



# Report and Recommendation of the President to the Board of Directors

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Project Number: 50254-001  
June 2017

## Proposed Policy-Based Loan Nepal: South Asia Subregional Economic Cooperation Customs Reform and Modernization for Trade Facilitation Program

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Asian Development Bank

## **CURRENCY EQUIVALENTS**

(as of 4 May 2017)

Currency unit	–	Nepalese rupee/s (NRe/NRs)
NRe1.00	=	\$0.0097441194
\$1.00	=	NRs102.626000

## **ABBREVIATIONS**

ADB	–	Asian Development Bank
ASYCUDA	–	Automated System for Customs Data
CPEI	–	customs procedures with economic impact
CRMSAP	–	Customs Reform and Modernization Strategies and Action Plan
DOC	–	Department of Customs
GDP	–	gross domestic product
LDC	–	least developed country
RKC	–	revised Kyoto Convention
SASEC	–	South Asia Subregional Economic Cooperation
TA	–	technical assistance
TFA	–	Trade Facilitation Agreement
TFAF	–	Trade Facilitation Agreement Facility
TFI	–	trade facilitation indicator
TRS	–	Time Release Study
WCO	–	World Customs Organization
WTO	–	World Trade Organization

## **NOTES**

- (i) The fiscal year (FY) of the Government of Nepal ends on 15 July. “FY” before a calendar year denotes the year in which the fiscal year ends, e.g., FY2017 ends on 15 July 2017.
- (ii) In this report, “\$” refers to United States dollars.

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## PROGRAM AT A GLANCE

<b>1. Basic Data</b>		<b>Project Number: 50254-001</b>	
<b>Project Name</b>	South Asia Subregional Economic Cooperation Customs Reform and Modernization for Trade Facilitation Program	<b>Department /Division</b>	SARD/SARC
<b>Country Borrower</b>	Nepal Nepal	<b>Executing Agency</b>	Department of Customs
<b>2. Sector</b>		<b>ADB Financing (\$ million)</b>	
✓ <b>Industry and trade</b>	Industry and trade sector development		11.00
	Trade and services		10.00
		<b>Total</b>	<b>21.00</b>
<b>3. Strategic Agenda</b>		<b>Climate Change Information</b>	
Inclusive economic growth (IEG)	Pillar 1: Economic opportunities, including jobs, created and expanded	Climate Change impact on the Project	Low
Regional integration (RCI)	Pillar 2: Trade and investment		
<b>4. Drivers of Change</b>		<b>Gender Equity and Mainstreaming</b>	
Governance and capacity development (GCD)	Institutional development	No gender elements (NGE)	✓
Private sector development (PSD)	Public financial governance		
	Conducive policy and institutional environment		
	Promotion of private sector investment		
	Public sector goods and services essential for private sector development		
<b>5. Poverty and SDG Targeting</b>		<b>Location Impact</b>	
Geographic Targeting	No	Regional	High
Household Targeting	No		
SDG Targeting	Yes		
SDG Goals	SDG8, SDG10, SDG16, SDG17		
<b>6. Risk Categorization:</b>		Low	
<b>7. Safeguard Categorization</b>		Environment: C Involuntary Resettlement: C Indigenous Peoples: C	
<b>8. Financing</b>			
<b>Modality and Sources</b>		<b>Amount (\$ million)</b>	
<b>ADB</b>		<b>21.00</b>	
Sovereign Stand-Alone Policy-Based Lending (Concessional Loan): Ordinary capital resources		21.00	
<b>Cofinancing</b>		<b>0.00</b>	
None		0.00	
<b>Counterpart</b>		<b>0.00</b>	
None		0.00	
<b>Total</b>		<b>21.00</b>	

## I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed policy-based loan to Nepal for the South Asia Subregional Economic Cooperation Customs Reform and Modernization for Trade Facilitation Program.<sup>1</sup>

2. The program will support the simplification, harmonization, and modernization of Nepal's trade processes to meet international standards. This will contribute to Nepal's national goals of promoting and diversifying exports, and help the country fulfill its commitments to the Trade Facilitation Agreement (TFA) of the World Trade Organization (WTO) and related international standards on customs.

## II. THE PROGRAM

### A. Rationale

3. **The development problem.** Nepal is a least developed country (LDC) aspiring to attain middle-income status by 2030, and the manufacturing sector will play a key role in achieving the aspiration.<sup>2</sup> In line with the global 2030 Agenda for Sustainable Development, the Government of Nepal has adopted development strategies that aim to expand the manufacturing sector and promote merchandise exports as vehicles for economic growth and poverty reduction.<sup>3</sup> The performance of Nepal's manufacturing sector has been lackluster, with its share in gross domestic product (GDP) declining over the years. The ratio of Nepal's exports to GDP has also declined steadily, the merchandise trade balance has worsened, and exports remain concentrated in a few markets and commodities.<sup>4</sup>

4. As a landlocked country virtually isolated from external markets, Nepal has high transport and trade costs. High trade costs impede export competitiveness and are often attributed to high tariffs and inadequate transport and trade-related infrastructure. To make its export sector competitive, Nepal liberalized its trade regime by cutting tariffs and removing quantitative restrictions. However, infrastructure deficiency and nontariff barriers pose challenges in reducing trade costs further. Studies have shown that inefficient, unpredictable, and opaque customs procedures are among the primary nontariff barriers in developing countries—contributing to high trade costs, poor business climate, and inability to integrate into global value chains.<sup>5</sup> In a 2016 business survey involving 501 Nepalese traders, 51% of exporters and 21% of importers reported

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<sup>1</sup> The design and monitoring framework is in Appendix 1.

<sup>2</sup> Government of Nepal, National Planning Commission; and Asian Development Bank (ADB). 2016. *Envisioning Nepal 2030: Proceedings of the International Seminar*. Kathmandu.

<sup>3</sup> Reference to trade as an engine for growth is made across the 2030 Agenda's 17 Sustainable Development Goals and 179 targets, including a doubling of LDCs' export market share. <https://sustainabledevelopment.un.org/post2015/transformingourworld>. The Government of Nepal has called for greater availability of concessionary loans and other forms of international support to improve Nepal's trade competitiveness and lower its trade costs. Government of Nepal, National Planning Commission. 2015. *Sustainable Development Goals, 2016–2030: National (Preliminary) Report*. Kathmandu.

<sup>4</sup> Economic Analysis (accessible from the list of linked documents in Appendix 2). The manufacturing sector's share of GDP declined from 9.5% in the mid-1990s to 6.5% in 2015. The ratio of merchandise exports to GDP declined from 15.4% in FY2000 to 5.1% in FY2014. The goods trade deficit more than doubled from 13.8% in FY2000 to 30.3% in FY2016.

<sup>5</sup> WTO. 2016. *Trade costs and inclusive growth: Case studies presented by WTO chair-holders*. Geneva; International Trade Centre. 2016. *SME Competitiveness Outlook: Meeting the standard for trade*. Geneva; and WTO. 2016. *World Trade Report 2016: Levelling the trading field for SMEs*. Geneva.

facing nontariff issues or procedural obstacles to trade.<sup>6</sup> Estimates show that for Nepal, nontariff trade costs are equivalent to applying a 325% ad valorem tariff on manufactured exports, 523% on agricultural products, and 391% overall.<sup>7</sup> Inaction on nontariff barriers, including those related to customs, imposes an opportunity cost for Nepal's businesses, government revenues, and the economy as a whole.

5. Nepal has made a global commitment to undertake customs reforms by acceding to the WTO's TFA, the first multilateral trading agreement signed since the WTO was established in 1995. The TFA aims to simplify, modernize, and harmonize export and import processes primarily through reforms to customs clearance procedures. Implementing TFA reforms for LDCs like Nepal is expected to increase the number of products exported by destination by 11.8%–12.8% and raise the number of destinations by product by 14.1%–21.3%. With nearly 90% of Nepalese exporters depending on imported inputs, improved customs procedures are expected to reduce trading costs, lower the cost of importing inputs, and make exports more competitive.<sup>8</sup>

6. **Binding constraints.** Although Nepal's Department of Customs (DOC) has made progress in introducing reforms and automation, it has largely remained a revenue-collecting enforcement body. It has yet to fully embody the "Customs in the 21st Century" vision of the World Customs Organization (WCO), which broadens the role of customs from regulating trade to include facilitating it.<sup>9</sup> Customs clearance procedures in Nepal remain focused on exercising at-the-border controls, subjecting some 80% of traded goods to physical inspection.<sup>10</sup> Border checkpoints are congested, and facilities and mechanisms for pre-arrival or post-clearance (behind-the-border) processing are inadequate.<sup>11</sup> Legitimate, low-risk trade suffers from inefficient processes, and is subject to the same red tape as potentially illicit, high-risk trade.<sup>12</sup> These constraints not only result in higher trade costs, but also revenue leakages. They pose social, environmental and cultural safety, and security risks. The lack of modern, risk-based procedures and institutional structures has also prevented the DOC from implementing customs procedures with economic impact (CPEI), which are needed to support the export sector.<sup>13</sup> The key elements of the constraints are:

<sup>6</sup> International Trade Centre. 2016. *Nepal: Company Perspective on Non-Tariff Measures—Summary of Findings, NTM Business Survey*. Discussion paper for the national round table on nontariff measures. Kathmandu. 14 September; and World Economic Forum. *The Global Enabling Trade Report 2016*. Economy profiles. Nepal. <http://reports.weforum.org/global-enabling-trade-report-2016/economy-profiles/#economy=NPL>.

<sup>7</sup> Economic Analysis (accessible from the list of linked documents in Appendix 2).

<sup>8</sup> Estimated gains and other gains from trade facilitation are in Nepal's Development Context and the Role of Trade Facilitation; and Economic Analysis (accessible from the list of linked documents in Appendix 2).

<sup>9</sup> WCO. 2008. *Customs in the 21st Century: Enhancing Growth and Development through Trade Facilitation and Border Security*. Brussels, Belgium. This policy document redefines the role of customs administrations to meet the new demands arising from the globalization of trade. Such demands task customs to exercise effective security and control of international supply chains, while undertaking greater facilitation of legitimate trade.

<sup>10</sup> The DOC's Automated System for Customs Data (ASYCUDA) system identifies high-risk cargo for red lane clearance with physical inspection, low-risk cargo for green lane clearance with minimum inspection, and medium-risk cargo for yellow lane clearance with document verification before release. It also generates statistics on the clearance rate of the three lanes.

<sup>11</sup> Government of Nepal, Ministry of Finance, DOC. 2017. *Time Release Study Report: Mechi & Biratnagar Customs 2017*. Kathmandu.

<sup>12</sup> Illicit trade includes (i) trade in counterfeit or contraband goods; (ii) smuggling of highly taxed goods, arms, cultural artefacts, and other items that threaten the security and safety of the society; and (iii) noncompliant trade, which avoids payment of duties and fees.

<sup>13</sup> The term CPEI was coined by the European Union's Customs Union and refers to specific measures to support the export sector. CPEI include customs warehousing, inward and outward processing, temporary admission of goods, and transit. Customs-related transit measures include the adoption of the Customs Convention on the International Transport of Goods Under Cover of TIR Carnets (TIR Convention).

- (i) **Absence of a legal framework to introduce a risk-based approach.** Nepal lacks the legal provisions to enable customs to play the role of a trade facilitator. The legislative framework governing customs procedures needs to incorporate the legal basis for adopting a risk-based approach. This includes incentivizing traders with a good record of compliance to benefit from faster clearance.
- (ii) **Unpredictable and inconsistent clearance procedures, unsupported by modern tools.** Predictable and transparent customs clearance requires a coherent compliance strategy that integrates behind-the-border functions of risk analysis and management, intelligence, valuation, post-clearance audit, and advance rulings. These are not in place or are underutilized in Nepal. In addition, many customs border offices are not connected electronically to the DOC headquarters, which hinders the application of unified and consistent customs processes across the country.
- (iii) **Dated institutional structure.** The DOC's organizational structure is not designed for modern customs procedures. Currently, 1,114 of the DOC's 1,283 customs officers (87%) are stationed at the field offices to conduct traditional at-the-border processes, and only a small number of staff at the DOC headquarters performs behind-the-border functions. Some of these functions, which require independent sections with segregated responsibilities, are dispersed within a larger entity. The DOC organizational chart does not reflect the links between the responsibilities of different sections, and mechanisms to facilitate cross-section coordination are not strong. Weakness in the procurement and automation sections precludes sustainable upgrading of the customs infrastructure.
- (iv) **Shortage of requisite human resource capacity for a modern customs administration.** The qualifications of most DOC staff are not aligned with the technical expertise needed to execute behind-the-border functions. About 80% of the workforce is composed of junior level non-officers with limited competency. Nepal's civil service system also imposes a 2-year staff rotation requirement, which makes retention of technical expertise within one agency a challenge. The DOC's approach to staff training has remained unplanned, without a comprehensive analytical basis or a long-term vision.

7. **Government reform agenda.** Trade facilitation as a means to promote exports is a priority in Nepal's national development agenda<sup>14</sup> as envisaged in the 14th periodic plan, FY2017–FY2020 and the Nepal Trade Integration Strategy, 2016.<sup>15</sup> To this end, Nepal's Parliament has ratified two key international agreements on expediting the movement, release, and clearance of goods: the WCO's revised Kyoto Convention (RKC) and the WTO's TFA.<sup>16</sup> According to the government's 2015 WTO TFA gap assessment and implementation action plan,<sup>17</sup> Nepal will comply with 31 of the 37 TFA measures by January 2022. The DOC will lead the implementation of 18 and co-lead in 15 of the 37 measures—most of them related to legal and procedural reforms, institutional framework, and training.<sup>18</sup> The TFA's entry into force on

<sup>14</sup> The development policy letter is in Appendix 3.

<sup>15</sup> Government of Nepal, National Planning Commission. 2016. *An Approach Paper of Fourteenth Plan, FY2017–FY2020*. Kathmandu; and Government of Nepal, Ministry of Commerce. 2016. *Nepal Trade Integration Strategy, 2016*. Kathmandu.

<sup>16</sup> The TFA is founded on the WCO's RKC, or the International Convention on the Simplification and Harmonization of Customs Procedures, and related international standards and best practices.

<sup>17</sup> The government conducted the gap analysis with technical assistance from the World Bank. ADB reviewed the drafts and provided inputs to World Bank Group. 2015. *WTO Trade Facilitation Agreement—Nepal Gap Assessment and Implementation Action Plan (Final Report)*. Washington, DC (restricted distribution).

<sup>18</sup> Nepal's Compliance with the World Trade Organization's Trade Facilitation Agreement (accessible from the list of linked documents in Appendix 2).



22 February 2017 signifies that Nepal's future performance in trade facilitation reforms will be subject to the WTO's enforcement mechanism of dispute settlement understanding.<sup>19</sup>

8. Since 2003, the DOC has been implementing the multiyear Customs Reform and Modernization Strategies and Action Plan (CRMSAP) in phases. Key achievements under the fourth phase of the CRMSAP, 2013–2017<sup>20</sup> include ratification of the RKC, rollout of the Automated System for Customs Data (ASYCUDA) World,<sup>21</sup> and commencement of the national single window,<sup>22</sup> all of which have contributed to improved TFA compliance. The Ministry of Finance has approved the fifth phase of the CRMSAP, 2017–2021,<sup>23</sup> which aims to transform customs operations to risk-based, paperless e-Customs, and to introduce CPEI to promote exports. Its strategic priorities and time-bound action points align with Nepal's implementation schedules for the WTO's TFA and the RKC (footnote 18).

9. **The proposed program.** The proposed program fully aligns with the reform priorities and implementation period of the CRMSAP, 2017–2021. The Asian Development Bank (ADB) has provided long-term policy assistance to support Nepal's trade facilitation sector in planning, implementing, and evaluating the CRMSAP phases. Budget support is considered appropriate to finance part of the projected resource gap to implement the CRMSAP, 2017–2021. The policy actions trigger and support (i) reforms on legal and procedural issues, (ii) simplified and unified procedures backed by automation tools, (iii) institutional reorganization, and (iv) human resources development. These would help Nepal substantially fulfill its WTO TFA commitments and complement the related activities of the government and other development partners, including those that have committed to support the TFA (para. 14). The two-tranche approach will allow for sequential reform milestones to be achieved in the short to medium term, setting the path toward the longer-term reform targets. This would sustain the impact of ADB's multidimensional support through continuous policy dialogue, investment, budget support, and capacity development at the national and South Asia Subregional Economic Cooperation (SASEC) levels.

10. **ADB's experience and value addition.** ADB's support for trade facilitation in Nepal dates to 1996 when it introduced automation to customs administration. While ADB has kept automation as the backbone, its contributions have evolved and it has increasingly combined the delivery of policy and capacity development support for legal, regulatory, and procedural reforms with the investment of resources needed to implement them.<sup>24</sup> ADB has helped the DOC (i) prepare for accession to the RKC; (ii) conduct the midterm review of the CRMSAP, 2013–2017 and formulate the CRMSAP, 2017–2021; (iii) compile an e-Customs master plan; (iv) establish customs client service desks; (v) conduct Time Release Studies (TRSs);<sup>25</sup> and (vi) draft legal amendments to the Customs Act, 2007 and related procedures for taking in relief consignment after the April 2015 earthquake and for lodging electronic declarations to launch the ASYCUDA World pilot projects.

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<sup>19</sup> WTO. Understanding on rules and procedures governing the settlement of disputes: Annex 2 of the WTO Agreement. [https://www.wto.org/english/tratop\\_e/dispu\\_e/dsu\\_e.htm](https://www.wto.org/english/tratop_e/dispu_e/dsu_e.htm). The TFA contains special and differential treatment provisions for developing countries and LDCs to safeguard implementation success (footnote 18).

<sup>20</sup> Government of Nepal, Ministry of Finance, DOC. 2013. *Customs Reform and Modernization Strategies and Action Plan (CRMSAP), 2013–2017*. Kathmandu.

<sup>21</sup> The pilot projects were rolled out in 2016 at the customs offices in Birgunj, Mechi, and Sirsiya Dry Port, and in 2017 in Biratnagar, Krishnagar and Bhairahawa, which together raise about 90% of customs-related revenues annually.

<sup>22</sup> The national single window system allows parties involved in trade and transport to lodge standardized information and documents at a single entry point to fulfill all import, export, and transit-related regulatory requirements.

<sup>23</sup> Government of Nepal, Ministry of Finance, DOC. 2017. *Customs Reform and Modernization Strategies and Action Plan (CRMSAP), 2017–2021*. Kathmandu.

<sup>24</sup> Sector Assessment (Summary): Industry and Trade (accessible from the list of linked documents in Appendix 2).

<sup>25</sup> The WCO developed the TRS as a methodology to identify bottlenecks affecting trade processes, thereby guiding implementation of measures to facilitate trade. Regular conduct of TRSs is part of the WTO's TFA (Article 7.6).

ADB's primary value addition is founded on the sector knowledge gained through its long-term engagement in Nepal's trade facilitation. The government's confidence in the partnership with ADB also testifies to ADB's record of translating knowledge into effective advisory and analytical inputs to DOC's policy formulation.

11. ADB, as an advocate of regional cooperation and integration, brings the added value of complementing country-level support to Nepal's trade facilitation with subregional initiatives. Since 2001, the ADB-supported SASEC program has provided a platform for member countries to address trade facilitation issues of subregional concern collectively, including those identified in the WTO's TFA.<sup>26</sup> The SASEC Trade Facilitation Strategic Framework, 2014–2018 envisages greater harmonization of trade procedures among the SASEC countries.<sup>27</sup> The SASEC Customs Subgroup, established in 2013, provides a venue for dialogue and capacity building among customs directors general of member countries on common issues related to customs modernization, in line with the WTO's TFA and other related international conventions.

12. **ADB lessons learned.** Key lessons from earlier ADB projects and an ADB program<sup>28</sup> point to (i) the appropriateness of two-tranche releases for policy-based lending to trigger and maintain reform momentum; (ii) the importance of sustained policy dialogue with concerned government agencies and private sector stakeholders to ensure implementation success; and (iii) the need for associated technical assistance (TA) to help the government achieve timely program and project completion.

13. **Alignment with ADB strategies.** The program is consistent with ADB's country partnership strategy, 2013–2017 for Nepal, which highlights support for customs modernization and transport connectivity as complementary investments to be coordinated through the SASEC program.<sup>29</sup> The proposed program is in the project pipeline of ADB's Operational Plan for Regional Cooperation and Integration, 2016–2020<sup>30</sup> and aligns with the SASEC Operational Plan 2016–2025.<sup>31</sup>

14. **Development partner coordination.** Development partners coordinate interventions in support of Nepal's trade facilitation on multiple levels: (i) formally through the national Aid for Trade<sup>32</sup> mechanism, the SASEC Customs Subgroup, and the global TFA Facility;<sup>33</sup> and (ii) more flexibly at the project level or through targeted collaboration in discrete activities.<sup>34</sup> At the project level, ADB has established a close partnership with the United Nations Conference on Trade and Development in implementing successive ASYCUDA projects. The World Bank's Nepal–India Regional Trade and Transport Project is further developing a national single window, conducting

<sup>26</sup> Nepal is a founding member of the ADB-supported SASEC program. Other members are Bangladesh, Bhutan, India, Maldives, Myanmar, and Sri Lanka.

<sup>27</sup> ADB. 2014. *South Asia Subregional Economic Cooperation Trade Facilitation Strategic Framework, 2014–2018*. Manila.

<sup>28</sup> ADB. 2017. *Completion Report: South Asia Subregional Economic Cooperation Trade Facilitation Program in Bangladesh, Bhutan, and Nepal*. Manila.

<sup>29</sup> ADB. 2013. *Country Partnership Strategy: Nepal, 2013–2017*. Manila. Regional Cooperation and Integration (accessible from the list of linked documents in Appendix 2) discusses other ADB projects in Nepal that complement the proposed program and are coordinated through the SASEC program.

<sup>30</sup> ADB. 2016. *Operational Plan for Regional Cooperation and Integration, 2016–2020: Promoting Connectivity, Competitiveness, Regional Public Goods, and Collective Action for Asia and the Pacific*. Manila.

<sup>31</sup> ADB. 2016. *South Asia Subregional Economic Cooperation Operational Plan, 2016–2025*. Manila.

<sup>32</sup> WTO. Aid for Trade. [https://www.wto.org/english/tratop\\_e/devel\\_e/a4t\\_e/aid4trade\\_e.htm](https://www.wto.org/english/tratop_e/devel_e/a4t_e/aid4trade_e.htm).

<sup>33</sup> The WTO established the TFAF in July 2014 to assist developing and least developed WTO member countries in reaping the full benefits of the TFA. The World Bank, the WCO, United Nations organizations, and governments of developed countries are among the TFAF members.

<sup>34</sup> Development Coordination (accessible from the list of linked documents in Appendix 2).

customs risk profiling, and developing selected trade-related infrastructure.<sup>35</sup> ADB has scheduled regular consultations with the World Bank project teams and has forged a partnership with the WCO to deliver joint capacity development initiatives regularly.

## B. Impact and Outcome

15. The program's impact will be expanded exports and increased export competitiveness of Nepal. It aligns with the government's vision articulated in the 14th periodic plan and the Nepal Trade Integration Strategy (para. 7). The outcome will be increased access by legitimate trade to simplified, harmonized, and modernized trade processes. This will be measured through greater use of green lane clearance for low-risk cargo (footnote 10), an increased percentage of web-based customs declaration clearance through ASYCUDA World, a reduction in the average customs clearance time,<sup>36</sup> and an overall improvement in trade facilitation indicator (TFI) scores.<sup>37</sup>

## C. Outputs

16. The program will support a policy framework, which is detailed in the policy matrix in Appendix 4. The policy actions will focus on six trade facilitation strategic priorities, all featured in the WTO TFA articles and central to the DOC's transformation to risk-based, trade-facilitating operations, collectively introducing and enhancing behind-the-border processing. These are (i) risk management, (ii) post-clearance audit, (iii) advance ruling, (iv) trade facilitation measures for authorized operators, (v) pre-arrival processing, and (vi) expedited shipment. The program's comprehensive review of customs legislation and expansion of customs automation will improve Nepal's compliance with 19 more WTO TFA articles. The program will thus help Nepal comply with 25 of the 37 WTO TFA articles, which is expected to result in a significant improvement in Nepal's TFI scores.<sup>38</sup> These 25 articles target reform areas that (i) require the DOC to lead the government's compliance efforts; (ii) are listed under the medium-term implementation schedule of 2–5 years from TFA ratification; (iii) have a high degree of alignment with the RKC commitments and the CRMSAP, 2017–2021 action points; and (iv) complement ongoing work of the government and its development partners (footnote 18). The program will also strengthen the DOC's institutional capacity to handle automation, procurement, accounting, and staff integrity promotion as enablers of the TFA reforms. The program's policy matrix of two tranches, each comprising 10 policy actions,<sup>39</sup> is designed to target the four elements of the binding constraints.

17. **Output 1: National policy and legal framework for trade facilitation improved.** The program will support (i) accession to the WTO's TFA and the RKC General Annex; (ii) achievement of the CRMSAP, 2017–2021 implementation milestones; (iii) submission of the legal amendments to the cabinet to comply fully with the RKC General Annex and with WTO TFA

<sup>35</sup> World Bank. Nepal–India Regional Trade and Transport Project. <http://www.worldbank.org/projects/P144335?lang=en&tab=overview>.

<sup>36</sup> The measurements will be from the TRSs (footnote 25). The 2016 TRS data (footnote 11) are in Sector Assessment (Summary): Industry and Trade; and Nepal's Development Context and the Role of Trade Facilitation (accessible from the list of linked documents in Appendix 2).

<sup>37</sup> Organisation for Economic Co-operation and Development. Trade facilitation indicators. <http://www.oecd.org/trade/facilitation/indicators.htm>.

<sup>38</sup> Nepal's score for 2015 was 0.8 on a scale of 0 to 2 (2 being the best possible performance). The CRMSAP, 2017–2021 performance indicators include improvement of the TFI score to 1.3 by July 2021 (footnotes 18 and 24).

<sup>39</sup> Tranche 1 policy actions are substantially completed in May 2017. The government will submit to ADB evidence of compliance by the end of June 2017 as stated in Evidence of Compliance with the Policy Matrix (accessible from the list of linked documents in Appendix 2).

measures on the six trade facilitation strategic priorities;<sup>40</sup> and (iv) drafting of legislative amendments and new legislation to comply with 19 customs-related TFA measures and CPEI.

18. **Output 2: Customs procedures improved.** The program will introduce risk-based approaches to Nepal's customs clearance, and the government will apply the streamlined procedures across the country. The program will promote further automation, which will enable the application of consistent and transparent clearance procedures. It will support (i) pilot testing of reengineered customs declaration processing steps in three customs offices,<sup>41</sup> (ii) pilot testing of ASYCUDA World in 10 customs offices,<sup>42</sup> and (iii) implementing a risk management framework and standard operating procedures.

19. **Output 3: Department of Customs organizational structure strengthened.** To enable the implementation of the centrally monitored, risk-based approach, the program will strengthen the DOC's organizational structure to perform the behind-the-border tasks identified in the six trade facilitation strategic priorities. The organizational restructuring exercise will revise the organizational chart to (i) rationalize the reporting channels of key technical sections, (ii) define the terms of reference for the sections, (iii) install mechanisms for better data sharing and coordination between the sections, and (iv) create new sections where needed. As part of the restructuring, ADB's associated stand-alone TA (para. 22) will help DOC analyze the required qualifications and terms of reference for individual staff positions. The DOC will implement the restructuring plan in incremental phases for a gradual but sustainable change. The program will support the (i) review of the DOC's organizational structure, (ii) formulation of a realignment plan, (iii) completion of the initial phase of the realignment plan, and (iv) establishment of a risk management section.

20. **Output 4: Department of Customs' capacity enhanced.** The adoption of the risk-based approach in customs operations in Nepal will require a long-term training plan for DOC staff to be implemented with adequate training tools. The government will prioritize the training required in the six trade facilitation priority areas, and the related areas of procurement, automation, accounting, and staff integrity. To fill technical capacity gaps and address staff rotation constraints, the DOC will launch a pool of experts scheme. This will involve a roster for customs experts to act as trainers or to undertake specialized assignments with the DOC. The program will support the (i) formulation of a DOC capacity development plan, (ii) development of training modules, and (iii) establishment of the pool of experts scheme.

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<sup>40</sup> Nepal's legislative framework complies with 96 of the 121 RKC General Annex standards. The remaining 25 standards require amendments in 22 articles of the Customs Act, 2007; two Customs rules; and one administrative instruction. A summary of the 25 amendments, in Nepali, is in Government of Nepal, Ministry of Finance, DOC. <http://customs.gov.np/en/%E0%A4%9C%E0%A4%BE%E0%A4%A8%E0%A4%95%E0%A4%BE%E0%A4%B0%E0%A5%80.html>

<sup>41</sup> Customs declaration processing typically involves (i) data capture and validation, (ii) monitoring of customs regulations, (iii) registration, (iv) calculation of duties and taxes, (v) selectivity, (vi) assessment, and (vii) release of goods. Streamlined and consistent application of these steps can be a challenge for customs administrations.

<sup>42</sup> In addition to the three customs offices that started using ASYCUDA World in 2016 (footnote 21), seven more pilot tests will be launched from the highest revenue-yielding customs offices. Together they collect over 95% of total customs-related revenues annually. In 2016, the three offices cleared 6% of the total declarations through this web-based customs management system. All figures are from government data sources.

## D. Development Financing Needs

21. Nepal has substantial development financing needs and faces an estimated infrastructure financing gap of 8%–12% of GDP annually until 2020.<sup>43</sup> Nepal's fiscal deficit averaged 1.2% in FY2003–FY2016 (footnote 7). A budget surplus of 1.4% of GDP was recorded in FY2016, reflecting chronically weak budget execution.<sup>44</sup> The fiscal deficit for FY2017, however, is projected at 8.8% of GDP or NRs229.3 billion.<sup>45</sup> More than half of this deficit is expected to be financed through foreign loans.

22. The government estimated the total cost of implementing the program during 2017–2021 to be about \$94 million, for which it has provisionally committed about \$52 million of its own resources (footnote 23). The government is expecting development partner support of \$21 million from this proposed ADB program. Additionally, the World Bank's trade and transport project (para. 14) will provide \$16 million, leaving a funding gap of \$5 million.<sup>46</sup> The government will ensure that the counterpart funds generated from the program's loan proceeds will support implementation during 2017–2021, which significantly enhances the sustainability of the program's reform measures. The government has also requested associated stand-alone TA to support reform implementation under the program.<sup>47</sup> The TA is estimated to cost \$1 million, which will be financed on a grant basis by a Special Fund administered by ADB.

23. The government has requested a concessional loan in various currencies equivalent to SDR15,341,000 (\$21 million)<sup>48</sup> from ADB's ordinary capital resources to help finance the program. The loan will have a 24-year term, including a grace period of 8 years; an interest rate of 1.0% per annum during the grace period and 1.5% per annum thereafter; and such other terms and conditions to be set forth in the draft loan agreement. The funds will be released in two tranches—\$10 million on loan effectiveness and \$11 million about 24 months later—once the government has complied with the policy conditions.

## E. Implementation Arrangements

24. The program period will be 4 years starting in July 2017. The DOC will be the executing and implementing agency. A program steering committee, chaired by the DOC director general, will guide and monitor implementation. Committee members will be drawn from the DOC, the Department of Industry, and the finance and commerce ministries. Members of the Customs National Trade Facilitation Committee, which represents trade-related stakeholders from the public and private sector, and ADB may be invited to the steering committee meetings. The steering committee will present the progress of and discuss issues on program implementation at regular meetings of the Customs National Trade Facilitation Committee. The DOC will form a program implementation framework, headed by its deputy director general (management), to supervise five thematic task forces: (i) coordination, (ii) legislation, (iii) automation, (iv) risk

<sup>43</sup> L. Andrés, D. Biller, and M. Herrera Dappe. 2013. *Reducing Poverty by Closing South Asia's Infrastructure Gap*. Washington, DC: World Bank. Quoted in ADB. Nepal Resident Mission (NRM). 2016. *Macroeconomic Update: Nepal*. 4 (2).

<sup>44</sup> The reasons for weak expenditure performance include (i) lack of project readiness; (ii) delays in project approval and budget release; (iii) delays in procurement; and (iv) weak overall project planning, implementation, and contract management capacity. In FY2016, trade and supply disruptions may also have affected capital spending. ADB. NRM. 2016. *Macroeconomic Update: Nepal*. 4 (2).

<sup>45</sup> The fiscal deficit for FY2017 is a "budget estimate." ADB. NRM. Economic Database.

<sup>46</sup> Additional government funds allocation and TFAF assistance (footnote 33) are expected to close the funding gap.

<sup>47</sup> Associated Technical Assistance (accessible from the list of linked documents in Appendix 2).

<sup>48</sup> SDR1 = \$1.36892 as of 9 May 2017.

management, and (v) organization and development. ADB will disburse loan proceeds following its *Loan Disbursement Handbook* (2015, as amended from time to time).

### III. DUE DILIGENCE

#### A. Economic and Financial

25. The program supports exports and economic growth through customs reform and modernization, which lower the cost of trade, and is expected to benefit Nepal's economy through various channels. A quantitative analysis undertaken shows a positive correlation between trade facilitation and trade. Based on simulation results, Nepal's exports are expected to increase by 23.0% and imports by 21.6% from improvement in trade facilitation.<sup>49</sup>

26. Nepal's economy is expected to benefit from lower trading costs, which can help reduce the price of imported inputs and improve manufacturers' access to imported inputs—thereby improving productivity in the manufacturing sector and making exports more competitive. The program is expected to lower entry barriers, enabling manufacturers to enter into new markets and products, and diversify their export basket. Other expected benefits include (i) increased participation of Nepalese firms in regional and global value chains, (ii) higher foreign direct investment inflows into Nepal as a result of the improved business climate, (iii) inclusive growth through poverty reduction and benefits to small and medium-sized enterprises, (iv) improvement in Nepal's customs revenue, and (v) a reduction in trade-related corruption (footnote 7).

#### B. Governance

27. ADB has carried out a financial management assessment.<sup>50</sup> The overall fiduciary risk for the program is *moderate*, because of (i) the lack of an internal audit service segregated from the processing of payments, (ii) capacity challenges in procurement and automation, and (iii) the perception of customs revenue leakages. These will be mitigated under the program through the expanded application of automation in customs clearance, as well as the requirement under the policy matrix to revise the DOC's organizational chart and train relevant DOC officials in priority areas, including accounting, automation, procurement, and staff integrity.

28. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government.

#### C. Poverty and Social

29. The reforms supported under the program will indirectly contribute to poverty reduction.<sup>51</sup> Beneficiaries from the program include current and future businesses, especially small and medium-sized enterprises, informal traders, and women traders. More exports and the ensuing growth of manufacturers, as well as more investment, are also expected to provide benefits through job creation, higher wages, and poverty reduction. The program is thus expected to contribute to inclusive and sustainable growth in the long term.

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<sup>49</sup> Economic Analysis; and Estimated Gains in Trade from Improvement in Trade Facilitation (accessible from the list of linked documents in Appendix 2).

<sup>50</sup> Financial Management Assessment (accessible from the list of linked documents in Appendix 2).

<sup>51</sup> Summary Poverty Reduction and Social Strategy (accessible from the list of linked documents in Appendix 2).



#### **D. Safeguards**

30. ADB's evaluation of the environmental and social impacts of each policy action shows that the program does not trigger ADB's safeguard policies. The program is classified *category C* for the environment, involuntary resettlement, and indigenous peoples.

#### **E. Risks and Mitigating Measures**

31. The overall risk rating for program implementation is *moderate*. Major risks and mitigating measures are described in detail in the risk assessment and risk management plan.<sup>52</sup> Key risks for the implementation of the program are related to the unstable political environment of Nepal, to be mitigated by ADB's continuous dialogue with the government, underpinned by close development partner coordination. Shortage of technical capacity in the DOC is also a risk, which the associated stand-alone TA's capacity development activities will help mitigate. Implementation of the government's Public Financial Management Reform Strategy will help address some of the country-wide fiduciary risks in the medium term. The integrated benefits and impacts are expected to outweigh the costs.

### **IV. ASSURANCES**

32. The government has assured ADB that implementation of the program shall conform to all applicable ADB policies, including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement, as described in detail in the loan agreement.

### **V. RECOMMENDATION**

33. I am satisfied that the proposed policy-based loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the loan in various currencies equivalent to SDR15,341,000 (\$21,000,000)<sup>53</sup> to Nepal for the South Asia Subregional Economic Cooperation Customs Reform and Modernization for Trade Facilitation Program, from ADB's ordinary capital resources, in concessional terms, with an interest charge at the rate of 1.0% per year during the grace period and 1.5% thereafter; for a term of 24 years, including a grace period of 8 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan agreement presented to the Board.

Takehiko Nakao  
President

1 June 2017

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<sup>52</sup> Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

<sup>53</sup> SDR1 = \$1.36892 as of 9 May 2017.

## DESIGN AND MONITORING FRAMEWORK

<b>Impact the Program is aligned with:</b> Nepal's exports expanded and export competitiveness increased (14th periodic plan, FY2017–FY2020; Nepal Trade Integration Strategy, 2016) <sup>a</sup>			
<b>Results Chain</b>	<b>Performance Indicators with Targets and Baselines</b>	<b>Data Sources and Reporting Mechanisms</b>	<b>Risks</b>
<b>Outcome</b> Legitimate trade's access to simplified, harmonized, and modernized trade processes increased	<b>By 2021</b> a. At least 70% of total cargo cleared in the green lane (2016 baseline: 22%)  b. 90% of the total number of customs declarations processed by ASYCUDA World (2016 baseline: 6%)  c. Average cargo clearance time recorded in the TRSs decreased by 30% (2016 baseline: average TRS results for imports: 18 hours 54 minutes; for exports: 11 hours 49 minutes) <sup>b</sup>  d. An overall score of 1.3 on OECD TFIs attained (2015 baseline: 0.8)	a. ASYCUDA World statistics and Customs Annual Report (DOC)  b. ASYCUDA World statistics (DOC)  c. TRS reports (DOC)  d. OECD TFIs	Political instability causes irregular trade patterns.
<b>Outputs</b> 1. National policy and legal framework for trade facilitation improved	<b>By 2017</b> 1a. The WTO's TFA and the RKC General Annex acceded to by the government (2016 baseline: not acceded to)  <b>By 2019</b> 1b. 100% of 2019 performance targets <sup>c</sup> under CRMSAP, 2017–2021 verified as achieved (2016 baseline: not achieved)  1c. Legislative amendments submitted to the cabinet for full compliance with the (i) RKC General Annex in all 121 general standards, and (ii) customs-related WTO TFA measures on the six trade facilitation strategic priorities (2016 baseline: amendments not submitted)  1d. 100% of planned legislative amendments and planned new legislation verified as compliant	1a. WTO and WCO websites  1b. CRMSAP, 2017–2021 progress report (DOC)  1c. Text of amended legislation (MOF); report on compliance with the RKC General Annex and the customs-related WTO TFA measures (DOC)  1d. Text of draft legislation (MOF);	The planned elections and transition from a unitary state to a federal structure delay implementation of reforms.



Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
<p>2. Customs procedures improved</p> <p>3. DOC organizational structure strengthened</p> <p>4. DOC's capacity enhanced</p>	<p>with 19 customs-related TFA measures and CPEI (2016 baseline: not compliant)</p> <p><b>By 2019</b></p> <p>2a. Reengineered customs declaration processing steps pilot tested in three customs offices (2016 baseline: not applicable)</p> <p>2b. ASYCUDA World rolled out in 10 customs offices (2016 baseline: three customs offices)</p> <p>2c. Decree on risk management framework and standard operating procedures issued by the DOC (2016 baseline: not applicable)</p> <p><b>By 2017</b></p> <p>3a. Phased realignment plan approved (2016 baseline: not approved)</p> <p><b>By 2019</b></p> <p>3b. Risk management section established in the DOC (2016 baseline: not established)</p> <p><b>By 2019</b></p> <p>4a. DOC capacity development plan approved (2016 baseline: not approved)</p> <p>4b. At least 10 training modules on the trade facilitation strategic priorities, procurement, accounting, integrity, and automation developed (2016 baseline: 0)</p> <p>4c. Pool of experts scheme established (2016 baseline: not established)</p>	<p>proposal for amendments (MOF)</p> <p>2a. Report on the Business Process Reengineering pilot tests (DOC)</p> <p>2b. ASYCUDA World statistics and customs annual report (DOC)</p> <p>2c. Customs progress report on risk management strategy (DOC)</p> <p>3a. Customs annual report (DOC)</p> <p>3b. Customs annual report (DOC)</p> <p>4a. Capacity development plan; customs annual report (DOC)</p> <p>4b. Customs annual report (DOC)</p> <p>4c. Customs annual report (DOC)</p>	

<b>Key Activities and Milestones</b> Not applicable
<b>Inputs</b> ADB: \$21 million (concessional OCR loan)
<b>Assumptions for Partner Financing</b> Not applicable

ADB = Asian Development Bank, ASYCUDA = Automated System for Customs Data, CPEI = customs procedures with economic impact, CRMSAP = Customs Reform and Modernization Strategies and Action Plan, DOC = Department of Customs, MOF = Ministry of Finance, OCR = ordinary capital resources, OECD = Organisation for Economic Co-operation and Development, RKC = revised Kyoto Convention, TFA = Trade Facilitation Agreement, TFI = trade facilitation indicator, TRS = Time Release Study, WCO = World Customs Organization, WTO = World Trade Organization.

Note: The government has also requested associated stand-alone technical assistance to support reform implementation under the program. The technical assistance is estimated to cost \$1 million, which will be financed on a grant basis by a Special Fund administered by ADB.

<sup>a</sup> Government of Nepal, National Planning Commission. 2016. *An Approach Paper of Fourteenth Plan, FY2017–FY2020*. Kathmandu; and Government of Nepal, Ministry of Commerce. 2016. *Nepal Trade Integration Strategy, 2016*. Kathmandu.

<sup>b</sup> Government of Nepal, MOF, DOC. 2017. *Time Release Study Report: Mechi & Biratnagar Customs 2017*. Kathmandu. The baseline figures for the import and export clearance time are taken from the average of the two TRSs done in Mechi and Biratnagar in 2016. The clearance time is a sum of the clearance stages measured in the TRSs, collating data from the entry of cargo vehicles in the customs territories to the final release of goods. The 2016 TRS data and findings are in Sector Assessment (Summary): Industry and Trade; and Nepal's Development Context and the Role of Trade Facilitation (accessible from the list of linked documents in Appendix 2).

<sup>c</sup> The 2019 performance targets are defined as those CRMSAP, 2017–2021 performance indicators included in policy action (2-1) in the policy matrix in Appendix 4. Policy Action (2-1): The Customs Reform and Modernization Strategies and Action Plan, 2017–2021 Implementation Milestones (accessible from the list of linked documents in Appendix 2).

Source: Asian Development Bank.

### **LIST OF LINKED DOCUMENTS**

<http://www.adb.org/Documents/RRPs/?id=50254-001-3>

1. Loan Agreement
2. Sector Assessment (Summary): Industry and Trade
3. Contribution to the ADB Results Framework
4. Development Coordination
5. Economic Analysis
6. Country Economic Indicators
7. International Monetary Fund Assessment Letter
8. Summary Poverty Reduction and Social Strategy
9. Risk Assessment and Risk Management Plan
10. List of Ineligible Items

### **Supplementary Documents**

11. Evidence of Compliance with the Policy Matrix
12. Policy Action (2-1): The Customs Reform and Modernization Strategies and Action Plan (CRMSAP), 2017–2021 Implementation Milestones
13. Associated Technical Assistance
14. Financial Management Assessment
15. Nepal's Development Context and the Role of Trade Facilitation
16. Nepal's Compliance with the World Trade Organization's Trade Facilitation Agreement
17. Estimated Gains in Trade from Improvement in Trade Facilitation
18. Regional Cooperation and Integration

## DEVELOPMENT POLICY LETTER



SINGHADURBAR  
KATHMANDU, NEPAL

Mr. Takehiko Nakao  
President  
Asian Development Bank  
6 ADB Avenue, Mandaluyong City  
Metro Manila, Philippines

09 May, 2017

09 MAY 2017

Dear Mr. President:

**RE: Letter of Development Policy for South Asia Subregional Economic Cooperation Customs Reform and Modernization for Trade Facilitation Program**

On behalf of the Government of Nepal, please allow me to thank you for the continued commitment and support of the Asian Development Bank (ADB) towards our vision of raising the living standards of the people by achieving sustainable economic growth. With the aim of graduating from the Least Developed Country Status by 2022 and to emerge as an inclusive, equitable, and prosperous middle-income country by 2030, Nepal is fully committed to the global development agenda of the Sustainable Development Goals. We value the long-term partnership with ADB, whose mission to help reduce poverty has helped Nepal score achievements in many areas of economic development, not least in the trade facilitation sector. For Nepal's trade facilitation, it is worth noting that ADB has mobilized its strengths as catalyst, coordinator, and knowledge leader of regional cooperation and integration, enabling Nepal to benefit from participation in the South Asia Subregional Economic Cooperation (SASEC) program.

Recognizing that trade is a powerful engine of economic growth across countries, the Government has been targeting trade sector development as an important means of poverty reduction and socio-economic development. It is, therefore, of particular concern that the country's balance in goods trade has been negative, worsening over the years as growth of import has outpaced that of exports. To address this issue, the Government has launched three successive trade integration strategies, starting with the Nepal Trade and Competitiveness Study of 2004, the year Nepal joined the World Trade Organization (WTO). Its latest, the Nepal Trade Integration Strategy (NTIS) 2016, aims to enhance export competitiveness by addressing cross-cutting issues. While the core of the strategy is dedicated to resolving supply capacity constraints and value chain development of priority products for export, trade facilitation is also highlighted among these cross-cutting issues as means to bring down the trade transaction costs and time.

The importance of trade facilitation and the urgency to act on reforms in this sector have been elevated this year, when Nepal's legislature ratified the WTO Trade Facilitation Agreement (TFA). While the Government agencies are collectively committed to fulfill the binding and time-bound obligations under this multilateral agreement, the most prominent role of Nepal's Department of Customs (DOC) in complying with majority of the TFA articles cannot be overstated. In today's world of cross-border supply chains and production networks, the role of customs has gone beyond revenue collection. Today, customs have assumed the role of being facilitators of implementing the economic policies of the governments that are aimed

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towards increasing foreign direct investments and enhancing the export potential of their respective countries. Modern customs and efficient customs procedures are critical to improving business climate and attracting foreign direct investment, especially the type that will help Nepal integrate into regional and global value chains. Exports in Nepal depend on imported inputs; making it easier and less costly to import will ultimately also help improve competitiveness of Nepalese exports, as well as support Nepalese exporters enter new markets and export new products.

The DOC, since 2003, has been implementing the Customs Reform and Modernization Strategies and Action Plan (CRMSAP), and the results have helped improve Nepal's trade facilitation environment. In this journey, ADB's partnership with the DOC, which dates back to 1996, has been instrumental in achieving key milestones, such as the advancement of customs automation and the accession to the Revised Kyoto Convention (RKC), to name but a few. Nonetheless, Nepal's customs administration is yet to espouse fully the modern customs business practice of risk management as a key principle to facilitate legitimate trade, while more efficiently addressing high risk consignments, conveyances, and people. To manage operations in a risk-based manner enables customs to simultaneously identify low risk flows and operators while targeting high risk cargoes. Only with this transformation to adopt risk-based approaches in customs, will the objective of introducing specific customs measures to support exporting businesses cease to be a distant dream.

The SASEC Customs Reform and Modernization for Trade Facilitation Program was prepared by a joint team of representatives from ADB and the Government of Nepal with reform initiatives grouped in the following broad development objectives:

- (i) **Improving the national policy and legal framework for trade facilitation:** Full accession to the WTO TFA and the RKC will open a new era for Nepal's trade facilitation, triggering urgency of reforms to comply with these international standards. To guide the reform directions, the new phase of CRMSAP, the CRMSAP 2017-2021, will be launched as the FY 2018 opens, and enshrined with the emerging priorities of risk management and export promotion. The policy actions will monitor progress made in this strategy's implementation. The new strategy is tailored to further improve Nepal's compliance level with the landmark international standards of the WTO TFA, the RKC and others. The program's policy actions will also include legal amendments to the customs legislations to comply with the RKC and priority WTO TFA articles, most central to adopting risk-based approaches; and legal review of customs-related WTO TFA provisions and other related international standards, particularly those concerning export promotion. As the CRMSAP 2017-2021's Foreword summarized, the strategy's activities are directed towards e-customs, post clearance audit, advance ruling, pre-arrival clearance, expedited shipment, risk management and trusted traders program.
- (ii) **Improving customs procedures:** Streamlined customs clearance procedures, supported with advanced automation tools, are key to risk-based approaches, ultimately reducing the transaction costs of trade. Policy actions include: (a) reengineering business processes for customs clearance, (b) advancing customs automation through expansion of the ASYCUDA World, (c) adopting a comprehensive risk management framework and standard operating procedures for risk-based approaches, and (d) conducting stakeholder consultations on a customs-related transit agreement, as one of the key measures for export promotion.

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(iii) **Strengthening the institution:** The Government of Nepal is initiating for specialized revenue service under Ministry of Finance by the mandate of current fiscal year budget approved by the parliament. According to the annual budget, Ministry of Finance has already initiated drafting Central Revenue Board Legislation that is agreed by the cabinet in principle. This will be a milestone in order to reform the revenue administration including customs with specialized revenue institutions. Introduction of modern risk-management, utilizing sophisticated and centrally-managed automation tools, will necessitate a major organizational restructuring at the DOC. While automation may help reduce the DOC's human resource needs at the field locations, a drastic increase in skilled manpower will emerge at the center to install and maintain comprehensive compliance monitoring systems. The expertise required by the DOC will not be limited to information technology, but progressively grow in functional areas to support the risk management framework. Focusing on introducing streamlined risk-based procedures with the use of automation, the policy actions will therefore deliver: (a) a review of the DOC's organizational structure, (b) formulation of a realignment plan, and (c) commencement of realignment, according to the plan.

(iv) **Institutionalizing capacity development:** Success of the above reforms is dependent on increase in DOC's technical capacity. The policy reforms will include: (a) development of a capacity development plan, grounded in the evidence from the skills gap analysis, and (b) launch of the "pool of expert (training of trainers)" scheme to minimize the loss of department-wide knowledge and to nurture in-house expertise. The capacity development plan will focus on the priority areas for risk-based approaches. To enable the modern processes to be implemented, the capacity development plan will also cover automation, procurement, accounting and staff integrity.

The outcome of the proposed program will be increased access by legitimate trade to simplified, harmonized, and modernized trade processes. It will be monitored in line with the indicators agreed upon with ADB. The Government is committed to implementing this program successfully. The Policy Matrix that accompanies this letter is reflective of and directly addresses the guiding principles and strategies of the CRMSAP 2017-2021. As indicated in the approved CRMSAP 2017-2021's Annex 3 (Budget Estimate), the Government will allocate adequate resources and funds to this end, including those from this proposed program and other development partners' support to trade facilitation.

The Government of Nepal remains firmly committed to the development agenda outlined above and to build on the reform efforts which have already been instituted. We would appreciate your favorable consideration of the proposed program loan and look forward to working together to achieve the targeted milestones of reforms, and to ensure that Nepal's 4-year national strategy of the CRMSAP 2017-2021 will be completed with outstanding success.

Sincerely,

*Krishna Bahadur Mahara*  
9.5.2017

Krishna Bahadur Mahara  
Deputy Prime Minister and Finance Minister  
Ministry of Finance, Kathmandu, Nepal

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**POLICY MATRIX**  
**SASEC CUSTOMS REFORM AND MODERNIZATION FOR TRADE FACILITATION**

<b>Output</b>	<b>Tranche 1</b> (By Q2 2017)	<b>Tranche 2</b> (Q3 2017–Q3 2019)	<b>Post Partnership Framework</b> (July 2021)
<p>1. National policy and legal framework for trade facilitation improved</p> <p>Related assistance:            – ADB associated stand-alone TA            – ADB JFPR TA 8442            – ADB STFP G0332</p>	<p><i>To promote international trade, the government issued a national strategy for customs reform and commenced amendments to the trade facilitation legal framework. Policy actions include:</i></p> <p>(1-1) The government issued CRMSAP 2017–2021, the multi-year national strategy, which includes a timeline for revision in the customs legislation required to comply with WCO’s RKC and the WTO TFA.</p> <p>(1-2) The government submitted the instrument of accession for (i) the body of the convention and general annex of RKC to WCO; and (ii) the WTO TFA to WTO.</p> <p>(1-3) The government (i) prepared an initial draft legislative amendment for revision in the Customs Act, Customs rules, and administrative instructions, for full compliance with the General Annex of RKC extended to cover the customs-related WTO TFA measures on the six trade facilitation strategic priorities and (ii) circulated to CNTFC for consultation on the proposed revision.</p>	<p><i>To promote international trade, the government will have proposed a legislative amendment on trade facilitation for approval in line with international standards. Policy actions include:</i></p> <p>(2-1) The government will have achieved the CRMSAP 2017–2021 implementation milestones<sup>a</sup> to enable risk-based customs clearance.</p> <p>(2-2) The proposed legislative amendments to comply with the General Annex of RKC extended to cover the customs-related WTO TFA measures on the six trade facilitation strategic priorities will have been submitted to the Cabinet.</p>	<p>Compliance improved against WTO TFA and other related international standards.</p> <p>CRMSAP 2017–2021 implementation completed.</p> <p>The customs legislation fully aligned with the RKC.</p> <p>The Cabinet approves the legislative amendments to comply with WTO TFA.</p>



Output	Tranche 1 (By Q2 2017)	Tranche 2 (Q3 2017–Q3 2019)	Post Partnership Framework (July 2021)
	(1-4) For the CRMSAP 2017–2021 implementation, the government endorsed a proposal and issued the instruction to commence the proposal's immediate implementation including preparation of (i) legal gap analysis on the customs-related WTO TFA measures and related international standards in particular those concerning CPEI, and (ii) draft legislation (including rules and administrative orders) required based on the findings of the gap analysis.	(2-3) The government will have (i) drafted an amendment to the customs legislations to comply with customs-related WTO TFA measures and related international standards in particular those concerning CPEI based on the completed legal gap analysis, and (ii) circulated the draft amendment to CNTFC for consultation. (2-4) The government will have consulted with the trade-related organizations on the adoption of the TIR convention.	
<p>2. Customs procedures improved to reduce costs of trade</p> <p>Related assistance:</p> <ul style="list-style-type: none"> <li>– ADB associated stand-alone TA</li> <li>– ADB JFPR TA 8442</li> <li>– ADB STEP L2685/G0225</li> <li>– ADB STFP G0332</li> <li>– World Bank NIRTTP</li> </ul>	<p><i>To reduce costs of international trade, the government took actions to re-engineer business process for customs clearance, proceeded with the customs automation through ongoing ASYCUDA world implementation, and introduced risk management to customs procedures. Policy actions include:</i></p> <p>(1-5) The government (i) approved the proposal to conduct BPR, and (ii) issued instructions on the proposal's immediate implementation.</p> <p>(1-6) The government rolled out the ASYCUDA world pilot in three customs offices, and completed a detailed evaluation and assessment of the rollouts with lessons learned and recommendations for future ASYCUDA world implementation.</p>	<p><i>To reduce costs of international trade, the government will have made further progress in adopting efficient clearance processes, implementing electronic-based customs management system, and converting its operation to a risk-based approach. Policy actions include:</i></p> <p>(2-5) The government will have (i) developed declaration processing steps within the scope of the ASYCUDA world, and (ii) pilot tested the re-engineered declaration processing steps at three sites.</p> <p>(2-6) The government will have: (i) adopted a comprehensive implementation plan for the ASYCUDA world, and its functionalities, and (ii) extended the ASYCUDA world's automated customs processing to the 10 highest revenue-yielding customs offices with the functionalities specified in the implementation plan.</p>	<p>Regular TRS are conducted to monitor and confirm decline in the cargo clearance time.</p> <p>90% of all import and export declarations are processed through the ASYCUDA world with relevant functionalities.</p> <p>80% of the cargoes are identified as low risk and segregated from the high risk cargoes for fast-track clearance.</p> <p>ASYCUDA world is interfaced with national single window system for harmonized inter-agency approach to trade facilitation.</p>



Output	Tranche 1 (By Q2 2017)	Tranche 2 (Q3 2017–Q3 2019)	Post Partnership Framework (July 2021)
	(1-7) The government (i) finalized the ongoing risk profiling exercise (May 2015), (ii) made adjustments (if any) to the identified risk profiles for programming them into the ASYCUDA world selectivity module, and (iii) formulated remaining action points towards effective implementation of the selectivity module.	(2-7) The government will have adopted a risk management framework and a risk management standard operating procedure based on the analyses of risk profiling (1-7), to integrate risk management into the customs clearance procedures.	
<p>3. Institution strengthened for effective and sustainable trade facilitation</p> <p><u>Related assistance:</u> – ADB associated stand-alone TA – ADB JFPR TA 8442</p>	<p><i>The government reviewed the current DOC organizational structure and formulated a realignment plan for improved customs procedures. Policy actions include:</i></p> <p>(1-8) The government (i) formed the ‘restructuring’ committee with participation from the Ministry of General Administration and the MOF to review DOC’s existing organogram and proposed a phased realignment plan to adopt risk-based approach to customs clearance, and (ii) submitted through the committee the phased realignment plan for MOF approval.</p>	<p><i>The government will have reorganized DOC for effective and sustainable trade facilitation; Policy action include:</i></p> <p>(2-8) The government will have completed the initial phase of the phased realignment plan to be in line with the task requirements of the six trade facilitation strategic priorities, which will include establishment of a dedicated risk management section in DOC.</p>	Review of the reorganization is conducted for evaluation and identification of further needs for reorganization.
<p>4. Capacity development plan institutionalized to strengthen operational capacities in a sustainable manner</p> <p><u>Related assistance:</u> – ADB associated stand-alone TA – ADB JFPR TA 8442</p>	<p><i>The government conducted a training needs assessment for a capacity development plan for effective and sustainable trade facilitation. Policy actions include:</i></p> <p>(1-9) The government conducted a gap analysis and training needs assessment focusing on the six trade facilitation strategic priorities as well as the related areas of procurement, accounting, integrity, and automation.</p>	<p><i>The government will have institutionalized the capacity development plan. Policy actions include:</i></p> <p>(2-9) Based on the completed gap analysis and training needs assessment, the government will have (i) formulated a capacity development plan to address the needs identified in the assessment under Policy Action (1-9); (ii) endorsed the training plan for the respective DOC units; (iii) developed training modules on the six trade facilitation strategic priorities as well as the related areas of procurement, accounting, integrity, and</p>	<p>Adequately trained and competent human resources available in DOC.</p> <p>The training on modern customs procedures regularly conducted, and further review and updates are made.</p>

Output	Tranche 1 (By Q2 2017)	Tranche 2 (Q3 2017–Q3 2019)	Post Partnership Framework (July 2021)
	(1-10) The government conducted competency mapping to identify a pool of experts to address the gaps under (1-9).	automation; and (iv) commenced implementation of the plans.  (2-10) The government will have formulated and commenced implementation of the “pool of expert” scheme.	

ASYCUDA = automated systems for customs data, BPR = business process re-engineering, CNTFC = Customs National Trade Facilitation Committee, CPEI = customs procedures with economic impact, CRMSAP = Customs Reform and Modernization Strategies and Action Plan, DOC = Department of Customs, JFPR = Japan Fund for Poverty Reduction, MOF = Ministry of Finance, NIRTTP = Nepal-India Regional Trade and Transport Project, RKC = Revised Kyoto Convention, SASEC = South Asia Subregional Economic Cooperation, STEP = Subregional Transport Enhancement Project, STFP = SASEC Trade Facilitation Program, TA = technical assistance, TFA = Trade Facilitation Agreement, TIR= Transports Internationaux Routiers (International Road Transport), TRS = Time Release Study, WCO = World Customs Organization, WTO = World Trade Organization.

<sup>a</sup> CRMSAP 2017–2021 implementation milestones are in Policy Action (2-1): The Customs Reform and Modernization Strategies and Action Plan (CRMSAP), 2017–2021 Implementation Milestones (accessible from the list of linked documents in Appendix 2).