



Program Information Document (PID)

Concept Stage | Date Prepared/Updated: 11-Feb-2022 | Report No: PIDC33538



BASIC INFORMATION

A. Basic Project Data

Country Nepal	Project ID P176498	Project Name Second Fiscal Policy for Growth, Recovery and Resilience Development Policy Credit (P176498)	Parent Project ID (if any) P173982
Region SOUTH ASIA	Estimated Board Date Oct 10, 2022	Practice Area (Lead) Macroeconomics, Trade and Investment	Financing Instrument Development Policy Financing
Borrower(s) Nepal	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
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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 had achieved respectable growth and poverty reduction before the pandemic, but many gains have been reversed by COVID-19. Growth averaged 4.9 percent between FY09 and FY19, fueled by remittance inflows that financed consumption and led to substantial poverty reduction. COVID-19 has reversed this trajectory and has led to the first



economic contraction in over three decades. At the same time the crisis has resulted in significant labor income shocks, with many workers reporting both earnings and job losses. Due to only a modest scale-up of social assistance programs in the immediate aftermath of the crisis there is a high risk that COVID will lead to persistent increases in poverty and inequality.

Nepal faces significant structural challenges to an inclusive and resilient recovery from the pandemic. The first challenge is of a fiscal nature: The country has experienced a rapid increase in deficits and debt levels in recent years, driven by a negative revenue shock imposed by COVID-19, high expenditure needs for vaccines and relief spending, and high pre-COVID spending levels due to a transition to federalism and reconstruction spending after the 2015 earthquake. Second, the transition to federalism has not only elevated spending, but has also created institutional ambiguities with regards to responsibilities across the three levels of government, which has resulted in service delivery gaps. Third, the domestic private sector is developing only gradually, and domestic job creation remains limited. This is driven by endemic barriers, such as a landlocked and challenging topography, and high remittance inflows that undermine external competitiveness, and is compounded by regulatory barriers and persistent infrastructure gaps. Fourth, Nepal faces substantial environmental challenges, driven both by a high vulnerability to climate shocks and high levels of ambient and indoor air pollution that impose public health costs.

Recognizing these challenges, the Government of Nepal (GoN) has transitioned to a green, resilient, and inclusive development (GRID) path through the Kathmandu Declaration in September 2021. This proposed operation will support the country's transition to GRID by supporting fiscal, regulatory, and institutional reforms to enhance fiscal resilience, strengthen service delivery, and support growth. This DPC forms a key component of the World Bank's wider support to the GRID agenda, which also include three other DPCs in the financial, environmental, and energy sectors as well as multiple IPF operations and ASA activities.

Relationship to CPF

The proposed operation supports four objectives of the FY19-FY23 Country Partnership Framework (CPF), as reflected in the Performance and Learning Review (PLR) of January 2022. They include (i) improved budget and revenue management (CPF objective 1.1), (ii) increased access to digital services (CPF objective 2.6), (iii) improved equity in access to quality education (CPF objective 3.1), and (iv) improved access to services and support for the well-being of vulnerable groups (CPF objective 3.2). Reforms to strengthen domestic revenue generation, leverage FDI, the building back greener agenda, the strengthening of Nepal's social protection system, and telecommunication reforms are consistent with these pillars.

C. Proposed Development Objective(s)

PDO: 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 to fiscal management, service delivery and economic policy to alleviate structural risks to growth and resilience in the aftermath of COVID-19. Results to improve fiscal management include (i) strengthening revenue collection; (ii) enhancing debt transparency; (iii) strengthening climate-resilient public infrastructure spending; and (iv) reducing greenhouse gas emissions through fiscal reforms. Reforms to service delivery aim to strengthen service provision in the education, health and social protection sectors, and to mainstream gender



considerations into disaster risk management. Growth reforms target the objectives of increasing competition in the telecommunication sector and the attraction of FDI to Nepal.

D. Concept Description

The proposed operation for US\$100 million is the second operation in a series of three and proposes to support fiscal and growth policy reforms that support the GoN's transition to GRID. 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, and contains reforms that support green and resilient growth. Green growth is supported through environmental fiscal policy reforms, support to public investment management, and through reforms to solid waste management. Reforms targeted at strengthening fiscal and debt sustainability as well as the climate-resilience of public infrastructure and disaster risk management will enhance resilience. The second pillar of the operation aims to enhance systems and regulations to protect the most vulnerable and support sustainable business growth. Actions under this pillar contribute to the inclusive development objective under GRID and encompass reforms to education, health and social protection spending that will support inclusiveness. Actions aimed at attracting FDI and reforming telecom regulations will strengthen aggregate growth.

The proposed operation is part of the World Bank's and other development partners' broader engagement to operationalize federalism and the GRID agenda in Nepal. The design of the operation is guided by the World Bank's 2021 Public Expenditure Review for Nepal. Two concurrently prepared DPCs support complementary reforms to operationalize GRID, including reforms to the enabling environment with a focus on environmental sector reforms (GRID DPC), and reforms aimed at greening the financial sector (Finance for Growth DPC). The proposed DPC adds a focus on fiscal and growth reforms. Reform implementation is supported by a broad IPF engagement, including through the Integrated Public Financial Management Reform Project, the Urban Governance and Infrastructure Project, the Strengthening Systems for Social Protection and Civil Registration Project, the Nepal School Sector Development Program, the Nepal Health Sector Management Reform PforR, and the Digital Nepal Acceleration Project. The recently approved IMF ECF program also contains complementarities to the supported program.

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

Poverty and Social Impacts

The set of reforms supported by pillar A are expected to have neutral to positive impacts on poverty reduction in the medium to long run. The impact of tax policy reforms on poverty will depend on the extent to which reforms progressively ease the tax burden in favor of the poor. Similarly, the impact of reforms to public investment depends on the extent to which enhanced efficiency of spending on climate resilient infrastructure reaches the poor, through improved targeting and quality of investments. Environmental fiscal policy reforms are expected to enhance access to low-emission technologies which can benefit the poor. Reforms to debt and solid waste management are expected to have neutral poverty impacts.

Pillar B is expected to have more direct effects on reducing poverty. Reforms that strengthen the social protection system, service delivery in education and health, and the mainstreaming of gender considerations into disaster risk management are expected to benefit the poor by enhancing access to social services and strengthening resilience to shocks through the improved responsiveness of social protection systems. Reforms to telecommunications and FDI are expected to be pro-poor by enhancing access to digital services and attracting new investments that can translate into more productive domestic jobs and ease SMEs' credit constraints.



Environmental, Forests, and Other Natural Resource Aspects

Reforms are expected to positively affect the environment, forests, and other natural resources, and to generate climate co-benefits. Under Pillar A the unified guidelines for public capital projects carried out through the National Project Bank will help prioritize projects aimed to boost climate adaptation. Incentives to encourage the use of electric induction cookstoves will lead to improvements in residential air quality, as people switch from LPG cooking or firewood cooking alternatives, which are both worse for indoor air quality. A new Solid Waste Management Policy will reduce greenhouse gas emissions and toxic pollutants generated from inappropriately disposed solid waste. The safe disposal and handling of hazardous waste will most notably bring about immediate benefits in terms of pollution reduction.

Pillar B includes reforms to enhance targeting and delivery of social protection programs to disaster-affected households, bringing better relief to vulnerable households that may otherwise turn to unsustainable forest and natural resource extraction practices to cope with the loss of livelihoods.

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APPROVAL

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