# Development Finance Assessment for Nepal

## Final Report

November 2017

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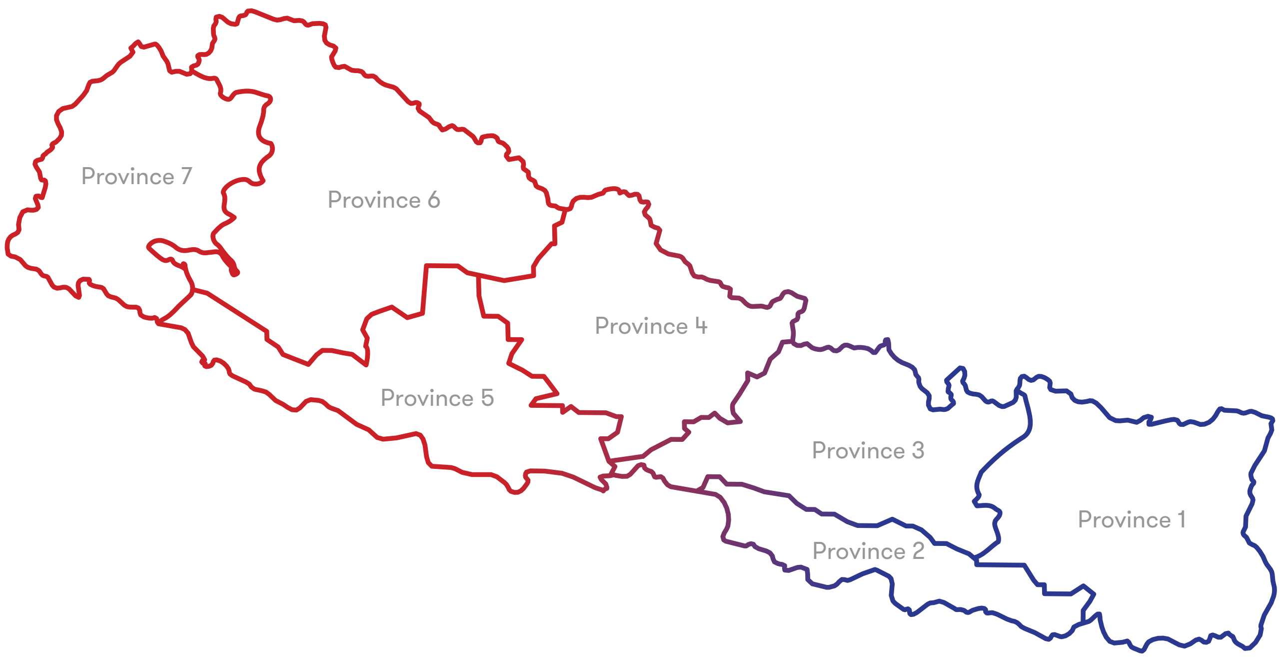

**Authors:** This assessment was prepared by Erlend Nordby (Team Leader), Jens Claussen, and Pushpa Lal Shakya.

**Acknowledgements:** This Development Finance Assessment (DFA) for Nepal was made possible by the leadership of the Ministry of Finance, International Economic Cooperation Coordination Division. We would like to express gratitude to the members of the Government Oversight Team which provided guidance to the consultants throughout the DFA process. Gratitude is also expressed to all stakeholders and partners, both within and outside the Government of Nepal, for their inputs and guidance throughout the process. This includes participants at both the Inception and Validation Workshops. Technical guidance was also provided by the Asia Pacific Development Effectiveness Facility (AP-DEF), as well as by UNDP. Financial contributions and support from the Asian Development Bank and the Government of the United Kingdom are greatly appreciated.



***November, 2017***

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# Foreword

This Development Finance Assessment (DFA) for Nepal was commissioned by the International Economic Cooperation Coordination Division (IECCD) of Ministry of Finance. The objective of the DFA is to shed light on the specific finance context of Nepal, looking across a range of public and private, domestic and external, sources of finance. It also provides insights into how the existing policies and institutional arrangements we have in place may need to be adjusted to reflect the increasingly complex finance landscape in Nepal and to maximize opportunities for additional resource mobilization in view of the financing gaps Nepal faces.

I take this opportunity to extend my appreciation to IECCD for taking lead for this assessment. Similarly, my thanks are also due to other members of the Oversight Team, comprised of representatives from various Divisions of the Ministry of Finance, National Planning Commission, Nepal Rastra Bank, the Ministry of Labour and Employment, and the Ministry of Industry. As we look ahead to the challenges of mobilizing and managing a range of different types of finance in pursuance of our country's development priorities, this type of intra-governmental collaboration will be critical, and I appreciate the initiative of IECCD to convene and seek inputs both within and outside the Ministry of Finance towards finalizing this important study.

Finally, I am hopeful that the Government, as well as relevant stakeholders, will be able to fully utilize the findings of the report in order to benefit from this assessment.

**Shankar Prasad Adhikari**
Finance Secretary
*November, 2017*

# Preface

This Development Finance Assessment (DFA) comes at a key moment for Nepal, as we celebrate important development achievements during the MDG era, while also facing the ambitious goals of becoming a Middle Income Country and achieving the SDGs by 2030. To translate this vision into action requires concrete and comprehensive strategies, including in relation to the mobilization and use of finance. This DFA provides evidence and analysis towards articulating how Nepal may make better use of existing finance, while not losing sight of the need to identify new avenues for mobilizing additional finance.

The Addis Ababa Action Agenda, which emerged from the *Third International Conference on Financing for Development* in 2015, emphasized the need for countries to take a more integrated approach to managing all types of finance, by improving integration across government, as well as between government and other stakeholders. The DFA for Nepal makes recommendations towards this end, and its findings provide an opportunity for discussions with current and new development partners on how to manage transitions in the availability, volume, and use of specific financing instruments by continuing to improve our policies and institutional arrangements. While the DFA recommendations outline an ambitious agenda, we are committed to materialize it and look forward to collaborating with our partners on this.

I would like to note that this DFA was overseen and guided by a Government Oversight Team. I extend my sincere thanks to all Oversight Team members, for the time and effort they contributed to defining the parameters of the study, attending Oversight Team meetings, and providing substantive feedback on several iterations of the report. The quality and relevance of this final DFA report have been much improved through these efforts.

I thank the DFA Team, Erlend Nordby (Team Leader), Jens Claussen, and Pushpa Lal Shakya, for their hard work in preparing the report. Dr. Ram Prasad Mainali, IECCD Under Secretary and National Project Manager of the Effective Development Financing and Coordination (EDFC) project, deserves thanks for his effort and commitment to bringing this study to its final stages. I would also like to appreciate and thank Ms. Ashley Palmer, Aid Effectiveness Specialist with UNDP/EDFC project for her contribution to review and ensure the quality aspects of the report. My thanks are also due to Mr. Tilakman Singh Bhandari and Mr. Lal Bahadur Khatri for their overall facilitation extended through the EDFC project.

I am hopeful that this report will be useful for policy makers, researchers, students, academics, development partners and those interested in better understanding the development finance context of Nepal.

Finally, I would like to extend my thanks and appreciation for the support provided by the United Nations Development Programme, the Asian Development Bank, and the United Kingdom's Department for International Development for making this DFA report possible.

**Baikuntha Aryal**
Joint Secretary and Chief, IECCD *and* Chair of DFA Oversight Team
*November, 2017*

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# Abbreviations

| | |
|---|---|
| **ADB** | Asian Development Bank |
| **AECF** | Africa Enterprise Challenge Fund |
| **AIN** | Association of International NGOs in Nepal |
| **AMP** | Aid Management Platform |
| **AP-DEF** | Asia Pacific Development Effectiveness Facility |
| **BLN** | Billion |
| **CBS** | Central Bureau of Statistics |
| **CDM** | Clean Development Mechanism |
| **CPDE** | CSO Partnership for Development Effectiveness |
| **CTF** | Clean Technology Fund |
| **DCR** | Development Cooperation Report |
| **DDC** | District Development Committee |
| **DDF** | Dolma Development Fund |
| **DFA** | Development Finance Assessment |
| **DFI** | Development finance institution |
| **DFID** | United Kingdom Department for International Development |
| **EDFI** | European Development Finance Institutions |
| **FCGO** | Financial Comptroller General Office |
| **FDI** | Foreign direct investment |
| **FY** | Fiscal year |
| **GAVI** | Global Alliance for Vaccines and Immunisation |
| **GDP** | Gross domestic product |
| **GEEREF** | Global Energy Efficiency and Renewable Energy Fund |
| **GFATM** | Global Fund to Fight AIDS, Tuberculosis and Malaria |
| **GFI** | Global Financial Integrity |
| **GNI** | Gross national income |
| **IECCD** | International Economic Cooperation Coordination Division |
| **IFC** | International Finance Corporation |
| **IFF** | Illicit financial flows |
| **IMF** | International Monetary Fund |
| **INFF** | Integrated National Financing Framework |
| **INGO** | International non-governmental organization |
| **JICA** | Japan International Cooperation Agency |
| **LDC** | Least developed country |
| **MDGs** | Millennium Development Goals |
| **MDTF** | Multi-donor Trust Fund |
| **MIC** | Middle-income country |

| | |
|---|---|
| **MoE** | Ministry of Education |
| **MoF** | Ministry of Finance |
| **MTEF** | Medium-term Expenditure Framework |
| **NGO** | Non-governmental organization |
| **NLSS** | National Living Standard Survey |
| **NNGO** | National non-governmental organization |
| **NPC** | National Planning Commission |
| **NPR** | Nepalese rupees |
| **NRB** | Nepal Rastra Bank (Central Bank of Nepal) |
| **NSDS** | National Strategy for the Development of Statistics |
| **NSS** | National Statistical System |
| **ODA** | Official development assistance |
| **ODI** | Overseas Development Institute |
| **OECD** | Organisation for Economic Co-operation and Development |
| **OECD/DAC** | OECD/Development Assistance Committee |
| **OOF** | Other official flows |
| **PEFA** | Public Expenditure and Financial Accountability |
| **PFM** | Public financial management |
| **PIDA** | Policy and Institutional Diagnostic Analysis |
| **PPA** | Power purchase agreement |
| **PPP** | Public-private partnership |
| **RBM** | Results-based management |
| **SAARC** | South Asian Association for Regional Cooperation |
| **SDGs** | Sustainable Development Goals |
| **SME** | Small- and medium-sized enterprises |
| **SWAp** | Sector-wide approach |
| **SWC** | Social Welfare Council |
| **UNDP** | United Nations Development Programme |
| **VAT** | Value-added tax |
| **WDI** | World Development Indicators |

# Executive summary

## Purpose of the Development Finance Assessment

This Development Finance Assessment (DFA) was commissioned by the Ministry of Finance (MoF) of Nepal, with support from the United Nations Development Programme (UNDP), the Asian Development Bank (ADB), and the United Kingdom Department for International Development (DFID).

The DFA was undertaken during the period from September 2016 to September 2017. The DFA team was comprised of two international consultants and one national consultant, with the International Economic Cooperation Coordination Division (IECCD) of the MoF as the team's designated focal point.

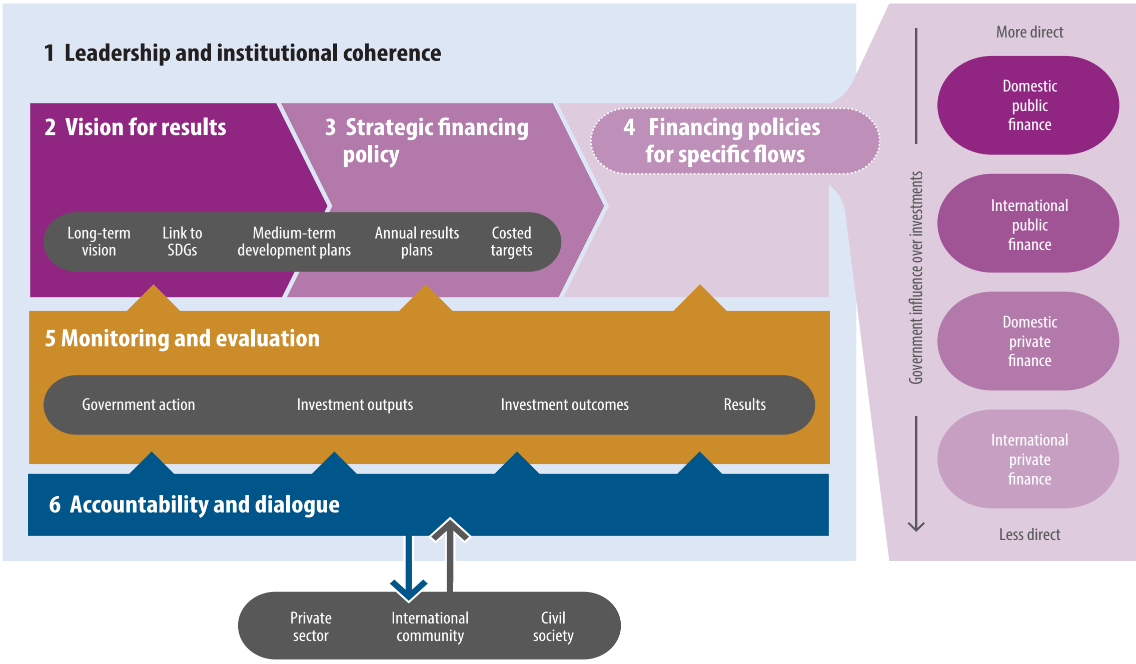
The DFA methodology was developed by the UNDP Bangkok Regional Hub, the Secretariat of the Asia Pacific Development Effectiveness Facility (AP-DEF), in response to demand from countries for support in managing the increasingly complex landscape of development finance. The Third International Conference on Financing for Development, held in Addis Ababa in July 2015, opened discussions on how to mobilize the unprecedented amounts of financial resources that will be required to achieve the Sustainable Development Goals (SDGs) by 2030. The Addis Ababa Action Agenda, agreed to at the Conference, assumes that countries will use their own national development strategies and plans to respond to the SDGs and calls for the adoption of Integrated National Financing Frameworks (INFFs).[1] The DFA methodology supports governments to use the concept of an INFF to help strengthen policies and actions for mobilizing different types of finance for sustainable development in a given country context.

An INFF is the system of institutional structures, policies and strategies that a government has in place to mobilize and utilize finance offered effectively and efficiently to achieve national development goals.[2] The conceptual model of an INFF, which is shown in Figure ES1, includes six building blocks: (1) Leadership that facilitates policy and institutional coherence; (2) A clear vision for results; (3) An overarching financing strategy; (4) Specific financing policies to mobilize and govern the use of different types of finance; (5) A monitoring and evaluation framework; and (6) An enabling environment for accountability and dialogue.

1 United Nations. 2015. "Addis Ababa Action Agenda of the Third International Conference on Financing for Development."

2 United Nations Development Programme (UNDP)/Asia Pacific Development Effectiveness Facility (AP-DEF). 2017. "Development Finance Assessment and Integrated Financing Solutions: Achieving the Sustainable Development Goals in the Era of the Addis Ababa Action Agenda."

**Figure ES1: Integrated National Financing Framework conceptual model[3]**




The Nepal DFA report is structured in seven sections. The first section covers the introduction, with section 2 covering the DFA methodology, and section 3 presenting the political and socio-economic context in which the INFF strategy of Nepal is developed. Section 4 presents the financial flows mapping and an analysis of each financial flow. In section 5, the report provides an assessment of the constraining factors and opportunities related to the policy and institutional environment; in section 6, alternative future trajectories of financial flows are presented; and in section 7, the conclusions and recommendations are presented.

## Country context

The economy of Nepal has long been in a situation of low investment and low growth and it remains among Asia's poorest countries despite notable progress in poverty reduction.[4] Following seven years with an interim constitution, a new constitution that establishes a new political system with a federal structure was approved by the Constituent Assembly in September 2015. For the first time in 20 years, local elections are being held in 2017, providing a basis for improved accountability and citizens' voice at the local level. According to the constitution, federal elections will be held by January 2018. The constitution also provides an opportunity to reduce political marginalization, to increase stability in the policy environment, and to create government and governance structures conducive to economic growth and social improvements.

Despite being a low-income country, Nepal has maintained reasonable macroeconomic stability over the last decade, with fiscal deficits below 4 percent of GDP and an average inflation rate of 8.7 percent

3 Ibid.

4 International Monetary Fund. 2017. "Staff Report for the 2017 Article IV Consultation."

between 2006 and 2015. Financial sustainability has also in part been strengthened by low budget execution rates, in particular low capital spending, combined with a steady increase in government revenues, which on average have increased 14.9 percent annually over the last decade, and 17.1 percent annually for the period from 2011 to 2015.[5]

In this context, the Government of Nepal has set ambitious development targets: to graduate from least developed country (LDC) status by 2022, achieve the SDG targets, and to emerge as an inclusive, equitable, and prosperous middle-income country (MIC) by 2030 with the spirit of a welfare state. To achieve these goals, the government will need to implement a series of structural reforms in parallel with the implementation of federal structures. Whereas the government's immediate priority is the implementation of the constitution, the government is also developing medium-term and long-term strategic frameworks that will provide a basis for government policies underpinning growth and development.

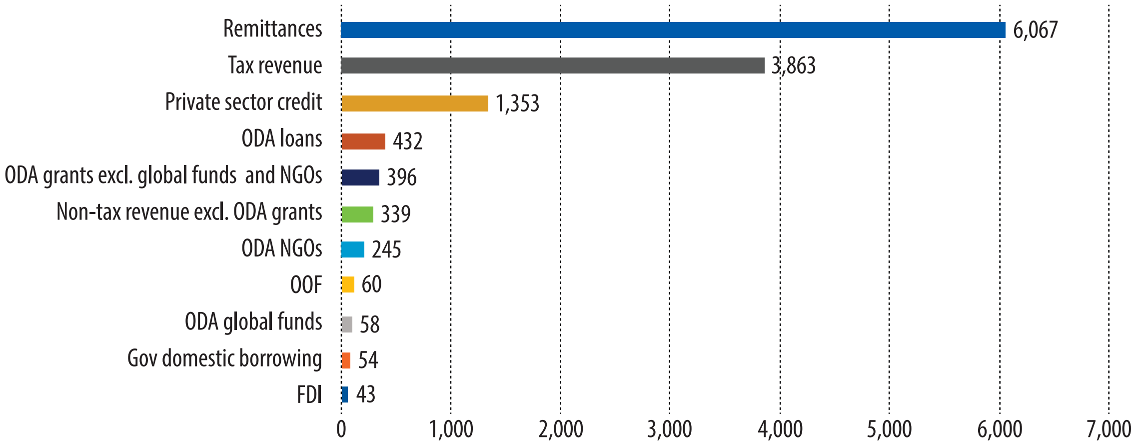
## Mapping the financial flows of Nepal

The financial flow analysis, presented in section 4, covers, to the extent that data has been accessible, the Fiscal Years (FYs) from 2005/2006 to 2014/2015. It maps the domestic and external, public and private capital flows that potentially can serve to finance the policy priorities of the Government of Nepal. To contextualize the financial mapping, comparison is made to regional averages and/or countries at a similar income level measured by gross national income (GNI) per capita, and to other countries in the region and at the same income level.

The mapping has been organized into three analytical levels. At the highest level (level 1) the analysis covers: a) domestic public; b) external public; c) domestic private; and d) external private flows. At level 2, the analysis covers conventional disaggregation of each of the level 1 financial flows, whereas level 3 analyses financial flows of specific interest where data availability allows for detailed disaggregated analysis in areas of particular relevance and interest (e.g. tax and non-tax revenues, different forms and channels of official development assistance (ODA) grants, funds for promoting private sector investments, and public-private partnerships (PPPs).

5 International Monetary Fund. 2015. "Staff Report for the 2015 Article IV Consultation."

**Figure ES2: Distribution of financing for development in millions of US dollars, 2015**




Source: Ministry of Finance, Organisation for Economic Co-operation and Development/Development Assistance Committee (OECD/DAC) and Nepal Rastra Bank.

Figure ES2 shows the distribution of financing in Nepal in the year 2015; section 4 of the report discusses each finance flow in detail and provides trend analysis over time.

The mapping has shown that government revenues in the form of taxes, grants and other non-tax revenues have gradually served as a major source of finance for Government of Nepal investments and programs to achieve policy targets. The Government of Nepal has displayed continued improvements in revenue performance over the last decade. Tax revenue has continued with a rising trend both in real value and as a share of GDP compared to countries at the same income level.[6] However, there is still scope to increase the tax-to-GDP ratio by eliminating exemptions (including on corporate income tax), expanding the tax base, and increasing tax compliance. In addition, tax generation from income taxes remains low compared to other countries in the region and can be increased further.

External finance in the form of ODA for financing public expenditure has declined over the years. Net ODA flows as compared to GNI per capita in Nepal is lower than almost all other countries in the same income bracket. Accordingly, the Government of Nepal has significant potential to raise more finance from ODA grants and concessional lending, primarily by increasing the capacity to utilize the finance offered and by accessing other and new concessional arrangements from other sources such as global programs and funds. Despite a significant nominal increase in funding from global programs and funds on concessional terms in recent years, this source of funding only constitutes on average 3.9 percent of total ODA disbursements and remains low compared to other countries with similar GDP per capita levels.[7] This suggests that Nepal has an opportunity to qualify for larger volumes of this source of concessional funding provided it can raise the capacity in planning and implementation.

Nepal is a destination for other official flows (OOF) from non-Organisation for Economic Co-operation and Development (OECD) countries such as China and India. In total, OOF has added another 6 percent to

6 See section 4.1 of the report for detailed information on data sources and references. The source for Government of Nepal revenue data is the Ministry of Finance; World Bank and International Monetary Fund data is used for country comparison.

7 See section 4.2 of the report for detailed information on data sources. Data on ODA flows to Nepal is from the Ministry of Finance; data for comparison with other countries is from OECD.

10 percent over and above ODA contributions during the last decade.[8] A major share of this funding has been directed towards education, health and public infrastructure projects in addition to some funding for lending to public corporations. The extent to which these sources of funding can be increased depends on the capacity of the Government of Nepal to plan and execute added investments.

The Government of Nepal has gradually reduced its reliance on domestic and external borrowing to cover public expenditure. The current Government of Nepal debt levels are at an all-time low level,[9] which allows increased debt financing on concessional terms without any significant risk of reaching unmanageable debt service levels. Access to additional debt financing can be acquired from concessional sources such as the multilateral development banks and development finance institutions (DFIs). The former will depend on the capacity of the Government of Nepal in planning and executing public sector investments; the latter will depend on the extent to which the policy and regulatory environment improve, including the framework for PPP opportunities with access to sectors and investments that potentially could become profitable through engagement by DFIs (such as hydropower and other public utility services).

Access to domestic credit is a major driver for the financing of new investments and allows people to purchase assets. During recent years, domestic credit in Nepal has grown significantly.[10] Despite these developments, according to the World Bank Enterprise Survey in 2013,[11] only 13.7 percent of companies use bank credit for financing of investments, which indicates that significant challenges prevail in the credit market. Among these challenges are competitive access to credit and lack of alternative channels of investments including hedge funds, mutual funds and venture capital funds.

While the local venture capital industry in Nepal is still in its infancy, the future prospects in Nepal have changed. Venture capital is directed at several sectors, including information technology, education, health care, agriculture and tourism, among others. Despite strong commitments to support startups in Nepal, venture capital funds lack viable startups in which to invest. The startups lack initial funding for putting together a viable business plan and entering a pilot phase to test the business model and market for their product and services to scale up to a viable commercial entity.

According to the International Finance Corporation (IFC) Enterprise Finance Gap Database, there are more than 111,000 small- and medium-sized enterprises (SME) operating in Nepal, accounting for 22 percent of the GDP of Nepal. However, 25 percent of these businesses do not have formal banking relations with financial institutions at the same time as there is an untapped market for SME lending estimated to be $2.5 billion.

There is scope for entry of many more venture capital funds in Nepal to foster competitiveness and increase outreach given the gap in access to finance and business development services. Many countries at the same income level have established venture capital programs and challenge funds with donor support, promoting SMEs in priority sectors such as agriculture and renewable energy. To promote SME startups and growth, the Government of Nepal could, in addition to creating a more enabling regulatory environment, establish venture capital funds/programs and/or challenge funds.

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8 See section 4.4 of the report for details. Data is from the Ministry of Finance and OECD.

9 See section 4.5 of the report; data is from the Nepal Rastra Bank.

10 Nepal Rastra Bank.

11 World Bank and International Finance Corporation. 2013. *Nepal-Enterprise Survey 2013*.

While Nepal has made efforts recently to attract more foreign direct investment (FDI) to reap the benefits of bringing in market access, technology and know-how from foreign companies, the level of FDI remains low compared to other countries at the same income level as well as the average of all South Asian countries.[12] The World Bank's "ease of doing business index" ranks Nepal at an average of 108 from 2008 to 2016. The longer-term trend shows an improving business climate and despite the low international rating, Nepal is, in several dimensions, on par or ahead of other countries in the region.

Despite this development, however, several challenges remain, in particular related to the enforcement of contracts (the time it takes for settlement in the legal system), processes related to tax payments (time rather than tax levels), access to finance and infrastructure conducive to business (in particular reliable electricity). The above are not only impediments to attracting FDI, but constraints for private sector investments in general. Addressing these constraints will likely yield growth in FDI to the levels of other countries at the same per capita income and serve to increase domestic private sector investments, including investments from the significant inflow of remittances (see below) as well as added inflow of equity financing from DFIs.

The Government of Nepal introduced the Public-Private Partnership (PPP) Policy in October 2016. The PPP contracts will be awarded through a competitive bidding process and if the projects are worth more than 1 billion Nepalese rupees (NPR), there will be a global bidding process to encourage more FDI. The extent to which PPP will grow in numbers and volume will, however, depend on further improvements in the business climate for private sector investments as mentioned above.

The inflow of remittances from Nepali people working abroad has emerged as the largest source of foreign exchange earnings, with an amount equivalent to 30.4 percent of GDP for FY 2014/2015. This is three times more than all other South Asian Association for Regional Cooperation (SAARC) countries, and is the highest among Asian countries.[13] While remittances play an important role in financing household investments and spending, less is used for savings and/or investment in productive assets. If the challenges related to the business climate, the entry of new financial intermediaries, and the need for more diversification of financial sector products and services are addressed, remittances can play a significant role as an additional source of finance for development.

ODA disbursements through international and national non-governmental organizations (NGOs) complement the funding of public sector programs. According to Organisation for Economic Co-operation for Development (OECD)/Development Assistance Committee (DAC) data, approximately 18 percent of total ODA to Nepal was disbursed for NGO program interventions. The NGO share of total ODA in 2015 was higher than the global average for countries at the same income level. This may be explained by the significant inflow of emergency aid after the 2015 earthquakes. However, on average, the ODA granted to NGOs as a proportion of total ODA in Nepal is not significantly higher in Nepal compared to its peers.

Many of the international NGO (INGO) and Nepalese NGO (NNGO) programs are implemented in partnership with the Government of Nepal. Some of the ODA disbursed to Government of Nepal programs are financing Government of Nepal partnerships with NGOs, many on contracts outsourcing service delivery and investments managed by them. To raise the level of Government of Nepal capacity to utilize ODA commitments, NGOs could be engaged further to supplement Government of Nepal capacity to

12 See section 4.8 of the report; data from World Bank.

13 See section 4.11 of the report; data from Nepal Rastra Bank and World Bank.

implement planned policies, particularly in sectors such as education and health. It is recognized, however, that for such a strategy to partner further with NGOs to be successful, the NGOs will have to be selected carefully, with attention to governance and capacity issues.

While the DFA focuses predominantly on access to finance, reducing illicit financial flows (IFFs) will also serve to increase available finance for development. According to the Global Financial Integrity data, IFFs in Nepal have been higher than net ODA received, in some years up to 60 percent more.[14] The major reasons cited include the decade-long internal conflict and political instability, prevalence of corruption in the bureaucracy and business community, tax evasion, lack of accountability and transparency in the private sector, low confidence of investors, and challenges with safeguarding the right to private property. While some of these issues are related to domestic challenges such as tax administration and enforcement, governance issues and business climate, others require international cooperation to promote transparency in transactions across countries (such as transfer pricing and non-disclosure of deposits in overseas accounts).

## Public sector management

The policy and institutional analysis component of the DFA is presented in section 5, along with a benchmark assessment of the INFF building blocks relating to the policy and institutional framework.

The government has shown a firm commitment to integrate the SDGs in national development plans, and as a signatory to several treaties on sustainable development, significant coherence in policies has been achieved.[15] With the new federal structures, localization of the SDGs is considered essential to determine the SDG policies and outcomes. While many uncertainties remain in various areas related to the process of transitioning to federal structures, including in areas such as planning, budgeting and fiscal transfers, the establishment of federal structures offers an opportunity to strengthen accountability mechanisms and adapt policies to local needs and circumstances.

Despite the fact that the policy agenda in Nepal largely has focused on the more pressing issues related to reconstruction efforts and on the implementation of the constitution, the SDG agenda, underpinned by a vision to achieve MIC status by 2030, has gained more focus over the last year, evidenced by formation of a SDG steering committee chaired by the Prime Minister and establishment of an informal SDG forum in the Parliament.

Nepal has a well-established tradition of development planning and procedures are established for results-based management. The plans are, however, often overly ambitious and targets are often not met. Moreover, constraints in the planning structures and procedures impact on the government's ability to plan strategically and prioritize effectively between competing demands. Among the constraints are the following:

- The line ministries and other spending agencies are currently not provided realistic budget ceilings to plan policy interventions in the medium term, and currently Nepal does not have a functioning Medium-Term Expenditure Framework (MTEF).

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14 Global Financial Integrity. 2015. "Illicit Financial Flows from Developing Countries: 2004-2013."

15 Government of Nepal, National Planning Commission. 2015. *Sustainable Development Goals 2016-2030 National (Preliminary) Report*.

- The linkages between the three-year periodic plans and the line ministries' sector plans are currently not adequately developed to ensure that national policies, as presented in the periodic plans, are translated into sector budgets with allocations linked to policy targets.[16]
- There is inadequate costing of planned policies and results monitoring is to a large extent output-based rather than based on performance assessments.[17]
- The local government sector faces significant capacity and financial constraints. This poses challenges to policy planning and causes risks in terms of growth and achievement of policy objectives; accountability mechanisms need to be established.

Given the existing shortcomings in planning and monitoring structures, incremental and input-output oriented planning practices remain more the norm than the exception in line ministries, despite the fact that most projects and programs require longer-term interventions and funding to yield benefits over a period of years.

With the government's ongoing revision of the MTEF structures, there is a notable opportunity to improve the current planning and monitoring system from a centrally and incremental input-output oriented system towards a more performance and evidence- oriented direction where the line ministries and spending agencies plan, prioritize and manage programs based on realistic resource envelopes, assessments of cost effectiveness, and performance against set policy objectives.

To achieve its planned policy objectives, the Government of Nepal needs to use the budget effectively as a management tool for implementing government policies. In recent years, the government's reform efforts have produced encouraging results at the federal level, which has put the Government of Nepal in a much better position than before to use public resources effectively and efficiently to achieve policy objectives. However, despite important improvements, for example, in terms of improved budget credibility, significant gaps remain to be addressed at both the federal and local government level.

The weaknesses in the government's public financial management (PFM) system has an impact on the use of existing resources, and on the government's ability to mobilize additional resources in support of national development objectives. A significant challenge is with absorptive capacity, as demonstrated by the underspending of planned investments, and overspending on recurrent expenditures. The underlying causes for low capital expenditure compared to original approved budgets relate to:

- Weak planning and implementation capacity, for example, in terms of timely preparatory plans and activities in certain sectors or at local government level
- Weaknesses in the government's budget execution processes, including delays in budget approval and release processes at various stages
- Inefficient or complex procurement procedures
- ODA commitments not adhered to by development partners
- Inadequate budgetary regulations with regard to virement procedures

16 Overseas Development Institute (ODI) Centre for Aid and Public Expenditure. 2013. "Operational risk assessment of public financial management reform in Nepal: a review of challenges and opportunities."

17 Government of Nepal, Ministry of Finance. 2015. "Public Expenditure and Financial Accountability (PEFA) Assessment."

To achieve its development objectives, the government therefore needs to continue to improve the budget reliability, with an immediate focus on addressing the capacity constraints related to capital expenditures.

Another critical aspect to address is fiscal decentralization. Local bodies are constrained financially, and the financial control environment is weak. Public financial management capacity is also weak, and planning and budgeting practices are incremental and lack adequate performance orientation. Hence, in practice, local bodies struggle to balance the competing demands of local citizens, communities and central government regulations and directives in policy planning and implementation.

The new constitution represents an opportunity to strengthen local level governance, with the possibility of introduction of revised governance and financial management structures, revised tax policy and redistribution mechanisms, and more simple, coherent and transparent financial regulations that may improve the capacity of local bodies to prioritize policies and budgets according to local needs.

Strengthened governance and improved efficiency depends, however, also on the enabling environment for accountability and dialogue. In Nepal the legal framework for establishing an enabling environment for accountability and dialogue appears to be in place with the Good Governance (Management and Operations) Act, 2064 (2008). Despite significant efforts to build the trust necessary to mobilize financing from stakeholders outside government, to ensure that policies are being designed and delivered effectively, and to ensure a voice for citizens, civil society, business, development partners and other actors in development, there are some important gaps that need to be addressed:

- To ensure oversight by the Parliament of the government's SDG policy, efforts to engage parliamentarians on the SDGs need to continue.
- Elected local governments are crucial to operationalization of development policies at local level. The recent and upcoming elections at local and provincial levels represent an opportunity to re-establish accountability mechanisms to increase citizens' voice at local government level.
- A professional and adequately staffed administration is critical to executing government policies in a transparent and accountable manner. Staffing levels and quality in local government administration are currently low, and at the central government level results-oriented norms and practices have not been entrenched in the civil service and public management systems.[18]
- The centralized planning system combined with incremental and detailed planning and budgeting practices, with a focus on line item management and outputs rather than program outcomes, weakens the extent that government ministries and agencies are held accountable.
- Further reform measures in PFM are therefore required to improve accountability and transparency in budget processes and PFM, improving the basis for citizens as well as the private and voluntary sectors to hold government institutions accountable for results.

In addition, measures need to be taken to strengthen the National Statistical System (NSS) to improve the basis for informed dialogue on the SDGs and evidence-based policymaking, building on existing support from several development partners in this area.

18 Government of Nepal, Ministry of General Administration/UNDP. 2014. "The Nepal Civil Service and Re-Structuring of the State."

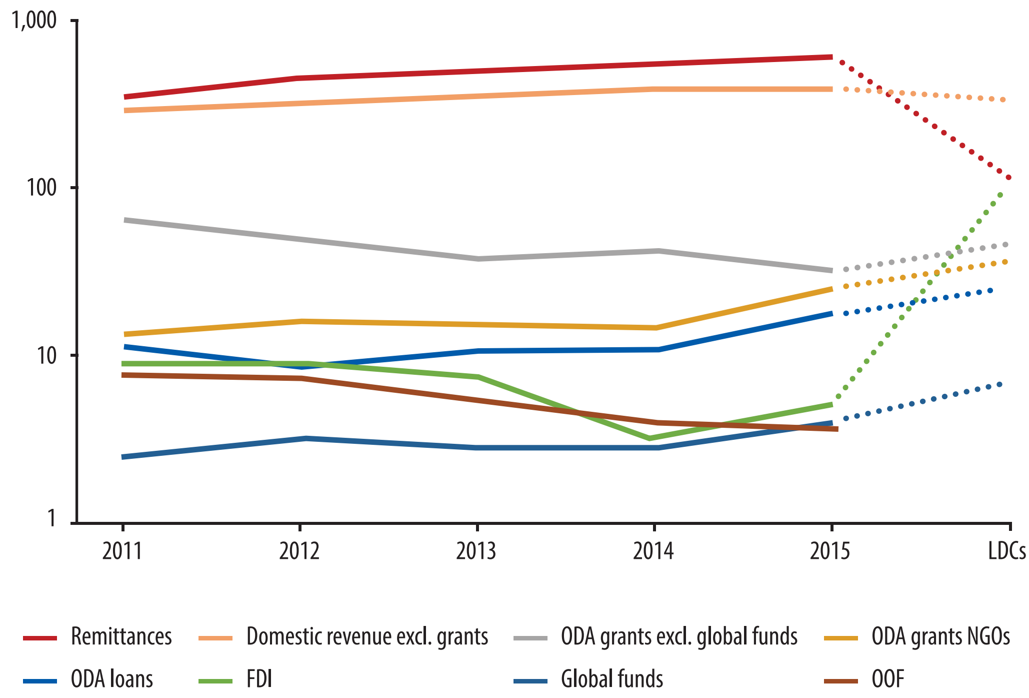
# Future financial flows

The financial flow analysis and the analysis of the public sector management structures and procedures demonstrate that Nepal has substantial potential to utilize existing sources of finance more efficiently and to mobilize additional sources of finance. This is based on the assumption that public sector absorptive capacity can be raised either through strengthening public sector management capacity to plan, budget, monitor and implement policies efficiently and effectively, and/or with a wider engagement with non-state actors, in delivery of public services through outsourcing/PPP arrangements.

A comparison of funding with other countries at the same income level illustrates the potential that Nepal may have to mobilize additional funding for development. The analysis in section 6 shows the potential of Nepal to raise additional finance for development when using the LDC average as a "benchmark".

Figure ES3 shows the trend in the major sources of finance for development using a logarithmic scale to show the detailed trends of all sources. The dotted lines estimate a future trend if Nepal was to reach the same level of funding from each source equivalent to the average of other LDCs.[19] It may serve to illustrate the potential for additional funding from different sources.

**Figure ES3: Trends in the sources of finance for Nepal compared to LDC average, in bln NPR at constant 2015 prices**




Note: The presentation is made in a logarithmic scale to display details of the trends for minor sources of funding. The data are to be considered as proxies only as the data available for each country in the LDC category varies from one variable to the other.

Source: Ministry of Finance and World Bank World Development Indicators.

19 For the analysis, the United Nations definition of LDCs has been used. See https://www.un.org/development/desa/dpad/least-developed-country-category.html (last accessed on 12 October 2017).

Based on the analysis, the following are opportunities for increasing concessional and non-concessional sources of finance:

- Domestic revenue will continue to increase with improved efforts in tax administration, among others. There is additional scope to raise the level of income and corporate tax by widening the tax base and reducing tax exemptions.
- Actual ODA disbursements compared to commitments are low due to low levels of absorptive capacity within the Government of Nepal. Improving capacity in execution is key to increasing utilization of ODA commitments.
- Compared to other low income countries, Nepal has yet to utilize fully the opportunities of ODA financing from global concessional funds in areas such as environment and climate prevention/ mitigation programs, renewable energy, education, and global funds for other key sectors.
- The Government of Nepal can make wider use of non-state partners, among others, through management service agreements and PPP arrangements in major sectors. In this way, NGOs also serve as an additional source of funding from developing partners' aid budgets.
- Opening up new sectors to the private sector will also attract more FDI, which is low compared to other low income countries, although this will require that key constraints for private sector entry and operations are addressed.
- An improved business climate will not only attract FDI, but also other forms of official flows in the form of concessional and non-concessional finance from DFIs and non-OECD countries that currently are at a low level compared to other low-income countries.
- Promoting new financial services and intermediaries, such as venture capital funds and other equity investment opportunities, can potentially raise finance from remittances and other private capital sources for private sector investments promoting domestic employment and income generation.
- IFFs represent a significant leakage of financial flows that could potentially promote development. Some of the challenges are related to tax administration and enforcement, governance issues and business climate, while others require international cooperation to promote transparency in transactions across countries (such as transfer pricing and non-disclosure of deposits in overseas accounts).

# Conclusions and recommendations

A main conclusion of this DFA is that while finance is one constraint to achievement of national development priorities, so too is the absorptive capacity to utilize the financing that is available.

Despite the fact that Nepal has demonstrated a strong capacity to generate domestic revenues, the assessment has concluded that to mobilize additional resources the government's absorptive capacity needs to be increased, either through reform measures that strengthen government planning, budgeting, and monitoring systems, and/or through a wider engagement with non-state partners in delivery of public services through outsourcing/PPP arrangements.

This DFA recommends that parallel actions, entailing both a change in policy and reform of the public management system of Nepal and its policy planning, budgeting and monitoring frameworks, are pursued to meet the financial needs and efficiency improvements that will be required to achieve national development goals.

The Government of Nepal is committed to develop an INFF to serve as a framework to help guide the dialogue on the reforms that are needed to move further towards a strategic, holistic and results-driven approach to financing the country's development priorities. The recommendations emerging from the DFA, aiming to improve efficiency in the use of available finance and to mobilize additional finance to support the achievement of the SDGs and the goal to reach MIC status by 2030, are as follows:

*2. Develop a strategy to increase access and diversify sources of finance*

Nepal has demonstrated a strong capacity to generate domestic revenues and is currently undertaking additional measures that will further strengthen domestic revenue mobilization. This DFA has, however, found that there is significant potential to mobilize both additional revenue sources and private finance that can support the government in achieving its objectives.

The analyses of financial flows and of public sector management structures and procedures demonstrate that Nepal has substantial potential to utilize existing sources of finance more efficiently, and to mobilize additional sources of finance. This is based on the assumption that public sector absorptive capacity can be raised either through strengthening the public sector management capacity to plan, budget, monitor and implement policies and/or with a wider engagement of non-state partners efficiently and effectively in delivery of public services through outsourcing/PPP arrangements.

A comparison of the finance landscape of other countries at the same income level illustrates the potential that Nepal may have to mobilize additional finance for development. The analysis in section 6 shows the potential of Nepal to raise additional finance for development when using the LDC average as a "benchmark".

The following measures should be considered to diversify sources of finance:

- Increase access and diversify sources of ODA grant funding; increase levels of debt financing on concessional (ODA) terms
- Explore new development partners and international investors
- Increase engagement of non-state partners in public service delivery and infrastructure investments, but with attention to identifying those partners that have the capacity to deliver
- Pursue improvements in the business climate and establish a grant facility for cost sharing of business development services
- Establish investment funds and/or state guarantee arrangements to leverage more equity finance for private sector development
- Continue to improve domestic revenue collection and expand tax base to the local level

*3. Develop financing strategies*

Over the last decade, the international financing architecture has become increasingly diverse with many new institutions, and regional and global funds offering concessional finance for different purposes. Nepal has significant potential to mobilize additional revenue and finance from these sources, similar to what many other countries have done. Currently, however, there is no strategy in place to mobilize additional finance.

Ideally, a financing strategy should be anchored in the sector ministries and be based on sector strategies and sector MTEFs. It is therefore recommended that the line ministries, when designing sector strategies, identify policy areas where additional finance can be mobilized. To illustrate, this may include identifying policy areas where PPP arrangements can be used, where national private actors can mobilize finance for projects that directly or indirectly support the SDG targets, where international funding mechanisms such as challenge funds can be utilized, or where existing ODA or OOF funding can be further increased. It may, however, also include identifying areas where non-state partners may contribute to increasing the government's absorptive capacity, for example, by delivering services that traditionally have been delivered by the public sector but where private sector actors may be able to deliver the same services of similar or higher standard at the same cost.

The following measures should be considered:

- Identify additional sources of non-discretionary finance at sector level and apply them before using domestic discretionary sources (such as tax revenues)
- Explore opportunities to establish Sector Wide Approaches (SWAps) to programming in new sectors and to utilize SWAps strategically to mobilize potential additional finance and explore other suitable program modalities.

*4. Strengthen institutional coherence*

In the government, SDG coherence needs to be institutionalized in the sector ministries. Based on the assumption that institutional coherence and the quality of the technical planning processes affects the government's capacity to mobilize additional finance and the capacity to achieve policy goals and targets, it is recommended that the planning processes are adjusted in a direction where formulation of goals, targets and strategies to a larger extent is assumed by the responsible sector ministries and their underlying agencies.

SDG coherence needs, however, also to be developed in the local government sector, in the Parliament, among representatives from the private sector and NGOs, and promoted through dialogue in the media. As a first step it is recommended that the government takes the initiative to engage further these stakeholders, building on existing efforts. It is recommended that each sector ministry develop dialogue and awareness strategies involving stakeholders at federal and local levels, the private and voluntary sectors, as well as with representatives of the media to:

- Further decentralize planning processes in a direction where goals, targets and strategies are formulated by the line ministries
- Develop sector-based dialogue and awareness-raising strategies
- Increase focus on the local governance and public finance reform agenda to support institutionalization of federal structures, including defining roles of local governments in development

*5. Strengthen alignment of the development vision and sector strategies*

A performance-oriented culture has not been entrenched in government ministries and agencies. As current practices in most government ministries remain focused on outputs rather than on program outcomes, alignment between the development vision and sector strategies is weak. These practices also constrain government's capacity to prioritize use of resources (allocation efficiency) and the ability of government to ensure that programs are implemented at the lowest possible cost while maintaining desired service quality levels (operational efficiency). This is, among other things, evidenced by weak budget execution, in particular of capital investments that require transparent planning, costing and performance management over several years. However, a broader set of institutional aspects are constraining policy execution, and weaknesses in the PFM system need to be addressed to ensure that the budget is used as an efficient tool for policy planning and execution.

Taking into consideration the weaknesses in the PFM system identified in the Public Expenditure and Financial Accountability (PEFA), the NPC is currently revising the MTEF formats, and some of these constraints are being addressed through ongoing reform programs under the PFM Multi-Donor Trust Fund (MDTF) and the Strengthening Public Management Programme. The Government of Nepal should use these ongoing reform efforts to improve efficiency in planning and budgeting. This requires that a coherent plan is developed that identifies the actions needed to transform the current planning and budgeting system into a more policy-oriented system, by introducing performance-oriented budgeting practices. The specific measures recommended are:

- Strengthen macroeconomic modelling to improve the reliability of revenue forecasts
- Roll out revised MTEF formats with reliable budget ceilings that include integrated reporting formats clarifying the linkages between budgets and measurable performance targets
- Strengthen the capacity of line ministries to cost policies and to develop integrated sector strategies and SWAps that are clearly linked to the national MTEF
- Improve monitoring systems by coordinating financial reporting and performance reporting mechanisms
- Implement quarterly or semi-annual budget performance reports for the line ministries that include integrated reporting on budget releases and performance targets

*6. Develop a robust monitoring, evaluation and learning system*

To ensure evidence-based policymaking and increase efficiency in the use of resources, and to monitor progress on SDG achievement, a comprehensive and reliable NSS is essential. It is therefore recommended that data requirements to monitor progress on the SDGs are coherently mapped and that a strategy is developed to address the gaps. Such a strategy should include: attention to defining the roles and responsibilities of various agencies to avoid duplication and mandate overlaps; and consideration of options for alignment of information systems across agencies. Furthermore, such a strategy should build on existing efforts by development partners (including the ADB, DFID, the International Labour Organization, the Japan International Cooperation Agency (JICA), and the World Bank) to support the Government of Nepal in strengthening capacity in the generation and use of data for development.

However, as monitoring of the SDGs will require data from a variety of sources, a strategy for improving SDG data should be aimed at alignment with a National Strategy for Development of Statistics (NSDS), rather than to fill specific SDG data gaps. Moreover, the strategy should address capacity-building across all elements of the NSS, provide clarity on NSS data gaps, identify challenges in terms of coordination and duplication of data, and present a realistic vision of where the NSS will be in a three-, five- and ten-year period in terms of national and regional statistics, including SDG statistics. The strategy should maintain a strong focus on user needs, and capacity-building measures should be equally as strong on the use and application of data for policymaking, as on data production. Despite the fact that funding for statistical capacity has stagnated in recent years, the SDGs are likely to impact positively on international commitments to strengthen data systems. The NSDS should therefore include a strategy aiming to mobilize external funding to build statistical capacity.

The following measures should be considered:

- Develop a strategy for improving SDG data and statistics that is aligned with the NSDS that addresses capacity-building both in the production and use of statistics across government institutions
- Develop and implement a strategy for mobilizing additional finance to support statistical capacity-building

*7. Strengthen the enabling environment for accountability and dialogue*

It will be essential that government institutions provide comprehensive and transparent information that is reliable and trusted to civil society and the private sector. The following measures should be considered:

- Formally constitute a SDG working group in Parliament mandated to promote parliamentary debates and raise SDG awareness, commitment and coordination in parliamentary committees, building on existing support to Parliament on the SDG agenda
- Increase capacity-building at the provincial and local levels to support institutionalization of accountable governance mechanisms
- Reform the civil service management structures and the planning and budgeting structures towards a performance-oriented system
- Involve the private sector more systematically in the project cycle and ensure the legal environment necessary for private sector engagement

# 1. Introduction

## 1.1 Background and context: Nepal Development Finance Assessment

Over the last decade, Nepal has experienced significant socio-economic improvements. Building on its positive experiences from a proactive Millennium Development Goals (MDGs) policy, the Government of Nepal has made a strong commitment to the achievement of the Sustainable Development Goals (SDGs), and aspires to graduate from least developed country (LDC) status by 2022 and to emerge as an inclusive, equitable, and prosperous middle-income country (MIC) by 2030, with the spirit of a welfare state.[20] The Government of Nepal recognizes that to achieve the ambitious MIC goal and the SDG targets, it will need new strategies that will help to improve the government's efficiency and effectiveness, increase the levels of finance, and create an enabling environment for private sector investment and growth.

In the context of the changing development finance landscape worldwide, Nepal, as most other developing countries, is currently exploring new opportunities and ways to mobilize and manage resources, both domestic and external as well as public and private, to finance its development plans and aspirations. Global policy and dialogue processes are relevant to these efforts, and the Government of Nepal participated in the Third International Conference on Financing for Development, held in Addis Ababa in July 2015.[21] At the conference, a discussion was opened on how to mobilize the unprecedented amounts of financial resources that will be required to achieve the SDGs, and an agreement, the Addis Ababa Action Agenda, that provides the foundation for countries to implement the SDGs, was reached. The agreement includes a series of bold measures to overhaul global finance practices and generate investments for tackling a range of economic, social and environmental challenges.[22]

The Addis Ababa Action Agenda assumes that countries will use their own national development strategies and plans to respond to the SDGs and calls for the adoption of Integrated National Financing Frameworks (INFFs).[23] In this regard, governments are now increasingly requesting support to take forward policy and institutional reforms to enable more integrated management of a broader set of finance flows to support the implementation of their national priorities and the SDGs.

Against this backdrop, the Ministry of Finance (MoF) of the Government of Nepal initiated this Development Finance Assessment (DFA) report. Focusing on linking finance with results, this DFA report aims to identify strategies to improve efficiency and effectiveness in the utilization of existing resources, and opportunities for the mobilization of additional resources. This DFA was commissioned by the Nepal MoF, with support from the United Nations Development Programme (UNDP), the Asian Development Bank (ADB), and the United Kingdom Department for International Development (DFID).

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20 Government of Nepal, National Planning Commission. 2015. "Sustainable Development Goals 2016-2030 National (Preliminary) Report."

21 "Addis Ababa Action Agenda Press Release." 2015. *Nepal Foreign Affairs*.

22 United Nations. 2015. "Press Release (15 July 2015): Countries Reach Historic Agreement to generate financing for new sustainable development agenda."

23 United Nations. 2015. "Addis Ababa Action Agenda of the Third International Conference on Financing for Development."

A DFA team, comprised of two international and one national consultant, was engaged to undertake the DFA. A DFA Oversight Team, with representatives from the MoF, the National Planning Commission (NPC), the Nepal Rastra Bank (NRB), the Ministry of Labour and Employment and the Ministry of Industry, has supported the DFA team with information and monitored the team's work.

The International Economic Cooperation Coordination Division (IECCD) of the MoF has been the team's designated focal point within the government, with the IECCD Chief as Chair of the Oversight Team. The DFA team and the MoF agreed to give particular attention to strategic measures that may improve the government's efficiency, and at the same time increase the financial flows that underpin the government's ability to deliver on the SDGs and achieve the goal of becoming a MIC.

## 1.2 Objectives and scope of work

The overall objective of this DFA report is to provide an overview of development finance flows and the institutions and policies that align this finance with national development goals and priorities. The assessment provides recommendations for a road map, using the concept of an INFF, to increase the alignment of financing flows to national development goals, improving the basis for achieving development results.

To achieve the overall objective, the scope of work covers the following:

- The report provides an overview of the evolution of the flows of financing for development and their allocation and contribution to national priorities and results, as expressed in plans and policies at the national, sector and subnational levels. In particular, the overview will look at how systems can be strengthened to align finance better with Nepal's national development priorities.
- The report assesses the role of the planning and budgeting process in linking both public and private finance with results.
- The report assesses the roles and responsibilities of national institutions and their associated policies in managing or influencing the development of individual financial flows to contribute to the national development priorities.
- The report analyses the interface between different flows, and the complementarities between the different sources of development finance, in contributing to achieve national development priorities.

## 1.3 Report structure

This DFA report is structured in seven sections. The first section has covered the introduction, with section 2 covering the DFA methodology, and section 3 presenting the political and socio-economic context in which the Nepal INFF strategy will be developed. Section 4 presents the financial flows mapping and an analysis of each financial flow. In section 5, the report provides an assessment of the constraining factors and opportunities related to the policy and institutional environment; in section 6, alternative future trajectories of financial flows are presented; and in section 7, the conclusions and recommendations are presented, including a draft road map for taking forward the recommendations.

# 2. The DFA methodology and approach

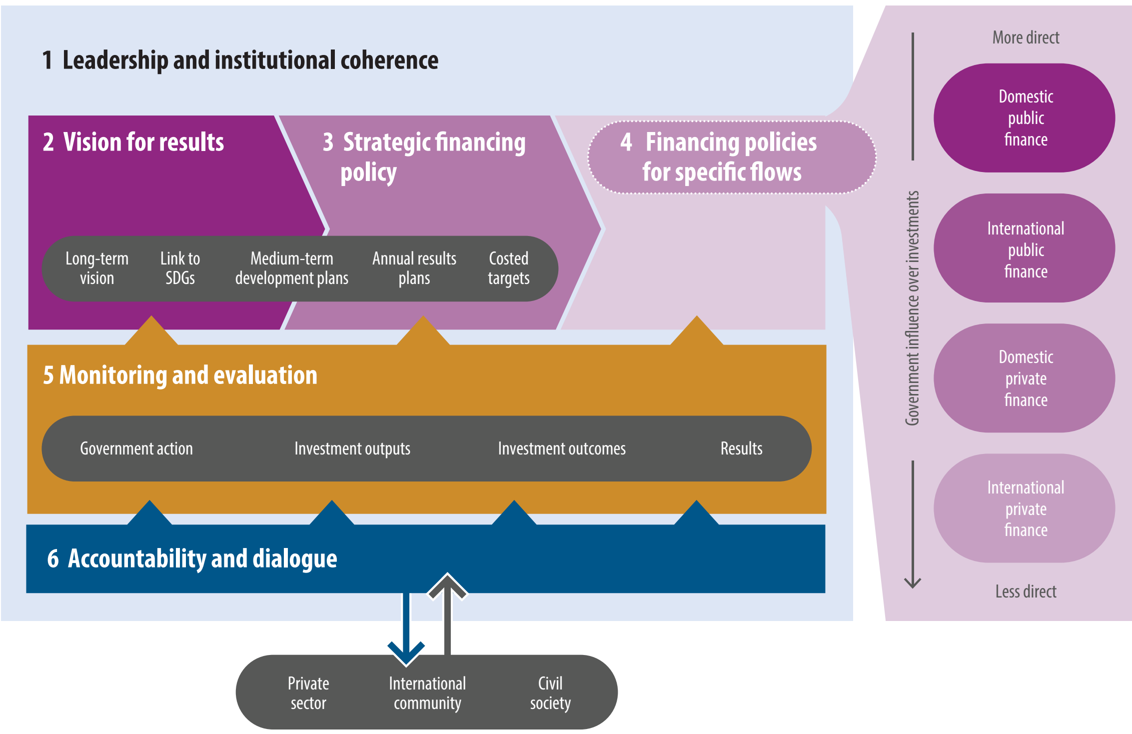
## 2.1 DFA methodology

The DFA methodology is based on the INFF conceptual model. The model is designed to assist countries to assess their systems of institutional structures, policies and strategies that governments have in place to mobilize and utilize finance effectively to achieve the SDGs.[24]

The DFA aims to provide recommendations and an initial road map to strengthen the INFF, with attention to the six building blocks, in order to support the government to identify strategies that can be pursued to increase the efficiency of government policies and the mobilization of domestic and external financial resources.

In Figure 1, the INFF conceptual model is presented. The model is structured around six building blocks that are critical to effective mobilization and use of finance, and importantly, the interaction between the building blocks in an integrated way. Considered together, the six INFF building blocks offer a conceptual framework that can prompt governments to assess their financing frameworks and guide thinking about reforms that are needed to strengthen them and achieve national development priorities and the SDGs.

### Figure 1: Integrated National Financing Framework conceptual model[25]




24 United Nations Development Programme (UNDP)/Asia Pacific Development Effectiveness Facility (AP-DEF). 2017. "Development Finance Assessment and Integrated Financing Solutions: Achieving the Sustainable Development Goals in the Era of the Addis Ababa Action Agenda."

25 Ibid.

Based on a country's policies, strategies and institutional structures, the DFA methodology establishes a baseline for each of the six INFF building blocks, by assessing the degree to which each building block is in place. A description of the building blocks has been presented by the Asia Pacific Development Effectiveness Facility (AP-DEF) and UNDP:[26]

**Building block 1: Leadership to facilitate institutional coherence** is essential to bring together actors from across, and outside, the government to build an integrated approach to meet finance challenges, ensure alignment in policies, and provide an overall results-oriented direction to leverage and utilize finance in support of sustainable development priorities.

**Building block 2: A clear vision for results** that the country wants to achieve is the foundation of an INFF on which financing plans and targets are built. It sets out the sustainable development outcomes and impact that the country wants to realize and is typically articulated in a national development plan or long-term vision. It should set out a realistic formulation to consider the cost and financial resources needed to achieve the goals, and therefore needs to include reference to the costs of achieving the vision.

**Building block 3: An overarching finance strategy** takes the long-term vision for results and develops proposals for the types of investments needed to meet the costs. It provides the framework within which specific finance policies for resource mobilization can be developed and operationalized, and should also take into account issues of the absorptive capacity of government institutions to deliver finance to achieve the vision for results. For many countries, the overarching finance strategy would be a significant extension of existing medium-term finance framework approaches.

**Building block 4: Specific finance policies** are articulated to mobilize different types of finance, in a scale and manner consistent with the overarching finance strategy. They govern a range of policies such as tax revenue strategies and national aid policies.

**Building block 5: A robust monitoring, evaluation and learning system** is key for a results-focused finance strategy. Systems that can effectively monitor the progress of government efforts to mobilize financing, to the outcomes of mobilized investments and the results that they contribute towards, can inform more effective approaches to the use of finance.

**Building block 6: An enabling environment for accountability and dialogue** is necessary to build trust to be able to mobilize financing from stakeholders outside the government, to make sure policies are being designed and delivered effectively and to ensure a voice for citizens, civil society, business, and other actors in development.

26 Ibid.

## 2.2 The DFA approach in Nepal

The financial flow analysis does, to the extent that data has been accessible, cover the Fiscal Years (FYs) from 2005/2006 to 2014/15, and incorporates domestic and external, public and private capital flows that can potentially serve to finance the policy priorities of the Government of Nepal. To contextualize the financial mapping, comparisons are made to regional averages and/or countries at a similar income level, as measured by gross national income (GNI) per capita, and other South Asian Association for Regional Cooperation (SAARC) countries.

The financial mapping has been organized into three analytical levels. At the highest level (level 1) the analysis covers: a) domestic public; b) external public; c) domestic private; and d) external private finance. At level 2, the analysis covers conventional disaggregation of each of the level 1 financial flows (e.g. domestic revenues, domestic lending), whereas level 3 analyses financial flows of specific interest where data availability allows for detailed disaggregated analysis (e.g. tax and non-tax revenues, different forms and channels of ODA grants, funds for promoting private sector investments and public-private partnerships (PPP)). Data has been subject to triangulation between different sources, using national official statistics and public sector finance data presented by the Government of Nepal as the primary source. In addition, the data analysis, in particular at disaggregated levels, has been supplemented by data and results from surveys and reviews undertaken on particular subjects. Table 1 categorizes the financial flows included in the DFA as domestic/external and public/private.

### Table 1: Categorization of financial flows included in the financial flow analysis

| | Public | Private |
|---|---|---|
| Domestic | • Tax revenues<br>• Non-tax revenues<br>• Government borrowing | • Domestic savings/investments<br>• Domestic credit<br>• National NGOs |
| External | • Official development assistance grants and loans<br>• Other official flows | • International financial markets<br>• International NGOs<br>• Foreign direct investment<br>• Remittances |

Following the mapping of finance flows, a Policy and Institutional Diagnostic Analysis (PIDA) is presented. The PIDA assesses the extent to which the policy, planning and budgeting structures of Nepal facilitate achievement of development objectives.

The PIDA is based on three sources of data: i) the outcome of the financial mapping; ii) primary data from interviews with public and private sector stakeholders collected by the DFA team; and iii) secondary data from diagnostic studies such as the Public Expenditure and Financial Accountability (PEFA) Assessment. Based on this analysis, baselines of each of the six INFF building blocks are summarized in text boxes.

The PIDA is followed by a prospective analysis that presents the trends and composition of the finance flows of Nepal compared with other countries at a similar income level. The analysis aims to illustrate the potential that Nepal may have to mobilize additional finance.

Based on the mapping of finance flows, the PIDA, and the prospective financial flow analysis, the DFA aims to provide advice to strengthen the INFF along the six building blocks.

## 2.3 Data collection

The analysis is based on primary financial data provided by the MoF, the Financial Comptroller General's Office (FCGO), the National Planning Commission (NPC), the Central Bureau of Statistics (CBS), Ministry of Labour and Employment, Ministry of Industry, and NRB, and on secondary data from the World Bank, the International Monetary Fund (IMF) and the Organisation for Economic Co-operation and Development (OECD) databases as well as others. In addition, the analysis was supplemented by data and results from various surveys undertaken to enable further analysis at disaggregated levels.

The team also collected qualitative data from a range of stakeholders including government institutions, private sector institutions, non-governmental organizations (NGOs), and development partners, which provided additional information by sharing relevant assessments, reviews and evaluations, as well as government documents. The data sources mentioned partly overlap, which gave the team the opportunity to triangulate the data between the different sources.

The public finance data from FY 2005/2006 to FY 2014/2015 are based on the final audited accounts by the Office of the Auditor General of Nepal. Data for FY 2015/2016 is thus to be considered final *unaudited* accounts. Data on external flows have been based on information from the NRB, while the more disaggregated analysis of individual flows has been based on the information from the MoF Aid Management Platform (AMP), OECD/Development Assistance Committee (DAC), the World Bank, and IMF, among others. The former is based on reports by international agencies present in Nepal, while OECD/DAC, IMF and the World Bank data are from their respective international headquarters. The World Bank and IMF data are reconciled with the NRB and FCGO data. While there are deviations between the different sources, the aggregates are based on primary sources from public accounts and balance of payments statistics, while the disaggregated data, with more detailed information about a particular flow (purpose, nature of disbursement, etc.) has been based on the other sources.

The disaggregated analysis of some flows, such as remittances and private equity funds, have in some cases been based on information from sample surveys, in which case they serve as estimates rather than actual accounts.

# 3. Country context

Following a decade-long armed conflict, the people's movement of 2006 and the abolition of the monarchy in 2008, Nepal has been undergoing a gradual transition to a federal democratic state. After seven years with an interim constitution, a new constitution with a federal structure was approved by the Constituent Assembly in September 2015, and Nepal is now a federal, democratic and republic state. According to the new constitution, the Federal Democratic Republic of Nepal will have three tiers of Government, with a central (federal), a provincial (state), and a local government level.

Currently, the Government of Nepal is implementing the 14$^{th}$ Periodic Plan. The 14$^{th}$ Periodic Plan has set an annual average growth target of 7.2 percent, and outlines plans to reduce poverty levels from the current level of 21.6 percent to 17 percent by 2019. The following sub-section presents the economic and socio-political context of Nepal, in which the government has set ambitious policy objectives to achieve the targets of the 14$^{th}$ Periodic Plan, and the longer-term ambition of achieving MIC status and the SDG targets relevant for Nepal by 2030.

## 3.1 Economic performance

Nepal has maintained a reasonable macroeconomic performance over the last decade, with fiscal deficits below 4 percent of GDP and an inflation rate of 8.7 percent, on average, between 2006 and 2015. Financial sustainability has in part been strengthened by a steady increase in government revenues, which on average increased by 14.9 percent annually over the last decade, and by 17.1 percent annually for the period between 2011 and 2015. However, budget execution rates remain low, in particular with regard to capital spending due to problems related to structural weaknesses such as poor project management and bureaucratic hindrances.[27] Moreover, political instability has fuelled the problems.

The internal capital market is getting stronger and more robust, with public sector debt well below the average in the region. Despite the continued increase in the trade deficit, the balance of payments has mostly remained favourable and the foreign exchange rate reserve is strong. A significantly low level of outstanding debt over recent years has created more fiscal space, which helps the government to increase loans for much-needed infrastructure and human capital improvements.

In 2015, GDP per capita in Nepal was $743, which is more than double compared to 2006, but is second lowest among the SAARC countries, and is less than half of India's gross domestic product (GDP) per capita. Table 2 shows GDP per capita in US dollars at current prices among SAARC countries.

27 International Monetary Fund (IMF). 2015. "Staff Report for the 2015 Article IV Consultation."

### Table 2: GDP per capita at current prices, US dollars, SAARC countries

| | 2006 | 2011 | 2015 |
|---|---|---|---|
| Afghanistan | 280 | 622 | 594 |
| Bhutan | 1,346 | 2,486 | 2,656 |
| India | 817 | 1,461 | 1,598 |
| Nepal | 351 | 694 | 743 |
| Maldives | 4,429 | 6,498 | 8,396 |
| Pakistan | 877 | 1,230 | 1,435 |
| Sri Lanka | 1,449 | 3,221 | 3,926 |

Source: World Bank, World Development Indicators (WDI).

Despite satisfactory macroeconomic management, the economy of Nepal has, for some time, been in a situation of low investment and low growth development, and Nepal remains among Asia's poorest countries.[28] The average real GDP growth over the last decade has been 4.3 percent; however, the annual average per capita growth has been lower than that of most other South Asian countries, at just 3.2 percent. Table 3 presents average GDP per capita growth, for SAARC countries, for the period from 2006 to 2015, and the periods from 2005 to 2010 and from 2011 to 2015. Nepal has the second lowest average annual growth among all SAARC countries over the last decade.

### Table 3: Average percentage GDP per capita growth rates, SAARC countries

| | 2006–2010 | 2011–2015 | 2006–2015 |
|---|---|---|---|
| Bangladesh | 4.8 | 5.1 | 4.9 |
| Bhutan | 7.4 | 3.9 | 5.7 |
| India | 6.5 | 5.4 | 6.0 |
| Nepal | 3.4 | 3.0 | 3.2 |
| Maldives | 5.9 | 2.7 | 4.3 |
| Sri Lanka | 5.6 | 5.3 | 5.4 |
| Afghanistan | 7.5 | 1.8 | 4.7 |
| Pakistan | 1.3 | 1.8 | 1.6 |

Source: World Bank, WDI.

In 2015, economic growth was slowed considerably by the disruption caused by the earthquakes in May and June 2015 that devastated large parts of the country and its infrastructure. Significant pledges for the reconstruction and rehabilitation of the earthquake damage and its victims were made by the international community, in particular from China and India and from the ADB. However, reconstruction efforts have been slow, with delayed disbursements from reconstruction funds, and only modest improvements in infrastructure have been achieved.[29]

28 IMF. 2017. "Staff Report for the 2017 Article IV Consultation."

29 The Economic Intelligence Unit. 2016. *Nepal Country Report*.

In FY 2015/2016, the economic growth of Nepal was also slowed by protests of the Tarai-based and ethnic political parties in the southern region and some of the hill regions, which were not satisfied with some provisions of the constitution. The protests led to a blockade on the southern border, resulting in disruptions in economic activity. This led to further disruptions in the transportation and trade routes to and from the southern border, causing shortages of fuel and other imported goods. The disruption at the southern border, which lasted for about six months, led to an increase in the inflation rate, a reduction in capital expenditures and revenue of the government, and ultimately slowed economic growth for FY 2015/2016 to the lowest level in 14 years.

The economic growth of Nepal remains highly dependent on the monsoon season, which affects the agricultural production that makes up about 31 percent of the economy of Nepal, with about 64 percent of the population dependent on the agricultural sector. For example, in FY 2014/2015, economic growth was slowed by the unfavourable monsoon, while in FY 2015/2016 the monsoon accelerated economic growth.

The economy of Nepal is also highly dependent on remittances, which have increased sharply over the last decade from 16.1 percent of GDP in 2006 to 31.8 percent of GDP in 2015, by far the highest in the SAARC region. Reports also highlight that Nepal is highly vulnerable to climate change, and that the increasing number of droughts, floods, hailstorms, landslides and crop diseases mostly affect the livelihoods of the poor.[30] In 2016, the economic growth rate increased by 6.9 percent and the inflation rate reduced to below 5 percent.

Despite increased integration into the international economy over the last decade, in particular with India, the economy of Nepal remains undiversified. The level of intra-regional trade remains significantly below its potential and holds back investments, which results in low growth of exports and increasing trade deficits. Trade obstacles include the lack of progress in lowering tariff barriers, slow development of adequate infrastructure, and high dependency on a single country for trade.

## 3.2 Poverty and inequality

Despite modest economic growth, Nepal has achieved a significant reduction in poverty, from about 31 percent in FY 2005/2006, to less than 25.2 percent in FY 2010/2011, to 21.6 percent in FY 2016/2017. Nepal has also made progress overall on the Human Development Index over the last decade, and on the underlying dimensions that are comparable over time. In 2016, Nepal ranked 145 out of 187 countries, on par with Kenya, and was the third lowest ranking country among SAARC countries, ranking above only Pakistan (147) and Afghanistan (171).[31]

Moreover, the third National Living Standard Survey (NLSS III), which was published in 2011, showed a significant improvement since FY 2003/2004 across many indicators, particularly in the areas of education, health and gender. Access to electricity supply also improved significantly from 45 percent in 2004 to 74 percent in 2011. Similarly, the dependency ratio improved by 19 percentage points, while the amount of land owned, number of assets, and adult literacy all improved by about 10 to 11 percentage points.[32]

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30 World Bank. 2017. "The World Bank in Nepal, Overview."

31 UNDP. 2016. Human Development Report 2016: *Human Development for Everyone.*

32 Government of Nepal, Central Bureau of Statistics. 2016. "Nepal Living Standard Survey 2010-2011, NLSS Third."

Recent data published by the NPC has shown significant improvements in access to water supply and sanitation (83.6 percent and 81 percent respectively in FY 2016/2017).

Although Nepal has recorded important socio-economic improvements, significant disparities in poverty and socio-economic conditions remain between regions, castes and genders. Chronic poverty is concentrated in the Mid-Western and Far-Western development regions, where access to public services, literacy rates and women's empowerment are all substantially worse when compared with other regions. Moreover, as elsewhere in South Asia, poverty in Nepal particularly affects women and socially excluded groups. For example, food self-sufficiency is much lower in the Mid-Western and Far-Western development regions than in other regions, women and socially excluded groups lag far behind in education and health, and gender disparities are more significant than in other regions.[33]

## 3.3 Political developments

After the armed conflict ended with a peace agreement in 2006, the country embarked on a series of challenging political and economic transitions. Elected Constituent Assemblies were formed in 2008 and 2013, and the decommissioning of the insurgent army was completed in 2012.

Since Nepal became a democratic republic in 2008, nine different government administrations based on different government coalitions and power-sharing deals have been sworn in.[34] Due to the frequent changes in government, combined with fragmented and identity-based political structures, there has not been predictable and strong political leadership in place to lead and implement needed structural reforms, nor have gaps in infrastructure development been adequately addressed. The current coalition government, led by the Nepali Congress, came to power in June 2017.

Despite political instability, Nepal has made significant achievements in terms of forging consensus around the country as a secular and democratic republic, with the aim to build an equitable, just, inclusive and prosperous society based on the principles of equality and proportional inclusiveness. A key milestone was reached when the Constituent Assembly, after seven years with an interim constitution, passed the seventh constitution of Nepal on 16 September 2015. The promulgation of a new constitution was, however, immediately followed by protests. Moreover, Tarai-based and ethnic political parties opposed the constitution, on the basis of being gender discriminatory, especially in regard to citizenship provisions and the demarcation of provinces.

While the promulgation of the new constitution undoubtedly creates opportunities for economic development and prosperity, it is also a reality that contentious political issues regarding the delineation of federal units remain to be solved, including economic issues, such as developing a fair and predictable system for the distribution of financial resources that provides equal opportunities for all localities. Moreover, prosperity requires strong leadership, clear and consistent policies, institutional coherence and strong accountability structures, including to create an enabling environment of predictability for small- and medium-sized enterprises (SMEs), regular access to electricity, sound infrastructure, security, and inclusion of socially excluded groups in decision-making processes and in economic activity.

33 Department for International Development. 2013. "Regional dimensions of poverty and vulnerability in Nepal."

34 The Economist Intelligence Unit. 2016.

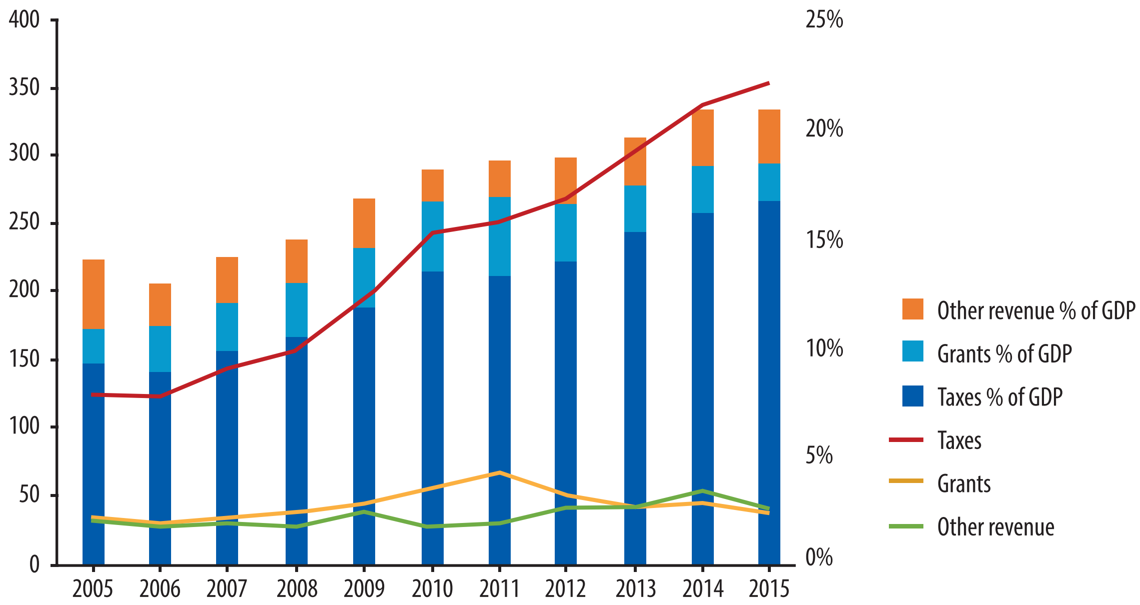
To achieve its medium- and longer-term policy objectives, the Government of Nepal will need to implement structural reforms in parallel with the implementation of the new constitution with federal structures. To implement the federal structures, the government has already held local level elections in three phases and has announced that elections of federal and provincial levels will be held concurrently in two phases on 26 November and 7 December 2017. After these elections new governments will be formed at provincial and federal levels, which will help to restore political stability and expedite the economic development agenda. The government is also developing strategic frameworks that will provide a basis for government policies to underpin growth and development. In this context the concept of an INFF provides an overview of the strategic entry points and policy options available to improve the linkage between public and private finance and development results in Nepal.

# 4. Mapping the finance flows of Nepal

## 4.1 Government revenues

Government revenues, which consist of taxes, grants and other revenues, serve as a major source of finance for Government of Nepal investments and programs to achieve the SDGs and the long-term vision. The Government of Nepal has displayed continuous improvements in revenue performance over the last decade, as illustrated in Figures 2 and 3.[35]

**Figure 2: Revenue in bln NPR at constant 2015 prices, and as percentage of GDP**




Source: Ministry of Finance, Budget Division.

Tax revenue has increased, with a rising trend both in real value and as a share of GDP compared to countries at the same income level. Total revenue has been growing steadily over the years, although at a decreasing rate in recent years.

A 2015 review of the tax policy framework[36] and implementation of various policy reforms will likely serve as a countermeasure to declining trends in revenue performance in the last years, including by the development of a unified tax code and further efforts to improve tax administration and compliance.

35 Due to the lack of reliable data, local governments' collected revenues (fees and taxes) are not included in the estimates. Local tax revenues constitute, however, a very low share of total revenues. Draft calculations based on data shared by the Ministry of Federal Affairs and Local Development (MoFALD) suggests that local government revenues were approximately 1.5 percent of the government's total tax revenues in FY 2012/2013.

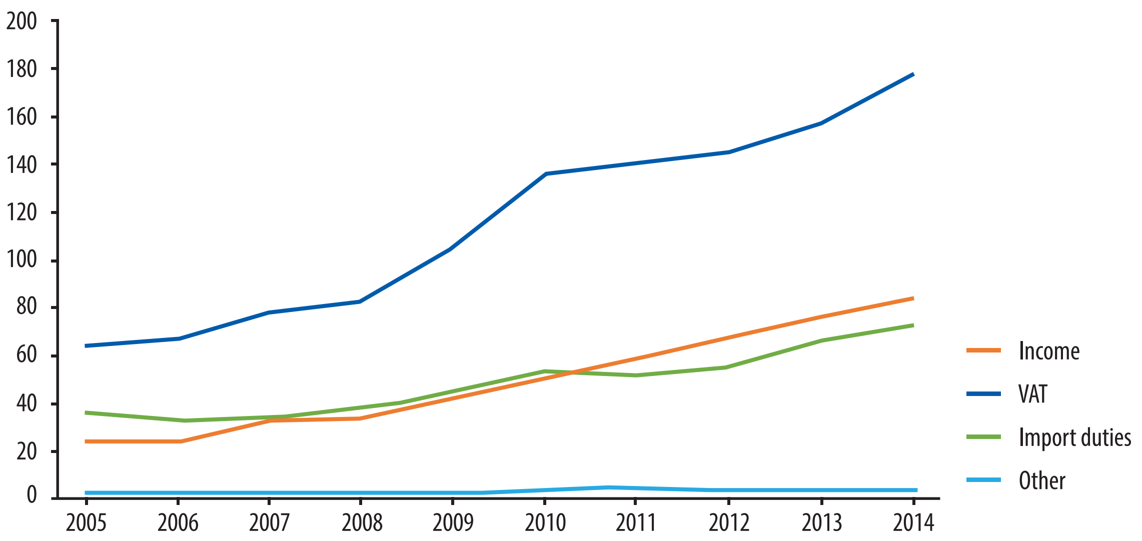
36 International Monetary Fund. 2015. "IMF Country Report No. 15/317."

### 4.1.1 Tax revenues

The Government of Nepal has put in place a diversified set of taxes as part of its tax policy. Tax revenue derives from a combination of direct and indirect taxes: income taxes, corporate taxes, value-added tax (VAT), and taxes on imports. The government's increase in tax revenues in real terms over the last decade is mostly due to rising VAT stemming from broadening of the tax base and continued efforts to improve the tax administration. Import duty collections have also increased in real terms due to an increase in imports financed by the growing volume of remittances, although not at the same level of growth as VAT. Accordingly, Nepal has transitioned from reliance on customs tax revenue to more diversified forms of taxes and in strengthening its tax administration.

Nepal has also undertaken tax administration reforms including partially moving to an e-system that allows for online registration and filing and establishment of a large taxpayer unit. These policy and institutional reform measures have increased the tax-to-GDP ratio of Nepal significantly over the past decade, and Nepal is currently among the best performers in the region, as shown in Figure 4. Collection of direct as well as indirect taxes has increased, with maximum gains accrued in the collection of indirect taxes, and with trade tax collection close to the global average.

**Figure 3: Tax revenue in bln NPR at constant 2015 prices**

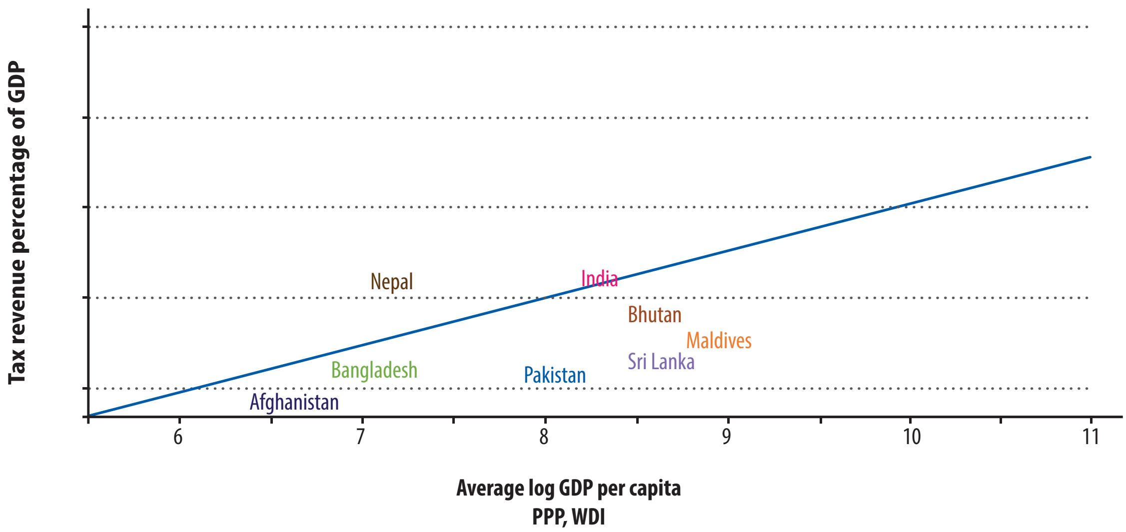



Source: Ministry of Finance, Budget Division.

These observations are confirmed by a survey of tax revenue performance among 102 countries. According to this survey, Nepal is among the countries in the SAARC region performing above the "global" average.[37]

37 Gupta, Poonam. 2015. "Generating Larger Tax Revenue in South Asia." The World Bank.

**Figure 4: Tax revenue percentage of GDP relative to income level (GDP per capita at PPP rates), SAARC countries**




PPP: Purchasing power parity

Sources: World Bank World Development Indicators and IMF Government Finance Statistics.

As displayed in Figure 4, only India has a similar level of tax revenue in percentage of GDP with a relatively effective tax regime and administration. Questions remain, however, as to whether the tax levels hinder private sector investments and growth, as Nepal has faced several years of lower than average GDP growth rates and lower private sector investment as compared to the other countries in the region.

Moreover, there is still considerable scope to increase the tax-to-GDP ratio by eliminating exemptions (including exemptions on corporate income tax), expanding the tax base and increasing tax compliance. Tax generation from income taxes remains low compared to other countries in the region and can be increased further. Less than 1 percent of the population pay income tax, which is among the lowest in the SAARC region and far below the "global average". Non-filers are estimated to be almost half of the eligible taxpayers for income tax.[38]

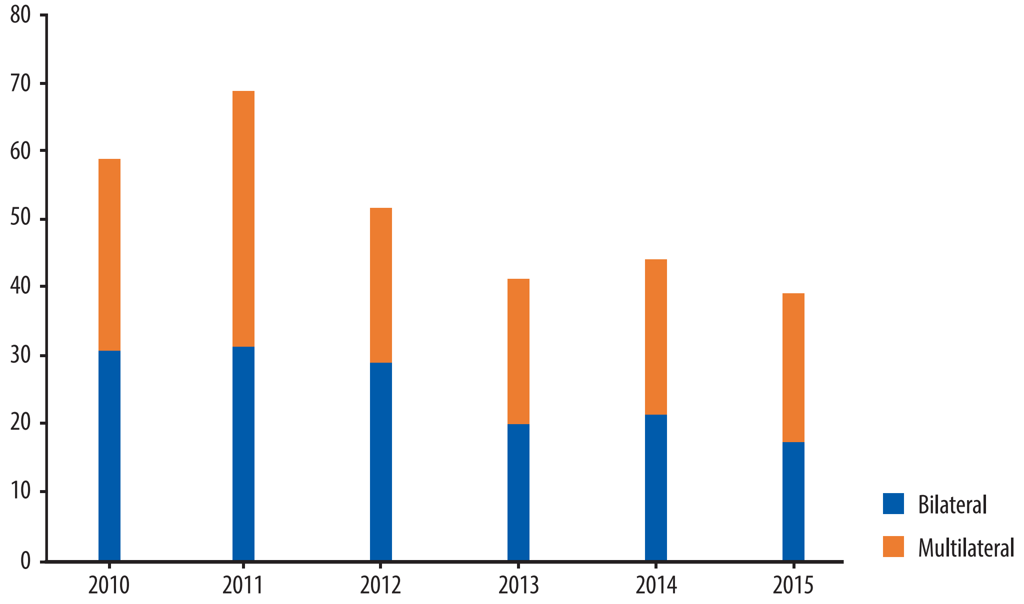
## 4.1.2 Other revenues

Non-tax revenues are dominated by concessional grants in the form of ODA from multilateral and bilateral sources. The real value of grants "on budget"[39] has declined over the years.

38 IMF. 2015. "IMF Country Report No. 15/317."

39 "On budget" refers to actual grant receipts as captured by the Government of Nepal cash management system "Treasury Single Accounts", which records all receipts and payments of the government using the state budget and accounting system for, among others, recording receipts by source of funding.

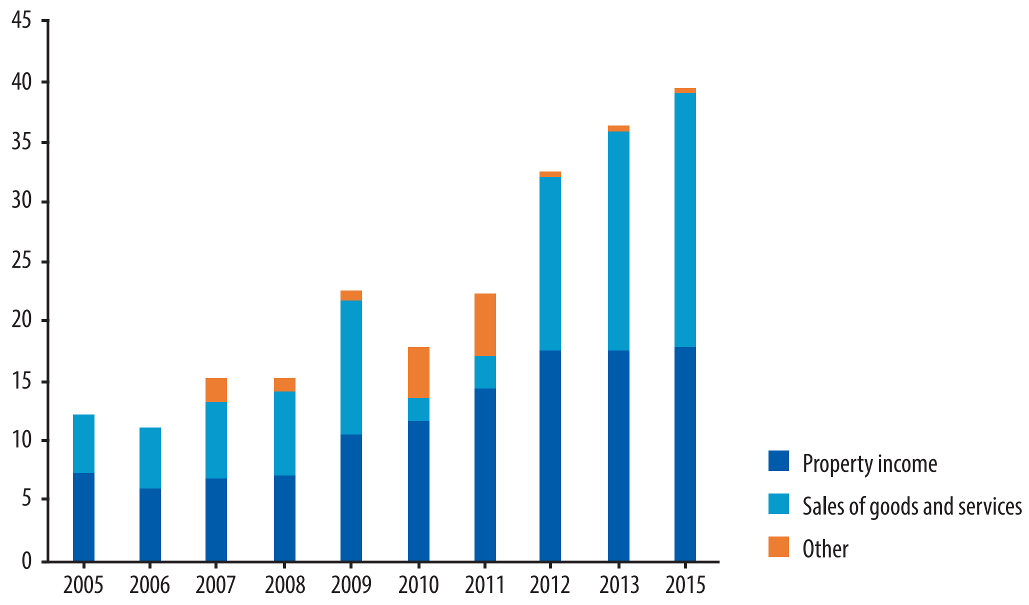
### Figure 5: Foreign grants on budget in bln NPR at constant 2015 prices




Source: Ministry of Finance and OECD/DAC.

In contrast to ODA grants, other non-tax revenues have increased as a source of revenue. Service charges from public assets and services reached the same level as the volume of the declining ODA grants by 2015. Figure 6 shows the composition of non-tax revenues, excluding ODA.

### Figure 6: Other non-tax revenues in bln NPR at constant 2015 prices



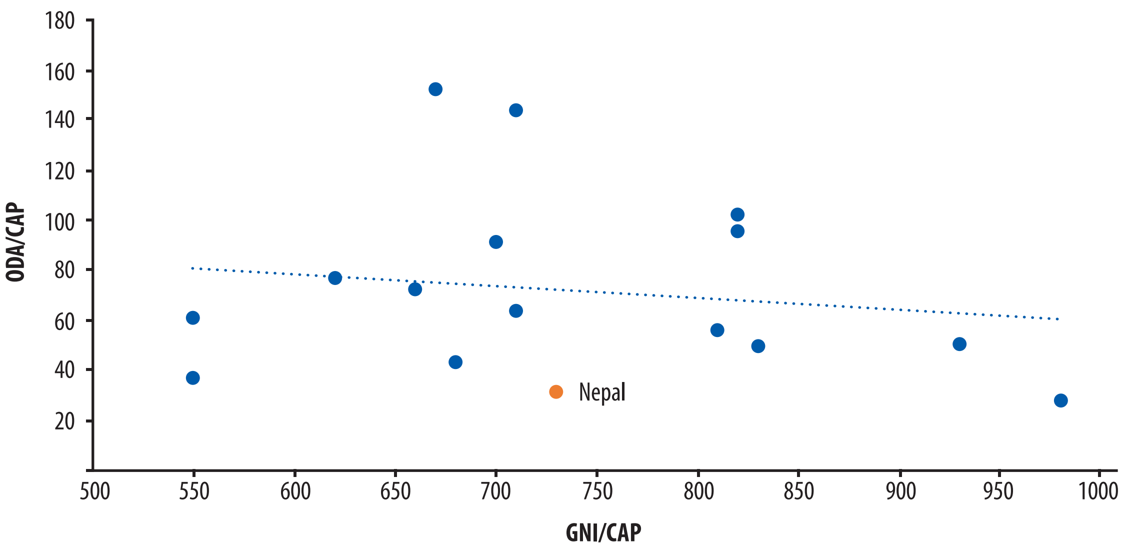

Source: Ministry of Finance, Budget Division.

## 4.2 Official development assistance

As shown in Figure 5, external finance in the form of ODA for financing public expenditure has declined over the years. This indicates that the Government of Nepal has significant potential to raise more finance from ODA grants; first, by increasing the capacity in utilizing grants offered (commitments) and second, by accessing other and new concessional arrangements from other sources such as global programs/ global funds.

Figure 7, which shows net ODA per capita by GNI per capita in the same income bracket as Nepal (between $500 to $1,000 per capita) confirms this assumption. The figure demonstrates that there is a correlation between GNI per capita levels and levels of ODA per capita as illustrated by the trend line (moving average). However, net ODA flows as compared to GNI per capita in Nepal is low at slightly above $30 per capita, which is lower than almost all other countries in the same income bracket. This clearly suggest that Nepal has the potential to attract additional ODA funding at a level closer to other countries in the same income bracket.

**Figure 7: Net ODA per capita in US dollars by GNI per capita for countries in 2014[40]**




Source: OECD/DAC – Geographical Distribution of Financial Flows to Developing Countries.

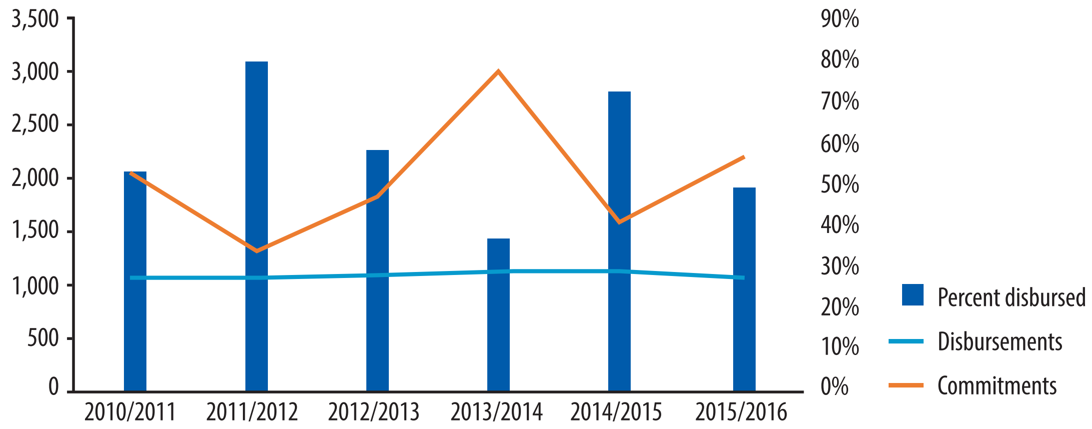
The above observation might also be due to Nepal having comparatively low internal absorptive capacity in the design of programs eligible for donor funding as well as low capacity in execution. This assumption is supported by Figure 8, which shows that donor commitments tend to be much higher than disbursements, and that there has been significant variation in donor commitments from one year to another over the last decade. However, it is also likely that contextual factors, such as the unstable political environment and relatively low compliance with donor aid policies and preferences (transaction cost of compliance with donor conditions), impacts on both donor commitments and low levels of disbursements.

40 Net ODA figures include both grants and lending on concessional (ODA) terms.

To increase transparency and accountability in the management of foreign aid, Nepal has pronounced Development Cooperation Policies over the years, most recently in 2014, and since 2010 has maintained an Aid Management Platform (AMP). With its annual Development Cooperation Report (DCR), the MoF draws on AMP data to offer government officials, donors and the public an overall view of aid trends in country. It has served as a tool to target better future development assistance.

An MoF analysis of AMP data[41] in FY 2014/2015 shows a high fragmentation of ODA commitments and disbursements. The analysis shows that Nepal is overcrowded with small projects scattered among various implementing agencies. Among others, there were more than 440 projects and development partners engaged with up to eight line ministries on average.

**Figure 8: ODA commitments and disbursements, FY 2010/2011 – FY 2014/2015 (in millions of US dollars and disbursement as a percentage of commitments)**

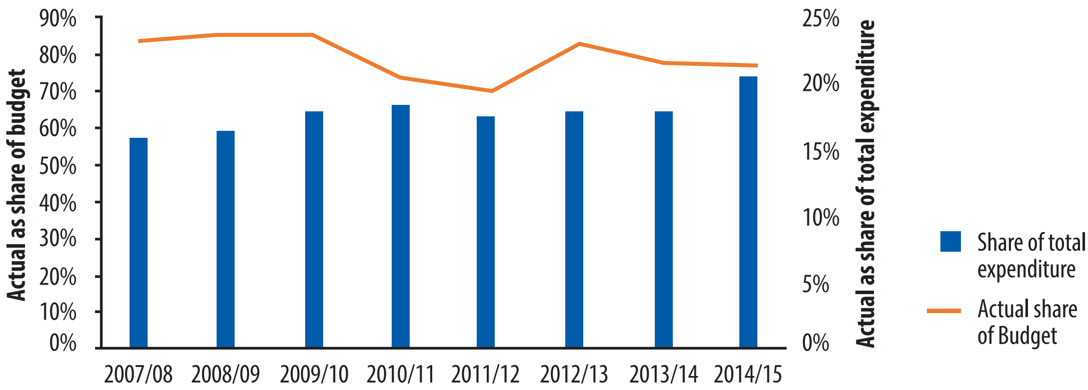



Source: Ministry of Finance and OECD/DAC.

This finding by itself may explain some of the reasons for the low absorptive capacity of ODA finance, as it demands significant capacity to manage such a diverse fragmented portfolio. A key policy response has been an attempt to direct development partners towards sector programs and promote donor-government dialogue to engage development partners in joint financing arrangements. This approach may serve to reduce transaction costs and fragmentation of scarce resources among many small-scale interventions with donor overcrowding in some sectors.

41 Government of Nepal, Ministry of Finance. 2016. "Development Cooperation Report: Fiscal Year 2014/15."

**Figure 9: Capital expenditure; actual as share of budget and actual as share of total public expenditure, FY 2007/2008 – FY 2014/2015**




Source: Ministry of Finance/FCGO.

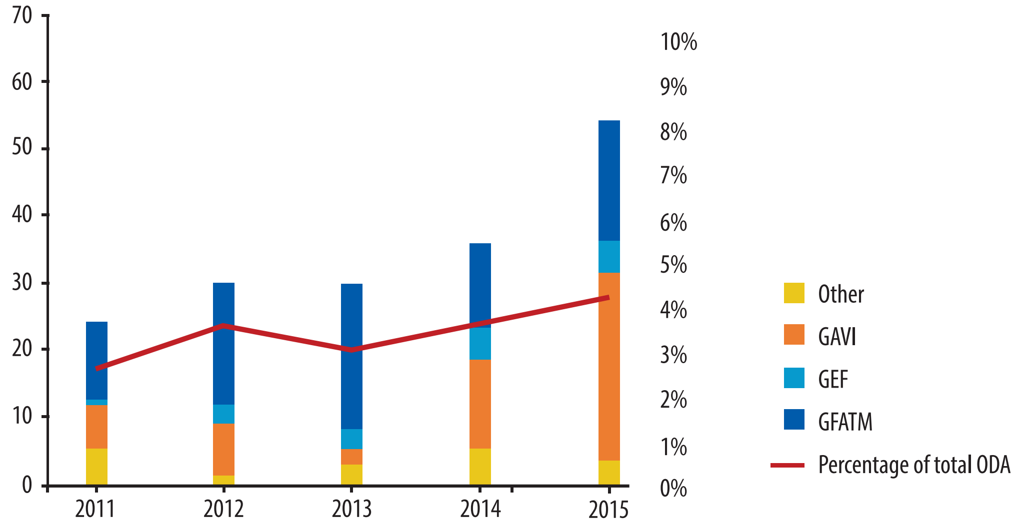
The relatively low level of absorptive capacity is also reflected in the low level of execution of planned public investments. Figure 9 shows capital expenditures as a share of the budget and as a share of total expenditures. The figure illustrates that actual expenditures for all years, except for FY 2014/2015, are significantly below budget. It also shows that the budgeted capital expenditures from the outset are low, particularly considering that Nepal is a mountainous low-density country with significant challenges to reach out with national infrastructure like roads, electricity, and for the construction of schools and health centres. Access to infrastructure services is also among the main challenges reported in business climate surveys (in addition to access to finance).

## 4.3 Global concessional funds

The trend in disbursements from global concessional funds such as the Global Alliance for Vaccines and Immunisation (GAVI), the Global Fund to Fight AIDS, Tuberculosis and Malaria (GFATM), the Global Partnership for Education and the Global Environment Facility has been increasing over the years, with the GFATM and GAVI as the major sources for funding health sector interventions. However, compared to other countries with similar GDP per capita levels, the finance from global concessional funds is low.

Despite a significant nominal increase in funding from global funds to Nepal during the last two years, as shown in Figure 10, funding from global funds constitutes only on average 3.9 percent of total ODA disbursements. Funding from global funds constitutes on average 70 percent more of total ODA disbursements in other countries at the same per capita income level where this funding on average constitutes 6.5 percent of ODA disbursements. This is despite the fact that the overall ODA per capita in Nepal is generally lower than its peers, suggesting that Nepal has an opportunity to qualify for larger volumes of this source of concessional funding provided it can raise capacity in planning and implementation.

**Figure 10: Global Development Funds–disbursements from 2011 to 2015 (in millions of US dollars and as percentage of total ODA disbursements)**




Source: Ministry of Finance and OECD/DAC.

There are several other sources of funding from global funds providing access to concessional finance also yet to be tapped into by Nepal beyond GFATM, GAVI, the Global Partnership for Education and the Global Environmental Facility. While a number are country and region specific, in particular for sub-Saharan African countries, Nepal is eligible for several of them. As Nepal is a low-income country it will be given specific priority in allocation of funding from global development funds/programs. The new and evolving allocation for climate financing is an example of the potential low-income countries have to raise more funding to meet challenges to adapt to climate change (national adaption programs) as well as to undertake mitigating actions (national mitigation programs).

According to the Climate Funds Update,[42] 17 countries in Asia have together received almost a quarter of all public climate finance from dedicated climate funds. The 27 global multilateral and bilateral climate funds it monitors have approved a total of $4.2 billion for 459 projects and programs in the Asia region. However, the diversity of active funds in the region is not matched in the distribution of finance. Considerable amounts of finance have flowed to the fastest-growing economies such as India and Indonesia, primarily for mitigation projects. On the other hand, many nations at considerable risk to climate change, such as Nepal, have received relatively little compared to the size of the country both in terms of population and area impacted by climate change.

42 The Climate Funds Update is a joint initiative of the Heinrich Böll Stiftung and the Overseas Development Institute (ODI). It monitors dedicated climate change funds from the stage when donors pledge funding through to the actual disbursement of financing for projects.

### Text Box 1. Global funds and financing climate mitigation

As an illustration of additional global funding sources on concessional terms, the following may serve as examples:

The Adaptation Fund is a financial instrument under the United Nations Framework Convention on Climate Change (UNFCCC) and its Kyoto Protocol. It was established to finance concrete adaptation projects and programs in developing countries party to the Kyoto Protocol in an effort to reduce the adverse effects of climate change impacting communities, countries and sectors. The Fund is financed with a share of proceeds from the Clean Development Mechanism (CDM) project activities as well as through voluntary pledges of donor governments. The share of proceeds from the CDM amounts to 2 percent of Certified Emission Reductions issued for a CDM project activity. To date, only one project has received funding in Nepal ("Adapting to climate induced threats to food production and food security in the Karnali Region of Nepal").

The Clean Technology Fund (CTF), one of two Multi-Donor Trust Funds within the Climate Investment Funds, promotes scaled-up financing for demonstration, deployment and transfer of low-carbon technologies with significant potential for long-term greenhouse gas emissions savings. Channelled through the Regional Development Banks and the World Bank, the CTF finances 12 country programs and one regional program. Nepal has not yet received financing from the CTF.

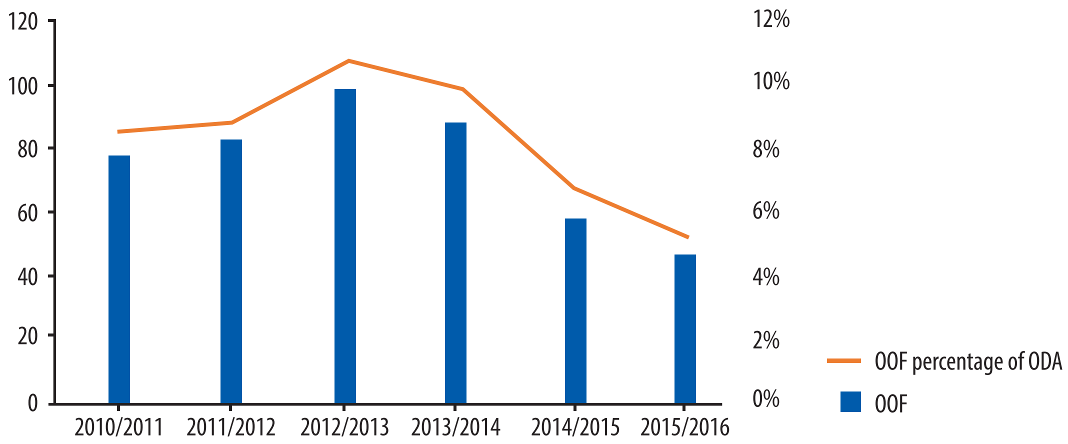
The Global Energy Efficiency and Renewable Energy Fund (GEEREF) is a PPP, designed to maximize the private finance leveraged through public funds, funded by the European Commission and managed by the European Investment Bank. GEEREF is structured as a fund of funds, and invests in private equity sub-funds that specialize in financing small- and medium-sized project developers and enterprises to implement energy efficiency and renewable energy projects in developing countries and economies in transition. To date, few of the funds invested in by GEEREF have found PPP projects eligible for financing in Nepal.

Given the objectives associated with these sources of finance and their potential for meeting financing requirements for many of the development challenges of Nepal in health, education, environment and climate change, there is potential to increase access to finance from global funds by more proactively engaging them in addressing development challenges in Nepal.

# 4.4 Other official flows[43]

Nepal is a destination for other official flows (OOF) from non-OECD countries such as China and India. In total, OOF has added another 6 to 10 percent over and above ODA contributions during the last decade, as shown in Figure 11. A major share of this funding has been directed towards education, health and public infrastructure projects in addition to some for lending to public corporations. Approximately 62 percent has been provided as cash grants, 27 percent as loans, and 11 percent in the form of technical assistance. The extent to which this source of funding can be increased depends on the capacity of the Government of Nepal to plan and execute added investments (ref. the observation related to the capacity of the Government of Nepal to utilize fully ODA commitments discussed in the sections above).

**Figure 11: Other official flows - disbursements FY 2010/2011 – FY 2015/2016 (in million US dollars)**




Source: Ministry of Finance and OECD/DAC.

Countries at the same income level as Nepal often also attract other forms of flows from multilateral and bilateral donor countries, among them additional forms of equity, quasi- equity and concessional credits[44] directed at public corporations and the private sector. One example is the 15 development finance institutions (DFI) forming part of the Association of European Development Finance Institutions (EDFI).

These flows are, however, highly dependent on the investment and business climate of the country, both as concerns risk and opportunities for repatriation of dividends. Nepal has the potential to attract concessional and/or venture capital from DFIs at significantly higher levels by, among others, further streamlining business registration, licensing and the regulatory environment as well as opening up new sectors for foreign investors. This is evidenced by the larger inflows from these sources by other countries at the same income level.

43 Other official flows (OOF) are defined as official sector transactions that do not meet ODA criteria. ODA is defined as government aid designed to promote the economic development and welfare of developing countries. ODA may be provided bilaterally, from donor to recipient, or channelled through a multilateral development agency such as the United Nations or the World Bank. ODA includes grants, "soft" loans (where the grant element is at least 25 percent of the total), and the provision of technical assistance.

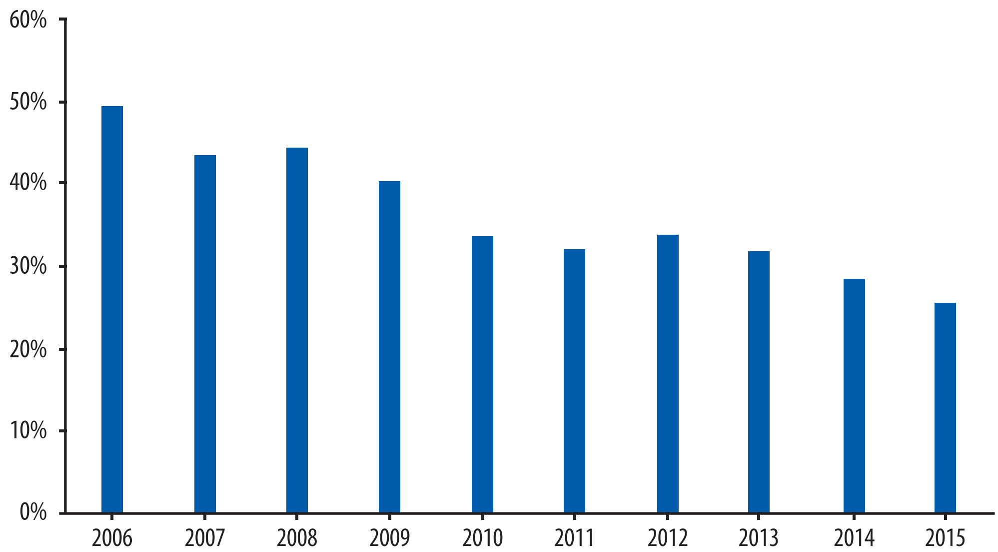
44 Concessional non-ODA equity and credits are for some of these agencies counted as ODA at the time of disbursement but then netted out as repayments are made, by repayments of the credit or sale of shares in private and public corporations or equity investment funds.

## 4.5 Government borrowing

The Government of Nepal has gradually reduced its reliance on domestic and external borrowing to cover public expenditure. This has provided the government with space to use borrowing to finance development activities. As shown in Figure 12, the country's debt-to-GDP ratio stood at a high level, at close to 50 percent of GDP in 2006, declining to 24.5 percent by the end of 2015. External debt-to-GDP has fallen to 15.4 percent and domestic debt-to-GDP is 9.1 percent. This reflects the emphasis of the Government of Nepal on maintaining macroeconomic stability through fiscal discipline.

A joint IMF/World Bank Debt Sustainability Analysis[45] concluded that the risk of debt distress in Nepal remains low. However, a Debt Management Performance Assessment[46] conducted by the World Bank in August 2014 called for improving the effectiveness of managerial oversight of debt management functions. It also recommended to task one entity with the preparation of a comprehensive debt management strategy, analyse the costs and risks of the debt portfolio, and make debt service forecasts more robust. Debt management was recommended to be strengthened in view of the increasingly complex debt instruments and larger borrowing envisaged in the future, particularly related to the development of the hydropower potential of Nepal.

**Figure 12: Government debt as percentage of GDP**




Source: Nepal Rastra Bank.

The current debt levels of the Government of Nepal are at an all-time low level that allows increased debt financing on concessional terms without any significant risk of reaching unmanageable debt service levels. Access to additional debt financing can be acquired from concessional sources such as the multilateral development banks and DFIs. Access to multilateral development bank financing is linked to the capacity of the Government of Nepal in planning and executing public sector investments. Access to DFI financing

45 IMF. 2015. "Request for Disbursement under the Rapid Credit Facility: Debt Sustainability Analysis." See https://www.imf.org/external/pubs/ft/dsa/pdf/2015/dsacr15224.pdf (last accessed on 13 October 2017).

46 World Bank. 2014. "Debt Management Performance Assessment."

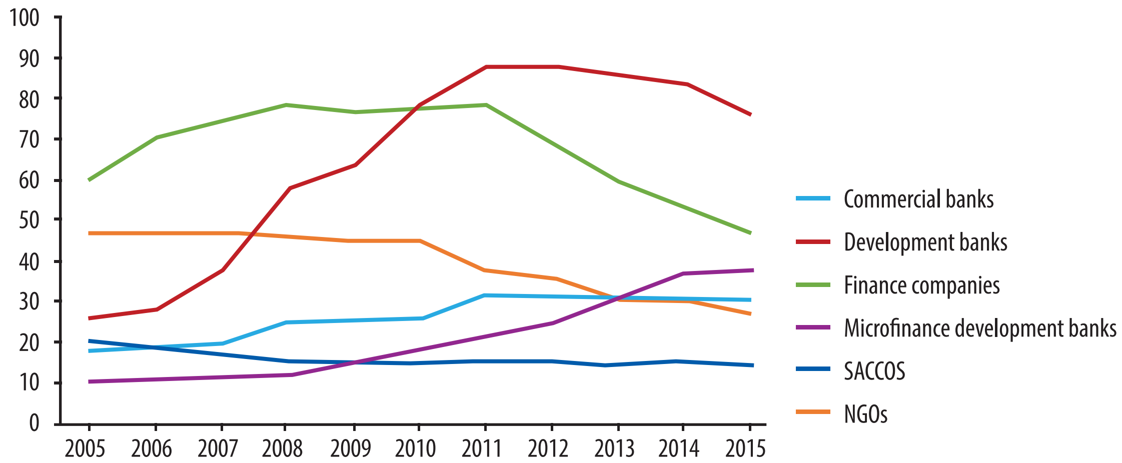
will depend on the extent to which the policy and regulatory environment improves, including the framework for PPP opportunities with access to sectors and investments that potentially could become profitable through engagement by DFIs (such as hydropower and other public utility services).

## 4.6 Private sector investments and credit

In 2015, 241 banks and non-bank financial institutions licensed by the NRB were in operation in Nepal. Of them, 30 were commercial banks, 76 development banks, 47 finance companies, 38 microfinance institutions, 15 saving and credit co-operatives, and 27 NGOs, as shown in Figure 13.

The credit market in Nepal is dominated by the commercial banks. Of the total deposits in 2015, shares were as follows: 82 percent commercial banks; 13 percent development banks; 4 percent finance companies; and 1 percent microfinance development banks. Share of the credit market is as follows: 78 percent commercial banks; 14 percent development banks; 4.6 percent finance companies; and 4 percent microfinance institutions.

**Figure 13: Number of licensed financial institutions**



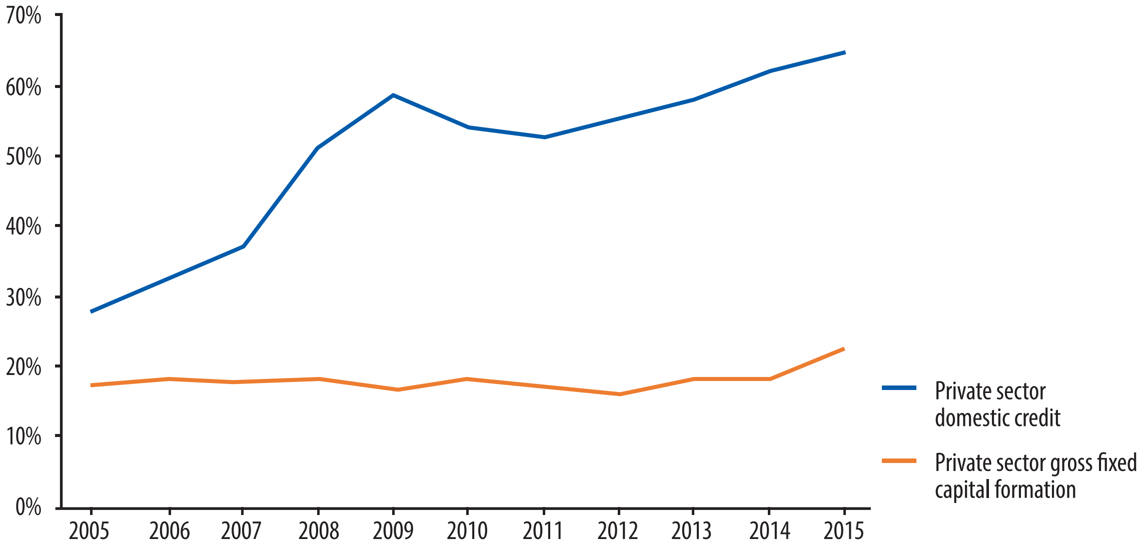

Source: Nepal Rastra Bank.

Access to credit is a major driver for financing of new investments and allows people to purchase assets. Excessive lending and borrowing creates monetary risks while credit availability promotes economic development. If domestic credit to the private sector is from 70 to 100 percent of GDP, a country is considered to have a relatively well-developed financial system. The amount of credit even exceeds 200 percent of GDP in some advanced economies. In some countries, domestic credit is less than 15 percent of GDP, i.e. firms and households essentially do not have access to credit for investment and purchase of assets.

During recent years, domestic credit in Nepal (public and private sector) has grown significantly with an initial 5.6 percent year-on-year increase, rising to 17.8 percent by 2015. The increase has been largely driven by an average year-on-year rise of 21.1 percent in credit to the private sector. Industrial production, wholesale and retail trade, construction and agriculture have been the key sectors to benefit from the expansion in credit.

This development reflects a more conducive domestic credit market for financing of private sector investments. As shown in Figure 14, in 2005, domestic credit to the private sector was 28 percent of GDP while in 2015, it was 65 percent. This compares to an increase in private sector gross fixed capital formation, rising from 17 percent to 23 percent of GDP during the same period.

**Figure 14: Private sector domestic credit and private sector gross fixed capital formation as percentage of GDP**




Source: Nepal Rastra Bank.

Despite these developments, as per the World Bank Enterprise Survey in 2013,[47] only 13.7 percent of companies use bank credit for financing of investments, which shows that significant challenges prevail in the credit market. Among these challenges are the following:

- The direct control by the government over the banks constrains competitive access to credit. Interventions by the Government of Nepal in the credit market to direct collateral-free loans at low interest rates to some target groups have resulted in banks increasing revenue generation from alternative sources, i.e. higher rates for lower risk and commercially viable investments.
- There are also provisions in the monetary policy that prohibit banks and financial institutions from charging interest above a predefined threshold for some sectors, which leads banks to charge higher interest in other sectors.
- The Central Bank has also restricted the spread in the deposit/lending rates. These controls over the credit market reduce the operational efficiency found in an open competitive credit market.
- There is a lack of alternative channels for investments, such as hedge funds, mutual funds and venture capital funds. Development of these alternatives will lead to more choices for investors and will promote more investment.
- Encouraging foreign financial institutions to enter the Nepalese market will promote more competition, lead to innovation, and increase choices for consumers, thus improving the financial market.

47 World Bank and International Finance Corporation. 2013. *Nepal–Enterprise Survey 2013.*

## 4.7 Venture/capital funds

Beyond the DFIs mentioned above, there are other private sector venture funds and programs backed by concessional donor funding in operation in Nepal. However, there are few sources of information on their actual size and outreach beyond a few market surveys.[48] These surveys suggest that their capital base and outreach is still very limited.

**Text Box 2. Venture capital leveraging domestic finance to promote SME growth and employment**

Venture capital for small- and medium-sized enterprises (SMEs) typically provides risk capital and technical assistance to entrepreneurs and fund managers in challenging markets. The need for risk capital is high in fragile and frontier countries like Nepal, where development needs can be addressed by bridging gaps in the value chain of the economy. SMEs in countries like Nepal have the potential to drive job creation and economic growth but they have little access to the capital they need and are typically too large to be served by microfinance institutions, yet too small to be served by commercial banks. They face other challenges too, such as a lack of staff with management skills or industry knowledge.

Venture capital funds and programs in countries at the same income level as Nepal that provide entrepreneurs with risk capital such as equity, loans, and quasi-loans combined with technical assistance, have shown by investing in SME firms, that they are able to expand their businesses, which in turn creates a significant number of jobs. SME venture programs also provide support to fund managers as they establish themselves in these markets.

On a wider economic level, some of the SME venture programs have paved the way for other private equity firms to enter these markets. This has happened by supporting needed changes in the regulatory environment to make it more conducive to private equity investments.

While the local venture capital industry in Nepal is still in its infancy, the prospects have changed. Venture capital is directed at several sectors including information technology, education, health care, agriculture and tourism, among others. Despite strong commitments of support, venture capital funds lack viable startups in which to invest in Nepal. Startups in Nepal lack initial funding for putting together a viable business plan and entering a pilot phase to test the business model and market for their products and services to scale up to a viable commercial entity. A growing number of actors supporting SMEs in Nepal recognize that early stage support is a key intervention in addressing challenges in developing entrepreneurship.

Another challenge is the lack of conducive legislative provisions and an investment climate related to venture capital, which affects investments in greenfield operations and startups in Nepal. The risk associated with a startup combined with regulatory risks makes it even more challenging for venture capital investments.

48 Reference, among others, includes reports by the Dolma Development Fund on health care, renewable energy and agriculture in 2014.

The Nepal Industrial Policy 1992 has defined small-scale industries as those that have fixed assets of up to 30 million NPR and medium-scale industries as those with fixed assets from 30 million to 100 million NPR. In Nepal, SMEs account for more than 90 percent of total industrial companies, generate more than 75 percent of employment in the industrial sector, and account for over 70 percent of the sector's contribution to national GDP.[49]

According to the International Finance Corporation (IFC) Enterprise Finance Gap Database, there are more than 111,000 SMEs operating in Nepal, providing employment to 1.75 million people, and accounting for 22 percent of the GDP of Nepal. However, 25 percent of these businesses do not have formal banking relations with financial institutions, at the same time as there is an untapped market for SME lending estimated to be $2.5 billion.

Venture capital funds that have been established in Nepal to address the above include:

- Business Oxygen Private Limited is a private equity fund in Nepal. The fund combines risk capital financing with advisory support to help SMEs develop financial systems, quality-assurance standards, and corporate governance frameworks. So far, the fund has invested in several companies.
- The Udhyami Impact Fund is a non-profit social venture incubated by Biruwa Ventures. It provides seed financing to entrepreneurs. It directly or indirectly also provides business development services (mentoring) to the investees.
- The Dolma Impact Fund is a private equity fund focused on SMEs in Nepal. It provides capital and business development services to client companies. The investments are between $500,000 and $3 million of mostly equity, preferred equity and convertible debt.

### Text Box 3. Challenge funds as means of promoting SME development and investments

A challenge fund is a competitive financing facility to disburse funding for development projects, typically utilizing public sector or private foundation funds for market-based or incentive-driven solutions. Typically, a challenge fund uses competition to find solutions to problems in areas related to a development objective. Each challenge fund has specific goals; it may be finding solutions to a particular health problem or methods to promote democracy through information and communications technology or for promotion of private sector development.

SMEs, organizations, institutions and individuals compete by submitting their project proposals. While they have to meet predetermined and fixed criteria, the applicants have great freedom in the design of their solution. The winning proposals are supported financially and matched by their own equity or contributions. An illustration of a funding arrangement that could be considered for Nepal is the Africa Enterprise Challenge Fund (AECF).

49 World Bank and International Finance Corporation. 2013. Nepal–Enterprise Survey 2013. See: https://www.enterprisesurveys.org/~/media/GIAWB/EnterpriseSurveys/Documents/Profiles/English/Nepal-2013.pdf (last accessed on 12 October 2017).

**Text Box 3. Challenge funds as means of promoting SME development and investments (continued)**

AECF is a fund that aims to reduce poverty by supporting private sector businesses that have a positive impact on rural communities in sub-Saharan Africa. Specifically, the AECF supports businesses in agriculture, agribusiness, rural financial services and communications systems, renewable energy and adaptations to combat climate change. The AECF provides catalytic funding in the form of repayable and non-repayable grants to businesses that would not otherwise have access to adequate financing. The AECF is part of the Alliance for Green Revolution in Africa and has been supported by the Governments of Australia, Canada, Denmark, the Netherlands, Sweden and the United Kingdom, the International Fund for Agricultural Development and global partnerships such as the Consultative Group to Assist the Poor.

The purpose of the fund is to scale up innovative and commercially sustainable business ideas that have the potential to impact positively the incomes of rural households. Through its support to SMEs it serves to increase the volume of private sector financing by leveraging AECF funds to share risk and catalyse private sector investment.

There is scope for entry of many more venture funds in Nepal to foster competitiveness and increase outreach, given the gap in access to finance and business development services. Furthermore, in many countries like Nepal, access to finance is one among other constraints; for example, access on concessional (grant) terms to business development and advisory services to develop their business and lines of production has proven equally important.

Many countries at the same income level have established venture capital programs and challenge funds with donor support, promoting SMEs in priority sectors such as agriculture and renewable energy. To promote SME startups and growth, the Government of Nepal could, in addition to creating a more enabling regulatory environment, establish a venture capital fund/program and/or challenge fund, as mentioned above.

## 4.8 Foreign direct investment

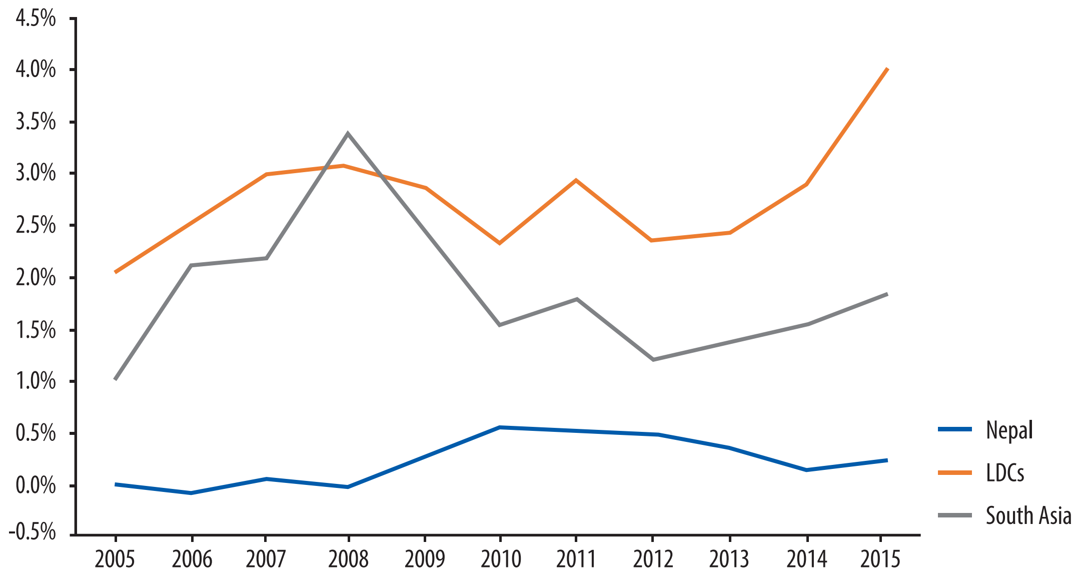
Foreign direct investment (FDI) is defined as the ownership of production facilities in a foreign country. To be classified as FDI, a foreign investor has to own at least 10 percent of a local company. If the ownership is less than 10 percent of the value of the local company, the investment is classified as portfolio investment.[50] The investment can be in manufacturing, services, agriculture, or other sectors and it can have originated as a greenfield investment, as an acquisition or as a joint venture (joint ownership with a local company).

When foreign companies start operations they hire people, especially if the investment is greenfield, i.e. if a new facility is created and/or if the production is labour intensive. Local companies often become suppliers to a large new foreign investor, thus increasing employment, which contributes to more value added through the entire value chain.

50 OECD. 2008. *OECD Benchmark Definition of Foreign Direct Investment-4th Edition.*

FDI also frequently leads to development or entry of new technologies and management practices. The training of local personnel will after some years lead to new business, due to knowledge transfer from the international partners to national counterparts and employees that subsequently start up new domestic companies based on training and acquiring new knowledge. Foreign companies also have established channels for placing their output on international markets.

### Figure 15: Foreign direct investment as percentage of GDP

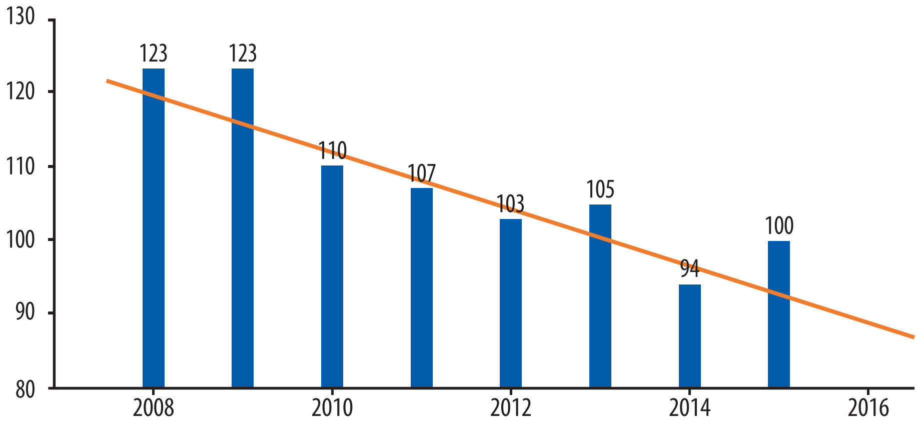



Source: World Bank.

While Nepal has made efforts recently to attract more FDI to reap the above benefits of bringing in market access, technology and know-how from foreign companies, the level of FDI remains low compared to other countries at the same income level (ref. LDCs in Figure 15) as well as the average of all South Asian countries.

The World Bank "ease of doing business index" ranks countries against each other based on how the regulatory environment is conducive to business operations with protections of property rights. Economies with a high rank (1 to 20) have simpler and friendlier regulations for this form of investment funds. The "ease of doing business index" ranking for Nepal averaged 108 from 2008 until 2016. The longer-term trend shows an improving business climate (as reflected by the trend line in Figure 16 showing change in ranking) and despite this low international rating, Nepal is along several dimensions on par or ahead of other countries in the region.

**Figure 16: Nepal – "ease of doing business index" ranking**




Source: World Bank.

Despite this development, several challenges remain, in particular related to the enforcement of contracts (especially the time it takes for settlement in the legal system), processes related to tax payments (time rather than tax levels), access to finance (as discussed in previous sections) and infrastructure conducive to business (in particular, reliable electricity). These factors are not the only impediments to attracting FDI, but are constraints relevant to private sector investments in general. The above issues are also raised in the March 2017 *Macroeconomic Update: Nepal*[51] with comprehensive analysis of the business climate for FDI relevant also for private sector development (PSD) in general. Among others, the analysis concludes with specific measures to promote PSD such as to improve the regulatory regime to be more predictable and less discretionary. The analysis points to simplification of legal and regulatory frameworks governing businesses and easing of visa and repatriation of earnings for FDI, eliminating overlaps in institutional mandates in the approval process, removing thresholds on the size of foreign investment and introducing automatic routes to permit foreign investments in priority sectors. Also, both domestic and foreign firms would benefit from an effective public-private dialogue platform, healthy industrial relations, resolution of labour shortages, and a robust and timely evaluation of industrial promotion schemes.

Addressing these constraints will likely yield growth in FDI to levels of other countries at the same per capita income and serve to increase domestic private sector investments, including investments from the significant inflow of remittances, which is discussed in a subsequent section of this report.

## 4.9 Public-private partnerships

The Government of Nepal introduced the Public-Private Partnership (PPP) Policy in October 2016. The policy, endorsed by the Cabinet, clarifies that the government must prepare guidelines for operation of a viability gap fund and project preparation facilitation fund to assist project developers and expedite implementation of PPP projects. The policy also calls on the government to prepare templates for procurement and project evaluation and approval. The act, regulation, directives and guidelines on PPP will be based on this policy.

51 Asian Development Bank. 2017. *Macroeconomic Update – Nepal*. Volume 5, No. 1.

### Text Box 4. FDI to promote infrastructure investments

The lack of a supportive business climate has significant implications for investments in industry, services and infrastructure required to achieve sustained economic growth, the SDGs and the overall policy and economic growth objectives of the Government of Nepal. For example, the Government of Nepal views hydropower development as a key opportunity for economic growth and human development. However, despite having investment policies in place since the 1990s, only 2 percent of the 43,000 Megawatt (MW) commercial potential of Nepal has been developed and hydroelectricity accounts for only 1 percent of the total energy supply.

At an Energy Development Council conference arranged in 2016, it was estimated that to develop 10 Gigawatts of on-grid hydropower, $20 billion would be required in the following ten years. Additionally, an investment of $5 billion in high-voltage transmission line projects will be needed by 2035.[52]

According to a study by Dolma Development Fund, small- and medium-scale projects that are feasible to develop over the next four to five years will require approximately $1.5 billion in investment. Despite recent growth in the national capital markets it is uncertain if local banks and venture capital providers can fulfil the capital needs for small- and medium-scale projects.[53]

For larger hydropower projects, credit needs to be provided by FDI, which currently is the only viable source of capital given the huge investment requirements. Potential investors are however facing complex issues. Recently, a $1.5 billion project agreement signed in 2007 to develop the Tamakoshi III that would generate 650 MW was withdrawn, as the Norwegian investor, Statkraft, decided not to invest due to "the increased bureaucratic hurdles for foreign investments, a fragile political situation and a geo-political situation leading to a non-conducive project".[54]

Although an increasing number of small-scale production units have been developed and are operated by private actors, the Nepal Electricity Authority's dominating role has made foreign large-scale investors risk adverse. For example, the transmission infrastructure is not of adequate quality to reassure investors that have a long-term perspective that they will be able to sell all power. There have also been challenges related to power purchase agreements that impose high risks on the producer.

Potential investors are also facing challenging issues related to forestry, environment and land. The approval processes for the various required permits are lengthy and slow. While the Investment Board Nepal is facilitating the processes, there is no coordinated "one window system" for permits where one single authority is responsible for issuing the necessary permits. Moreover, there is a need for improved information systems that provide reliable project background data for investors to assess project risks. This includes background information on construction cost, geological conditions and the overall operational cost.[55]

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52 Awale, Sujata. 2016. "Nepal Seeks Investors for 10GW of Hydropower Projects by 2026." *Renewable Energy World.*

53 Dolma Fund in partnership with Intellecap. 2014. "A Report on Market Data for Private Sector Investments in Nepal - Renewable Energy Sector."

54 "Norwegian firm quits $1.5 billion Nepal hydropower plan." 2016. *The Local.*

**Text Box 4. FDI to promote infrastructure investments (continued)**

Attracting private investment requires reliable and predictable mechanisms for sharing risks, the provision of common infrastructure such as transmission networks, regulatory improvements, improved information systems, and streamlined policies and procedures with transition to a one-window system that is conducive to foreign investors. Although successive governments in Nepal have expressed a commitment to attract private sector investment to develop hydropower potential, progress in establishing the enabling environment for private investments has been limited.[56]

There is limited data available on total PPP investments over the years and there are no comprehensive statistics on the number of current PPP arrangements. Such arrangements are, among others, found in hydropower with PPA, water supply, waste management and health care. There is also a significant potential to scale up outsourcing of public service delivery in sectors like education, in particular for secondary education, with a policy target to achieve 95 percent net enrolment in seven years.

Through the PPP policy and framework, it is envisaged that there will be more private sector participation in development of various physical infrastructure, such as roads, bridges, hydropower projects and transmission lines. The policy has directed all public entities to identify priority areas and hold consultations with the private sector on project development. It also incorporates a provision on unsolicited proposals, which encourage private developers to approach the government for development of various projects.

PPP contracts will be awarded through a competitive bidding process and if the projects are worth more than 1 billion NPR, it will be a global bidding process to encourage more FDI as well. The extent to which PPPs will grow in number and volume will, however, depend on further improvements in the general business climate for private sector investments as discussed above.

## 4.10 International NGOs

International NGOs (INGOs) represent an additional source of funding for development, in addition to acting as partners in development cooperation with the Government of Nepal. INGOs invest and support operations in a number of sectors, including social sector service delivery, renewable energy, agriculture, and environmental interventions as well as providing support to civil society partner organizations in Nepal. INGOs in Nepal have formed an Association of International NGOs in Nepal (AIN) that currently has 139 members. According to data from the Nepal Social Welfare Council (SWC),[57] 270 INGOs are registered with them, among others, as registration is a requirement to obtain tax and duty concessions. These are over and above the more than 3,900 Nepali NGOs (NNGO) registered with the SWC. In addition, various NGOs are registered with the Chief District Administration offices present in 75 districts, putting the estimated total number of NGOs at more than 15,000.

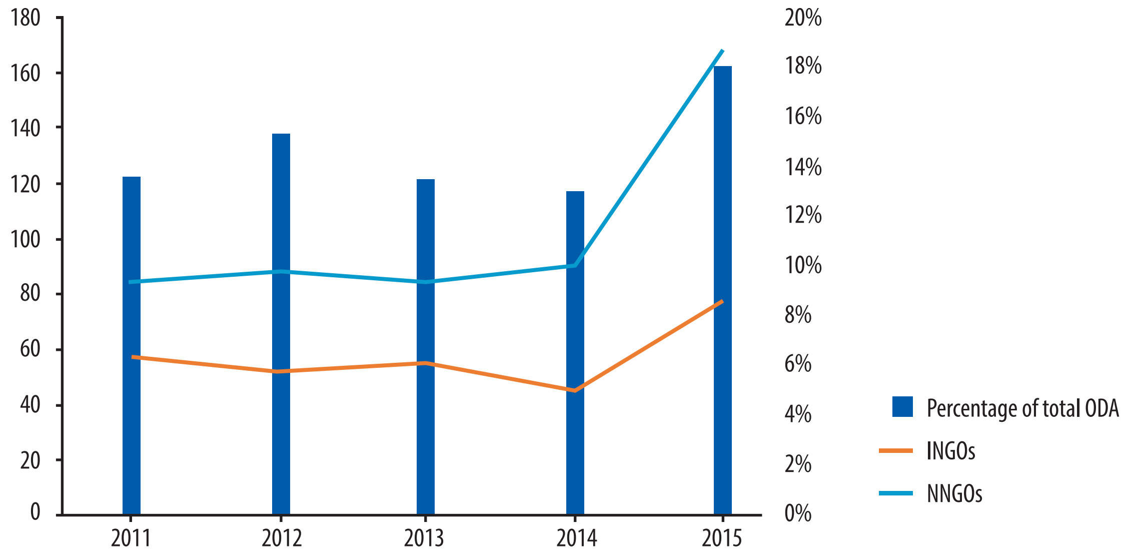
55 Awale, Sujata. 2016. "What Investors Want?" *The Himalayan Times.*

56 World Bank. 2015. Project Appraisal Document on proposed credit to Nepal for the Power Sector Reform and Sustainable Hydropower Development Project.

57 The Nepal Social Welfare Council (SWC) is a government body established to coordinate and facilitate NGOs in Nepal.

INGOs mobilize money from voluntary contributions from the global community and countries of origin as well as funding from the aid budget of their respective donor country. In many cases, they work with national governments as partners in program implementation. An example is INGO and NNGO participation alongside the government in rehabilitation of physical infrastructure damaged by the earthquakes in 2015, including rehabilitation and construction of schools and health posts.

**Figure 17: ODA disbursements to Nepal through NGOs (in millions of US dollars and percentage of total ODA)**




Source: OECD/DAC.

ODA disbursements through INGOs and national NGOs complement funding of public sector programs. According to OECD/DAC data, approximately 18 percent of total ODA to Nepal was disbursed for NGO program interventions, as shown in Figure 17. The NGO share of total ODA was higher in 2015 than the global average for countries at the same income level. This factor may be explained by the significant inflow of emergency aid after the 2015 earthquakes. Part of it may also be explained by the fact that total ODA to Nepal is low as compared to other countries at the same income level, i.e. NGOs as a proportion of total ODA is higher even if the total ODA per capita managed by NGOs is not significantly higher in Nepal compared to its peers. This in turn is partially linked to the capacity of the Government of Nepal in implementing total ODA commitments.

Many of the INGO and NNGO programs are implemented in partnership with the Government of Nepal as evidenced by data from the MoF AMP. Some of the ODA disbursed to Government of Nepal programs is financing Government of Nepal partnerships with NGOs, including through contracts outsourcing service delivery and investments managed by them. NGOs could be engaged further to supplement the capacity of the Government of Nepal to implement planned policies, and thus raise the level of capacity to utilize ODA commitments. This is done today to some extent in social sectors like health and education, renewable energy and environmental programs. However, there is potential to scale up these forms of arrangements like the opportunity to engage the private sector more within the new PPP framework, adding capacity for the Government of Nepal in public service delivery. It is important to note that while there is opportunity for the Government of Nepal to expand partnerships with NGOs, such a strategy would need to carefully consider the track record, governance arrangements, and delivery capacity of potential NGO partners.

**Text Box 5. Government partnership with NGOs for public service delivery: The case of Armenia**

There are many cases when a government or local authorities outsource services to NGOs. The outsourcing is usually not performed on the basis of pursuing any compensation or profit for the NGO, but rather based on a social partnership agreement entered into between the government or the local authority and the NGO.

The Republic of Armenia provides direct allocations to NGOs from the State Budget for public service delivery. The allocations are made to support NGOs focused on providing a comprehensive set of community-based services in cities all over Armenia. A number of local communities in Armenia have, based on proposals from NGOs, adopted a Social Partnership Charter. On the basis of the Charter, the respective local municipality donates from its local budget grants to the NGO to implement certain activities in the social sector by entering into cost-sharing agreements.

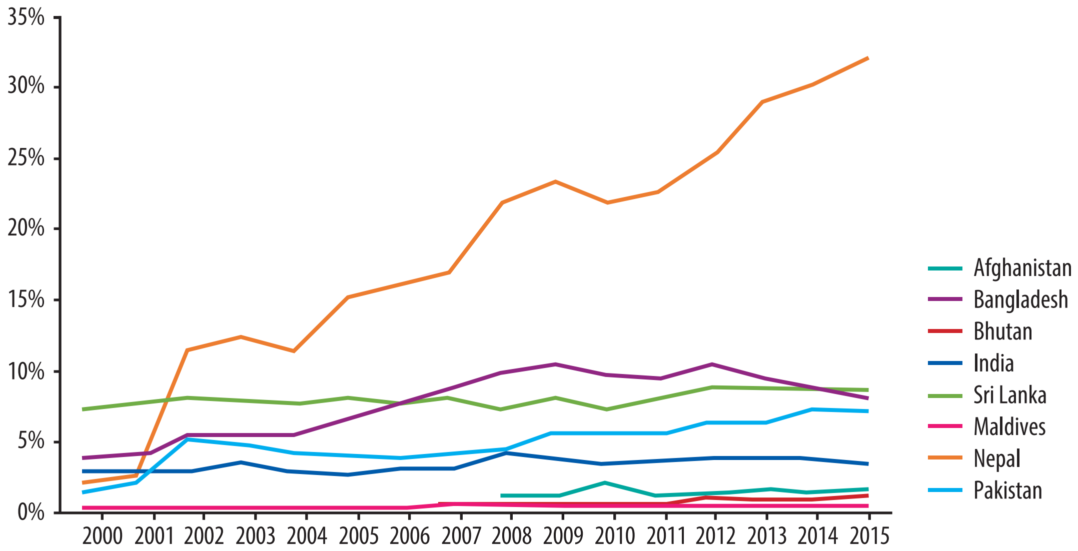
One example is the "Mission Armenia" NGO. The NGO has established units that provide a comprehensive set of community-based services. The services are provided through a community-based social health care model. The Ministry of Labour and Social Issues has granted a license to "Mission Armenia" for their social service provision. "Mission Armenia" implements its activities through cooperation with the central government, local government bodies and other local and international organizations.

The NGO "Bridge of Hope" provides services to children and youth with disabilities and their parents to overcome their isolation and to help them integrate into community life on an equal basis with others. "Bridge of Hope" has long been mainstreaming placement for children and youth with disabilities and focuses on inclusion. The programs are directed to create equal opportunities and improve the conditions for children with disabilities so that they can achieve their own goals free from physical and attitudinal barriers. The Ministry of Labour and Social Affairs of the Republic of Armenia outsources their child centres' services to the "Bridge of Hope" for the latter to deliver the services through the child centres.

## 4.11 Remittances

The inflow of remittances from Nepali people working abroad has emerged as the largest source of foreign exchange earnings with an amount equivalent to 30.4 percent of GDP for FY 2014/2015. This is three times more than all other SAARC countries, and is the highest among Asian countries, as shown in Figure 18.

**Figure 18: Remittances as percentage of GDP in the SAARC region, 2000-2015**

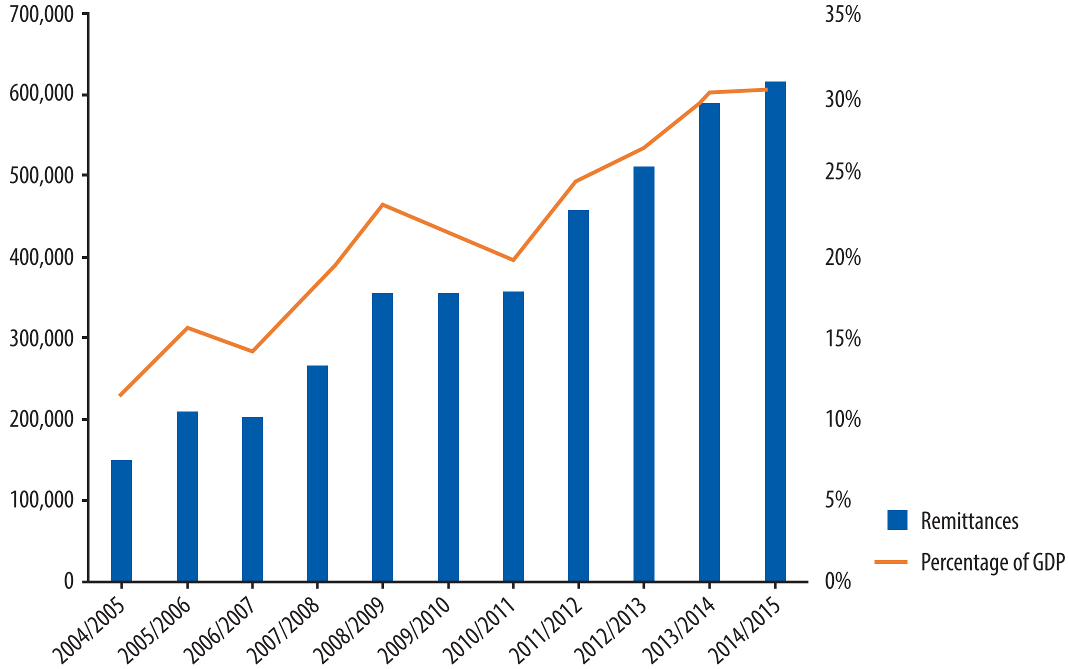



Source: World Bank.

Remittances are nearly 10 times higher than foreign aid and 2.5 times larger than the foreign exchange earnings of exports of goods and services. Figure 19 shows the steady increase in remittances in both absolute amounts and as a share of GDP, which in FY 2014/2015 was over 30 percent.

There are more than 2.1 million Nepali migrant workers abroad (in a population of an estimated 28.5 million in 2015). According to NRB statistics, more than 500,000 persons went overseas for work in 2014/2015. In total, approximately 25 percent of male adults work outside Nepal, in particular in India, Malaysia and the United States, as well as in the Middle East.

**Figure 19: Remittances in million NPR at constant FY 2014/2015 prices and percentage of GDP**




Source: Nepal Rastra Bank.

A recent sample study by NRB from September 2016[58] shows that investments in and rehabilitation of existing domestic (housing) property remain the main use of remittances (49 percent of total remittances). The second most important use of remittances is for the financing of education (34 percent).

While remittances play an important role in financing household investments and spending, less is used for savings and/or investment in productive assets. If addressing the challenges related to the business climate and entry of new financial intermediaries and instruments in the financial sector, remittances can play a significant role as an additional source of finance for development purposes.

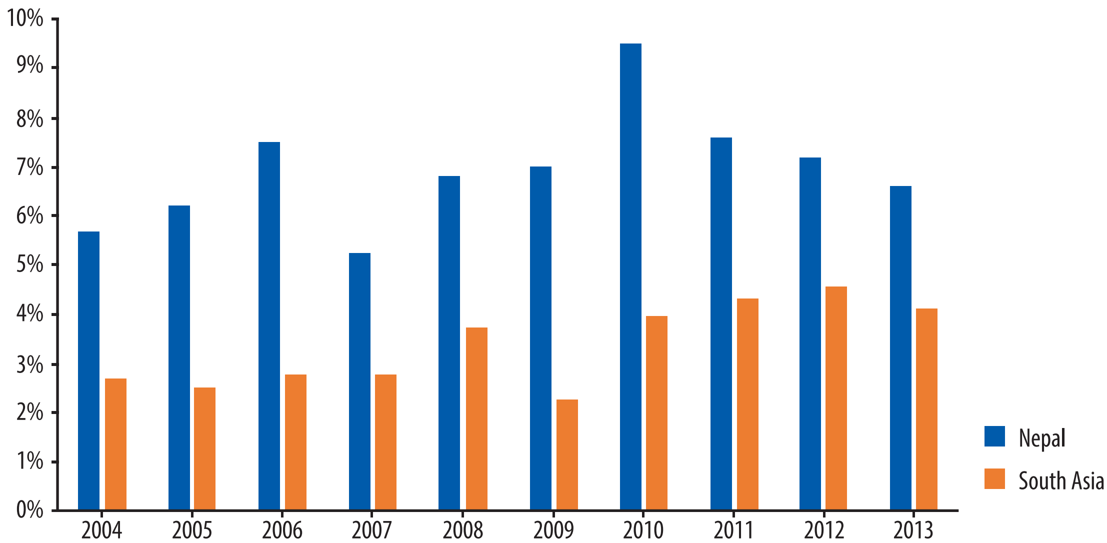
58 Nepal Rastra Bank. 2012. "Impact Evaluation of Remittances: A Case Study of Dhanusha District."

## 4.12 Illicit financial flows

The above sections have presented challenges and opportunities related to finance for development. However, another challenge related to the mobilization of additional resources for development is to reduce and eventually curb illicit financial flows (IFFs), which potentially would add significant resources for development. The most common definition of IFF is "money illegally earned, transferred, or used that crosses borders."[59] IFFs reduce domestic resources and tax revenue needed to fund programs and infrastructure investments and are receiving growing attention as a key development challenge. IFFs are often symptomatic of low private sector confidence in the domestic economy, vested interests and weaknesses in transparency and accountability.

According to the latest data from Global Financial Integrity,[60] developing and emerging economies lost $7.8 trillion in IFFs from 2004 through 2013, with illicit outflows increasing at an average rate of 6.5 percent per year, nearly twice as fast as global GDP. In Nepal, this net outflow of money has fluctuated between 6 percent and 10 percent of GDP during 2004 through 2013 (the last year for which data on IFFs is available). This is higher than the average of its regional peers, with only Bangladesh estimated to have close to the same level for some years. Figure 20 shows IFFs in Nepal in relation to the average of South Asian countries.

**Figure 20: Illicit financial flows as percentage of GDP, 2004–2013**




Source: Global Financial Integrity.

According to the same Global Financial Integrity data, IFFs have been higher than net ODA received, in some years up to 60 percent more. The major reasons for IFFs in Nepal include:

- Decade-long internal conflict followed by political instability
- Prevalence of corruption in the bureaucracy as well as in the business community

59 The World Bank, European Parliament, and Global Financial Integrity have similar definitions.

60 Global Financial Integrity. 2015. "Illicit Financial Flows from Developing Countries: 2004-2013."

- Tax evasion-oriented mindset among businesspeople
- Lack of accountability and transparency in the private sector
- Low confidence of investors
- Government's failure to safeguard the right to private property
- Problem of under-invoicing and over-invoicing in trading
- Transfer pricing in international trade

While some of these issues are related to domestic challenges such as tax administration and enforcement, governance issues and business climate, others require international cooperation to promote transparency in transactions across countries (such as transfer pricing and non-disclosure of deposits in overseas accounts).

Addressing some, or all, of these issues can, however, raise the level of finance for development significantly and several are linked to opportunities to attract other forms of finance (such as improvement in the business climate and promoting private equity markets with financial intermediaries/venture capital funds for domestic investment opportunities).

# 5. Public sector management

Based on information from interviewees and on secondary information from policy, institutional and PFM reviews, this section assesses how the public sector management structures and procedures of the Government of Nepal facilitate achievement of development objectives and the SDGs. By identifying constraints and opportunities for change that can contribute to improve the capacity of the Government of Nepal to plan, budget and implement policies supportive of the SDGs and Vision 2030, which has as a main objective to develop Nepal as a MIC, the aim of this section is to establish an INFF baseline for Nepal and a rationale for recommendations for an INFF road map that can assist the government to deliver on its goals.

The first part of this section assesses the coherence between the development objectives of Nepal and the SDGs. The following sections assess institutional aspects affecting efficiency in planning, budgeting and monitoring processes. Finally, capacity constraints in the civil service and the enabling environment for accountability and dialogue are considered.

## 5.1 Policy coherence

Nepal successfully adopted the MDGs, and integrated and mainstreamed the objectives into national strategic development plans and sector policies. In a challenging conflict and post-conflict environment, the achievements of Nepal have been significant, with progress made towards achieving most of the MDG targets.

As an LDC country with a proactive MDG policy, the Government of Nepal closely observed the SDG negotiations, and by 2015, the NPC had started a process of aligning national development plans with the prospective SDGs. An SDG 2016-2030 National (Preliminary) Report was commissioned by the NPC as part of their work with integrating the SDGs into the current three-year periodic plan, the 14$^{th}$ Periodic Plan beginning in mid-July 2016. The report also facilitated a government exercise to set strategies and priorities for the next 15 years to ensure that long-term planning is consistent with the SDGs and the long-term vision to develop as a middle-income country by 2030, and to guide the medium term plans.[61]

The preliminary report systematically assessed the SDGs and their relevance from the perspective of Nepal, proposed national SDG targets and identified possible indicators and tentative benchmarks.[62] One of the key findings of the report was that there is a relatively high degree of policy coherence between the existing policies of the Government of Nepal and the SDGs. As a signatory to a number of United Nations conventions on sustainable development, including those on energy, environment, anti-corruption, good governance and human rights, Nepal has already adopted several SDG commitments in its policies and strategies.

In June 2017, the NPC issued an SDG Baseline Report. The report presented key SDG indicators, updated their baseline status and revised targets set for 2030. The report also provided guidance on the way

61 Government of Nepal, National Planning Commission. 2017. "Nepal's Sustainable Development Goals, Baseline Report."

62 Government of Nepal, National Planning Commission. 2015. "Sustainable Development Goals 2016-2030, National (Preliminary) Report."

forward to achieve the SDGs and Vision 2030, among others emphasizing the need for macroeconomic policy reforms, the importance of undertaking an SDG needs assessment and estimating financial requirements, the need to prioritize and sequence the SDGs and to incorporate them further into the next periodic plans, and to coordinate the implementation of the SDGs at the federal, provincial and local levels. Moreover, the report particularly emphasized the need for mobilizing additional domestic revenues and ODA, as well as the importance of the private sector for promoting economic growth and the cooperatives sector/civil society having a complementary role in social sectors.

Both NPC reports focused attention on the importance of improved governance and demonstrated that many of the SDGs require effective and efficient institutions and policies, which also need to fit the realities facing federal, provincial and local level governments.

In consultation with the DFA team, central government stakeholders clarified that the SDGs, due to broad thematic coverage and comprehensive and ambitious targets, are far more challenging to integrate in national and local level policy strategies than the MDGs. It was also emphasized that there still are significant data gaps that need to be filled to establish baselines and monitor progress for many of the SDG targets. Moreover, existing surveys need to be expanded and new surveys will need to be established, i.e. the capacity to produce reliable SDG data and statistics needs to be improved, building on existing support in this area from several development partners.

Despite these challenges, government stakeholders confirmed to the DFA team that the key government institutions are firmly committed to the SDGs and that the government aims to integrate all SDG targets in Vision 2030 and medium-term plans at the national, provincial and local government levels. Recently, the SDG commitment was institutionalized through the establishment of an SDG Steering Committee, under the chairmanship of the Prime Minister. Moreover, in government administration, SDG working groups have been constituted under the Vice Chairman of the NPC, with the mandate to coordinate SDG implementation at different levels of government.[63] The NPC has also initiated a consultancy study aiming to cost the SDG targets and to develop a SDG financing strategy.

### 5.1.1 SDGs and Vision 2030 coherence in non-government sectors

While efforts to improve policy and institutional coherence are underway, government stakeholders consulted confirmed that the SDGs are comprehensive, ambitious and challenging, and that to achieve them will require massive mobilization of resources as well as significant capacity enhancement across government institutions. This would also need to include cooperation with private sector, voluntary sector, the international finance institutions and donor community.

This view was largely reflected by both NGOs and private sector stakeholders consulted by the team. The voluntary sector expressed strong commitment to working with the government and the private sector to mobilize financial and human resources, for example, in the education, health and environmental sectors, for the achievement of SDG targets and Vision 2030. Yet, some stakeholders consulted emphasized that the current government policies are not conducive for NGO engagement, reflecting a general government scepticism towards the voluntary sector. For example, it was pointed out by some stakeholders in the education sector that attempts to build PPPs in education have not been successful due to regulatory

63 Government of Nepal, National Planning Commission. 2017. "Nepal's Sustainable Development Goals, Baseline Report."

provisions hindering adequate fees and salary structures, effectively obstructing establishment of new schools, despite the urgent need in certain areas.

Other private sector stakeholders consulted by the DFA team expressed that a more investment-friendly climate, with changes to legal and regulatory regimes, will be needed to mobilize private sector resources. Moreover, private sector stakeholders consulted generally expressed concern that highly needed institutional, legislative and regulatory reforms are deferred, constraining mobilization of private sector resources. For example, several energy sector stakeholders emphasized that the dominating role of a single government company, the Nepal Energy Authority, which operates a transmission network and generates or sells energy at the same time, creates an unfair market situation where potential investors avoid entering the market, as it may have an incentive to obstruct competitors' access to infrastructure. This again leads to inefficiencies in the energy market, that in Nepal are reflected in high government subsidies that have become a major drain on public resources, and in high prices for consumers compared to, for example, India.

It was, however, also recognized that the government has taken important initiatives to facilitate dialogue and engage investors. For example, the Nepal Power Investment Summit was held from 31 May to 3 June 2016 with private sector and government participants from many countries, providing a sound platform for dialogue.[64]

### 5.1.2 Localizing the SDGs and Vision 2030

The local elections held in 2017 are the first local elections since 1997, and since 2002, district and local governments have in practice been administrated by the central government. As local governments, up to the recent election, have not been held accountable to constituencies through local elections, the accountability mechanisms have been weak and represent a key constraint.

The new provincial and local governments will face significant challenges to effective and efficient planning, budgeting and policy implementation. Civil servants in charge (Local Development Officers for District and Village Development Committees and Chief Executive Officers for municipalities) had been appointed by the government, and regularly changed upon application from one or more of the main parties with the result that very few remained in office for more than one year. This made the officials both highly risk averse and largely unaccountable, as they were removed or rotated before the impact of any positive change they may have initiated could become apparent.[65] Moreover, capacity enhancements in local bodies are limited by a highly centralized human resources management system. For example, positions are often unfilled, and staff members are frequently transferred. This constrains the local administration's capacity to adapt policies to local challenges and circumstances.

Localization of the SDGs and Vision 2030 is also constrained by inadequate financial resources and a highly complex fiscal transfer system with predominately earmarked transfers that gives limited discretion for prioritization according to local needs. Moreover, a concern raised from some stakeholders consulted referred to the substantial costs related to establishing the seven provinces and over 700 local bodies, which requires institutional set-up with human resources, hardware and software infrastructure, likely to constrain further resources available for service delivery in a transitional period of several years.

64 Awale, Sujata. 2016. "Nepal Seeks Investors for 10GW of Hydropower Projects by 2026." *Renewable Energy World.*

65 Asian Development Bank (ADB). 2016. "Strengthening Public Sector Management Program: Progress Report on Tranche Release (Second Tranche)."

Moreover, while the establishment of new federal structures is a window of opportunity for strengthening accountability structures so that local citizens have an influence on local government policies, service delivery and the prioritization of SDG commitments, a strategy for localizing the SDGs and Vision 2030, also needs to address adequately how fiscal decentralization mechanisms can ensure a transparent, predictable and fair distribution of resources enabling local governments to plan and implement policies efficiently. It also needs to address how local government's Human Resource Management systems can be strengthened in a way that increases local governments' capacity to plan, budget and implement policies according to local needs and its citizens' priorities.

### 5.1.3 Increased SDG coherence in Parliament

Over the last year the SDGs have increasingly been given more attention in the political discourse outside of government. Whereas parliamentarians consulted by the team in 2016 explained that there is no SDG champion in the Parliament and that the policy agenda in Nepal is focused on the more pressing issues related to reconstruction efforts and on the implementation of the constitution, the SDGs has been given more attention by parliamentarians over the last year. With support from UNDP, an informal forum in Parliament has been launched, providing an arena for parliamentarians to debate and coordinate SDG-related issues. In addition, the DFA team has been informed that several events have been organized for parliamentarians with interaction and orientation on the SDGs.

### 5.1.4 Strengthening policy and institutional coherence

Moving forward, it is crucial that the Government of Nepal continues to improve policy and institutional coherence. To ensure coherence in sector policies and ministries, complementary strategies, related to the planning, budgeting and reporting systems discussed below, need to be pursued.

SDG coherence also needs, however, to be anchored outside the central government's planning and budgeting processes. Provincial and local level governments, parliamentarians, representatives from the private sector and NGOs, all need to be engaged in a broad national SDG and Vision 2030 dialogue, with the aim of integrating the national level vision into national and local development policies and strategies, and in the non-government sectors' engagements.

**Text Box 6. INFF Building Block 1: Leadership that facilitates institutional coherence**

- The government is showing a firm commitment to follow up the SDG agenda. The government has established several institutional mechanisms for the SDGs, including a High-Level SDG Steering Committee, chaired by the Prime Minister.[66] NPC is assigned the responsibility to follow up on the commitments of Nepal and operationalize implementation and SDG working groups have been constituted under the Vice Chairman of the NPC.
- The NPC has taken leadership and initiated a process aiming to operationalize and integrate the SDGs relevant to the Nepal context at all levels of government. These initiatives include identifying targets and indicators, setting baselines for about 50 percent of targets, and commissioning a study to cost the SDGs.

**Text Box 6. INFF Building Block 1: Leadership that facilitates institutional coherence (continued)**

- The MoF has the sole responsibility for financing policies related to taxes and foreign aid coordination, whereas NPC has overall responsibility on economic planning and programming and has emerged as the principal adviser to the government on economic policies and as the key coordinator of economic and policy management. Institutional mandates for macroeconomic functions are shared between NPC, the Central Bank, the MoF and FCGO, and administrative functions such as procurement and tax and custom administration are spread among government agencies and line ministries.
- Line ministries are awaiting more clarity on how to adapt and integrate the SDG goals and targets in the planning and budgeting processes.
- Provincial and local level governments have not been adequately involved in SDG processes, and institutional leadership on localizing the SDGs is unclear.
- The SDG agenda in the political discourse outside of government has been constrained by other pressing issues, but over the last year several initiatives have been implemented to increase knowledge and attention to the SDGs among parliamentarians.

## 5.2 Policy planning constraints

The NPC is responsible for formulation of the long-term plan, the medium-term periodic plans, the Medium-Term Expenditure Framework (MTEF) and annual programs, i.e. translation of macroeconomic forecasts into the annual resource envelope.

Nepal has a well-established tradition and experience with development planning processes. There have been nine Five-Year Plans since 1956 and four Three-Year Plans since 2006 that have established national and sector policy priorities and development targets. The periodic plans are, however, ambitious and even though the targets are indicative of the government's policy ambitions, the targets are often not met within the set time-frame.

The Government of Nepal has also, since the beginning of the millennium, made significant efforts to introduce results-based management (RBM) systems and procedures at all levels of government. The RBM system was introduced with the MTEF, which was operational from 2002. Guidelines and formats were developed and substantial achievements were made in terms of the introduction of RBM reporting in government ministries and at the local government level. However, the reporting remains to a large extent output-oriented, and the results orientation did not manage to change the norms of the civil service from process orientation to results orientation.[67] Nevertheless, the previous periodic plans integrated the MDGs and their targets, and the NPC has, as discussed above, prepared a three-year plan for 2017 to

66 Descriptions of other committees and institutional mechanisms can be found in the report of the Government of Nepal, "National Review of Sustainable Development Goals", prepared by the National Planning Commission as part of its Voluntary National Review at the 2017 High-Level Political Forum on Sustainable Development. Government of Nepal, National Planning Commission.

67 Government of Nepal, Ministry of General Administration and UNDP. 2014. "The Nepal Civil Service and Re-Structuring of the State."

2019, assessed the SDGs and their targets with the aim to integrate them into the periodic plan to the extent found relevant. The NPC, with support from the ADB, is also currently formulating Vision 2030, a long-term economic vision for the country.

**Text Box 7. INFF Building Block 2: A clear vision for results**

- As a signatory to a number of United Nations conventions on sustainable development, including those on energy, environment, anti-corruption, good governance and human rights, Nepal has already adopted several SDG commitments in its planning systems and policy strategies.
- Currently, the SDG goals and targets are not fully integrated into the national development plan. However, building on experiences from the MDG era, the NPC has initiated a process aiming to integrate and mainstream all SDG goals and targets relevant to Nepal into the 14$^{th}$ national periodic development plan, the medium-term budget framework and annual work plans. The NPC is also in the process of formulating Vision 2030, a long-term economic vision for the country.
- The SDG targets are not yet costed. The government has, however, launched a consultancy review with the objective to update the SDG National Report and implementation strategy that is expected to be finalized in 2017. The consultancy provisions for a costing of the SDG targets and development of a financing strategy. The process shall be based on a review of existing costed master plans and strategies.
- Although some sectors have established costing procedures, a recognized weakness is that the costing of policy strategies generally is weak and that policy targets often are overly ambitious. Moreover, there is a capacity gap in government to use systematically the existing information on expenditures and performance to inform policy strategies, budget prioritization and program management.
- Uncertainty exists regarding the feasibility of achieving the SDG goals. It is recognized that extensive resource mobilization, as well as significant capacity enhancement across government institutions, cooperation with the private sector, voluntary sector and international finance institutions, and the donor community, will be required.

### 5.2.1 Systemic impediments to efficient policy planning and monitoring

Despite the fact that the government has a comprehensive planning and monitoring system in place, there are some constraints in the planning structures that impact on the government's ability to plan strategically and prioritize effectively between competing demands. The most important aspects include:

- The line ministries and other spending agencies are currently not provided with realistic budget ceilings to plan policy interventions in the medium-term. Moreover, although Nepal has had a Medium-Term Expenditure Framework (MTEF) in place since FY 2002/2003, covering a three-year period anchored by the macro-fiscal framework and forecasts, the MTEF has been weakening over the last years, and was not produced for the current MTEF period (FY 2016/2017 – 2018/2019). This reflects that the MTEF, after some years of operation, increasingly became a paperwork exercise without substantial policy and budget impacts. The NPC is currently planning to update the MTEF formats and guidelines, providing the crucial linkage between the government's planning and budgeting framework with reliable budget ceilings, as well as outcome-based targets and indicators for performance monitoring.

- The linkages between the three-year periodic plans and the line ministries' sector plans are currently not adequately developed to ensure that national policies, as presented in the periodic plans, are translated into sector budgets with allocations linked to policy targets. Moreover, the NPC issues guidelines to the sector ministries for their detailed policy planning and programming with the intention that line ministries develop their own strategic plans that accord closely with relevant sector and cross-sector priorities as presented in the periodic plan.[68] These guidelines have, during the period FY 2002/2003 – FY 2015/2016, been supplemented by a medium-term fiscal framework providing a budget ceiling for the line ministries to develop their strategic plans. However, few ministries develop comprehensive and credible sector plans. Currently only three ministries have costed sector plans, which are Sector-Wide Approaches (SWAps) in the education, health and rural roads sectors. The costing of the SWAps has, however, been inconsistent with the MTEF budget ceilings. Previously, seven other sectors had business plans, which were non-costed strategies, but these have been discontinued.[69]
- There is inadequate costing of planned policies and the results monitoring is to a large extent output-based rather than based on performance assessments. The basis for prioritization of programs and projects in the planning and budgeting processes is therefore weak. However, the NPC does apply a rating system that is used to prioritize programs and projects for preparation of the periodic plan, and for capital expenditures, the NPC and relevant line ministries assess all proposals from central government spending units, including local-level bodies, against national objectives and sector plans. Proposals are then categorized into four priority categories, P1 – P4. Almost 90 percent of all projects and programs are categorized as P1. Hence, a comprehensive system that ensures prioritization of policy interventions based on adequate analysis of cost effectiveness that would ensure that the programs, projects and interventions with highest return are prioritized, is currently not operational.
- After almost two decades without local elections, the local government sector faces significant constraints, posing challenges to policy planning and risks in terms of growth and achievement of policy objectives. Despite that, the District Development Committees (DDCs) had developed and submitted periodic development plans to NPC, the DDCs were not provided a reliable medium-term fiscal framework in which to plan, and the plans have therefore mostly not been realistic. Moreover, the lack of local elected political representation implied that the basic prerequisite for local institutions being held accountable to their plans, policies and results had been absent. Representation in local planning processes have, however, been ensured by a 14-step participatory planning and budgeting process that requires each local body to involve local stakeholder groups in the planning process. Nevertheless, local governments have also been constrained by a number of other factors, such as lack of adequate resources, constrained administrative capacities, and relatively high population growth, which inhibits effective implementation of development plans.

In terms of implementation of the development goals and targets, the current challenges in the planning structures represent a significant constraint. With the existing shortcomings in planning and monitoring structures, incremental and input-output oriented planning practices remain more the norm than the exception in the line ministries, despite that most projects and programs require longer-term interventions and funding to yield benefits over a period of years.

68 ODI. 2013. "Operational risk assessment of public financial management reform in Nepal: a review of challenges and opportunities."

69 Government of Nepal, Ministry of Finance. 2015. "Public Expenditure and Financial Accountability (PEFA) Assessment."

### 5.2.2 Opportunity for systemic shift towards more performance-oriented planning and monitoring structures

To plan for effective and efficient implementation of policies therefore requires that the Government of Nepal addresses the current shortcomings in the planning structures with the aim of developing comprehensive and more realistic performance oriented medium-term policy planning practices. Moreover, with the government's ongoing revision of the MTEF structures, there is a notable opportunity to improve the current planning and monitoring system from a centrally and incremental input and output- oriented system towards a more performance- and evidence-oriented direction where the line ministries and spending agencies plan, prioritize and manage the programs based on realistic resource envelopes, assessment of cost-effectiveness and performance against set policy objectives.

## 5.3 Budgeting constraints

To achieve its planned policy objectives, the Government of Nepal needs to use the budget effectively as a management tool for implementing government policies. This requires a well-coordinated and strong PFM system that effectively supports aggregate fiscal discipline, strategic allocation of resources and efficient service delivery.

### 5.3.1 Fragmented institutional responsibilities in the budget process

The budget process of Nepal is highly fragmented. The MoF is the central budget authority, but key macroeconomic responsibilities are shared between the NPC, the NRB (Central Bank) and FCGO. Whereas NPC has a key role in formulating the MTEF and the capital budget, the MoF plays a crucial role both late in the budget preparation stage in setting the recurrent budget, and during budget execution where it has the primary authority over virement decisions, in formulating and implementing revenue policy, and in international aid coordination.[70]

Of the 18 potential core finance functions a finance ministry could undertake, only three rest solely or overwhelmingly with the MoF itself: foreign aid coordination, tax policy, and budget preparation. In practice, the bulk of macroeconomic responsibilities are shared with the NPC and the Central Bank (5 out of 18: macro-fiscal forecasting and analysis, fiscal policy formulation, the interface between monetary and fiscal policy, fiscal risk analysis, and financial sector supervision). The FCGO carries out a large share of core expenditure work (5 out of 18: treasury and cash management, internal control, internal audit, accounting policy, and debt management). The other five functions (tax administration, customs administration, intergovernmental relations, public asset management, and procurement) are spread over other agencies and departments, some, but not all, of which are formally in a line management relationship with the MoF.[71]

70 ODI. 2013.
71 Ibid.

**Text Box 8. INFF Building Block 3: An overarching financing strategy**

- An overall financing strategy that links development goals and results with sources of finance is currently not in place. However, to improve the basis for macro level and sectoral planning, NPC has initiated a consultancy that will assess the SDG resource needs, estimate SDG resource requirements, and design an SDG financing strategy. The use of the consultancy outputs by the NPC, the MoF and sector ministries in planning, budgeting and management processes will be essential.
- While a financing policy is not yet in place, national development plans, policy strategies and current and planned reforms provide some direction. For example, domestic revenue mobilization is continuously being strengthened through ongoing and planned improvements to the tax policy, the tax system and tax administration. FDI is expected to grow as the business climate improves, for example, through public sector reforms and amendments to existing laws and regulations.
- The government has extensive experience with MTEF processes. Provided that the MTEF process was well functioning, this should ensure spending is driven by costed medium-term sector strategies, and budget allocations linked to medium-term policy outcomes. Currently, however, although the government has a medium-term fiscal framework, it does not provide government ministries and agencies with realistic budget ceilings to plan policy interventions in the medium-term. Furthermore, sector strategies do not include realistic cost estimates. The bases for policy-based budgeting processes that ensure efficient budget prioritization driven by sector strategies, and program management based on coherent performance information, are therefore not in place. Moreover, a recognized weakness is that there is a capacity gap in government to use systematically the available information on expenditures and performance to inform policy strategies, budget prioritization and program management.
- NPC is currently in the process of updating MTEF formats, which will improve predictability in resource allocation and strengthen the linkages between finance, budget allocations and performance objectives, and, as such, improve the basis for policy-based budgeting.

### 5.3.2 Public financial management reform evidence promising but further improvements needed

The Government of Nepal considers the public financial management (PFM) system as essential to contributing to implementation of the government's policy objectives. In 2015, a government-led Public Expenditure and Financial Accountability (PEFA) Assessment[72] concluded that substantial progress had been made in terms of deepening and strengthening the PFM structures. Compared to the previous PEFA that was published in 2008,[73] the 2015 assessment showed that among the 28 indicators used to assess the PFM system, 16 improved, 10 indicators remained unchanged and two indicators deteriorated. The improvement was encouraging as the government's reform efforts have produced important results that have set the Government of Nepal in a much better position than previously to effectively and efficiently use public resources to achieve its policy objectives. However, despite important improvements, significant gaps remain to be addressed, and Nepal is currently implementing a reform program financed by six donors through a World Bank-administered Multi-Donor Trust Fund (MDTF) for PFM.

72 Government of Nepal, Ministry of Finance. 2015. "PEFA Assessment."

73 Government of Nepal, Ministry of Finance. 2008. "PEFA Assessment."

A key condition for using the budget as an effective tool for implementing the government's planned policy priorities is that the budget is reliable. The PEFA assessed the budget reliability of Nepal along four indicators: aggregate expenditure outturn, expenditure composition outturn, revenue outturn and contingency allocation, which capture the immediate results of the PFM system by comparing budget outturn to the original approved budget.

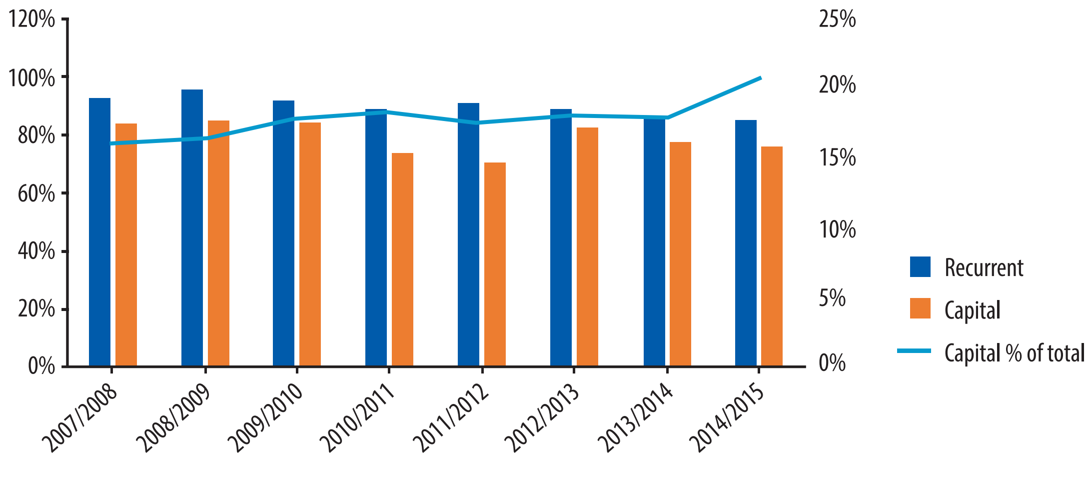
The PEFA Assessment concluded that budget credibility in Nepal has improved significantly. Moreover, despite the fact that the NRB, together with the MoF in recent years, has set relatively ambitious revenue ceilings six months before the budget year, budgeted revenues have been relatively on target. Also, budget outturn has been relatively stable with low variance compared to the original budget. Nevertheless, the PEFA Assessment demonstrated that composition of the expenditures varies considerably, between 17 percent and 5 percent over the three FYs assessed, FY 2010/2011 – FY 2012/2013. Moreover, despite the fact that the overall outturn of the budget is relatively consistent with the original budget, considerable within-year budget reallocations occur regularly.[74]

### 5.3.3 Absorptive capacity challenges

A significant challenge in terms of achievement of the government's policy objectives is the underspending of planned investments, and overspending on recurrent expenditures.

As illustrated in Figure 21 below, capital expenditure as a share of total expenditure has gradually increased from 16 percent of the total budget in FY 2007/2008 to 21 percent in FY 2014/2015. However, the budget execution of capital expenditures is lower than the execution of recurrent expenditures, and falls short of planned investments. In FY 2007/2008, 84 percent of the capital budget was disbursed, whereas only 76 percent of the original capital budget was disbursed in FY 2014/2015.

**Figure 21: Recurrent and capital actual expenditure compared to original approved budget, and capital expenditure as percentage of total expenditures, FY 2007/2008 – FY 2014/2015**




Source: Ministry of Finance, Budget Division.

74 Government of Nepal, Ministry of Finance. 2015. "PEFA Assessment."

The underlying causes for low capital expenditures compared to original approved budget may relate to the following:

- Weak planning and implementation capacity, for example, in terms of timely preparatory plans and activities in certain sectors or at local government level
- Weaknesses in the government's budget execution processes, including delays in budget approval and release processes at various stages
- Inefficient or complex procurement procedures
- ODA commitments not adhered to by development partners
- Inadequate budgetary regulations regarding virement procedures

Hence, despite strong performance in revenue collection, and having achieved significant improvements in PFM structures and budget reliability, it remains a significant challenge for the Government of Nepal to implement the planned programs, projects and activities. To achieve its development objectives, the government therefore needs to continue to improve the budget reliability, with an immediate focus on increasing the capacity constraints related to capital expenditures. Furthermore, the Government of Nepal also requires continued improvements in revenue performance to meet the needs for increased capital investments required to meet the government's policy objectives in the coming years. Taxpayer compliance is still low, and strengthening of tax administration and tax compliance is likely to increase revenues without increasing the taxation levels.

### 5.3.4 Fiscal decentralization measures to improve efficiency in service delivery

Another critical aspect to address is fiscal decentralization. Though there is significant variance in available resources for discretionary use, local bodies are constrained financially, and the financial control environment is weak. PFM capacity is also weak, and planning and budgeting practices are incremental and lack adequate performance orientation. Also impacting the accountability of public expenditures until recently is the lack of locally elected representatives to be held accountable for prioritization and the efficient use of resources. Hence, in practice, local bodies struggle to balance the competing demands of local citizens, communities and central government regulations and directives in policy planning and implementation.

Despite these challenges at the local government level, the new constitution represents a new opportunity for local level governance, with the possible introduction of revised governance and financial management structures, and more simple, coherent and transparent financial regulations that may improve the capacity of local bodies to prioritize policies and budgets according to local needs. As Nepal moves into federal structures it will also be important to revise the tax policy and redistribution mechanisms to ensure adequate distribution of revenues between the state and local levels, and sufficient discretionary resources to all local bodies. Significant capacity enhancement will however be needed to underpin the local government's effective and efficient use of resources in a manner that is consistent with national policy targets, as well as local needs and preferences.

### 5.3.5 Continued focus on PFM reform processes needed

The ongoing PFM reform efforts are largely centred around the initiatives financed by the MDTF for PFM. The MDTF contains four components all addressing critical PFM weaknesses. For the local government sector, a second phase of the Strengthening Public Financial Management Programme, administrated by the ADB, is planned. Moving forward, it is critical that the INFF takes stock of the PFM reform efforts both at central and local level, and ensures that all critical issues related to public sector planning and budgeting are adequately integrated into the ongoing reform efforts, and that the reform efforts adequately address all institutions with spending mandates in a coordinated and timely manner.

#### Text Box 9. Aligning public and private finance for the SDGs

Nepal receives ODA from a broad range of bilateral and multilateral donors. In addition, many INGOs are active in Nepal and global funds contribute substantially in some sectors (ref. section 4). Current levels of external funding appear, however, to be significantly below potential, as bilateral donor commitments are substantially higher than actual disbursements and funding from global funds is substantially lower than comparable countries. As has been argued in the previous and following sections, the reasons for this are linked to constraints in the planning and budgeting system and procedures, and to weaknesses in public sector management and accountability structures, which reduces the capacity of government to absorb additional funding effectively. The SWAps have proved effective in establishing more performance focused planning and budgeting in many countries. SWAp mechanisms were originally designed to align donor support with country priorities, to align funding under one disbursement and financial management process, and to create a shift in policies that strengthens national planning, budgeting and monitoring mechanisms. By design, the expenditure framework developed with a SWAp promotes transparency in resource allocation and accountability for donors and country governments in their progress towards improved technical and allocative efficiencies. The expenditure framework facilitates the evaluation of SWAps and holding governments and donors mutually accountable to their commitments, though this often has considerable transaction costs.[75]

With the MDGs, funding architectures were changed, including through the establishment of international health and education funds. Today funding complexity is further increasing, with opportunities to attract domestic and international finance, e.g. from climate and environmental funds that can be attracted to support public and private investments and venture and challenge funds targeting private sector investments.

Nepal has experience with SWAps in some sectors such as education and health. The SWAp is an approach that, if successfully implemented in other sectors as well, and adequately aligned to the national MTEF, can be used as a targeted approach to address the current constraints in planning and budgeting at sector level. However, given the increased complexity of development challenges and funding opportunities and ambitious SDG goals and targets, innovative adaptation of the SWAps should be considered. This would be with the aim of integrating the potential contribution of non-government stakeholders to SDG goal achievement, and to identify how and by whom domestic and external finance can be utilized to finance both public and private sector initiatives.

75 Chansa C, Sundewall J, Mcintyre D, Tomson G, Forsberg BC. 2008. "Exploring SWAP's contribution to the efficient allocation and use of resources in the health sector in Zambia." *Health Policy Planning* 23. (2008): 244-51.

### 5.3.6 Strengthening public sector management

As clarified above, the Government of Nepal has in recent years undertaken important measures to strengthen the planning and budgeting processes. Moreover, previous and on-going reforms have strengthened the PFM system and increased the number of possibilities to use effectively the budget to execute the policy plans. Government agencies at central and local levels are familiar with systems and procedures for RBM that underpin performance orientation, though the reporting remains largely input oriented.

However, despite these improvements, there are also some significant developments that constrain achievement of policy objectives. For example, while RBM and MTEF systems were introduced 15 years ago, the MTEF is currently not operational. Results-based monitoring systems are implemented throughout government ministries and agencies, but generally they are more output than outcome oriented. Moreover, they are not adequately aligned to budgets, and generally results-oriented norms and practices have not been entrenched in the civil service and public management systems. Hence, planning and budgeting processes are dominated by incremental and output-oriented norms rather than by performance-oriented and outcome-based culture and practices.

The experience of Nepal suggests that establishing more advanced systems for planning and budgeting has not been adequately supplemented with capacity enhancement programs and changes in the Nepal civil service management system that are necessary to change the norms and cultures that underpin performance oriented planning and budgeting. This is by no means unique to Nepal. Studies by OECD, which has been in the forefront of promoting performance based planning and budgeting, and experiences from other Asian countries, clearly suggest that implementation gaps in performance planning and budgeting are related to insufficient adjustments in public service management systems and inadequate focus on long-term capacity-building programs that support the reform efforts.[76] This is because performance-oriented planning and budgeting systems require high capacity across government agencies, not only to collect and report on performance data, but to use the data during planning and implementation to enhance efficiency.

#### Text Box 10. Civil service challenges

There have been many attempts to undertake civil service reform in Nepal, but they have not been fully implemented as planned. In 2011, the Administrative Restructuring Commission, spelled out the problems and challenges in the civil service across different categories. The Ministry of General Administration summarized the main weakness as the following:

- Low level of motivation of civil servants
- Administrative machinery becoming too bloated
- Unnecessary expansion in the number of government agencies and their employees
- Too many layers in the decision-making process
- Weak mechanism to hold individual officials responsible

76 See: OECD. 2011. "Survey on Performance Budgeting." Kroll, Aleksander. 2015. "Drivers of Performance Information Use: Systematic Literature Review and Directions for Future Research." *Public Performance and Management Review*. 48/3. Park, Nowook and Jang, Joung-Jin. 2015. "Performance budgeting in Korea: Overview and assessment." *OECD Journal of Budgeting*. 2014/3.

**Text Box 10. Civil service challenges (continued)**

- Adopting new technology effectively remains a challenge
- Lack of responsiveness towards citizens and a lack of decentralization of necessary authority to the officials down to the field offices

The Ministry also pointed out that significant structural, managerial and behavioural challenges remain to be addressed, including:

- Local level personnel tend to be located at the district headquarters only, seriously affecting service delivery and other development initiatives in the field
- The pace of decentralization is slow and the Local Self Governance Act has not been implemented
- The administrative culture is not performance oriented
- Incentives are limited and not fully linked to performance
- Accountability is avoided rather than shouldered

In its report, the Ministry explored the principles that should inform the process of federalizing the civil service, as well as possible models of civil service structure and management that could be pursued in civil service reform in Nepal.

Source: Government of Nepal, Ministry of General Administration/UNDP. 2014. "The Nepal Civil Service and Re-structuring of the State."

In the international literature on performance planning and budgeting, it is often stated that development of this capacity depends on having recruitment and incentive systems in place that ensure that civil service staff are motivated and have a full understanding of what this form of budget management means. To improve the quality of the planning and budgeting systems, towards a more performance oriented and decentralized system, is a challenging endeavour. Among others, it requires an operational MTEF that provides reliable budget ceilings in which sector ministries can prioritize based on costed policies and medium-term policy objectives defined in SWAps and programs. It also requires adequate capacity and a performance-oriented culture, often combined with incentive- based Human Resource Management systems, which facilitate the use of performance information in all stages of the planning, budgeting and implementation processes.

Sustainable improvements cannot be achieved only by introducing new systems and procedures for planning and budgeting. To ensure that performance information is used in a manner that improves effectiveness and efficiency, measures that change norms and cultures in the civil service from process to performance orientation must be taken. This will require comprehensive capacity-building programs and changes in the civil service incentive systems in Nepal across government institutions. Moreover, the government will need to approach the current challenges of its civil service in a coherent approach through civil service reform. The reform should address current challenges as identified by the Ministry of General Administration in its 2014 report,[77] both for central and local government. Independent of government level, a restructuring of the civil service needs to ensure that agencies are provided adequate autonomy to be held accountable for results, that recruitment and change of positions is based on

77 Ibid.

professional merit, that remuneration and career development are linked to performance, and that civil servants are provided incentives to improve knowledge and performance throughout their careers.

Effective civil service reforms are generally recognized to be long-term endeavours. While there are certainly short-term measures that can motivate staff, such as salary supplements and other types of monetary incentives, the "quick-win" benefits of such interventions must be weighed carefully against the risk of overall distortions to the civil service structure, including from a PFM and fiscal sustainability perspective.[78] The case of Afghanistan, for example, has been widely cited as a situation in which donor efforts to strengthen the civil service resulted in a "shadow" public administration with unsustainable distortions between those officials working on donor-supported salaries and those on "regular" government salaries.[79] Nonetheless, there are examples of short-term strategies to improve performance, including through non-monetary incentives such as award and recognition mechanisms for good performance, such as those implemented in the Philippines.[80]

### Text Box 11. INFF Building Block 5: A robust monitoring and evaluation system

- A comprehensive system for monitoring the SDGs has not been established. Significant data gaps need to be filled to establish baselines and monitor progress for many of the SDG targets.
- An assessment undertaken by NPC[81] acknowledges that the government's monitoring capacity needs to be strengthened in government institutions, including the Central Bureau of Statistics (CBS), that existing survey data needs to be supplemented with expanding existing surveys and that new surveys should be developed to fill the data gaps. A number of development partners provide support, however, to strengthening various areas of the capacity of the Government of Nepal in statistics and monitoring.
- At the same time, existing routine data systems should be improved and the planning and monitoring system should be tailored to the SDGs. Currently the planning, budgeting and monitoring processes are not adequately integrated and management procedures are inadequate to ensure policy-based planning, budgeting and monitoring processes. The reporting is often output-oriented and not used to undertake cost-benefit analysis informing budget prioritization. The NPC is, however, in the process of updating the MTEF formats that may strengthen the outcome orientation in reporting and monitoring, provided that the linkages between plans, budgets and monitoring frameworks are strengthened and line ministries' capacity to report and utilize performance information in daily management processes is strengthened.

78 Paul, Elisabeth. 2010. "Motivating Civil Servants for Reform and Performance." *UNDP Global Event Working Paper.*

79 See, for example, reference to the findings of a European Commission evaluation of public administration reform in Afghanistan at http://www.adamsmithinternational.com/explore-our-work/central-asia/afghanistan/a-better-civil-service-evaluation-of-the-public-administration-reform-proce/ (last accessed on 14 October 2017).

80 For details on the example of the Philippines, as well as other relevant country case studies, see: Paul, Elisabeth. 2010. "Motivating Civil Servants for Reform and Performance." *UNDP Global Event Working Paper.*

## 5.4 Enabling environment for accountability and dialogue for the SDGs

As discussed above, there is a relatively high degree of coherence between national policy objectives and the SDG goals, and the government is leading a process to integrate the SDG targets into the national development strategy. However, the SDG process is currently not anchored outside the central planning and budgeting agencies. Significant effort therefore needs to be made to ensure that the SDG goals and targets are adequately integrated in sector policies and strategies both at central and local government levels.

Equally important, however, is mobilization of non-government stakeholders. Private sector institutions, though currently divided and mostly confined to traditional commercial businesses, can play a crucial role and become an important tool for the government both in terms of mobilization of finance, and in improving efficiency in delivery of government policies and services. For example, the private sector may play a more prominent role in infrastructure development through PPP arrangements, in the energy sector by taking on responsibilities in transmission networks, and in social sectors by delivering primary services where the government currently lacks adequate capacity. Similarly, the cooperative sector can provide core services in the social sectors, and play an important role in mobilizing local resources and expressing community needs to government and private sector investors. Media engagement is also crucial, both as a watchdog function and as a channel for dialogue between citizens, private and state actors.

The 2014 Development Cooperation Policy recognizes the role of private sector and civil society partners in supporting the development of Nepal. However, in terms of providing platforms for inclusive dialogue between the Government of Nepal, development partners, private sector and civil society, the main dialogue forums provisioned for in the 2014 Development Cooperation Policy–including the Nepal Portfolio Performance Review, Local Development Partners Meetings, and Joint Sectoral Reviews–have primarily focused on bringing together the Government of Nepal and development partners.

Nepal is not the only country that has been challenged in establishing inclusive dialogue forums. Of the 81 low- and middle-income countries that participated in the 2016 monitoring round of the Global Partnership for Effective Development Cooperation, only 51 percent were found to have all the elements in place for meaningful inclusive dialogue around development cooperation.[82] However, some countries have made good progress in strengthening such platforms. The CSO Partnership for Development Effectiveness (CPDE) notes the example of the Government of Kenya, which brings together CSOs and other development partners on a monthly basis to discuss development effectiveness issues.[83] Myanmar is another country that has been recognized for progress in this area, with the government inviting participation of civil society in sector working groups, for example.[84] Looking ahead, the Government of Nepal may also consider strengthening its existing dialogue platforms to deepen engagement with private sector and civil society.

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81 Government of Nepal, National Planning Commission. 2015. "Sustainable Development Goals 2016-2030 National (Preliminary) Report."

82 OECD/UNDP. 2016. *Making Development Co-operation More Effective: 2016 Progress Report*. OECD Publishing, Paris.

83 CSO Partnership for Development Effectiveness (CPDE). 2016. "GPEDC Indicator Two: Civil society operates within an environment which maximises its engagement in and contribution to development- An assessment of evidence." *CPDE Working Group on CSO Enabling Environment and CPDE Working Group on CSO Development Effectiveness.*

84 OECD/UNDP. 2016. *Making Development Co-operation More Effective: 2016 Progress Report, Country Monitoring Profile for Myanmar.* OECD Publishing, Paris.

To achieve broad engagement around the SDG agenda it will be essential that government institutions in Nepal provide comprehensive and transparent information that is reliable and trusted at different levels in the society. In Nepal, the Good Governance Act (2008) is key legislation that aims to ensure that administrative functions serve the public interest; promote equity and inclusiveness; ensure the rule of law; guarantee human rights and rule by law; ensure transparency, objectivity and accountability; and promote devolution of power and the participation of citizens in planning and budgeting.

Despite impressive achievements in some areas, such as the government's successful focus on inclusion of citizens' groups in local planning and budgeting through the Local Government and Community Development Programme, significant gaps remain to be addressed to ensure accountability and transparency both at the national and local government levels. This includes addressing the following aspects that have been discussed in this report:

- The Parliament's constructive engagement on the SDGs is essential to establish broad ownership and commitment to the SDGs and to ensure oversight and control with the government's SDG policy by Parliament. An informal SDG forum in Parliament has been established. However, the attention of parliamentarians given to the SDGs and long-term development policies have, according to some stakeholders, been seriously constrained by political instability with frequent changes in government, and by more pressing issues related to reconstruction efforts and on the implementation of the constitution.
- A professional and adequately staffed administration is critical to executing the government's SDG policies in a transparent and accountable manner that encourages engagement with citizens' groups, the private and corporate sectors, and the media. Staffing levels and quality in local government administrations are currently low, and at the central government level, results-oriented norms and practices have not been entrenched in the civil service and the public management system.
- The centralized planning system combined with incremental and detailed planning and budgeting practices, with a focus on line item management and outputs rather than program outcomes, weakens the extent that government ministries and agencies are held accountable. Rather than focusing on high-level results, which will be essential in implementation of the SDGs, focus both in government and Parliament is drawn towards budget items and outputs.
- Over the last ten years, the PFM reform measures have contributed to progress in budget credibility, hence improving the basis for accountability in budget planning and budget execution. Despite improvements, the most recent PEFA report[85] points out that to lift its rank to that of MIC, the Government of Nepal needs to adopt reforms that improve budget comprehensiveness, which due to extraordinary expenses has been undermined. Furthermore, within-year virements are high and execution of capital expenditure is low, and despite external scrutiny of budget execution by the Office of the Auditor General, corrective measures are often not adequately followed up by government agencies and local bodies. Further reform measures in PFM are therefore required to improve accountability and transparency in budget processes and PFM, improving the basis for citizens as well as the private and voluntary sectors to hold government institutions accountable for results.

85 Government of Nepal, Ministry of Finance, 2015. "PEFA Assessment."

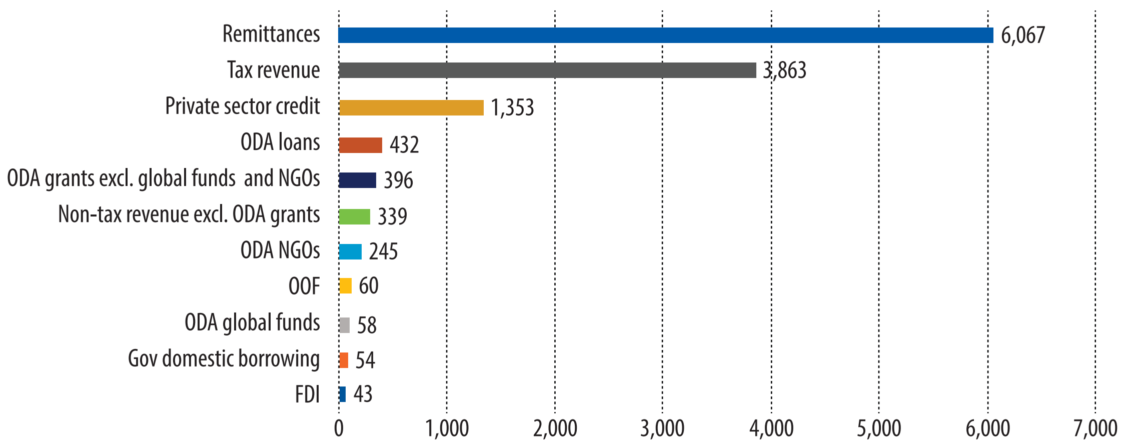
### Text Box 12. INFF Building Block 6: An enabling environment for accountability and dialogue

- An informal SDG forum in Parliament has been established, but parliamentary supervision and oversight of the SDGs needs further improvement.
- The Nepal Business Forum was established in 2010 as a mechanism for coordination between government and private sector stakeholders.
- There are also established mechanisms for coordination of development aid. The MoF AMP is an online web-based system that the government and donors use to manage development aid.
- The 2014 Development Cooperation Policy recognizes the role of private sector and civil society, but the main dialogue forums mentioned in the Policy – including the Nepal Portfolio Performance Review, Local Development Partners Meetings, and Joint Sectoral Reviews — are primarily between the Government of Nepal and development partners and do not regularly include private sector and/or civil society partners.
- The lack of elected political representatives (until recently) at local levels has meant that local bodies are not held accountable for prioritization or the efficiency in the use of resources by its citizens. This constrains the capacity to achieve development goals as local bodies are not held accountable to citizens for how they prioritize and spend available resources.
- Weak administrative capacity in local and central government administrations and lack of performance-oriented norms and culture constrains the government capacity to be transparent and accountable.
- Centralized planning structures and incremental line item planning, budgeting and management strengthens the focus on outputs but blurs the focus on the high-level objectives and aims. It weakens the government's capacity to prioritize effectively and its capacity to have constructive engagement with the Parliament, citizens, media and non-governmental stakeholders.
- Despite strengthened capacity with improved transparency and public access to financial information, the 2015 PEFA Assessment demonstrated that the PFM system needs to be further strengthened to ensure that PFM practices are more transparent and accountable to the public.

# 6. Future financial flows to achieve policy targets

The sources of finance as presented in the sections above are summarized in Figure 22, which shows the value of different sources of finance in 2015. The major and significant source of external finance is remittances, which have increased significantly over the last decade but will likely level out and even decline if policies to generate domestic employment and income opportunities succeed with a more conducive environment for private sector development. Tax revenue is the largest source of public finance and as mentioned in sections above, a source of government revenue that compares favourably with low-income countries and other countries in the region. Another major source is domestic credit to the private sector that has increased significantly over the years i.e. finance for private sector consumption and investments increased from 28 percent of GDP in 2005 to 65 percent in 2015. This compares to an increase in private sector investments rising from 17 percent to 23 percent of GDP during the same period. The various concessional (ODA) grants and loans constitute a smaller share of funding as do the grants to NGOs. FDI and OOFs constitute a minor share, also when compared to other countries at the same GDP per capita level.

**Figure 22: Distribution of financing for development in millions of US dollars, 2015**

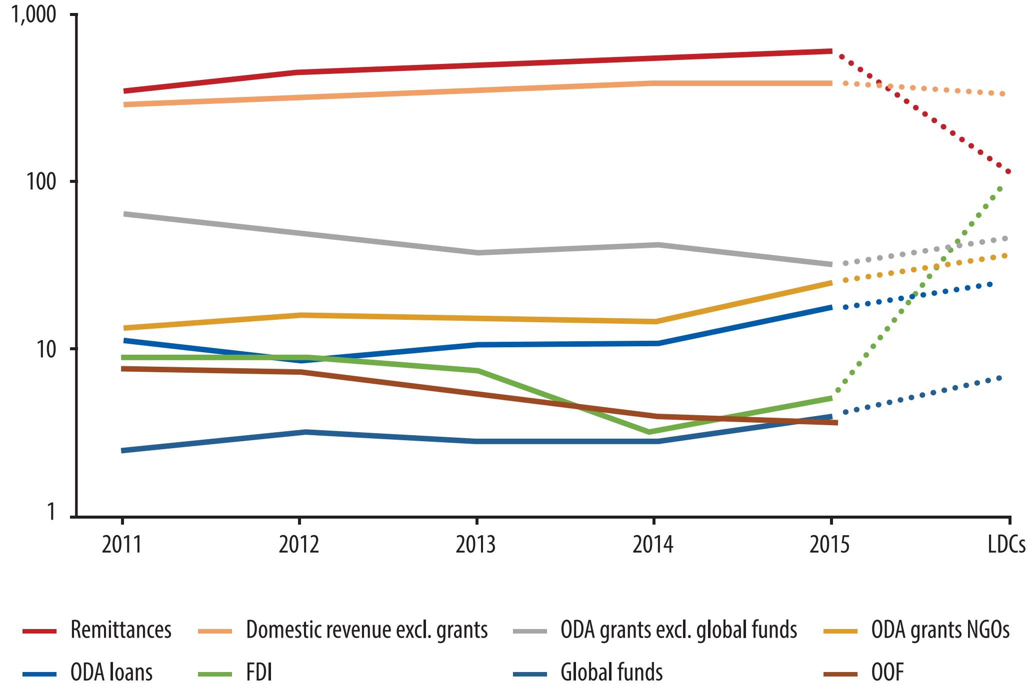



Source: Ministry of Finance, OECD/DAC and Nepal Rastra Bank.

Comparing the trend and composition of the above sources of finance with other countries at the same income level may serve to illustrate the potential that Nepal has to mobilize additional finance for development. This is based on the assumption that public sector absorptive capacity can be raised either through public sector capacity measures, increased efficiency in implementation of public investments and/or through a wider engagement of non-state actors in delivery of public services through outsourcing/PPP arrangements.

Figure 23 shows the trend in the major sources of finance for development using a logarithmic scale to show the detailed trends of all sources. The dotted lines estimate a future trend if Nepal was to reach the same level of funding from each source equivalent to the average of other LDCs.[86] It may serve to illustrate the potential for additional funding from different sources if the level of finance of Nepal from each source was to be at the average of LDCs in total.[87]

**Figure 23: Trends in the sources of finance for Nepal compared to LDC average, in bln NPR at constant 2015 prices**




Note: The presentation is made in a logarithmic scale to display details of the trends for minor sources of funding. The reference to LDC is according to the definition by the United Nations. The data are to be considered as proxies only as the data available for each country in the LDC category varies from one variable to the other.

Source: Ministry of Finance and World Bank World Development Indicators.

Based on the analysis from the sections above and using the LDC average as a "benchmark" the following can give an indication of opportunities for increasing the level of concessional and non-concessional sources of finance:

- Remittances are a major source of income for households in Nepal compared to the average of other low-income countries. The future trend will likely not generate an increasing volume of remittances; growth in private sector development in Nepal will likely absorb more of the labour force in the domestic economy. However, with a more diversified private capital market, remittances can potentially

86 For the analysis, the United Nations definition of LDCs has been used and the average for each source of finance as a benchmark is for these 47 countries ref. https://www.un.org/development/desa/dpad/least-developed-country-category.html (last accessed on 15 October 2017). Data to compare private sector credit is not available for the majority of the countries and thus is not included in the analysis.

87 DFID is currently supporting CBS in revising the national account and has indicated to the DFA team that the revision may result in an upward adjustment of GDP. An upward adjustment of the GDP of Nepal would impact on the results but not the recommendations of this DFA. In Figure 23 an upward adjustment of the GDP would imply that the financial flows of Nepal above the LDC average (e.g. remittances and domestic revenues) would be adjusted down and be more on par with other LDCs, whereas for financial flows below the regional average (e.g. ODA, OOF and FDI) Nepal would be even further lagging behind other LDCs.

serve as an additional source of finance for PSD if venture capital and other arrangements could yield higher returns for remittances than private consumption and investment in household assets.

- Domestic revenue will continue to increase with improved efforts, including in tax administration, though compared to other low-income countries, the tax revenue of Nepal compares favourably as a source of income. However, there are opportunities to increase tax revenues further, among others, by widening the tax base for income tax and reducing discretionary tax exemptions.
- Actual ODA disbursements compared to commitments are low due to the low level of absorptive capacity within the Government of Nepal. Efforts to strengthen the capacity of the Government of Nepal to utilize aid offered can potentially raise the level of ODA, both in the form of grants and concessional lending without challenging debt sustainability levels. If using the LDC average as a benchmark, concessional funding on ODA terms could be raised as much as 50 percent compared to 2015 disbursements.
- Compared to other low-income countries, Nepal has yet to utilize fully the opportunities for targeted ODA financing from global concessional funds in areas such as environment and climate prevention/mitigation programs, renewable energy and education, as well as global funds for other key sectors. For this particular source of ODA funding, the level of additional financing could be raised by as much as 70 percent if using the average of LDCs as the benchmark.
- The Government of Nepal can make a wider use of NGOs and the private sector, among others, through management service agreements and PPP arrangements in major sectors (as is currently done in the health sector) to supplement its own capacity in execution of investments and service delivery. NGOs also serve as an additional source of funding from developing partners' aid budgets.
- Opening up new sectors to the private sector will also attract more FDI, which is low compared to other low income countries. However, this requires that key constraints for private sector entry and operations are addressed. The average FDI levels of LDCs are almost 20 times higher than that of Nepal.
- An improved business climate will not only attract FDI, but also other forms of official flows in the form of concessional and non-concessional finance from DFIs and non-OECD countries (such as China and India), which currently are at a low level compared to other low-income countries. The actual level is, however, difficult to establish as there is not sufficient data to estimate the average for LDCs.
- A major and fast-growing source of finance for Nepal has been transfers in the form of remittances from the significant and increasing number of its labour force working abroad. This form of finance serves as an important source of consumption and property investment for its citizens. However, as in many other countries, promoting new financial services and intermediaries such as venture capital funds and other equity investment opportunities, can potentially raise finance for private sector investments for domestic employment and income generation.
- As many startups and greenfield operations often require risk capital/subsidies to develop their business, establishing challenge funds and other funding arrangements and programs may serve to promote new business opportunities and growth of SMEs similar to what several other low-income countries have done successfully. However, equally important are the availability of business development services to develop viable business plans and pilot greenfield operations, in particular for SMEs.

### Text Box 13. INFF Building Block 4: Specific financing policies

**Public sector revenues**

Domestic revenues can be raised by further efforts to improve tax administration and compliance and by raising the level of revenue from income tax, which in Nepal is low compared to its peers. These are key elements for a policy to raise the level of domestic revenue.

**External public finance**

The LDC average as a benchmark for concessional funding on ODA terms suggests that Nepal can raise the level of ODA by as much as 50 percent compared to 2015 disbursements. This can be achieved by implementing a reform program to improve the capacity and implementation of the aid management policy of the Government of Nepal to strengthen its capacity to utilize aid committed, in the form of grants and concessional lending, without challenging debt sustainability levels. One element of a policy to increase the capacity of the Government of Nepal for design and implementation of required interventions is promotion of PPP arrangements and more use of outsourcing arrangements by engaging non-state partners for public service delivery.

Compared to peers, Nepal attracts a low share of finance from global concessional funds. A strategy should be developed to identify what international finance sources could be used to finance interventions for specific policy objectives.

**Domestic private sector**

There is scope for entry of many more venture funds in Nepal to foster competitiveness and increase outreach given the gap for access to finance and business development services. This can be promoted by improving the regulatory environment as well as offering partial risk sharing in the form of guarantee/co-financing by the Government of Nepal.

SME startups and greenfield operations often require risk capital/subsidies to develop their business. Establishment by the Government of Nepal of challenge funds and other funding arrangements/ programs for business development services will serve to promote new business opportunities and growth of SMEs similar to what several other low-income countries have done successfully.

**External private sector/finance**

The main elements for attracting increasing volumes of FDI and directing remittances to productive investments for private sector development include interventions to improve further the business climate as well as interventions to promote domestic private sector investments.

# 7. Conclusions and recommendations

## 7.1 New development phase

After seven years with an interim constitution, a new constitution that sets a new political system with a federal structure was approved by the Constituent Assembly in September 2015. For the first time in 20 years, local elections were held in 2017, providing a basis for improved accountability and citizens' voice at the local level. Federal elections will, according to the constitution, be held by January 2018. These elections will be, according to many observers, a test for the new constitution. They also provide an opportunity to reduce political marginalization, increase stability in the policy environment, and create government and governance structures conducive to economic growth and social improvements.

Despite the optimism created with the new constitution, Nepal is facing significant development challenges. Infrastructure investments have not been adequate and the business climate has been unsupportive of growth. Due to lack of opportunities at home, many citizens have been moving abroad to seek alternative income opportunities. Nepal was also hit by two major earthquakes, in April 2015 and May 2015, with damages and losses estimated at close to one third of the country's GDP. The result of the above has been an economy in a situation of low-investment, low-growth development; as such, Nepal remains among Asia's poorest countries.

Notwithstanding the above challenges, the Government of Nepal has managed to maintain sound macroeconomic management and broadly follows a fiscal policy with emphasis on mobilizing domestic revenue and reducing reliance on domestic and external borrowing. Domestic revenue collection outperforms many of the countries in the region and other countries at the same income level, and debt service levels are low as a share of total expenditure after years of accelerated repayments.

## 7.2 Integrated National Financing Framework for Nepal

This study has assessed the current revenues and financial inflows (both domestic and foreign, public and private, non-concessional and concessional), to identify opportunities for increasing levels of finance for development. The study has also assessed the public sector management system, and identified key institutional factors that constrain planning, budgeting and implementation of public investments and service delivery, and hence affect the public sector's capacity to efficiently and effectively utilize existing finance as well as the capacity to utilize additional sources of finance.

One main conclusion of this DFA is that while finance is one constraint to achievement of the SDGs and attainment of MIC status, so is the absorptive capacity to utilize the financing that is available. Provided that the public sector management systems and procedures effectively and efficiently utilize available resources, additional private and public finance can be mobilized from both domestic and foreign sources in support of achieving these goals.

While the government in recent years has implemented reform measures that gradually have improved the PFM system, earlier reforms of the planning, budgeting and management systems, such as performance oriented MTEF and RBM systems, have not been sustained, and new measures that improve efficiency and increase capacity to mobilize and use existing and new resources are needed.

The above calls for a policy to encourage more non-state actors to supplement the capacity of the Government of Nepal in implementation of changes in the business climate combined with arrangements to attract larger inflows of finance to promote growth in public and private sector investments. To address the current institutional constraints, a change in the planning and budgeting systems and practices is needed, both at federal and local levels, from a centrally and incremental input- and output-oriented system towards a more performance and evidence-oriented direction where the line ministries, spending agencies and local governments plan, prioritize and manage the programs based on realistic resource envelopes, and assesses cost effectiveness and performance against set policy objectives.

Changes in public sector management systems and practices need to be underpinned by civil service reform and measures that aim to strengthen the capacity of civil service management and staff and the accountability of federal and local government institutions. To facilitate mobilization of resources from the private and voluntary sectors, accountability structures also need to be reinforced through further improvements to the PFM systems at the federal and local levels, and by continuing to strengthen commitment to the SDGs among parliamentarians, local elected representatives and the media. Moreover, to improve the basis for evidence-based policymaking and to ensure that SDG progress is adequately monitored, increased support to strengthen production and use of statistics needs to be prioritized.

The Government of Nepal is committed to develop an INFF to serve as a holistic framework that systematically and coherently addresses its development challenges and sets out a strategy for the government to deliver on its development objectives. The following presents key recommendations to improve efficiency in the use of available finance and identify opportunities to mobilize additional finance, structured around the six INFF building blocks as presented in earlier sections of this report. Details of these recommendations with some illustrations from Nepal and other countries have been presented in respective sections above.

### 7.2.1 Diversify and strengthen financing strategies

Nepal has demonstrated a strong capacity to generate domestic revenues, and is currently undertaking additional measures that will further strengthen domestic revenue mobilization. This DFA has, however, demonstrated that there is significant potential to mobilize both additional revenue sources and private finance that can support the government in achieving its policy objectives:

#### I. Develop a strategy to increase access and diversify sources of ODA funding

Nepal has a significant potential to raise the level of ODA, both in the form of grants and concessional lending. By sourcing additional concessional finance, Nepal can also increase access to ODA funding and raise additional concessional finance from the growing number of global funds and DFIs.

Nepal is, as compared to many other countries in the region and countries at the same income level, far from utilizing its potential to access global concessional funds in various sectors. As an illustration, Nepal has received relatively little from global climate funds as compared to the challenges it faces and the size of the country both in terms of population and area impacted by climate change. The

Government of Nepal has acknowledged that there is likely to be a large financing gap for achieving the SDG targets and that it will have to look to mobilize resources from across different types of public and private, as well as domestic and external, finance sources.[88]

### II. Increase the engagement of non-state actors in public service delivery and infrastructure investments

Despite the capacity constraints in public sector service delivery, evidenced by low budget execution and comparatively low levels of ODA, both NGOs and the private sector play only a minor role in execution of public service delivery, with some notable exceptions such as waste management and power generation.

The Government of Nepal has significant potential to scale the capacity in service delivery by outsourcing more service delivery to NGOs, the private sector, and other development partners, but with attention to screening potential partners carefully to ensure adequate capacity and appropriate governance arrangements. By engaging non-state actors to supplement the capacity of public sector service delivery, for example, in the education and health sectors, the Government of Nepal will be able to increase its budget releases, which again will provide access to additional sources of finance such as ODA funding.

PPPs may be one avenue in terms of strengthening private sector engagement, such as through service delivery or management contracts in which the Government of Nepal takes a regulatory role and/or uses the budget as a financial incentive to encourage NGO/private sector participation.

For larger investments in utilities and infrastructure, investments in PPPs can potentially attract additional external finance through FDI, while social sector service delivery (with major potential in secondary and tertiary education) could bring in added concessional finance accessible by INGOs, who in turn cooperate with NNGOs, and achieve efficiency gains by outsourcing service delivery to the domestic private sector.

### III. Increase level of debt financing on concessional terms

The current Government of Nepal debt levels are at an all-time low level. The low debt level allows increased debt financing at concessional (ODA) terms without any significant risk of reaching unmanageable debt service levels.

Access to additional debt financing can be acquired from concessional sources such as multilateral development banks and DFIs. The former is linked to the capacity of the Government of Nepal in planning and executing public sector investments, the latter is linked to the extent to which the policy and regulatory environment improve, including the framework for PPPs in sectors and investments that potentially could become profitable through engagement by DFIs (such as hydropower and other public utility services).

### IV. Further changes in the business climate and establishing investment funds

Improvements in the business climate are needed to promote both domestic investments and FDI, which remain very low compared to other countries at the same income level and the average of all South Asian countries.

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88 Government of Nepal National Planning Commission prepared as part of its Voluntary National Review at the 2017 High-Level Political Forum on Sustainable Development: Government of Nepal, National Planning Commission. 2017. "National Review of Sustainable Development Goals."

To improve the business climate, the Government of Nepal can pursue a more pro-active policy directed at establishing investment/guarantee facilities to leverage private sector finance for greenfields/startups and development of SMEs. Moreover, there is scope for entry of many more venture funds in Nepal to foster competitiveness and increase outreach, given the gap in access to finance and business development services that has been identified by several surveys and confirmed by the annual "ease of doing business" ranking by the World Bank.

In many countries like Nepal, access to finance is one among other constraints. However, access on concessional terms to business development services and research to develop SMEs and new lines of production in existing industries has proven equally important. Many countries at the same income level have established venture capital programs and challenge funds that also include business development services with donor support promoting SMEs in priority sectors such as agriculture and renewable energy. To promote SME startups and growth, the Government of Nepal could, in addition to creating a more enabling regulatory environment, promote venture capital funds/programs, including business development services, as many other countries have done.

**V. Opportunities for remittances as a source of private sector investments**

Remittances are a major source of finance for household income and expenditure that, with a more diversified offer of financial intermediaries, can become an additional source of finance for investment in private sector development.

If the government addresses the challenges related to the business climate and entry of new financial intermediaries and instruments in the financial sector, a major source of finance for household consumption and expenditure, namely remittances, can also play a significant role as an additional source of finance for promoting investments in SMEs.

### 7.2.2 Develop financing strategies

Over the last decade, the international finance architecture has become increasingly diverse, with many new institutions, and regional and global funds offering concessional finance for different purposes. Nepal has significant potential to mobilize additional revenues and finance from these sources, similar to other countries. Currently, however, there is no strategy in place to mobilize additional finance.

Nepal is, as compared to many other countries in the region and countries at the same income level, far from utilizing its potential for access to global concessional funds in various sectors. Nepal also has significant potential to raise the level of ODA from its current sources, both in the form of grants and concessional lending.

Ideally, a financing strategy should be anchored in the sector ministries and be based on the sector strategies and sector MTEFs. It is therefore recommended that the line ministries, based on sector strategies or SWAps, identify policy areas where additional finance can be mobilized. To illustrate, this may include identifying policy areas where PPP arrangements can be used, where national private actors can mobilize finance for projects that directly or indirectly support SDG targets, where international funding mechanisms such as challenge funds can be utilized, or where existing ODA or OOF funding can be further increased. It may also include identifying areas where non-state partners may contribute to increasing government's absorptive capacity, for example, by delivering services that traditionally have been delivered by the public sector but where private sector actors may be able to deliver the same services at a similar or higher standard at the same cost.

Nepal has some experience with SWAps. It is recommended that the Government of Nepal explore opportunities to establish SWAps in other sectors, and that SWAps are utilized to map strategically potential additional finance that can be mobilized.

### 7.2.3 Strengthen institutional coherence

The government has shown firm commitment to align national plans and strategies with the SDG goals and targets. Nevertheless, further policy and institutional coherence is needed to ensure that SDG targets become an integral part of all ministries' planning, management and budgeting procedures.

SDG coherence needs to be institutionalized in the sector ministries. Based on the assumption that institutional coherence and the quality of the technical planning processes affects the government's capacity to mobilize additional finance and the capacity to achieve the SDG policy goals and targets, it is recommended that the planning processes are adjusted in a direction where the formulation of goals, targets and strategies is to a larger extent assumed by the responsible sector ministries and their underlying agencies. Actions to be considered include:

- Increase the involvement of decision makers from line ministries from the outset of the planning process
- Establish strategic management groups mandated to guide policy and planning processes in the sectors, oversee SDG policy coherence, and prepare SWAps
- Establish technical working groups mandated to support the sector ministries to operationalize and cost policy targets, introduce SDG policy markers in budget execution, strengthen prioritization within the medium-term budget ceilings, and strengthen performance-oriented reporting mechanisms

SDG coherence also needs to continue to be developed in the Parliament, among representatives from the private sector and NGOs, and in the media. As a first step, it is recommended that the government takes the initiative to engage further these stakeholders. It is recommended that each sector ministry develop dialogue and awareness strategies involving stakeholders at federal and local levels, the private and voluntary sectors, as well as representatives of the media.

With the new federal structures, localization of the SDGs is considered essential to determine the SDG policies and outcomes. While many uncertainties remain in various areas related to the process of transitioning to federal structures, including in areas such as planning, budgeting and fiscal transfers, the establishment of federal structures offers an opportunity to strengthen accountability mechanisms and adapt policies to local needs and circumstances. It is therefore recommended that institutionalization of the federal structures is underpinned by a stronger focus on the local governance and public finance reform agenda, aiming to reinforce governance and financial management structures at the local level.

### 7.2.4 Strengthen alignment of development vision and sector strategies

As a signatory to many United Nations conventions on sustainable development, many of the SDG goals and targets are adopted in the national development plan. The NPC has initiated a process to include all SDGs relevant to Nepal into the national development plan, and is committed to integrating and mainstreaming all SDG goals and targets in the medium-term budget framework and annual work plans.

Recently the government also launched a consultancy review that is set to undertake a costing of the SDG targets and develop a financing strategy. The NPC is also in the process of formulating Vision 2030 as a long-term economic development vision for the country.

Nepali government institutions are aware of the fact that the aspiring goals and targets in the development vision and NDP are highly ambitious and often not realistic, and that there is a lack of coherence between national plans and sector strategies. Technical capacity to integrate and operationalize the targets in sector plans, to realistically cost and prioritize the plans within the medium-term budget framework, and to ensure that the plans are put into effect at federal and local levels, is highly constrained.

Moreover, a performance-oriented culture has not been entrenched in government ministries and agencies, which are generally applying incremental and output-oriented rather than performance oriented planning and budgeting practices, despite that the planning and budget formats and procedures largely support performance-based procedures. These practices constrain the government's capacity to prioritize use of resources (allocation efficiency) and the ability of the government to ensure that programs are implemented at the lowest possible cost while maintaining desired service quality levels (operational efficiency). This is, among others, evidenced by weak budget execution, in particular of capital investments that require transparent planning, costing and performance management over several years. However, a broader set of institutional aspects are constraining policy execution, and weaknesses in the PFM system need to be addressed to ensure that the budget is used as an efficient tool for policy planning and execution.

Taking into consideration the weaknesses in the PFM system identified in the PEFA reviews, the NPC is currently revising the MTEF formats, and some of these constraints are being addressed through ongoing reform programs including the PFM MDTF and the Strengthening Public Management Programme. The Government of Nepal should use these ongoing reform efforts to strengthen the efficiency in planning and budgeting. This requires that a coherent plan is developed that identifies the actions needed to transform the current planning and budgeting system into a more policy-oriented planning and budgeting system, by introducing performance-oriented budgeting practices. The specific measures recommended are as follows:

- Strengthen macroeconomic modelling to improve the reliability of revenue forecasts that are used to establish overall resource envelopes for public sector spending and line ministries' budget ceilings
- Roll out revised MTEF formats with reliable budget ceilings that include integrated reporting formats clarifying the linkages between budgets and measurable performance targets that are reported upon by the line ministries and agencies on an annual basis
- Strengthen the capacity of line ministries to cost policies and to develop integrated sector strategies, if possible SWAps that serve as sector MTEFs that are clearly linked to the national MTEF
- Improve monitoring systems by coordinating financial reporting and performance reporting mechanisms
- Implement quarterly or semi-annual budget performance reports for the line ministries that include reporting on budget releases and performance targets

The experience of Nepal, as well as that of a number of OECD member countries, demonstrates that introduction of advanced performance-oriented systems with multi-year planning and budgeting frameworks needs capacity-building across government to ensure that the systems are used to improve efficiency of public spending in order to be sustainable. To yield sustainable results these measures must be underpinned by a civil service system that creates incentives for government staff to increase their capacity and improve their performance.

The government therefore needs to approach the current challenges of its civil service with a coherent approach through civil service reform. The reform should address current challenges as identified by the Ministry of General Administration in 2014,[89] both for central and local governments. Independent of government level, a restructuring of the civil service should ensure that government ministries and agencies are provided adequate autonomy to be held accountable for expected results, that recruitment and change of positions is based on merit, that remuneration is linked to performance, and that civil servants are provided incentive systems to improve knowledge and performance throughout their careers.

### 7.2.5 Develop a robust monitoring, evaluation and learning system

A system for monitoring the SDGs has not been established, and the government's mapping of the SDG targets and the SDG baseline study revealed that there are significant data gaps that need to be filled to establish baselines and monitor progress for many of the SDG targets.

To ensure evidence-based policymaking and increase efficiency in the use of resources, as well as to establish baselines and monitor progress on SDG achievement, a comprehensive and reliable National Statistical System (NSS) is essential. For example, a recent study estimates that investments in statistical capacity provide a return of $16 for every $1 invested in educational statistics.[90] It is therefore recommended that data requirements to establish baselines and monitor progress on the SDGs are coherently mapped, and that a strategy is developed to address these gaps. Such a strategy should include attention to defining the roles and responsibilities of various agencies, to avoid duplication and overlaps in mandate, as well as consideration of options for alignment of information systems across agencies. The formulation of such a strategy should review and build on existing support by development partners (including DFID, the World Bank, JICA, and the ADB) to support the Government of Nepal in areas of statistical capacity and the overall generation and use of data for development.

However, as monitoring of the SDGs will require data from a variety of sources, a strategy for improving SDG data should be aligned with a National Strategy for Development of Statistics (NSDS), rather than to fill specific SDG data gaps.[91] Moreover, the strategy should address capacity-building across all elements of the NSS, provide clarity on NSS data gaps, identify challenges in terms of coordination and duplication of data, and present a realistic vision which outlines where the NSS will be in a three-, five- and ten-year period in terms of national and regional statistics, including SDG statistics. The strategy should maintain a strong focus on user needs, and capacity-building measures should be equally as strong on the use and application of data for policymaking, as on data production.

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89 As identified in the report: Government of Nepal, Ministry of General Administration/UNDP. 2014.

90 PARIS21. 2016. *Partner Report on Support to Statistics Press 2016.* See http://www.paris21.org/sites/default/files/PRESS-2016-web-final.pdf (last accessed on 15 October 2017).

91 According to the OECD, the National Statistical System (NSS) is the ensemble of statistical organizations and units within a country, that jointly collect, process and disseminate official statistics on behalf of national government (see OECD Glossary of Statistical Terms: https://stats.oecd.org/glossary/detail.asp?ID=1726 –last accessed on 15 October 2017). In Nepal, the NSS is not officially defined, and it demonstrates a functional nature rather than as envisaged in the Statistics Act 2015. However, various agencies are producing and disseminating statistics, and the system is therefore partially decentralized. Government of Nepal, Central Bureau of Statistics. 2017. "A Compendium of National Statistical System of Nepal."

The SDGs represent a unique opportunity to strengthen the NSS. The Government of Nepal acknowledges that data systems need to be improved, and internationally it is increasingly recognized that investments in strengthening statistical capacity will be needed in order to monitor the SDGs. Despite the fact that funding for statistical capacity has stagnated in recent years, the SDGs are likely to impact positively on international commitments to strengthen data systems. The NSDS should therefore include a strategy aiming to mobilize external funding to building statistical capacity in Nepal.

### 7.2.6 Strengthen the enabling environment for accountability and dialogue

An enabling environment for accountability and dialogue is essential to build the trust necessary to mobilize non-government stakeholders for the SDGs. Private sector institutions can play a crucial role and become an important partner for the government, both in terms of mobilizing additional finance and improving efficiency in delivery of government policies and services. Encouraging further private sector engagement may be helped by inviting their involvement more systematically in the project cycle, and ensuring that the legal framework is in place to do so.

Despite significant commitment to the SDGs in key government institutions and commitment in the voluntary sector, the SDG agenda is currently not adequately anchored outside of the central government ministries, although there have been initiatives to involve non-government stakeholders in the SDG agenda. To achieve broad engagement in the SDG agenda it will be essential that government institutions provide comprehensive and transparent information, that is reliable and trusted, to civil society and the private sector. The framework for accountability and dialogue is in place, and in recent years, accountability mechanisms that increase citizens' voice and reduce marginalization have been developed through participatory planning and budgeting processes at the local level. However, significant gaps remain to be addressed to strengthen accountability mechanisms that support transparent and open dialogue between government, private sector and the voluntary sector. The following measures should be considered:

- The Parliament's constructive engagement in the SDG agenda is essential to establish national ownership and commitment to the SDGs. It should therefore be considered to formalize the SDG forum in Parliament, with representatives from different parliamentary committees, mandated to promote parliamentary debates, to further raise awareness and commitment to the SDGs in the parliamentary committees.
- Elected local governments are crucial for the operationalization of the SDGs at the local level. Successful local elections held this year and initiation of elected local bodies are thus key milestones towards establishing accountable local government institutions. Capacity-building targeting local government administrations, locally-elected representatives, and citizens' groups, will be required to ensure accountable local governance structures. SDG awareness raising should be integrated in ongoing reform programs.
- A professional and adequately staffed civil service is critical to executing the government's policies in a transparent and accountable manner. It is therefore recommended that the government reform the current civil service management structures, ensuring that adequate incentive mechanisms are in place to motivate staff to improve their performance, and that the current rotational system is replaced by a merit-based system designed to meet the demand for highly professionalized skills in the civil service.

- The centralized planning system of Nepal, dominated by incremental planning and budgeting practices, weakens the extent that government ministries and agencies are held accountable to high level results. It is therefore recommended that the planning and budgeting system is reformed towards a performance-oriented system. This includes reintroduction of the MTEF with performance-oriented templates, improved alignment between the planning and budgeting processes, and performance oriented budgeting and management practices in government.
- Despite improvements in the PFM system, recent assessments demonstrate that the Government of Nepal needs to take measures to strengthen further the PFM system at the local and federal levels. With the ongoing institutionalization of federal structures, increased focus should be given to fiscal decentralization and PFM in local bodies.

### Table 4: Summary of INFF recommendations

| | |
|---|---|
| 1. Develop a strategy to increase access and diversify sources of finance | • Increase access and diversify sources of ODA grant funding; increase level of debt financing on concessional (ODA) terms<br>• Explore new development partners and international investors<br>• Increase engagement of non-state partners in public service delivery and infrastructure investments<br>• Pursue improvements in the business climate; establish grant facility for cost sharing of business development services<br>• Establish investment funds and/or state guarantee arrangements to leverage more equity finance for private sector development<br>• Continue to improve domestic revenue collection; expand tax base to local level |
| 2. Develop sector level financing strategies | • Identify additional sources of non-discretionary finance at sector level and apply them before using domestic discretionary sources (like tax revenues)<br>• Explore opportunities to establish SWAps in new sectors and to utilize SWAps strategically to mobilize potential additional finance; explore other suitable program modalities |
| 3. Strengthen institutional coherence | • Further decentralize planning processes in a direction where formulation of goals, targets and strategies are formulated by the line ministries<br>• Develop sector-based dialogue and awareness-raising strategies<br>• Increase focus on the local governance and public finance reform agenda to support institutionalization of federal structures, including defining roles of local governments in development |
| 4. Strengthen alignment of the development vision and sector strategies | • Strengthen the macroeconomic modelling to improve the reliability of revenue forecasts<br>• Roll out of revised MTEF formats with reliable budget ceilings that include integrated reporting formats clarifying the linkages between budgets and measurable performance targets<br>• Strengthen the capacity of line ministries to cost policies and to develop integrated sector strategies, if possible SWAps that are clearly linked to the national MTEF<br>• Implement quarterly or semi-annual budget performance reports for the line ministries that include integrated reporting on budget releases and performance targets |
| 5. Develop a robust monitoring, evaluation and learning system | • Develop a strategy for improving SDG data and statistics that is aligned with a National Strategy for Development of Statistics, that addresses capacity-building both in the production and in the use of statistics in government institutions<br>• Develop a strategy to mobilize finance for building statistical capacity |
| 6. Strengthen the enabling environment for accountability and dialogue | • Formalize the SDG forum in Parliament, to continue to promote parliamentary debates and raise SDG awareness and commitment in parliamentary committees<br>• Increase capacity-building at the local level to support institutionalization of accountable governance mechanisms<br>• Reform the civil service management structures; reform the planning and budgeting structures towards a performance-oriented system<br>• Involve private sector more systematically in the project cycle; ensure the legal environment necessary for private sector engagement |

## 7.3 Outline of a draft road map for implementation of DFA recommendations for Nepal

Based on the outcome of this DFA with its recommendations and resulting INFF, the following presents an *initial outline of a road map*, to be considered for implementation. As a next step in the DFA process, this draft road map would need to be further elaborated, under MoF leadership, and key stakeholders consulted, with particular attention to a conducting a comprehensive mapping of existing development partner support in key areas and where gaps remain. A future iteration of the road map may also include establishing targets for mobilization of different types of finance, building on the findings of the DFA which highlight LDC benchmarks which may inform the level of ambition of Nepal in resource mobilization. The road map is to serve as a tool for managing and monitoring implementation of actions to address the recommendations emerging from the DFA.

The DFA road map is suggested to serve as a "rolling plan" to be expanded and updated as and when required, reflecting progress in implementation. It is suggested that the road map is managed by the MoF, with the DFA Oversight Team serving as the steering committee and the relevant parliamentary committee serving as the oversight committee. The road map will accordingly serve as a plan for implementation and a reporting template to advise on progress (ref. separate column to track status of implementation).

The draft road map contains two main components: cross-cutting actions and sector financing strategies. The former are actions that cut across the sectors and relate to findings of the DFA on public sector planning and management in general, legal and regulatory issues as well as business climate. The latter follows a suggestion to operationalize core recommendations through sector financing strategies to be piloted in selected sector ministries.

The criteria for selection of pilot ministries should be those ministries with opportunities to mobilize additional revenues, including global and/or regional concessional funds (ODA) as well as OOF, and with opportunities to engage non-stakeholder partners to complement public sector capacity and finance in sector program execution, such as NGOs, private sector, and other non-state partners, through PPPs or other contractual arrangements.

**The road map presented is a first draft of an action plan, to serve as a tool and with actions serving as an initial proposal.** Moreover, under each set of actions there may be additional actions to be considered to be added, either before completing the action plan or during implementation as progress in implementation is assessed and new information is revealed.

| Dimension | Thematic area | Strategic actions | Responsibility | Main stakeholders | Development Partners providing support | Timeframe | Status of implementation |
|---|---|---|---|---|---|---|---|
| Cross-sectoral actions | Political engagement and supervision | • Present the DFA to the Cabinet for endorsement<br>• Present the DFA to relevant committees in Parliament, including SDG, Finance and selected sector committees<br>• …………. | MoF, with support of NPC | Executive / Cabinet, relevant parliamentary committees, political parties | UNDP, ….. | November/December 2017 | (ongoing/completed <date> with description of current results) |
| | Raising domestic revenue | • Review current practices for income tax and exemptions<br>• Assess opportunities for widening the income tax base through revision of current income tax regime<br>• ……….. | MoF | MoF | IMF, World Bank, …. | January 2018 | |
| | Raising ODA and OOF | • To be addressed at sector level ref. Sector Financing Strategy below | MoF | Sector ministries | Depending on ministries chosen for piloting | | |
| | Improving the business climate | • Review the legal framework challenges already identified and requirements for more effective mechanisms for resolving legal disputes related to business transactions and licensing ref. prevailing constraints identified by the World Bank Group's *Doing Business Report*<br>• Expand current interventions, among others, in establishing SME challenge fund, to also consider Government of Nepal-supported programs for SME, business development services, and additional risk capital/ startup grants for SME greenfield/ startups<br>• …………… | MoF | MoF, Ministry of Industry, Investment Board Nepal | DFID, IFC, JICA, USAID, World Bank, …. | Additional components of ongoing programs | |

| Dimension | Thematic area | Strategic actions | Responsibility | Main stakeholders | Development Partners providing support | Timeframe | Status of implementation |
|---|---|---|---|---|---|---|---|
| Cross-sectoral actions (continued) | Increase alignment of the development vision and sector strategies | • Assess alternative macroeconomic models that can be adopted to strengthen the reliability of macroeconomic forecasts and improve the basis for monetary policy, medium-term revenue forecasts and expenditure ceilings at federal and provincial levels<br>• Develop a macroeconomic model capacity-building action plan targeting staff in key agencies providing inputs into the chosen model<br>• Roll-out of revised MTEF formats to federal spending agencies that include integrated financial and program performance reporting formats, explicitly aiming to clarify the link between financial and performance planning and reporting<br>• Pilot provincial government MTEFs in selected provinces<br>• .......... | MoF, with support of NPC | MoF, NPC, Ministry of Federal Affairs and Local Development, provincial level governments | World Bank, ADB, DFID | January/ December 2018 | |

| Dimension | Thematic area | Strategic actions | Responsibility | Main stakeholders | Development Partners providing support | Timeframe | Status of implementation |
|---|---|---|---|---|---|---|---|
| Cross-sectoral actions (continued) | Reduce systemic barriers in budget implementation | • Identify systemic barriers to efficiency in budget implementation related to project and program planning, budget approvals and releases, and procurement regulations and procedures<br>• Based on the assessment, and the current PFM program, develop and implement an action plan including opportunities to prepare budget implementation prior to final approval of the budget<br>• ….. | MoF, with support of NPC | MoF, with support of NPC | World Bank, DFID, Government of Norway, …. | January to December 2018 | |
| | Improve capacity, motivation, performance and accountability of civil service management and staff at all levels of government | • On the basis of the recommendations of the Administrative Restructuring Commission and reform options presented in the 2014 report from the Ministry of General Administration, "The Nepal Civil Service and Re-structuring of the State", formulate and implement a strategy to ensure that:<br>a. Ministries, agencies and provincial and local governments are provided adequate autonomy and human resource capacity to be held accountable for results<br>b. Recruitment and change of positions is based on professional merit at federal, provincial and local government levels<br>c. Remuneration and career development are linked to performance<br>d. …. | Ministry of General Administration | MoF | World Bank, ADB, UNDP, …. | January 2018 | |

| Dimension | Thematic area | Strategic actions | Responsibility | Main stakeholders | Development Partners providing support | Timeframe | Status of implementation |
|---|---|---|---|---|---|---|---|
| Cross-sectoral actions (continued) | Improve capacity to produce and use statistics for monitoring performance | • Based on the NPC SDG baseline report, develop a strategy for developing statistical capacity required to establish baselines for and monitor progress of the SDG targets where data is currently lacking<br>• Assess how donor support to statistical capacity-building can be further strengthened to accelerate production and use of data required to monitor progress on the SDGs/Vision 2030 targets<br>• . . . | NPC/CBS | | DFID, UNDP, . . . . | January to June 2018 | |
| Sector Financing Strategy | Implementation support and guidance | • Identify selected ministries for piloting financing strategies<br>• Establish a DFA technical implementation support team<br>• Identify and appoint a DFA anchor in selected ministries where piloting will take place<br>• Establish in-house DFA technical implementation teams in each selected ministry represented by all relevant ministry divisions<br>• . . . . | MoF/ Oversight Team in dialogue with UNDP | Selected ministries for piloting | UNDP and others pending ministries selected | November to December 2017 | |
| | Accountability and dialogue | • Sector ministries identify key non-government stakeholders to engage in sector dialogue | MoF/line ministries/ CBS | Selected line ministries, non-government stakeholders, relevant Parliamentary committees, . . . . | UNDP and others pending ministries selected | January to March 2018 | |

| Dimension | Thematic area | Strategic actions | Responsibility | Main stakeholders | Development Partners providing support | Timeframe | Status of implementation |
|---|---|---|---|---|---|---|---|
| Sector Financing Strategy (continued) | Accountability and dialogue (continued) | • Sector ministries establish DFA/ Vision 2030 stakeholder forums, engaging key stakeholders from civil society, private sector and Parliament, with the aim to aid the ministries in sector policy planning, to mobilize finance to support policy implementation, and to provide feedback on performance<br>• Stakeholder forums meet twice a year and publish outputs on relevant web page<br>• Pilot training program for government staff and non-government stakeholders in the use of SDG and Vision 2030 statistics<br>• …….. | | | | | |
| | Utilization of alternative financing sources and engaging non-state stakeholders in policy implementation | • Based on the sector plans, budgets and SWAps, map components that can be considered for alternative financing sources that directly or indirectly will support the SDGs/ Vision 2030<br>• Identify opportunities to mobilize additional funding, from sources such as international challenge or green funds, ODA or OOF<br>• Identify opportunities to engage non-state stakeholders in program components, through use of PPP/ service contracts etc. | MoF/line ministries | Selected line ministries, non-government stakeholders, …. | UNDP and others pending ministries selected | November 2017 to June 2018 | |

| Dimension | Thematic area | Strategic actions | Responsibility | Main stakeholders | Development Partners providing support | Timeframe | Status of implementation |
|---|---|---|---|---|---|---|---|
| Sector Financing Strategy (continued) | Utilization of alternative financing sources and engaging non-state stakeholders in policy implementation (continued) | • Identify requirements to access additional funding for particular funding mechanisms, such as planning, budgeting and monitoring requirements<br>• Assess requirements to engage non-state stakeholders, such as legal/regulatory requirements and contractual arrangements to engage them<br>• Identify and assess areas that need to be strengthened in the selected ministries' planning, budgeting and monitoring procedures, with the aim to maximize the use of those alternative funding sources and to efficiently utilize non-state stakeholders<br>• ............. | | | | | |
| | Policy planning and budget formulation | • Assess coherence between the current sector plan/SWAp and the MTEF and annual budget<br>• Assess opportunities to improve the performance (outcome) orientation, coherence and consistency in the ministries' planning, budgeting and monitoring framework<br>• Based on the above mapping and assessment, update the sector plan/SWAp, ensure consistency and clear linkages between sector plan outcomes, the MTEF and the annual budget | MoF/NPC/ Line ministries | Line ministries/ provinces and local government | UNDP and others pending ministries selected | November 2017 to June 2018 | |

| Dimension | Thematic area | Strategic actions | Responsibility | Main stakeholders | Development Partners providing support | Timeframe | Status of implementation |
|---|---|---|---|---|---|---|---|
| Sector Financing Strategy (continued) | Policy planning and budget formulation (continued) | • Assess how planning, budgeting and monitoring procedures can be adapted to support a stronger performance (outcome) orientation in planning, budgeting and monitoring processes<br>• Assess the quality of costing methodologies, and if the costing methodologies are adequately reflected in the medium term plans and the sector MTEF; propose measures to improve costing methodologies<br>• Develop tools for cost-benefit analysis to be applied in policy planning and budget prioritization processes, and ensure that the methodology is consistently applied<br>• Develop a capacity-building plan for performance (outcome) based planning, budgeting and reporting, targeting program management and technical staff<br>• ….. | | | | | |
| | Budget implementation | • Assess sector specific barriers to efficient budget implementation, and develop an action plan to improve systems and procedures that may increase efficiency in implementation of approved budget, related to program planning and management, procurement and timely budget releases<br>• …………… | MoF/Line ministries | Line ministries / Provincial and local government | UNDP and others, pending ministries selected | November 2017 to June 2018 | |

| Dimension | Thematic area | Strategic actions | Responsibility | Main stakeholders | Development Partners providing support | Timeframe | Status of implementation |
|---|---|---|---|---|---|---|---|
| Sector Financing Strategy (continued) | Monitoring and evaluation | • Develop a reporting template with indicators of change in composition of finance and engagement of non-state actors in implementation either as separate reporting or as an integrated element of MTEF progress reporting<br>• Identify tools and procedures that can improve the capacity of the ministry to coherently monitor and report on sector performance (outcomes) and financial information, and to consistently use this information in program management and budgeting processes<br>• ………… | MoF/Line ministries | NPC/Line ministries | UNDP and others, pending ministries selected | November 2017 to June 2018 | |
| | ………… | • ………… | | | | | |

# Annex 1: List of documents reviewed

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# Annex 2: Terms of reference for Oversight Team

**Nepal Development Finance Assessment (DFA): Terms of reference for Oversight Team**

*Draft for consultation: 15 July 2016*

**Introduction**

Government leadership and ownership of the DFA is essential. Therefore, outlining the process and oversight responsibilities involved in undertaking a DFA process is important. Such a description also provides a useful basis to identify ways of enhancing quality assurance and provide clarity on the roles of different actors in the process. The constitution of a formal Oversight Team (OT) is a key aspect of consolidating the government's leadership and governance role in the assessment process.

For the Nepal DFA, the Ministry of Finance (MoF) has commissioned the DFA and will therefore lead the Oversight Team. The scope of the DFA will address key areas of responsibility of several Divisions of MoF including: (i) International Economic Cooperation Coordination Division, (ii) Budget Division, (iii) Revenue Division, and (iv) Economic Analysis Policy Division. The DFA will also cover development finance flows that fall under the mandate of other Government ministries and institutions. Their membership and active participation on the OT will also be critical: (i) National Planning Commission, (ii) Ministry of Labour, (iii) Ministry of Industry, and (iv) Nepal Rastra Bank.

During the DFA process, should it become advantageous or necessary to invite additional institutions to join the OT, the OT Chair or other OT members may so recommend.

**Objectives and main activities of the Oversight Team**

The Oversight Team will play the overall governance and leadership role in the DFA process. The main objectives of the Oversight Team are proposed as follows:

- Support the DFA fieldwork. Facilitating the work of the research team by (i) ensuring access to key decision makers and government documents and (ii) removing any obstacles that may delay the DFA process;
- Oversee quality and accuracy of the assessment. The OT will supervise and guide the research team by (i) reviewing the DFA intermediary and final outputs produced by the team (ii) ensuring that the assessment is accurate and provides the necessary depth to be useful for government decision-making;
- Ensure government buy-in. The OT will lead the discussion with government, development partners and other relevant stakeholders about the DFA findings, as well as on implementation of the recommendations and next steps.

The Oversight Team will formally meet at agreed milestones of the DFA process, and its members may informally engage to support specific tasks of the DFA team. The primary duties of the OT are proposed as follows:

- Support the DFA customization and determination of specific areas to be addressed, to ensure it addresses the Government of Nepal's strategic interests and objectives;
- Approve objectives, scope, expected outputs and methodology of the DFA;

- Approve and supervise the DFA work plan and key milestones;
- Provide strategic direction and feedback, especially if the DFA team faces significant challenges;
- Review the documents presented by the DFA team and provide comments within the agreed timeframe;
- Endorse the outcomes of the DFA and the resulting Implementation road map;
- Facilitate in-depth discussion within the Government of Nepal on the outcomes of the DFA and the recommendations expressed in the road map;
- Support follow-up to the assessment and the implementation of the road map;
- Support the dissemination of the DFA to wider audiences (Parliament, Development Partners, Business and Civil Society Organizations, etc.).

**Chair of the Oversight Team**

The Chairmanship of the OT is not necessarily a time consuming function, but it is an essential one, given the importance of securing high-level involvement and buy-in from decision-making levels around the outcomes of the DFA. The participation of the Chair includes key moments of the DFA process such as: (i) to open and participate in the Inception Workshop where the DFA is presented to a broad group of stakeholders and (ii) to open and participate in the Validation Workshop, where the primary outcomes of the DFA are presented to the government. The Chair will also have a lead role to convene in-depth discussions within the government on the outcomes of the DFA and the recommendations expressed in the road map.

The Chair of the OT for the Nepal DFA will be Mr. Baikuntha Aryal, Joint Secretary of IECCD in the MoF.

**The DFA focal point**

Mr. Lal Bahadur Khatri, Under Secretary of MoF/IECCD and the National Project Manager of the Effective Development Financing and Coordination (EDFC) project will act as the Member-Secretary of the Oversight Team and DFA focal point who will undertake the day-to-day management of the DFA process and proposes the following essential features of the assessment for approval by Oversight Team. These will include:

*The DFA timetable and meetings schedule*, covering preparatory work, the actual assessment process and any follow up arrangements. Adequate time to carry out the assessment (partly a function of the scope of the DFA and availability and access to data, existing studies and policy documents), agreement on definitions and thus information requirements, and adequate organization in terms of arranging meetings with the right people and accessing relevant data, documents and sources of information.

*The technical definitions* (e.g. PPPs, FDI, OOFs, South-South Cooperation), and the information requirements based on these definitions, and likely sources of data.

# Annex 3: Oversight Team

1. Baikuntha Aryal, Joint Secretary, MoF (Chair)
2. N.P. Poudel, Under Secretary, National Planning Commission
3. Anuj Dahal, Deputy Director, Nepal Rastra Bank
4. Shiva Sharma, Under Secretary, MoF (Revenue Management Division)
5. Ishwori Aryal, Under Secretary, MoF (Budget and Program Division)
6. Kishan S. Basnet, Under Secretary, MoF (Economic Policy Analysis Division)
7. Shiv Ram Pokharel, Under Secretary, Ministry of Labour and Employment
8. Bimal Baral, Under Secretary, Ministry of Industry

# Annex 4: Participants at DFA Inception and Validation Workshops

## *Participants at DFA Inception Workshop, 30 September 2016*

| Name | Designation | Institution |
|---|---|---|
| Baikuntha Aryal | Joint Secretary (JS) | Ministry of Finance (MoF) |
| Tek Bahadur Khatri | Under Secretary | Ministry of Finance (MoF) |
| Suba Prasad Rijal | Under Secretary | Ministry of Finance (MoF) |
| Lal Bahadur Khatri | Under Secretary | Ministry of Finance (MoF) |
| Narayan Dhakal | Under Secretary | Ministry of Finance (MoF) |
| Surya Prasad Pokharel | Under Secretary | Ministry of Finance (MoF) |
| Shiva Sharma | Under Secretary | Ministry of Finance (MoF) |
| P. Upadhyay | Under Secretary | Ministry of Finance (MoF) |
| Balram Yadab | Section Officer (S. O.) | Ministry of Finance (MoF) |
| Binod K. Bhattarai | Senior Agricultural Economist | Ministry of Agricultural Development (MoAD) |
| Mukunda K. Pokharel | Under Secretary | Ministry of Education |
| Bhakta Raj Joshi | Under Secretary | Ministry of Health (MoH) |
| Ananda K. Pokharel | Under Secretary | Ministry of Industry (MoI) |
| Shyam Raj Adhikari | Under Secretary | Ministry of Labour and Employment (MoLE) |
| Chandra Kanta Bhandari | Director | Office of the Auditor General (OAG) |
| Renaud Meyer | Country Director | UNDP |
| Bal Ram Poudel | Programme Management Analyst | UNDP |
| Dlan Srenrale | Programme Analyst | UNDP |
| Heema Khadka | Assistant Country Director | UNDP |
| Erlend Nordby | DFA Team leader | UNDP |
| Pushpa Lal Shakya | DFA Consultant | UNDP |
| Jens Claussen | DFA Consultant | UNDP |
| Shreejana Rajbhandari | Programme Analyst | Asian Development Bank (ADB) |
| Ainsley Hemming | Head, Development Cooperation | Embassy of Australia |
| Analraj Bhattarai | National Council Member | Confederation of Nepalese Industries (CNI) |
| Saroj Nepal | Chief Advisor | Embassy of Denmark |
| Pekka Seppala | Deputy Country Manager | Embassy of Finland |
| Ved Prakash | Attaché | Embassy of India |
| Pramesh P. Shrestha | Head, Finance and Controlling | Embassy of Switzerland |
| Sita Ghimire | Senior Officer | Federation of Nepalese Chamber of Commerce and Industry (FNCCI) |
| Sanjeev Pokharel | Deputy Chief Technical Advisor | Deutsche Gesellschaft für Internationale Zusammenarbeit GmbH (GIZ) |
| Ram Prasad Bhattarai | Assistant Project Manager | JICA |

## *Participants at DFA Validation Workshop, 4 September 2017*

| Name | Designation | Institution |
|---|---|---|
| Baikuntha Aryal | Joint Secretary | Ministry of Finance (MoF) |
| Ram Prasad Mainali | Under Secretary | Ministry of Finance (MoF) |
| Yug Raj Pandey | Under Secretary | Ministry of Finance(MoF) |
| Kishan Singh Basnet | Under Secretary | Ministry of Finance (MoF) |
| Ratnesh Shashi | Section Officer | Office of the Investment Board |
| Bishesh Kumar Pradhan | Data Management Assistant | EDFC/Ministry of Finance (MoF) |
| Daya Sagar Shrestha | Executive Director | NGO Federation of Nepal |
| Shanker Man Singh | Deputy Director General | Confederation of Nepalese Industries |
| Renaud Meyer | Country Director | UNDP |
| Sophie Khemkadze | Deputy Country Director | UNDP |
| Ashley Palmer | Aid Effectiveness Specialist | UNDP |
| Dharma Swarnakar | Programme Analyst | UNDP |
| Kamal Raj Sigdel | Head of Communications Unit | UNDP |
| Santa Subba | Programme Assistant | UNDP |
| Chandni Mandal | United Nations Trainee | UNDP |
| Erlend Nordby | DFA Team leader | UNDP |
| Pushpa Lal Shakya | DFA Consultant | UNDP |
| Jens Claussen | DFA Consultant | UNDP |
| Anjan Panday | Senior Programme Officer | ADB |
| Strahan Spencer | Economic Adviser | DFID |
| Craig Irwin | Statistics Adviser | DFID |
| Aayash Rai | Resident Advisor | Embassy of Denmark |
| Kusuma Bansal | Second Secretary | Embassy of India |
| Suchita Kishore | Second Secretary | Embassy of India |
| Diepak Elmer | Head of Cooperation | Embassy of Switzerland |
| Paul Rueckerl | Acting Country Director | Deutsche Gesellschaft für Internationale Zusammenarbeit GmbH (GIZ) |
| Shanker Raj Pandey | Head of Office | KfW Development Bank |
| Ram Prasad Bhandari | Programme Manager | JICA |
| Manjila Basnet | | *Arthadabali* (magazine) |

# Annex 5: Participants at DFA Oversight Team meeting

### *15 February 2017*

| Name | Designation | Institution |
|---|---|---|
| Baikuntha Aryal | Joint Secretary | Ministry of Finance (MoF) |
| Lal Bahadur Khatri | Under Secretary | Ministry of Finance (MoF) |
| Kishan Singh Basnet | Under Secretary | Ministry of Finance (MoF) |
| Yug Raj Pandey | Under Secretary | Ministry of Finance (MoF) |
| Surya Pokharel | Under Secretary | Ministry of Finance (MoF) |
| Bimal Prasad Baral | Under Secretary | Ministry of Finance (MoF) |
| Shiva Sharma | Under Secretary | Ministry of Finance (MoF) |
| Lal Bahadur Khatri | Under Secretary | Ministry of Finance (MoF) |
| Shiva Ram Pokharel | Under Secretary | Ministry of Labour and Employment (MoLE) |
| Raman Nepal | Director | Nepal Rastra Bank (NRB) |
| Tilak Bhandari | Deputy Project Manager | Effective Development Financing and Coordination (EDFC) Project |
| Dharma Swarnakar | Programme Analyst | UNDP |
| Ashley Palmer | Governance and Development Effectiveness Specialist | UNDP Bangkok Regional Hub |
| Pushpa Lal Shakya | DFA Consultant | UNDP |
| Jens Claussen | DFA Consultant | UNDP |

# Annex 6: Stakeholders consulted during DFA Inception Mission

### *19-30 September 2016*

1. 19 September 2016, meeting with UNDP.
2. 20 September 2016, meeting with Ministry of Finance.
3. 20 September 2016, second meeting with UNDP.
4. 20 September 2016, meeting at Ministry of Finance.
5. 21 September 2016, meeting with Dr. Yuba Raj Khatiwada, former Vice Chairman, National Planning Commission and former Governor, Nepal Rastra Bank.
6. 22 September 2016, meeting with NGO Federation of Nepal.
7. 22 September 2016, meeting with Nepal Rastra Bank.
8. 23 September 2016, meeting with Alternative Energy Promotion Centre.
9. 23 September 2016, meeting with Ministry of Energy.
10. 24 September 2016, meeting with Chairman of Finance Committee, Mr. Prakash Jwala, Legislature–Parliament of Nepal.
11. 25 September 2016, meeting with Chairman of Confederation of Nepalese Industries, Mr. Hari Bhakti Sharma.
12. 25 September 2016, meeting with Executive Director of Office of the Investment Board of Nepal, Mr. Maha Prasad Adhikari.
13. 26 September 2016, meeting with Ministry of Labour and Employment.
14. 26 September 2016, meeting with Ministry of Industry.
15. 27 September 2016, meeting with Acting Chairperson of Federation of Nepalese Chamber of Commerce and Industries (FNCCI) Ms. Bhawani Rana and Energy Department Chief of FNCCI, Mr. Gyanendra Lal Pradhan.
16. 28 September 2016, meeting with Mr. Renaud Meyer, Country Director, UNDP.
17. 30 September 2016, meeting with Private Sector Association of Boarding School of Nepal.