The knowledge focal person at the resident mission will facilitate and coordinate the knowledge work on day-to-day basis.

5. ADB's flagship publication - the *Asian Development Outlook* - and Nepal's biannual *Macroeconomic Update* will continue to provide an assessment of Nepal's economic situation and challenges. This information is critical in identifying areas for financial and knowledge partnerships, as well as policy and institutional capacity gaps. ADB will support provincial and local governments in preparing investment plans and project banks based on the situational analysis and stakeholder consultations as part of the upstream knowledge support. ADB will also consider impact evaluation of projects where feasible.

6. The identified knowledge gaps and needs (section A) will be addressed through an integrated approach of (i) projects, programs, and associated technical assistance (TA); (ii) policy and institutional reforms and/or advisory support; (iii) technical and analytical studies; and (iv) capacity development under three strategic objectives:

(i) **Strategic objective 1: Improved infrastructure for private sector-led growth.**

ADB will work closely with the government to identify evolving knowledge gaps and produce relevant knowledge products and services that fit local conditions, identify lessons, and replicate good practices. ADB will also proactively engage in providing policy advice to the government and strengthen institutional capacity. This will include development and implementation of appropriate systems, such as asset management systems and e-government procurement systems. Relevant analytical, technical, and diagnostic studies will inform reform strategies and plans. Innovative approaches and solutions in specific areas or sectors will be pilot tested with the aim of replicating successful approaches on a larger scale, e.g., the use of smart grid in the energy sector.

ADB will coordinate with other stakeholders in the country, such as the Investment Board of Nepal and the Federation of the Chamber of Commerce and Industries, to assess and determine the investments and policy reforms needed to improve the business environment and advance private sector growth.

(ii) **Strategic objective 2: Improved access to devolved services.** To improve public services, investment projects, programs, and TA will be utilized to address knowledge gaps (Table A1). Coordination and collaboration with development partners and research institutions working in these priority areas in Nepal will be expanded, ensuring complementarity in knowledge work. Knowledge products produced by other development partners can inform the design of ADB programs and projects, and joint policy dialogue with the government can be undertaken to effectively address critical policy gaps. This will also enable ADB to explore other important areas, such as health and social protection, where knowledge work could contribute to improved services. Upstream knowledge products, such as a subnational public expenditure and financial accountability

survey, will help in developing the subnational PFM reform plan. ADB will also support the SNGs in localizing the SDGs, compiling the necessary data for monitoring, and generating progress reports.

For capacity development, ADB will continue its partnership with Nepal Administrative Staff College to deliver training programs through the Capacity Development Resource Center, especially to SNG agencies. These training programs are mainly related to project implementation, such as procurement, financial management, safeguards, environmental impact assessment, and gender equality and social inclusion. Other training in the sectors or projects will be undertaken through TA attached to projects.

(iii) **Strategic objective 3: Environmental sustainability and resilience.** ADB will continue to mainstream environmental sustainability and disaster resilience in the design of infrastructure projects. Staff of executing and implementing agencies will be trained through the Capacity Development Resource Center. Analytical and diagnostic studies, such as on the implications of climate change on water resources and agriculture, will also be carried out to identify policy, technical, and systemic issues. Appropriate strategies to address these issues will be identified and implemented through projects, TA, and regular policy dialogue.

7. **Disseminating knowledge.** ADB will continue to improve the accessibility of knowledge gained from operational activities, research, policy dialogue, and capacity development efforts. It will enhance its communication through print, digital, and social media to disseminate knowledge externally and internally. Knowledge sharing within ADB will continue to be encouraged through regular knowledge seminars, and staff will be encouraged to share knowledge on various platforms including ADB blogs, videos, and journals.

### C. Areas of Collaboration with Partners

8. Collaboration and coordination with local academic and research institutions and development partners, including national and international nongovernment organizations, will be pursued and strengthened. In education, for example, ADB has been collaborating and coordinating with the World Bank and other development partners in undertaking knowledge work. In the urban and water sectors, ADB is collaborating with the Japan International Cooperation Agency for technical and analytical work. In energy, ADB is working with the Embassy of Norway in undertaking diagnostic studies for sector reforms. In agriculture and natural resources, ADB is planning to collaborate with international organizations such as the International Centre for Integrated Mountain Development and the International Rice Research Institute for relevant studies. Such collaboration and partnerships will be enhanced under the new CPS. Partnerships with civil society and the private sector will also be explored, for example, in community-based disaster risk management plans, and in preparing sample business plans and orienting farmers in establishing agribusinesses. Findings from independent studies will be used in designing new programs and projects.

### D. Resource Allocation

9. Much of the knowledge work will be funded with ADB's TA funds associated with projects and programs. Resources from trust funds and regional TA and sector and thematic groups will be sought to further support the knowledge work in Nepal. ADB will process TA to implement the country knowledge plan and to respond as appropriate to requests from the government and other stakeholders. These resources will be allocated strategically and reviewed periodically.

**LIST OF LINKED DOCUMENTS**

<http://www.adb.org/Documents/CPS/?id=NEP-2020>

1. Inclusive and Sustainable Growth Assessment
2. Development Coordination Matrix
3. Indicative Country Operations Business Plan