



Concept Paper

Project Number: 50254-001
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Proposed Policy-Based Loan Nepal: South Asia Subregional Economic Cooperation Customs Reform and Modernization for Trade Facilitation

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Asian Development Bank

CURRENCY EQUIVALENTS

(as of 28 October 2016)

Currency unit	–	Nepalese rupee/s (NRe/NRs)
NRs 1.00	=	\$0.009
\$1.00	=	NRs106.97

ABBREVIATIONS

ADB	–	Asian Development Bank
ASYCUDA	–	Automated Systems for Customs Data
CRMSAP	–	Customs Reform and Modernization Strategies and Action Plan
DOC	–	Department of Customs
GDP	–	gross domestic product
OECD	–	Organisation for Economic Co-operation and Development
SASEC	–	South Asia Subregional Economic Cooperation
TA	–	technical assistance
TFA	–	Trade Facilitation Agreement
TFI	–	Trade Facilitation Indicator
WTO	–	World Trade Organization

NOTES

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

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PROGRAM AT A GLANCE

1. Basic Data		Project Number: 50254-001	
Project Name	South Asia Subregional Economic Cooperation Customs Reform and Modernization for Trade Facilitation	Department /Division	SARD/SARC
Country Borrower	Nepal Nepal	Executing Agency	Department of Customs
2. Sector	Subsector(s)	ADB Financing (\$ million)	
✓ Industry and trade	Industry and trade sector development		11.00
	Trade and services		10.00
		Total	21.00
3. Strategic Agenda	Subcomponents	Climate Change Information	
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		
4. Drivers of Change	Components	Gender Equity and Mainstreaming	
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		
5. Poverty and SDG Targeting		Location Impact	
Geographic Targeting	No	Regional	High
Household Targeting	No		
SDG Targeting	Yes		
SDG Goals	SDG8, SDG10, SDG17		
6. Risk Categorization:	Low		
7. Safeguard Categorization	Environment: C	Involuntary Resettlement: C	Indigenous Peoples: C
8. Financing			
Modality and Sources		Amount (\$ million)	
ADB		21.00	
Sovereign Program loan: Asian Development Fund		21.00	
Cofinancing		0.00	
None		0.00	
Counterpart		0.00	
None		0.00	
Total		21.00	
9. Effective Development Cooperation			
Use of country procurement systems		Yes	
Use of country public financial management systems		Yes	

I. THE PROGRAM

A. Rationale

1. The proposed South Asia Subregional Economic Cooperation (SASEC) Customs Reform and Modernization for Trade Facilitation Program (the Program)¹ is a policy-based loan to help improve Nepal's trade facilitation environment, thereby contributing to the national goals of promoting and diversifying exports. It will support Nepal's implementation of the World Trade Organization's (WTO) Trade Facilitation Agreement (TFA), a set of new, binding international standards, and related best practices on trade facilitation. The Program will implement select reforms under the TFA, building on ADB's past support to Nepal's trade facilitation sector under the SASEC program.² The Program aligns with the government's ongoing customs reform and modernization initiatives, including those assisted by other development partners.

2. Nepal is a landlocked, least-developed country that is geographically isolated from global market and has inefficient trade procedures. The country is deemed "logistics unfriendly" and its trade carries highest costs in South Asia, which, in turn, are among the highest in the world.³ High trade costs make the supply chain unreliable and unpredictable, preventing Nepalese firms from joining global and regional value chains. This has created conditions for weak export performance.⁴ As a TFA signatory, Nepal is committed to comply with its 36 measures, most of which relate to customs. These measures require reforms to legal/procedural issues, institutional frameworks, and human resources/training. Nepal's compliance with the TFA to date is the worst in South Asia and among the worst in the world (Appendix 4).

3. ADB has been supporting trade facilitation in Nepal through improved automation, as well as through policy reforms and related capacity building.⁵ Together with other development partners,⁶ ADB has helped improve customs formalities (automation, procedures, and documents) and availability of trade-related information. ADB and other development partners have supported the Department of Customs (DOC) in (i) preparing for accession to the Revised Kyoto Convention;⁷ (ii) formulating an e-Customs master plan; (iii) rolling out the Automated

¹ The Program is included in ADB. 2016. *Country Operations Business Plan: Nepal, 2017–2019*. Manila; and ADB. 2015. *Regional Cooperation Operation Business Plan: South Asia, 2016–2018*, as a national project with regional implications.

² Nepal is a founding member of the ADB-supported regional cooperation program since 2001, whose priority sectors have been trade facilitation, transport and energy. Other members are Bangladesh, Bhutan, India, Maldives, and Sri Lanka.

³ In the World Bank's 2016 Logistics Performance Index, Nepal was ranked 124th of 160 countries for overall performance, and 149th for the efficiency of customs and border management clearance. Nepal's cost of exporting a container in 2014 was \$2,545 and importing one cost \$2,650. The South Asian average cost to export a container was \$1,923 and importing a container cost \$2,118. World Bank. 2014. *World Integrated Trade Solution*. Washington, DC.

⁴ Nepal has a high negative trade balance of \$6.25 billion (2015) or 30% of gross domestic product (GDP). Manufactured commodities made with or from imported goods are among its top 10 merchandise exports, including garments, apparel, iron and steel articles, footwear, and beverages.
<http://wits.worldbank.org/CountrySnapshot/en/NPL>.

⁵ ADB. 2010. *Subregional Transport Enhancement Project*. Manila (L2685/G0225); ADB. 2012. *South Asia Subregional Economic Cooperation Trade Facilitation Program*. Manila (G0332); and ADB. 2013. *Technical Assistance to Nepal for Supporting Participation in the South Asia Subregional Economic Cooperation Trade Facilitation Program*. Manila.

⁶ The two main development partners with ongoing initiatives in Nepal's trade facilitation sector and with whom ADB is regularly consulting are the World Bank Group and the World Customs Organization (Appendix 4).

⁷ The International Convention on the Simplification and Harmonization of Customs Procedures, developed by the World Customs Organization, were revised and entered into force in February 2006. Nepal's parliament ratified the convention in September 2016.

System for Customs Data (ASYCUDA) World; (iv) establishing customs client service desks; and (v) improving the DOC website.

4. Much remains to be done to simplify, harmonize and modernize Nepal's trade processes. Nepal's 2015 WTO TFA gap assessment and implementation action plan⁸ calls for implementing 31 of the 36 measures within 2 to 5 years of TFA's entry into force. These include measures to further simplify trade documentation, enable advance rulings, promote automation, and implement related institutional arrangements. Incorporating the TFA provisions into the Customs Act and other related legislation is crucial to ensuring the benefits of these reforms. Based on studies, developing countries, including Nepal, are expected to benefit most from TFA implementation in terms of lower trade costs, faster export growth, more gross domestic product (GDP) growth, and increased revenue collection.⁹

5. Trade facilitation is a priority in Nepal's national development agenda, ADB's Country Partnership Strategy 2013–2017,¹⁰ and the ADB-assisted SASEC program. The Fourteenth Plan, FY2017–FY2019¹¹ contains trade facilitation-related policy actions under the commerce sector. Its key priorities include lowering trade transaction costs by simplifying trade processes and reforming institutions. Similarly, the Nepal Trade Integration Strategy 2016¹² cites lower customs clearance costs as a way to improve export competitiveness. The SASEC Operational Plan 2016–2025 and the SASEC Trade Facilitation Strategic Framework 2014–2018 envisage greater harmonization of trade procedures among the SASEC countries.¹³ Given its long-standing support to the SASEC program, particularly in the trade facilitation sector, ADB is well placed to assist Nepal in implementing reforms to comply with the TFA.

6. Policy-based lending is the most appropriate instrument to help the government comply with the time-bound obligations under the TFA. Among the TFA measures, the proposed Program will target those which: (i) will build on ADB's past support to DOC; (ii) are complementary with the government's and other development partners' ongoing activities; and (iii) have the largest impact on trade flows (Appendix 4). The required policy reforms—which include those related to regulations, procedures, and automation at the field level—will be captured in the proposed policy actions. They incorporate knowledge gained from sustained ADB policy dialogue and ongoing capacity building. The government's performance in meeting scheduled milestones will guide tranche releases.

⁸ The gap analysis was conducted with technical assistance from the World Bank Group. World Bank Group. 2015. *World Trade Organization Trade Facilitation Agreement—Nepal Gap Assessment and Implementation Action Plan (Final Report)*. Washington, DC. [restricted distribution]. ADB reviewed the draft versions and provided input.

⁹ TFA implementation will increase global merchandise exports by as much as \$1 trillion per annum. WTO. 2015. *World Trade Report 2015—Speeding up Trade: Benefits and Challenges of Implementing the WTO Trade Facilitation Agreement*, Geneva. The Organisation for Economic Co-operation and Development (OECD) states that lower trade costs from full TFA implementation could reach 16.5% of total costs for low income countries, while the worldwide trade costs could be reduced by 12.5–17.5%. OECD. 2015. *Implementation of the WTO Trade Facilitation Agreement: The Potential Impact on Trade Costs*.

¹⁰ ADB. 2013. *Country Partnership Strategy: Nepal, 2013–2017*. Manila. Its aims include enhanced global–local connectivity to facilitate regionally balanced and inclusive growth.

¹¹ Government of Nepal. National Planning Commission. 2016. *Approach Paper of the Fourteenth Plan, FY2017–FY2019*. Kathmandu.

¹² Government of Nepal. Ministry of Commerce. 2016. *Nepal Trade Integration Strategy 2016*, Kathmandu.

¹³ ADB. 2016. *South Asia Subregional Economic Cooperation Program Operational Plan, 2016–2025*, Manila; ADB. 2014. *South Asia Subregional Economic Cooperation Trade Facilitation Strategic Framework 2014–2018*. Manila.

B. Impacts, Outcome, and Outputs

7. The Program's impacts will be (i) Nepal's exports expanded and export competitiveness increased and (ii) faster, cheaper, more predictable, and more secure cross-border trade and transport in the SASEC region achieved. The first is aligned with the government's vision articulated in the Fourteenth Plan, FY2017–FY2019 and the Nepal Trade Integration Strategy 2016. The second contributes to realizing SASEC Operational Plan 2016–2025's vision (para. 5). The outcome will be Nepal's trade processes simplified, harmonized and modernized to international standards. The expected outputs¹⁴ will be (i) measures to simplify trade documentation proposed to the Cabinet; (ii) issuance of advance rulings enabled; (iii) application of advanced customs automation system increased; and (iv) institutional capacity strengthened. The preliminary design and monitoring framework is in Appendix 1.

C. Program Costs and Financing Plans

8. The tentative financing plan is in Table 1. It was prepared based on the (i) analysis of the government's budget deficit and the development financing needs, (ii) analyses of DOC's annual budget allocations to implement the Customs Reform and Modernization Strategies and Action Plan (CRMSAP) in the preceding years, and (iii) existing studies on TFA implementation costs (Appendix 5: Development Financing Needs). The funds will be released in two tranches—\$7 million on loan effectiveness, and \$14 million approximately 24 months later—once the government has complied with the policy conditions.

Table 1: Tentative Financing Plan

Source	Amount (\$ million)	Share of Total (%)
Asian Development Bank		
Concessional ordinary capital resources (COL) (loan) ^a	21.00	100.00
Total	21.00	100.00

^a Total program loan of \$21.0 million is a mixture of \$14.0 million sourced from the Asian Development Fund regional pool for 2017–2018, and the remaining \$7.0 million from the country allocation. Source: Asian Development Bank estimates.

D. Indicative Implementation Arrangements

9. The executing and implementing agency will be the DOC. The proposed Program will be implemented over 4 years from July 2017, coinciding with the national strategy of CRMSAP 2017–2021, which is being prepared. The existing Customs National Trade Facilitation Committee,¹⁵ chaired by the Director General of the DOC, will serve as a program steering committee to guide and monitor implementation. A program management unit will be formed at the working level.

¹⁴ ADB will provide a stand-alone capacity development technical assistance (TA) of \$1 million to help DOC achieve the Program outputs. An ADB trust fund will finance the capacity development TA on a grant basis, and ADB will administer it. The key outputs of the TA will be: (i) proposed legal text for the revised Customs Act formulated, together with associated handbooks and standard operating procedures; (ii) configuration of the customs management automation system toward "paperless" declaration processing completed; (iii) stakeholder awareness on new customs reform measures increased; and (iv) advanced knowledge and skills among the customs officials in automation, procurement, new business processes and monitoring and evaluation fostered.

¹⁵ Members of the committee include DOC, as well as public- and private-sector representatives. The committee meets approximately every 4 months.

II. DUE DILIGENCE REQUIRED

10. A program impact assessment to project the economic benefit of the government's reform agenda will supplement (i) the sector assessment and (ii) the risk assessment and risk management plan. The initial poverty and social analysis is in Appendix 3.

III. PROCESSING PLAN

A. Risk Categorization

11. The Program is categorized as low risk, based on (i) the loan size below \$50 million; (ii) ADB's sound record in Nepal's trade facilitation sector;¹⁶ (iii) the DOC's reasonable track record in implementing externally financed projects;¹⁷ and (iv) absence of anticipated safeguard issues related to environment, resettlement, and indigenous peoples.

B. Resource Requirements

12. The Program will require 7 staff members: 1 lead international staff (10 person-months), 1 economist (1.5 months), and 2 national staff (8 person-months) from the South Asia Regional Cooperation and Operations Coordination Division (SARC); 1 finance specialist from the South Asia Office of the Director General (1 person-month); 1 counsel from the Office of the General Counsel (2 person-months), and 1 staff member from the Nepal Resident Mission (3 person-months). Preparatory work for the proposed program design is also supported by the international and national consultants under ADB's ongoing technical assistance.¹⁸

C. Processing Schedule

13. The proposed processing schedule is detailed in Table 2.

Table 2: Proposed Processing Schedule

Milestones	Expected Completion Date
Concept clearance	November 2016
Loan fact finding	January 2016
Management review meeting	March 2017
Loan negotiations	April 2017
Board consideration	June 2017
Loan signing	July 2017
Loan effectiveness/first tranche release	August 2017

Source: Asian Development Bank.

IV. KEY ISSUES

14. The key issues include (i) ensuring effective and practicable implementation arrangements to overcome government capacity constraints; (ii) ensuring continuation of the key staff in the relevant DOC sections, especially during the Program implementation period; and (iii) sustaining the reform momentum amid frequent changes in government.

¹⁶ The tranches of the earlier program grant G0332 were released and the program closed in a timely manner. Implementation of the customs automation component of the ongoing transport project L2685/G0225 is on track (footnote 2).

¹⁷ The DOC is one of the executing agencies of the World-Bank-funded Nepal-India Regional Trade and Transport Project (Appendix 4). Implementation status as of March 2016 is rated as "moderately satisfactory." <http://www.worldbank.org/projects/P144335/nepal-india-trade-transport-facilitation-project?lang=en>.

¹⁸ ADB. 2013. *Technical Assistance to Nepal for Supporting Participation in the South Asia Subregional Economic Cooperation Trade Facilitation Program*. Manila.

DESIGN AND MONITORING FRAMEWORK

Impacts the Program is aligned with:

- a. Nepal's exports expanded and export competitiveness increased (The Fourteenth Plan, FY2017–FY2019; Nepal Trade Integration Strategy 2016)^a
- b. Faster, cheaper, more predictable, and more secure cross-border trade and transport in the South Asia Subregional Economic Cooperation (SASEC) region achieved (SASEC Operational Plan 2016–2025)^b

Program Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting	Risks
<p>Outcome</p> <p>Nepal's trade processes simplified, harmonized and modernized to international standards</p>	<p>By 2022:</p> <p>An overall score of 1.3 on OECD TFIs attained (2015 Baseline: 0.8)</p> <p>National legislation made fully compliant with the Revised Kyoto Convention General Annex in all 122 general standards (2016 Baseline: 101 general standards compliant)</p> <p>80% of the total cargoes cleared on the green lane (2016 Baseline: 40%)</p> <p>90% of the total number of declarations processed by ASYCUDA World (2015 Baseline: 0%)</p>	<p>OECD TFIs</p> <p>2021 Report on Revised Kyoto Convention General Annex compliance (Department of Customs)</p> <p>ASYCUDA World statistics (Department of Customs)</p> <p>ASYCUDA World statistics and Customs Annual Report (Department of Customs)</p>	<p>Political instability leads to government and parliament inaction in approving reform measures.</p>
<p>Outputs^c</p> <p>1. Measures to simplify trade documentation proposed to the Cabinet</p>	<p>By 2021:</p> <p>1a. Draft amendments to legislation submitted to the Cabinet on acceptance of copies, reduction of the required number of documents, and processing of online submissions</p> <p>1b. Formal rules on acceptance of duplicate or electronic copies developed</p> <p>1c. Time Release Studies conducted in major customs points</p>	<p>1a. Text of draft legislations and proposal for amendments (Ministry of Finance)</p> <p>1b. Text of formal rules (Department of Customs)</p> <p>1c. Time Release Study reports (Department of Customs)</p>	<p>Completion of customs reforms is hampered by personnel changes and vested interests.</p> <p>Progress in staff capacity development lags behind the reform action plans.</p>

Program Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting	Risks
2. Issuance of advance rulings enabled	<p>By 2021:</p> <p>2a. Legal text on advance rulings submitted to the Cabinet for approval to incorporate in the revised Customs Act</p> <p>2b. Implementing rules and procedures on advance rulings developed in a manual</p> <p>2c. Organizational unit on advance rulings established with clear terms of reference</p> <p>2d. ASYCUDA World functionality on advance rulings configured and tested</p>	<p>2a. Text of draft Customs Act (Ministry of Finance)</p> <p>2b. A manual on rules and procedures (Department of Customs)</p> <p>2c. Customs annual report (Department of Customs)</p> <p>2d. Customs Annual Report (Department of Customs)</p>	
3. Application of advanced automated system increased	<p>By 2021:</p> <p>3a. Draft amendments to legislation submitted for Cabinet approval on: broader rights to release imported goods before final determination of duty and tax; full application of customs control on the basis of risk; and expedited shipment</p> <p>3b. Electronic Transactions Act amended to permit electronic payment of customs duties and other charges</p> <p>3c. Implementation policies, guidelines, and rules drafted and approved regarding the release of goods before final determination of duty and tax, expedited shipment, and pre-arrival processing of cargo</p>	<p>3a. Text of draft legislations and proposal for amendments (Ministry of Finance)</p> <p>3b. Amended Electronic Transactions Act (Ministry of Science, Technology and Environment)</p> <p>3c. Text of policies, guidelines and rules (Department of Customs)</p>	

Program Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting	Risks
	<p>3d. ASYCUDA World configured and tested to include expedited shipment, selectivity module, performance measurement, auditing, and pre-arrival processing</p> <p>3e. Customs officials trained, infrastructure prepared, and advocacy sessions conducted to process pre-arrival clearance at three major Customs offices</p>	<p>3d. Customs annual report (Department of Customs)</p> <p>3e. Customs annual report and ASYCUDA statistics (Department of Customs)</p>	
4. Institutional capacity strengthened	<p>By 2021:</p> <p>4a. Directives issued to establish new organizational structures</p> <p>4b. Multi-year capacity development program launched</p> <p>4c. Automated performance monitoring mechanism launched</p>	<p>4a. Ministry of Finance directives</p> <p>4b. Customs Annual Report (Department of Customs)</p> <p>4c. Customs Annual Report (Department of Customs)</p>	
Key Activities and Milestones			
Not applicable			
Inputs			
ADB: \$ 21 million (loan)			
Assumptions for Partner Financing			
Outputs not administered by ADB that are necessary to reach the outcome include: National Single Window launched, trade laboratories improved, Trade Portal launched, National Trade Facilitation Committee strengthened, India–Nepal transit arrangements facilitated, and risk management system improved (the World Bank Group) (Appendix 4).			

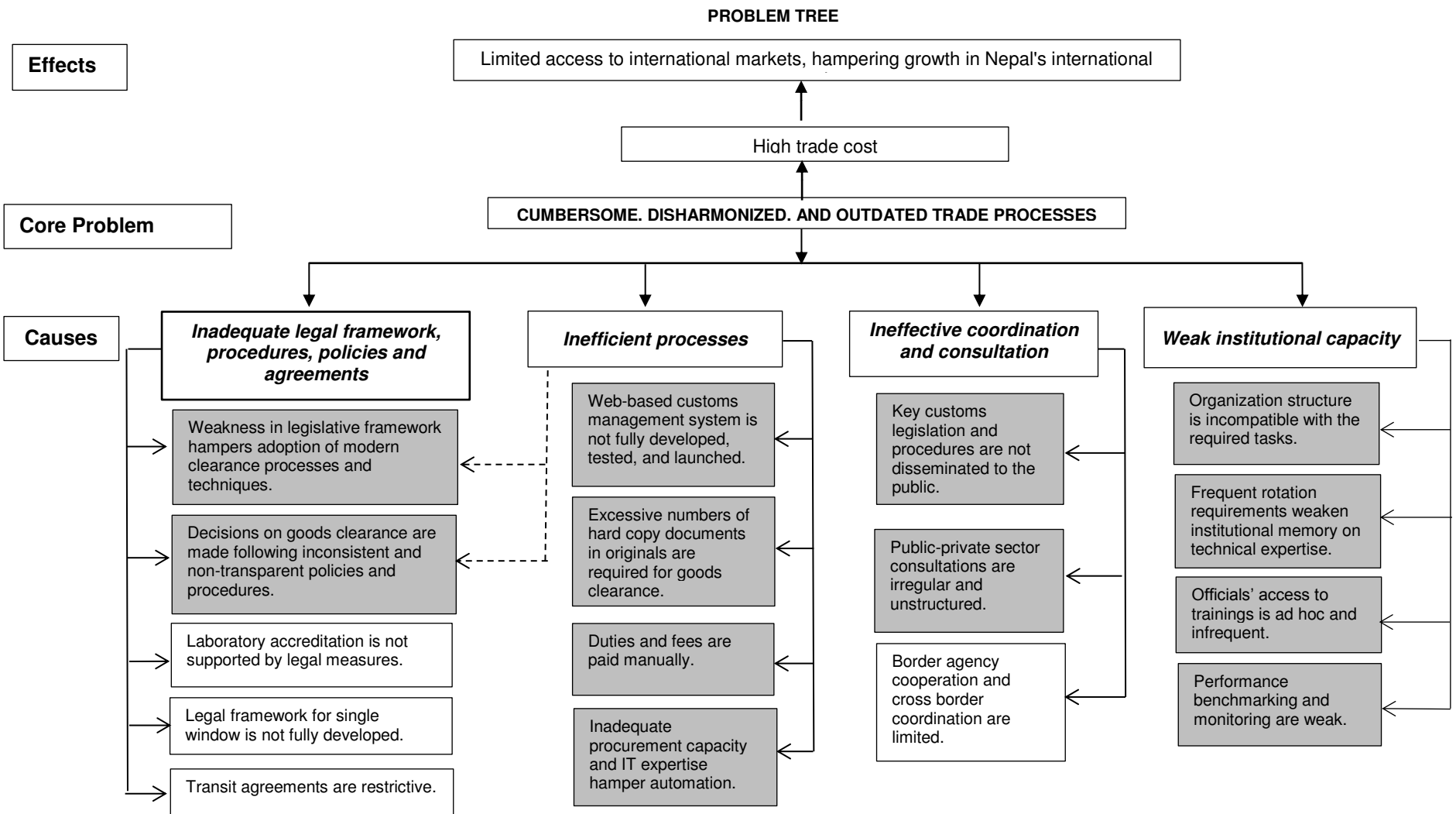
ADB = Asian Development Bank; ASYCUDA = Automated System for Customs Data; OECD = Organisation for Economic Co-operation and Development; SASEC = South Asia Subregional Economic Cooperation; TFI = Trade Facilitation Indicator.

^a Government of Nepal, National Planning Commission. 2016. *Approach Paper of the Fourteenth Plan, FY2017–FY2019*. Kathmandu; Government of Nepal, Ministry of Commerce. 2016. *Nepal Trade Integration Strategy 2016*. Kathmandu.

^b ADB. 2016. *South Asia Subregional Economic Cooperation Program Operational Plan, 2016–2025*, Manila.

^c Baselines for all output indicators are not applicable.

Source: Asian Development Bank.



INITIAL POVERTY AND SOCIAL ANALYSIS

Country:	Nepal	Project Title:	South Asia Subregional Economic Cooperation Customs Reform and Modernization for Trade Facilitation
Lending/Financing Modality:	Policy-Based Lending	Department/ Division:	SARD/SARC

I. POVERTY IMPACT AND SOCIAL DIMENSIONS

A. Links to the National Poverty Reduction Strategy and Country Partnership Strategy

Nepal aspires to graduate from least development country status by 2022 and become a middle-income country by 2030. The Fourteenth Plan, FY2017–FY2019 aims to facilitate socioeconomic transformation and poverty reduction through high economic growth with productive employment and equitable distribution of resources. The Fourteenth Plan aims to reduce the number of poor people to 16.0% of the population from the current estimate of 21.6% and achieve annual gross domestic product growth of 7.1% per year, with non-agricultural growth estimated at 8.3% per year. The Country Partnership Strategy (CPS) for Nepal (2013–2017) is in line with the national development goals and aims to enhance global–local connectivity to facilitate regionally balanced and inclusive growth, and prioritizes investment on transport (among other things). This is to be complemented by investments in customs modernization, coordinated through the South Asia Subregional Economic Cooperation (SASEC) program. The proposed program is fully aligned with the CPS, and will indirectly reduce poverty.

According to the Organisation for Economic Co-operation and Development (OECD) and the World Trade Organization (WTO), lower trade costs mean more trade, and potentially higher incomes, with distributional impacts within countries.¹ Lower trade costs may indirectly help reduce poverty by promoting export diversification, participation in global value chains, export opportunities for small- and medium-sized enterprises, improvements to government revenue collection, and increased attractiveness for foreign direct investment. The proposed Program aims to improve the efficiency and reduce the costs of imports and exports, contributing indirectly to Nepal's broader development goal of export promotion and diversification. The Program will enhance ongoing efforts in customs modernization, and will closely align with the government's next phase of the Customs Reform and Modernization Strategies and Action Plan (CRMSAP) 2017–2021, which is being developed with ADB technical assistance.² It will build on the ongoing ADB support in customs automation by triggering the requisite legal and procedural reforms to maximize the use of automation tools. The Program will also initiate institutional and human resource capacity building to support full automation of customs clearance procedures at Nepal's major customs offices. The Program targets issues that have a high potential to reduce Nepal's trade costs. The OECD Trade Facilitation Indicators (TFIs) estimate that trade costs in low-income countries can drop by as much as 16.5% in low-income countries as a result of full implementation of the WTO Trade Facilitation Agreement.

B. Poverty Targeting

General Intervention Individual or Household (TI-H) Geographic (TI-G) Non-Income MDGs (TI-M1, M2, etc.)

The Program is classified as general intervention. It does not specifically target the poor, but it indirectly reduces poverty through export diversification gains, participation in global value chains, greater export opportunities for small- and medium-sized enterprises, improved revenue collection, and increased attractiveness of Nepal as a destination for foreign direct investment.

¹ OECD/WTO. 2015. *Aid for Trade at a Glance 2015: Reducing Trade Costs for Inclusive Sustainable Growth*, OECD Publishing. Paris.

² ADB. 2013. *Technical Assistance to Nepal for Supporting Participation in the South Asia Subregional Economic Cooperation Trade Facilitation Program*. Manila.

C. Poverty and Social Analysis

1. Key issues and potential beneficiaries.

Gains from customs modernization will facilitate the growth of small- and medium-sized enterprises, particularly export-oriented businesses, which will support entrepreneurs nationwide. Nepal, which depends heavily on imports, including essential food items, will also likely benefit from lower costs of essential commodities, in turn boosting household savings. Finally, increased revenue collection by the customs administration (which collected 42% of government revenue in FY2015, inclusive of the value-added tax and excise on import, together with the customs duty, which constituted 18% of the total revenue)³ will help the government finance targeted poverty reduction programs, including financing the expanding social protection programs.

2. Impact channels and expected systemic changes.

The Program's longer term benefits include reducing trade barriers, thereby contributing to prosperity and welfare. Studies have cited improved trade (and therefore higher economic growth) as a contributor to export competitiveness, private sector development, foreign direct investment, market integration, and employment opportunities. The Program's more direct beneficiaries could include smaller firms (with limited resources to cope with burdensome controls), exporters and producers of goods, as well as freight operators. Producers of agricultural and other perishable goods are likely beneficiaries; delivery delays can reduce the value of their goods. Cumbersome customs procedures may matter most for the rural poor because their export products are often perishable. Consumers may gain access to higher quality and lower priced goods.

3. Focus of (and resources allocated in) the PPTA or due diligence. Not Applicable

4. Specific analysis for policy-based lending.

There are three major channels through which trade affects households: (i) the distribution channel, relating to changes in prices of goods and services; (ii) the enterprise channel, relating to changes in profits, wages, and employment; and (iii) the government channel, relating to changes in taxes and transfers. The Program's proposed reforms will have an indirect impact on poverty through all three channels leading to more economic growth, employment, and income opportunities.

II. GENDER AND DEVELOPMENT

1. What are the key gender issues in the sector/subsector that are likely to be relevant to this project or program?
This Program does not have direct gender consequences. Women's participation in Nepal's business sector is low but growing in micro and small enterprises particularly in the agriculture sector and handicrafts. The Program's indirect impacts will benefit women entrepreneurs.

2. Does the proposed project or program have the potential to make a contribution to the promotion of gender equity and/or empowerment of women by providing women's access to and use of opportunities, services, resources, assets, and participation in decision making?
 Yes No Please explain.

The gender effects will be indirect, through higher economic growth and poverty reduction. Women traders may find increased access to trade opportunities, benefiting from the automation of customs procedures, which will drive down the cost of doing business, and thereby making small and medium enterprises profitable for exports.

3. Could the proposed project have an adverse impact on women and/or girls or widen gender inequality?
 Yes No Please explain

The program does not involve any specific gender issues.

4. Indicate the intended gender mainstreaming category:
 GEN (gender equity) EGM (effective gender mainstreaming)
 SGE (some gender elements) NGE (no gender elements)

III. PARTICIPATION AND EMPOWERMENT

1. Who are the main stakeholders of the project, including beneficiaries and negatively affected people? Identify how they will participate in the project design.

Ministry of Finance, Department of Customs, customs field offices, other trade-related government ministries (Ministry of Commerce, Ministry of Agricultural Development, Ministry of Industry), banks, manufacturers, producers of agricultural goods, traders, freight forwarders, customs agents, among others. They are represented in the Customs National Trade Facilitation Committee, which will act as the project steering committee. Local/provincial customs trade facilitation committees are established at towns and cities of main border crossing points with comparable membership.

³ Government of Nepal. Ministry of Finance. 2016. *Budget Speech of Fiscal Year 2016/2017*. Kathmandu.

<p>2. How can the project contribute (in a systemic way) to engaging and empowering stakeholders and beneficiaries, particularly, the poor, vulnerable and excluded groups? What issues in the project design require participation of the poor and excluded?</p> <p>Regular coordination meetings through the Customs National Trade Facilitation Committee will create opportunities for public-private dialogue. Service-users of border clearance can be engaged in these consultations and raise their views, including small and medium scale enterprises.</p>
<p>3. What are the key, active, and relevant civil society organizations in the project area? What is the level of civil society organization participation in the project design?</p> <p>(L) Information generation and sharing (L) Consultation (L) Collaboration (L) Partnership</p> <p>Not applicable</p>
<p>4. Are there issues during project design for which participation of the poor and excluded is important? What are they and how shall they be addressed? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No Please explain.</p> <p>Not applicable.</p>
IV. SOCIAL SAFEGUARDS
<p>A. Involuntary Resettlement Category <input type="checkbox"/> A <input type="checkbox"/> B <input checked="" type="checkbox"/> C <input type="checkbox"/> FI</p>
<p>1. Does the project have the potential to involve involuntary land acquisition resulting in physical and economic displacement? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No</p> <p>2. What action plan is required to address involuntary resettlement as part of the PPTA or due diligence process?</p> <p><input type="checkbox"/> Resettlement plan <input type="checkbox"/> Resettlement framework <input type="checkbox"/> Social impact matrix</p> <p><input type="checkbox"/> Environmental and social management system arrangement <input checked="" type="checkbox"/> None</p>
<p>B. Indigenous Peoples Category <input type="checkbox"/> A <input type="checkbox"/> B <input checked="" type="checkbox"/> C <input type="checkbox"/> FI</p>
<p>1. Does the proposed project have the potential to directly or indirectly affect the dignity, human rights, livelihood systems, or culture of indigenous peoples? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No</p> <p>2. Does it affect the territories or natural and cultural resources indigenous peoples own, use, occupy, or claim, as their ancestral domain? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No</p> <p>3. Will the project require broad community support of affected indigenous communities? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No</p> <p>4. What action plan is required to address risks to indigenous peoples as part of the PPTA or due diligence process?</p> <p><input type="checkbox"/> Indigenous peoples plan <input type="checkbox"/> Indigenous peoples planning framework <input type="checkbox"/> Social Impact matrix</p> <p><input type="checkbox"/> Environmental and social management system arrangement <input checked="" type="checkbox"/> None</p>
V. OTHER SOCIAL ISSUES AND RISKS
<p>1. What other social issues and risks should be considered in the project design? None.</p> <p><input type="checkbox"/> Creating decent jobs and employment <input type="checkbox"/> Adhering to core labor standards <input type="checkbox"/> Labor retrenchment</p> <p><input type="checkbox"/> Spread of communicable diseases, including HIV/AIDS <input type="checkbox"/> Increase in human trafficking <input type="checkbox"/> Affordability</p> <p><input type="checkbox"/> Increase in unplanned migration <input type="checkbox"/> Increase in vulnerability to natural disasters <input type="checkbox"/> Creating political instability</p> <p><input type="checkbox"/> Creating internal social conflicts <input type="checkbox"/> Others, please specify _____</p> <p>2. How are these additional social issues and risks going to be addressed in the project design? None of the social issues and risks will be associated with the Program.</p>
VI. PPTA OR DUE DILIGENCE RESOURCE REQUIREMENT
<p>1. Do the terms of reference for the PPTA (or other due diligence) contain key information needed to be gathered during PPTA or due diligence process to better analyze (i) poverty and social impact; (ii) gender impact, (iii) participation dimensions; (iv) social safeguards; and (v) other social risks. Are the relevant specialists identified?</p> <p><input type="checkbox"/> Yes <input checked="" type="checkbox"/> No (not applicable)</p>
<p>2. What resources (e.g., consultants, survey budget, and workshop) are allocated for conducting poverty, social and/or gender analysis, and participation plan during the PPTA or due diligence? Not applicable.</p>

NEPAL'S COMPLIANCE WITH THE TRADE FACILITATION AGREEMENT OF THE WORLD TRADE ORGANIZATION (SUMMARY)

1. In December 2013 the World Trade Organization (WTO) forged the Trade Facilitation Agreement (TFA), a multilateral agreement to address key non-tariff barriers to trade. At this time, Nepal made time-bound commitments to implement 36 measures—most of them related to customs—in the areas of legal/procedural reforms, the institutional framework, and human resources/training. TFA implementation is expected to lower trade costs and support growth in exports and in gross domestic product (GDP). It will also help export diversification, participation in global value chains, greater export opportunities for small- and medium-sized enterprises, improved revenue collection, and increased attractiveness of the country as a destination for foreign direct investment.¹

2. **Customs Reform Modernization Strategies and Action Plan (CRMSAP).** The Department of Customs (DOC) has been implementing the CRMSAP since 2003 in phases, each phase programmed for 3 to 4 years. The fourth-phase CRMSAP, 2013–2017 aims to improve customs services in four areas: (i) trade facilitation, (ii) enforcement and compliance, (iii) organizational development, and (iv) e-Customs.² DOC is currently formulating with ADB technical assistance³ the fifth-phase CRMSAP, 2017–2021. On finalization, the CRMSAP's action plans are expected to be consistent with Nepal's schedule for implementing WTO TFA. The successive phases of CRMSAP have brought Nepal closer to TFA compliance.

3. **Current status of compliance with WTO TFA.** Of the 36 TFA reform measures, 2 are fully aligned, 11 substantially aligned, and 16 partially aligned, with 7 in need of actions to commence, according to the government's 2015 WTO TFA gap assessment and implementation action plan.⁴ This government's action plan—in which it committed to implement 31 of the 36 measures 2 to 5 years after the TFA's entry into force⁵—lists 104 actions, 82 of them in the areas of legal/procedural reforms, the institutional framework, and human resources/training. The remaining actions largely concern infrastructure/equipment and communications/information technology. The gap assessment also underscored DOC's central role in TFA compliance: 21 of the 36 measures require DOC to lead or implement reforms alone. Of the remaining 15 measures, 13 require DOC to play a substantial part. Only two measures had no explicit role for DOC.

4. The Organisation for Economic Co-operation and Development (OECD) developed a tool to assess country-level compliance with the TFA. In 2015, Nepal scored 0.8 on a scale of 0 to 2 (2 being the best possible performance), making Nepal the lowest ranking country in South

¹ Basnett, Y. and Massa, I. May 2015. *Trade Facilitation: Rapid Evidence Assessment*, Overseas Development Institute, London.

² Government of Nepal, Ministry of Finance. Department of Customs. 2013. *Customs Reform and Modernization Strategies and Action Plan 2013-2017*. Kathmandu.

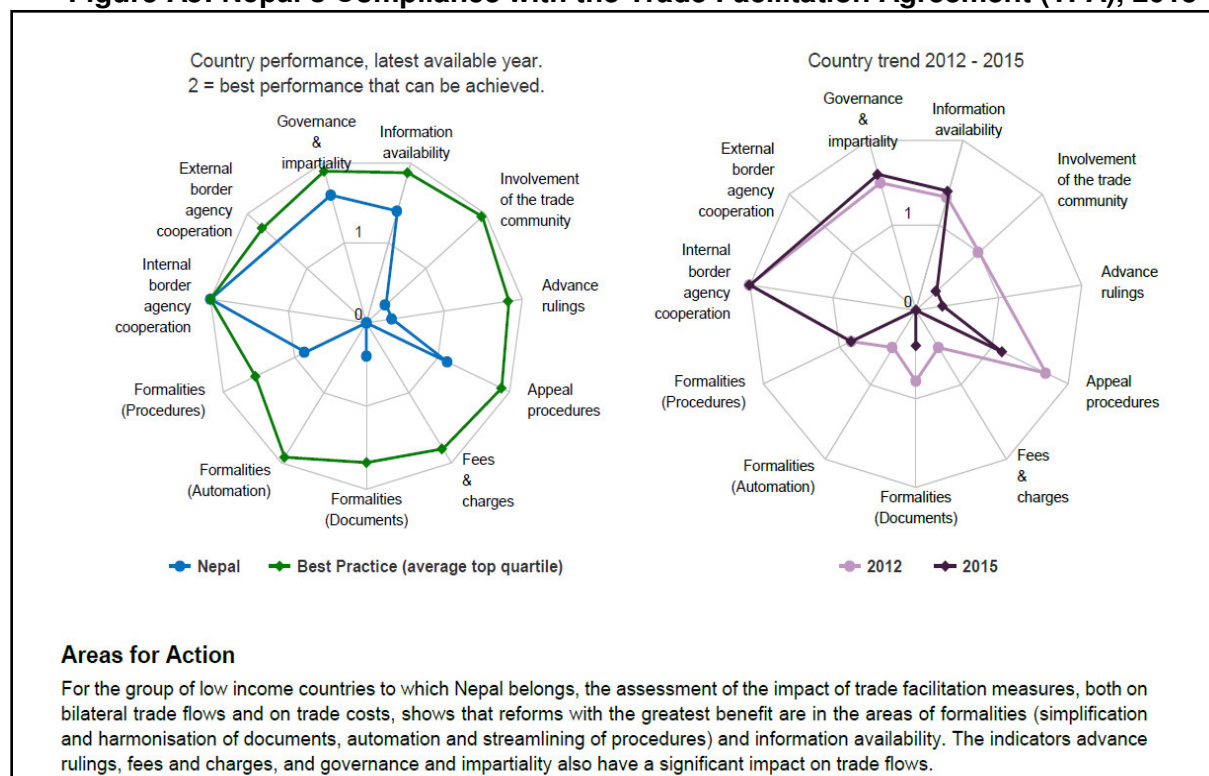
³ ADB. 2013. *Technical Assistance to Nepal for Supporting Participation in the South Asia Subregional Economic Cooperation Trade Facilitation Program*. Manila.

⁴ The gap analysis was conducted with technical assistance from the World Bank Group. World Bank Group. 2015. *World Trade Organization Trade Facilitation Agreement—Nepal Gap Assessment and Implementation Action Plan (Final Report)*. Washington, DC. [restricted distribution]. ADB reviewed draft versions and provided input.

⁵ The entry into force is expected to be declared within 2016, when two thirds of the members complete the domestic ratification process. As of August 2016, 91 out of the 164 WTO members have submitted their acceptance of TFA, including 11 least developed countries. Nepal's Ministry of Commerce submitted to the Cabinet in July 2016 the proposal for TFA accession.

Asia and among the lowest in the world.⁶ The OECD Country Note for Nepal (Figure A5) recommended changes that could most improve trade flows: (i) introduction of advance rulings; (ii) lower fees and charges; and (iii) better formalities (documents, automation, and procedures).

Figure A5: Nepal's Compliance with the Trade Facilitation Agreement (TFA), 2015



Source: OECD Trade Facilitation Indicators Country Note (Nepal).

5. **Development partner support and coordination.** Coordinated donor efforts have supported government efforts to improve trade facilitation. Recent and ongoing ADB support to DOC⁷ has contributed to improving TFIs on formalities (automation, procedures, and documents) and information availability. Notable support areas include actions to prepare Nepal to accede to the Revised Kyoto Convention,⁸ formulate an e-Customs master plan, roll out the Automated System for Customs Data (ASYCUDA World), establish customs client service desks, and improve the DOC website. Greater use of automation also improves the TFIs on governance, transparency, and impartiality by reducing face-to-face transactions in customs clearance. Support to ASYCUDA World—a pilot of which was rolled out in January 2016—triggers legal and procedural reforms to maximize the use of automation tools, and initiates institutional capacity building for fully automated clearance at Nepal's major customs offices.

⁶ Interactive tools on the OECD website allow users to compare country performance in WTO TFA across 11 indicators. <http://www.oecd.org/trade/facilitation/indicators.htm>. "Country Note – Nepal" was generated in June 2016. The 2015 ratings of other South Asian countries are: India (1.5), Sri Lanka (1.4), Bangladesh (1.1), Maldives (1.1), and Bhutan (0.9).

⁷ ADB. 2010. *Subregional Transport Enhancement Project*. Manila (L2685/G0225); ADB. 2012. *South Asia Subregional Economic Cooperation Trade Facilitation Program*. Manila (G0332); and ADB. 2013. *Technical Assistance to Nepal for Supporting Participation in the South Asia Subregional Economic Cooperation Trade Facilitation Program*. Manila.

⁸ The International Convention on the Simplification and Harmonization of Customs Procedures, originally developed by the World Customs Organization, and revised and entered into force in February 2006.

The World Bank Group has provided technical assistance to the government to conduct the TFA gap assessment.⁹ It has also been supporting Nepal's trade facilitation sector since June 2013 through its Nepal-India Regional Trade and Transport Project, which includes developing a National Single Window,¹⁰ designing a trade portal, and building capacity for the national trade facilitation committee, coupled with works on trade-related infrastructure. In terms of the OECD TFIs, the World Bank project will help improve internal and external border agency coordination, information availability, and involvement of the trading community, among other things. The World Bank project's contribution to automation is also high, given that the project is implemented in close coordination with ADB's support to ASYCUDA World. The National Single Window is expected to be interfaced with ADB-supported ASYCUDA, once both systems have been sufficiently developed and tested.¹¹ Other development partner initiatives include International Finance Cooperation's technical assistance to a customs risk management system and the World Customs Organization's joint initiative with ADB to provide training in valuation under the South Asia Subregional Economic Cooperation (SASEC) program.¹²

⁹ World Bank Group. 2015. *World Trade Organization Trade Facilitation Agreement—Nepal Gap Assessment and Implementation Action Plan (Final Report)*. Washington, DC. [restricted distribution].

¹⁰ The National Single Window 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. Other components of the World Bank project include support for testing facilities, the transit regime, and capacity building for the national trade facilitation committee.

<http://www.worldbank.org/projects/P144335?lang=en&tab=overview>

¹¹ The World Bank project's planned closing date is 31 December 2019. As of August 2016, the bidding process for the National Single Window had begun.

¹² <http://www.sasec.asia/index.php?page=event&eid=189&url=nep-second-natl-workshop-customs-valuation>.

DEVELOPMENT FINANCING NEEDS (SUMMARY)

1. The Government of Nepal has substantial financing needs. The fiscal deficit has averaged around 2% of gross domestic product (GDP) since 2000, and had lessened somewhat to 0.7% of GDP in 2015. The FY2017 budget projected the budget deficit for FY2017 to be NRs366.1 billion (\$3.5 billion), of which NRs195.7 billion (\$1.8 billion) or 53.5% was to be financed through foreign loans.¹ The Department of Customs (DOC) collects approximately 40% of total government revenue each year, with the FY2015 figure reaching NRs193.12 billion (42%, which includes the value-added tax and excise on import, in addition to the customs duty, which alone accounts for 18% of total government revenue). The proposed Program will enhance the DOC's capacity to collect government revenue.

2. The government requests the proposed four-year Program loan, indicatively set at \$21 million, based on the analysis of the DOC's budget over recent years. For FY2017, the DOC has a budget of NRs1.17 billion (\$11.02 million), which includes an ADB grant from an ongoing project and earlier tranche releases² worth a combined NRs799.91 million (\$7.48 million). The DOC's capital and recurrent expenditures in the preceding years have risen from \$8.80 million in FY2014 to \$10.01 million in FY2016, with ADB project and program support accounting for a significant percentage.³ The DOC, like the rest of the government, has low capacity to absorb funds. It is committed to meet annual budget expenditure targets, particularly to increase capital expenditures by fostering greater procurement capacity, which is a policy condition of the proposed Program.

3. The World Trade Organization (WTO) has noted challenges in calculating the costs of complying with the Trade Facilitation Agreement (TFA) and, more broadly, of undertaking trade facilitation reforms.⁴ Still, in 2015 the government with ADB technical assistance⁵ undertook a preliminary budgeting exercise for the pending reform measures, as part of the mid-term review of the ongoing Customs Reform and Modernization Strategies and Action Plan (CRMSAP) 2014–2017. Informed by relevant existing studies,⁶ this exercise identified remaining actions in CRMSAP 2014–2017, together with their budget requirements. The review estimated the cost of implementing the remaining reforms at \$19 million, excluding large-scale infrastructure. The next Customs Reform and Modernization Strategies and Action Plan (CRMSAP) 2017–2021 will include most of the remaining actions as well as new areas of work, such as establishment of a program for trusted traders or authorized economic operators. Its implementation is to be closely linked to the schedule of compliance with the WTO TFA measures.

¹ Figures on the government budget and revenue in paragraphs 1 and 2 are from Ministry of Finance. 2016. *Budget Speech of Fiscal Year 2016/2017*, Kathmandu.

² ADB. 2010. *Subregional Transport Enhancement Project*. Manila (L2685/G0225); and ADB. 2012. *South Asia Subregional Economic Cooperation Trade Facilitation Program*. Manila (G0332).

³ According to DOC's Budget Section, the shares of the two ADB project funds (footnote 2) in the total expenditures are: 17% (FY2014), 20% (FY 2015), and 26% (FY2016).

⁴ For instance, inception costs of customs automation alone may vary from \$550,000 to \$57 million, depending on the country. The difficulty of estimation stems from the fact that trade facilitation reforms are often deeply connected to broader policy objectives, and the costs vary considerably, depending on the type of measures and the country's level of economic development. See, "Implementation Costs of Trade Facilitation Reform", pp.116–124 in World Trade Organization. 2015. *World Trade Report 2015—Speeding up Trade: Benefits and Challenges of Implementing the WTO Trade Facilitation Agreement*, Geneva.

⁵ ADB. 2013. *Technical Assistance to Nepal for Supporting Participation in the South Asia Subregional Economic Cooperation Trade Facilitation Program*. Manila.

⁶ On the cost of TFA reforms, see also United Nations Conference on Trade and Development (UNCTAD). 2014. *The New Frontier of Competitiveness in Developing Countries: Implementing Trade Facilitation (Transport and Trade Facilitation Series No.5)*. Geneva. The mid-term review and its cost analyses were informed by previous studies on Nepal's trade facilitation sector. World Bank. 2013. *Nepal Trade Facilitation and Logistics Improvement Study: Customs Infrastructure Master Plan*. Washington, DC; and World Bank. 2013. *Nepal Trade Facilitation and Logistics Study: Master Plan*. Washington, DC.