



Program Information Document (PID)

Concept Stage | Date Prepared/Updated: 11-Nov-2020 | Report No: PIDC29600



BASIC INFORMATION

A. Basic Project Data

Country Nepal	Project ID P173982	Project Name Nepal Programmatic Fiscal Policy for Growth Recovery and Resilience DPC (P173982)	Parent Project ID (if any)
Region SOUTH ASIA	Estimated Board Date Feb 18, 2021	Practice Area (Lead) Macroeconomics, Trade and Investment	Financing Instrument Development Policy Financing
Borrower(s) Ministry of Finance	Implementing Agency Ministry of Finance		

Proposed Development Objective(s)

The program's development objectives are to (i) strengthen the regulatory and institutional framework to build back better and greener and (ii) enhance systems and regulations to protect the most vulnerable and support sustainable business growth.

Financing (in US\$, Millions)

SUMMARY

Total Financing	100.00
------------------------	--------

DETAILS

Total World Bank Group Financing	100.00
World Bank Lending	100.00

Decision

The review did authorize the preparation to continue

B. Introduction and Context

Country Context

Nepal's economy has been hit hard by COVID-19, primarily through the shock to the service sector and remittance inflows. Prolonged mobility restrictions from March to July - imposed to curtail the spread of the virus - have significantly impacted all sectors of the economy. The impact on tourism, transport, and associated services such as hotels and restaurants has been particularly devastating and is estimated to have caused about 1 million job losses. Remittance



inflows, a key driver of private consumption growth and poverty reduction, plummeted by 12.8 percent between mid-March and mid-July 2020 compared to the same period in the previous year, driven by a slowdown in outmigration due to the suspension of labor approvals for foreign employment in March, and subsequent border closures. As a result, there has been a sharp reduction in growth to 0.2 percent in FY20 from an average of 7.3 percent in FY17-FY19. As a third of Nepal's population lived close to the poverty line before the pandemic hit, poverty is likely to have increased due to COVID-19, with the poor and vulnerable suffering disproportionately from reduced remittances, foregone earnings from potential migration, job losses in the informal sector, and rising prices for essential goods.

The Government of Nepal's response to these challenges is a combination of health, economic and social support measures structured in three phases: "Relief, Recovery and Resilience" (3R). In the relief stage, emergency fiscal and monetary measures include higher health and social assistance spending, tax relief measures, relaxed liquidity provisions for the financial sector, lower interest rates, and the extension of loan repayment dates. In the recovery and resilience stages, the government will focus on revitalizing affected businesses in the agriculture, industry, tourism, and construction sectors, and invest in local market infrastructure. It also aims to adopt reforms to promote more sustainable, inclusive and resilient growth through investments in green infrastructure and adoption of climate-induced risk mitigation. The "forestry for prosperity" program, for example, is expected to create jobs while enhancing forest ecosystem services. The government also intends to invest in physical and digital infrastructure to promote increased connectivity and trade. Nepal is also participating in the G-20 debt service suspension initiative (DSSI), which is expected to free up at USD 29.8 billion of resources between May 1 and December 31, 2020.

COVID-19 has made the structural weaknesses of Nepal's economic model more apparent. While the economic contribution of agriculture has declined consistently over the last 20 years, the sector still accounts for over 30 percent of GDP and 62 percent of employment as low investment and access to finance limit formal firm growth. Nepal attracts the lowest share of foreign direct investment (FDI) to GDP in the region and MSMEs struggle with obtaining financing from the financial sector that predominately relies on conventional collateral-based lending. The tax system discourages private sector development, encourages informality and, in FY19, collected 46 percent of total revenue through distortionary border taxes which elevate production costs and generate an anti-export bias. As a result, in 2018, over 81 percent of employment was informal, with significantly more women relying on informal jobs. A lack of employment opportunities has caused 2.8 million predominately male Nepalese to work abroad, fueling remittance inflows that finance consumption, reduce export competitiveness, and foster import dependence. Nepal is also undergoing an ambitious transition to federalism and, since FY18, has devolved significant expenditure responsibility to 753 newly created municipalities and 7 provinces. Limited human resources, a fragmented public financial management system and confusion over concurrent responsibilities have resulted in service delivery gaps and exacerbated the underspending of capital budgets.

Relationship to CPF

The proposed operation supports three pillars of the FY19-FY23 Country Partnership Framework (CPF). They include (i) strengthening public institutions with an emphasis on improved budget and revenue management, (ii) private sector-led jobs and growth, and (iii) promoting inclusion and resilience. Reforms to strengthen domestic revenue generation, leverage FDI and foreign borrowing for growth, the building back greener agenda, and the strengthening of Nepal's social protection system are consistent with these pillars. This DPC series complements other on-going policy and investment lending operations such as the Finance for Growth DPC series, the Integrated Public Financial Management Reform Project, the COVID-19 Emergency Response and Health Systems Preparedness Project and the Youth Employment Transformation Initiative (YETI) project. Finally, the proposed DPC is complemented by technical support provided through the Nepal Federalism Support Platform, in close collaboration with other donors.



C. Proposed Development Objective(s)

The program's development objectives are to (i) strengthen the regulatory and institutional framework to build back better and greener and (ii) enhance systems and regulations to protect the most vulnerable and support sustainable business growth.

Key Results

The proposed operation supports reforms that aim to keep a line of sight towards addressing Nepal's long-term development challenges and provide support to individuals and firms affected by the crisis. Results to address Nepal's long-term development challenges to build back better and greener include (i) facilitating trade and reducing the reliance on import taxation; (ii) enhancing debt transparency and the management of public liabilities; (iii) improving the quality of public investment projects; (iv) expanding digital connectivity to bridge the digital divide; and (v) strengthening the climate-resilience of public infrastructure. Actions aimed at supporting individuals and firms aim at (i) providing social protection and strengthening the resilience of social protection systems; (ii) expanding access to services through increased use of electronic transfers; (iii) improving the delivery of health, education and social protection services at the subnational level; (iv) attracting foreign loans and investment to support firms, and (v) enhancing data production for decision-making.

D. Concept Description

The proposed operation for US\$ 100 million is the first in a series of three that will support the Government of Nepal's Relief, Restructuring, and Resilience (3R) plan to address the economic and social impacts of the COVID-19 pandemic. The operation is structured under two pillars, the first of which aims at strengthening the regulatory and institutional framework to build back better and greener (aligned with Pillar 4 of the [World Bank Group COVID-19 Crisis Response Approach Paper](#)). Proposed reforms focus on (i) reducing distortions in the tax and customs system through amendments to import taxes and a new Customs Bill, as well as adjustment to VAT exemption and corporate income tax incentives; (ii) enhancing debt management and transparency through the publication of debt bulletins and the implementation of a new Debt Management Bill, (iii) strengthening public capital spending through the implementation of a "National Project Bank"; (iv) bridging the digital divide by expanding broadband access and updating the digital legal framework and (v) strengthening the climate resilience of infrastructure through new Environmental Protection Regulations.

The second pillar of the operation aims to enhance systems and regulations to protect the most vulnerable and support sustainable business growth. Reforms under the second pillar are consistent with the priorities on "Protecting Poor and Vulnerable People" (Pillar 2) and "Ensuring Sustainable Growth and Job Creation" (Pillar 3) of the [WBG's COVID-19 Crisis Response Approach Paper](#). Proposed reforms focus on (i) compensating for the loss of livelihoods by expanding and strengthening the resilience of the social protection system; (ii) enabling digital government to people transfers to expand access to services; (iii) strengthening human capital investments through reforms to the intergovernmental system; (iv) alleviating constraints to attracting foreign investment and finance for the private sector (in collaboration with IFC); and (v) addressing critical gaps in Nepal's data system to support effective relief through proper monitoring and evaluation of the decentralized fiscal system.

Reforms from the proposed operation are closely aligned with the Government's 3R program as announced in the Budget Speech and the Monetary Policy statement. Actions and triggers under Pillar 1 support and complement the following areas of the GoN's 3R program: (i) enhancing resource management, debt transparency and the national project bank; (ii) supporting the digital economy; and (iii) focusing on a green and clean recovery helping ensure that



Nepal builds back in a manner that is environmentally sustainable and climate resilient and contributes to climate change mitigation. Reform measures under Pillar 2 support the GoN's special focus on the vulnerable segments of society, among others through the expansion of existing programs (as announced in the FY21 budget), the establishment of a social registry and the strengthening of human capital to support a resilient recovery. Reforms under pillar 2 are further aligned with the 3R program focus on facilitating digital payments, improving the investment climate and on facilitating capital inflows into Nepal. The operation has been prepared in close collaboration with the development partner community, through the government's high-level Advisory '3R' panel on appropriate policy responses to the COVID-19 crisis, the International Development Partner Group and the Economic Growth and Private Sector working groups. The operation has also been prepared in close collaboration with the Japanese International Cooperation Agency, which is considering providing parallel financing.

The Ministry of Finance (MOF) is responsible for coordinating the overall implementation of the DPC. The MOF has experience with World Bank policies and procedures through lending and technical assistance. A long history of budget support operations has built up some institutional capacity on data requirements and overall monitoring arrangements. A government steering committee, chaired by the Secretary of the Ministry of Finance, has been established to oversee, coordinate and monitor progress with reforms supported by the proposed operation. The availability and quality of data to monitor progress is generally good as Nepal has implemented the IMF's Enhanced General Data Dissemination System and regularly publishes data on the websites of MOF, the Nepal Rastra Bank and the Central Bureau of Statistics. Timely follow-up and close cooperation with development partners in the provision of technical assistance will further reinforce reform implementation and reform sustainability.

E. Poverty and Social Impacts, and Environmental, Forests, and Other Natural Resource Aspects

Poverty and Social Impacts

The operation is expected to generate positive effects on the poor and the bottom 40 percent of households. In the short to medium term, reforms to (i) improve access to existing social assistance transfers (i.e. the child grant) and local employment programs, as well as to (ii) improve the targeting of beneficiaries through enhanced availability and use of data are expected to benefit the poor and vulnerable. Reform measures to improve government effectiveness and public capital spending are also expected to indirectly benefit these groups, as more efficient investments in infrastructure and services can accelerate growth and job creation. In particular, improving the selection and prioritization of capital projects is critical to address the wide spatial heterogeneities in jobs and welfare across Nepal. Improved access to digital technologies in rural and remote areas is also expected to have positive distributional effects.

Environmental, Forests, and Other Natural Resource Aspects

The operation is expected to have mostly positive effects on the environment, forests and other natural resources. More stringent environmental assessment requirements supported as part of the Environmental Protection Rules and the environmental impact assessment for projects included in the National Project Bank are expected to support greater adherence to standards. The expansion of existing social protection measures will reduce the likelihood of poor households resorting to unsustainable extraction of forest products as a coping strategy to deal with the economic fallout of the COVID-19 pandemic. The extension of employment programs is also expected to benefit the environment by funding green infrastructure, ecological conservation and environmental protection activities. On the other hand, facilitated imports of health-related items is expected to have a negative impact due to the inadequate solid waste management system in Nepal. While solid waste collection rates vary, disposal is uniformly inadequate, leading to waste dumps on riverbanks or riverbeds. The World Bank's engagement in the sector through two ASAs in FY20 and the Nepal



Urban Governance Improvement Project, as well as technical assistance to several municipalities, is expected to mitigate such risks. In addition, weaknesses still remain in the regulatory framework governing environmental assessments of proposed investment projects. These are expected to be addressed through subsidiary regulations or guidelines, and through World Bank support to the implementation of the federalism capacity building plan.

CONTACT POINT

World Bank

Kenechukwu Maria Ezemenari, Florian Michael Blum
Senior Economist

Borrower/Client/Recipient

Ministry of Finance
The Secretary
Minister of Finance
moev@mof.gov.np

Implementing Agencies

Ministry of Finance
The Secretary
Finance
moev@mof.gov.np

FOR MORE INFORMATION CONTACT

The World Bank
1818 H Street, NW
Washington, D.C. 20433
Telephone: (202) 473-1000
Web: <http://www.worldbank.org/projects>

APPROVAL

Task Team Leader(s):

Kenechukwu Maria Ezemenari, Florian Michael Blum



Approved By

Country Director:	Lada Strelkova	11-Nov-2020
-------------------	----------------	-------------