

NEPAL

COUNTRY STRATEGY PAPER 2007-2013

MID-TERM REVIEW DOCUMENT IP 2011-2013

APRIL 2010

ACRONYMS

ADB	Asian Development Bank
BIMSTEC	Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation
BOG	Basic Operating Guidelines (main donor group in Nepal)
CA	Constituent Assembly
CAP	Conflict Affected People
CPA	Comprehensive Peace Agreement
CPN-Maoist	Communist Party of Nepal-Maoist
CPN-UML	Communist Party of Nepal-United Marxist Leninist
DCI	Development Cooperation Instrument
DfID	Department for International Development (UK)
DPs	Development Partners
CSP	Country Strategy Paper
EC	European Commission
EFA	Education For All
EIDHR	European Instrument on Democracy and Human Rights
EU-EOM	European Union-Election Observation Mission
FF	Food Facility
FY	Fiscal Year
GDP	Gross Domestic Product
GLOF	Glacier Lake Outburst Flood
GoN	Government of Nepal
GSP	Generalised System of Preferences
GTZ	Gesellschaft fuer Technische Zusammenarbeit (D)
HDI	Human Development Index
IFS	Instrument for Stability
IDPs	Internally Displaced Persons
I/NGOs	International/Non-Governmental Organisations
IP	Indicative Programme
JFA	Joint Financing Agreement

JRM	Joint Review Mission
KPI	Key Performance Indicators
LDC	Less Developed Country
MDGs	Millennium Development Goals
MoF	Ministry of Finance
MoE	Ministry of Education
MoPR	Ministry of Peace and Reconstruction
MIP	Multi-Annual Indicative Programme
MTR	Mid-Term Review
NC	Nepali Congress
NDF	Nepal Development Forum
NER	Net Enrolment Ratio
NDSP	National Development Strategy Paper
NGO	Non-governmental organisation
NPR	Nepalese rupee
NPTF	Nepal Peace Trust Fund
NSA	Non-State Actors
PFM	Public Finance Management
PRSP	Poverty Reduction Strategy Paper
QSG	Quality Support Group
SAFTA	South Asia Free Trade Agreement
SBS	Sector Budget Support
SDC	Swiss Agency for Development and Cooperation
SMEs	Small and Medium-sized Enterprises
SSRP	School Sector Reform Programme
SWAP	Sector Wide Approach Programme
SPS	Sanitary and Phytosanitary
TA	Technical Assistance
TBT	Technical barriers to trade
TRTA	Trade Related Technical Assistance
TYIP	Three-Year Interim Plan
UNDP	United Nations Development Programme
UNMIN	United Nations Mission in Nepal

WTO

World Trade Organisation

Part 1: Executive Summary

Nepal is going through a period of historic political change. The Comprehensive Peace Agreement signed on 21 November 2006 ended a decade-long conflict that claimed 14 000 lives. The adoption of the interim constitution on 15 January 2007 paved the way for the free and fair election of the Constituent Assembly on 10 April 2008, which led to the declaration of a Federal Democratic Republic of Nepal on 28 May 2008 and the abolition of a 240-year old monarchy. Although these changes are impressive, much more remains to be achieved in the years ahead. Bringing real and tangible changes to the lives of the 28 million citizens of Nepal - the real winners of the April 2008 elections - represents one of the key challenges facing the government.

The people expect the government to build a New Nepal featuring, among other things, an inclusive, just society, an end to impunity, respect for human rights and a solid, vibrant democracy. The people also look forward to having a social and economic system that provides reliable access to good quality basic services such as education and health, generates jobs, protects the environment and eradicates poverty. Recent events show that the complexities of bringing about such changes have not been fully understood or properly addressed. A broad political consensus has not been achieved, nor has an efficient implementation framework been put in place. Furthermore, Nepal is in a fragile state facing new threats caused by the food crisis, the global financial crisis, the economic slowdown and climate change.

King Gyanendra's political take-over on 1 February 2005 obliged the Commission to put all cooperation activities on hold, in line with the EU position. Consequently, the preparation of the EC Country Strategy Paper for Nepal began only in late 2006. Following the April 2007 Jana-Andolan, a careful assessment of the political, economic and social situation in Nepal resulted in an EC response strategy anchored in three priority areas of cooperation: stability and peace building; education and trade facilitation; and economic capacity building. There are also cross-cutting themes such as the environment, gender issues, conflict prevention and human rights. Additional means of cooperation were brought to Nepal through thematic programmes such as NSA and EIDHR, which benefitted Non-State Actors and Local Partners, as well as funds made available under the Instrument for Stability.

MTR consultations with the government, civil society and other stakeholders included a dialogue with representatives from the Nepalese parliament on 18 June 2009. The meeting with CA members was a seminal event: never before had a development partner engaged in a cooperation strategy discussion with elected representatives of the people of Nepal. The MTR process confirmed that the EC response strategy and its three priority areas for cooperation is still relevant for the period 2011-2013. The stakeholders also welcomed the Commission's attention to new cross-cutting policy issues: climate change, migration, trade-related technical assistance, regional cooperation and drugs. The aid effectiveness agenda is progressing steadily, helped along by the remarkable results achieved and experience gained in the education sector under the EFA and SSRP programmes.

Despite the challenging political context, implementation of the IP 2007-2010 and other cooperation activities has gone smoothly. The balance of the entire budget of €60 million will be committed by 2010. Furthermore, a sizeable amount of funds has been invested in activities developed by I/NGOs and other stakeholders for thematic programmes such as NSA, EIDHR and SWITCH. The Commission also provides significant financial support for action to assist Bhutanese refugees and to tackle the emerging food crisis. Among the key lessons learned are the need to stay proactively engaged in the development process and peace building, to strengthen stakeholders' implementation capacity and to promote political consensus.

In view of the challenges still facing Nepal, one of the poorest countries in Asia, and in line with the MTR findings, we recommend that the EC response strategy, as defined in 2006 with its three priority areas, remain on track during the period 2011-2013. Attempts must be made to encourage the government to get the private sector actively involved in the process of change and in national efforts to achieve the MDGs. The IP 2011-2013 will have an indicative budget of €60 million. The financial breakdown of the current and previous IPs for the three priority areas is as follows: IP 2007-2010 €60 million (education: €36 million; peace building: €22 million; trade: €2 million); IP 2011-2013 €60 million (education: €30-36 million; peace building: €15-21 million; trade: €3-9 million). (See also ANNEX 1).

Part 2: Analysis of the Policy Framework and Cooperation Strategy

2.1 Policy Framework

Political context: Nepal is going through a period of historic political change. Since the mass protests of April 2006 (Jana-Andolan 2) the country has seen significant, positive political developments. The Comprehensive Peace Agreement was signed on 21 November 2006 - ending a decade-long conflict which cost 14000 lives. The interim constitution was adopted on 15 January 2007 and, on the same day, the Maoists made their landmark return to Parliament. They took part in the interim government led by the Nepali Congress, which took office on 30 March 2007. The election of the Constituent Assembly followed, on 10 April 2008, and the declaration of a Federal Democratic Republic of Nepal on 28 May 2008, abolishing 240 years of monarchy. The real winners of the April 2008 election, monitored by the EU-EOM, are the people of Nepal - and they have high expectations. They expect the political transformation to deliver genuine changes in their lives (peace dividends) in the short term, and the emergence of a New Nepal in the longer term.

Successive governments have attempted to bring about changes. They have held forums and meetings to discuss strategies with development partners, aimed at building an inclusive and just society, ending impunity, ensuring respect for human rights and developing a solid and vibrant democracy. The government also aims to create a social and economic system that can provide reliable access to good quality basic services such as education and health, and that can generate jobs, protect the environment and eradicate poverty. However, although the successive coalition governments - CPN-Maoist (August 2008-May 2009) and UML (May 2009 to date) - have continued to declare their commitment to implementing the CPA provisions, the peace process has not really moved forward since November 2006. On the critical and difficult issue of army integration and reform of the armed forces, progress remains poor, characterised by mutual distrust. The continuing presence of the two standing armies - the Nepal Army and the Maoist People's Liberation Army - is inherently destabilising. UNMIN, which plays a critical role, had its mandate recently extended to 23 January 2010. It will also be a huge challenge to implement the second key component of the peace process, namely to draft the new constitution by May 2010 - with no more than a six month extension as stipulated in the interim constitution - and to organise the new round of elections for 2011.

While the peace process is dragging its feet, the government is confronted with new challenges. Political intolerance is increasing following the collapse of the first coalition government on 4 May 2009, when the Prime Minister, former Maoist leader, Mr Pushpa Kamal Dahal, aka Prachanda, decided to dismiss the army chief, General Rookmangud Katawal. Clashes between activists from different political parties have intensified, with incidents mostly provoked by youth wings of political parties and/or the student's unions affiliated with them. In the Terai region, the political and security situation have become quite challenging. The Madhesis, who have settled/are living in the region's 20

districts along the 1800-km border with India, continue to clamour for adequate political representation and recognition of their rights in the country's future system of governance. The government's attempts to resolve this situation have been unsuccessful. The armed groups of the Terai are very heterogeneous and split by internal disagreements.

The process of political change in Nepal is complex. Ten years of armed conflict combined with a period of autocratic rule have left the country's institutions weak and subject to political pressure. Entrenched impunity continues to be the key obstacle to reforming government institutions, particularly local governance bodies, law and order enforcement bodies and criminal justice. Recent failures to reform the police have led to a public security crisis that has contributed to the general deterioration of human rights and the proliferation of criminal gangs.

Economic context: Sustained growth has not materialised as expected. After rebounding to a healthy 4.7 percent in FY07/08, economic growth seems to have fallen back to a modest average of 3.3 percent per annum, realised from FY01/02 to FY07/08. It will be difficult to achieve higher growth in the next few years, as the political situation is still too unstable to allow business to flourish. Furthermore, the economy is still affected by an unreliable power system, a lack of law and order, and an opaque regulatory framework. Nepal's economy depends on agriculture, which is the primary source of employment. Farming has been regularly affected by floods and landslides during the monsoon season, and since grain production is totally dependent on rainfall, climate change will certainly further exacerbate the chronic food crisis.

Without remittances, the Nepalese economy would have been in a disastrous situation. In 2007, the country received a staggering US\$ 1.6 billion, excluding remittances from India. If estimated inflows from India are included, the total would represent 25 percent of its GDP. During the conflict, remittances helped to keep the economy afloat and to sustain consumer spending as well as spending on education, housing and other real estate investment. The direct impact of the financial crisis on the economy has been negligible so far, since Nepal is largely isolated from international financial markets. However, the country is not immune from the global slowdown, which will impact tourist arrivals, remittances, trade and foreign direct investment. Current statistics indicate that inflows of tourists and remittances fluctuate but do not represent a source of concern yet. Given the role played by these two major sources of foreign exchange in the economy, the government is monitoring them regularly. The robust growth of revenue collection of 22.6 percent in FY07/08 (projected to increase by 34 percent in FY08/09) should help to cushion the effects of any downturn resulting from the financial crisis. However, it will be a challenge to maintain fiscal and macroeconomic policy, given the expansionary FY08/09 budget with its expenditure outlay of NPR 218.6 billion - 53 percent greater than the estimated expenditure in FY07/08.

Nepal's local investment climate is not conducive to dynamic private sector initiatives and many of the country's industries are closing down due to problems of energy security, trade union agitation and related security issues. The GoN is in the process of updating a Nepal Trade Integration Strategy (aka Diagnostic Trade Integration Study first formulated in 2003/04), which will take a fresh look at sectors for which trade could be developed. Given current economic and political constraints, the industries most likely to succeed are highly labour-intensive, minimally energy-dependent and widespread sectors (not limited to the Kathmandu Valley) with immediate market access to India and China, such as high-value agricultural production. The GoN plans to address these new potential areas for growth through a five year rolling strategy for trade, in which development partners' support would be channelled through a SWAP. This study is expected to be finalised by April 2010 and would provide interesting opportunities for donors to help build Nepal's trade and economic capacity through a SWAP.

India remains Nepal's largest trading partner, absorbing over 66 percent of the country's exports. Imports from India accounted for nearly 60 percent of total imports in 2008. Nepal is a member of the WTO, BIMSTEC and SAFTA. The country continues to benefit from the EU's Everything But Arms trading scheme with LDCs and will be exempted from GSP rules of origin for certain textile products until 31 December 2010.

Social context: Although Nepal is one of the poorest countries in the world and the poorest country in South Asia, progress on a number of social indicators has been impressive, in spite of the conflict. Poverty incidence dropped from 42 percent in 1996 to 31 percent in 2004; life expectancy, infant and maternity rates and adult literacy have improved. However, Nepal's HDI rank dropped to 145 (out of 179 countries) in 2008 from 142 (out of 177) in 2007. According to the 2008 Economic Survey of the Ministry of Finance, 24 percent of the population lives below the poverty line (one dollar a day). The gains mentioned above, which have been hampered by conflict, political instability and weak governance, have not been extensive enough to make a significant impact on poverty and inequality which have been rising since the mid-1980s, particularly affecting people in the remote, rural areas where 80 percent of the population lives.

According to the UN, Nepal has the potential to attain almost all the MDGs (1-7) by 2015 if the government and the development community make serious efforts to improve the implementation of programmes across the country. However, even though most of the MDGs could be met at the national aggregate level, it will still be a challenge to reduce regional, ethnic, and gender-based inequality in achieving these goals. Nepal has huge ethnic and linguistic diversity, with wide discrepancies in people's social and economic standing depending on their geographic location, ethnicity, caste and gender.

Despite the conflict, the social sector (education and health) has performed reasonably well. Access to education and health services has improved substantially. Net school enrolment rates reached 93.7 percent in 2009. In the health sector, the maternal mortality ratio decreased to 281 per 100 000 live births in 2006 from 539 in 1996. Nonetheless, significant challenges remain, such as the vast disparity between boys and girls and between different social communities in access to primary school education, or the lack of health workers in remote geographical regions. The 2009 Human Development Report indicates that Nepal is in 139th position in terms of female (as % of male) enrolment in education (primary, secondary and tertiary combined), and 185th in terms of female life expectancy at birth. Overall, Nepal's gender-related development index is 98.6% of its HDI value. One hundred and eleven countries have better rankings than Nepal. Furthermore, the need for child protection is on the rise as a large number of children are exposed to violence, abuse and exploitation.

Governance: Although the CPA, official statements and the Interim Constitution all express commitment to inclusiveness, good governance remains a major problem. Marginalised groups (women, Madheshis, Dalits and Janajatis)¹ are excluded from the decision-making process and continue to be severely under-represented in most political party central committees, state structures such as courts and police, local authorities and other entities. Although new pro-inclusion policy measures have been taken, such as adopting the new Civil Service Bill and amending the Armed Police Force Regulations, these measures have yet to be properly implemented.

Environmental context: Nepal has a very fragile ecosystem and its dramatic topography makes the country prone to flooding and Glacier Lake Outburst Floods (GLOFs). While Nepal's per capita

¹ Madhesi are the people of the southern plains; the Dalit are the low caste people (so-called untouchables); Janajati are the indigenous people, with last names such as Sherpa, Tamang, Magar, Gurung, Rai and Limbu.

greenhouse gas emissions are negligible, the country is one those most affected by the negative consequences of climate change, such as flash floods and droughts.

2.2 Cooperation strategy

Cooperation context: The political changes since 2006 have not fundamentally affected the government's poverty reduction strategy. The first coalition government produced a National Development Strategy Paper (NDSP) for FY 2009/10 – 2011/12, based on the interim government's Three Year Interim Plan which expires in July 2010. The NDSP was also consistent with the previous 10th plan in placing strong emphasis on spurring investment, job creation and growth while reducing inequality and exclusion. The NDSP was to be presented and discussed with development partners during the Nepal Development Forum 2009, scheduled for 12-14 May, but unfortunately, following the resignation of the Maoist government, the NDF was postponed to a later date. Nevertheless, given the Government's unchanged strategic orientations and the huge need for peace building and social development, the EC's assistance priorities as set out in the CSP are still relevant. During the Mid-Term Review process, the EC's response strategy was discussed with all key stakeholders within the broader context of new EC/EU policy objectives and commitments. The stakeholders welcomed the introduction of new cross-cutting policy issues (climate change, migration, aid for trade, regional cooperation and drugs) in the cooperation programme, and three of these issues - climate change, aid for trade and migration - emerged as priorities for the next few years. Thus, Nepal needs to build its capacity to deal with climate change impacts, as they will seriously undermine the fragile development process and put the MDGs at risk. Nepal also needs to urgently enhance its trade-related capacity in order to break away from current trading patterns dominated exclusively by India and diversify its export basket. When it comes to migration, one of the main challenges facing Nepal is to ensure the safe migration of the millions of workers whose remittances have become one of the key pillars of Nepal's economy.

Donor coordination in Nepal is operating effectively and the EC is an active participant in the country's main donor coordination groups such as the Basic Operating Guidelines Group (BOG) and the Uttstein++. The EC, working together with other development partners, particularly the World Bank and Danida, was instrumental in developing the capacity of the Ministry of Education to lead the change from a project-based approach and sub-sector policy support through a basket funding mechanism to a programme-oriented approach with funding channelled as budget support during the preparation of the programme Education for All (2004-2009).

As for the aid effectiveness agenda, the government is mapping donor support in all sectors with a view to discussing how to make donor programmes more selective and ensure that they complement one another better. The government has also prepared a new draft foreign aid policy in line with the Paris Principles and the commitments made in Accra and Doha. The document will be presented at the next NDF, where discussions will focus on establishing mutual understanding and agreement between the government and development partners on how to mobilise aid more effectively, for example by implementing a jointly-adopted National Action Plan on Aid Effectiveness. Significant constraints – political instability, weak institutional capacity, etc. - remain in the process to make aid more effective in Nepal. On 27 January 2010, the Ministry of Finance, as a leading institution, has taken the initiative to launch Phase 2 of the Paris declaration evaluation programme, which will play a strategic role in the implementation of Nepal's action plan on aid effectiveness. The results of the whole process will be discussed at the 4th High Level Forum on Aid Effectiveness to be held in Seoul in October 2011.

Nepal has an active civil society. Its representatives, acting alone or in collaboration with other international NGOs, have been very helpful to EC development cooperation in Nepal. During the MTR, the non-state actors, local partners and parliamentarians have been fully involved in discussing key issues, including those recently introduced by the EC/EU. Although the above-mentioned

stakeholders have confirmed that the EC cooperation strategy 2007-2013 responds adequately to Nepal's peace and development challenges, they also called for additional funding support.

The dialogue with representatives from the CA assembly on 18 June 2009 was a seminal event. It was the first time that a development partner had the opportunity to discuss its cooperation strategy with elected representatives of the people of Nepal.

Performance and results assessment: While the country's performance is largely mixed, the overall relationship between the EC and Nepal is positive. The first IP 2007-10 provided for action on three fronts:

- (i) action to promote stability and peace through the Government of Nepal's instrument (the Nepal Peace Trust Fund);
- (ii) action to implement the Comprehensive Peace Agreement (CPA) and subsequent peace-related agreements;
- (iii) action to improve education in Nepal, via the School Sector Reform Programme (SSRP).

A €2 million project to support small businesses (SMEs) was also included. This project was originally meant for inclusion in the MIP for the first CSP (2002-06) but could not be implemented due to the political situation in the country at that time. The Memorandum of Understanding for the Multi-Annual Indicative Programme for 2007-2010 was signed in the margins of the 6th EC-Nepal Joint Commission Meeting, held in Brussels on 15 January 2009.

The above-mentioned project to support SMEs was initially meant to be part of the third focal sector (Trade Facilitation and Economic Capacity Building). However, during the MTR conducted in Nepal in March 2009, the MoF requested the EC to transfer the budget for this project to Education, to give greater support to the SSRP. The €2 million intended for SMEs have therefore been added to the €11 million already allocated to the SSRP. Donors took a positive view of cooperation with the GoN on education (60% of the IP 2007-10, or €36 million), and the action plan for this sector is being implemented smoothly. The action plan for peace and stability (37% of the IP) is being prepared for implementation in 2010.

As discussed above, Nepal's development challenges are huge: lawlessness is rife, especially in the Terai, and the country could slide from fragile to failed status if donors do not respond to opportunities and threats in time. In the current post-conflict scenario, development has taken a backseat and no development activities are being carried out in the far-flung districts. In order to recover from the development backlog, confidence-building measures, transitional justice and social reconstruction are key priorities and should be addressed via a two-pronged approach, managing the twin agenda of post-conflict work and development backlog. Special attention must be paid to the rural areas. Similarly, it will be crucial to restore the confidence of the private sector as the current climate is not very business-friendly. Added to that is the current energy crisis and Nepal's vulnerability to global challenges such as climate change and the global economic slowdown and financial crisis (with workers returning from the Gulf and other major employment areas).

Lessons learned: The implementation of IP 2007-2010 has provided some insights that were used in drawing up the new IP. One of the key lessons was the need to stay proactively engaged in the development and peace-building processes. Experience gained by donors in providing budget support in the education sector is being shared with donors supporting the peace-building process. Two other lessons are the importance of strengthening the implementation capacity of key stakeholders, such as partners in the non-focal areas, making it fully responsive to the specificities of

the EC's rules and regulations, and the need to promote political consensus so that development can proceed efficiently.

Strengthening the cooperation strategy: In the context of Nepal, a country moving from conflict to peace, it was easy to justify the three focal areas (stability and peace building, education and trade facilitation and economic capacity building). Nevertheless, some improvements are needed in the IP 2011-2013, to strengthen the CSP for the 2007-2013 programming period. These improvements include:

- Achieving a greater alignment of EU cooperation with the country's policies and systems, in line with the Paris Declaration on Aid Effectiveness, and in particular under Priority 2: Stability and Peace Building;
- Contributing to the sustainability of the peace process by putting more emphasis on economic development and tangible peace dividends, especially in the rural areas;
- Making aid more effective by enhancing coordination and harmonisation between donors, ensuring alignment with partner countries' strategies and preparing the ground for more complementarity and division of labour by adopting multi-donor arrangements, such as co-financing or delegated cooperation;
- Encouraging the GoN to take more ownership by adopting a demand-driven approach to programming, by working closely with the GoN to identify areas of intervention and by ensuring that the GoN has sufficient resources and capacity to implement projects/programmes whenever sector budget support is not possible;
- Mainstreaming the following cross-cutting issues in all EU action, as appropriate: human rights, gender equality, democracy, good governance, conflict prevention, the rights of children and indigenous peoples, environmental sustainability and combating HIV/AIDS.
- Possible interventions related to tackling climate change will be taken up through the appropriate European Thematic Programme.
- The Link between Relief, Recovery and Development (LRRD) is also very important for Nepal as the country has emerged from a protracted conflict. Possible ways of implementing LRRD activities could be taken up through a range of instruments such as the IfS, DCI, NSA or the FF, or could perhaps be part of the Stability and Peace Building Programme as proposed under MIP II.

The EC response strategy 2007-2013 remains adequate to address Nepal's development challenges: (i) reducing poverty by promoting sustainable development and economic growth in a peaceful environment, with special attention being paid to the social sector; (ii) more inclusive development, leading to increased social cohesion and a substantial reduction in poverty in line with the MDGs. From the results of the consultations held, we conclude that no major adjustments are required to the Nepal Country Strategy Paper 2007-2013.

3. Indicative Programme for 2011-2013

Introduction

On the basis of the MTR process and in line with the CSP 2007-2013, the IP 2011-2013 will aim at continuing the three-pronged approach:

- **Education:** Continuing to assist Nepal with the sustainable development of its education sector by creating a capacity-building environment, including new programmes to support coherence between the different education sub-sectors and between education and other sectors that have an impact on resource management, such as health, local development, trade, etc.
- **Stability and Peace Building:** Further restoring and consolidating the functioning of the democratic institutions and the institutional framework to ensure a smooth transition to a democratic process, to facilitate the development of an inclusive and law-abiding new Nepal and to secure the conditions for sustainable livelihood.
- **Trade Facilitation and Economic Capacity Building:** Fostering a business environment that is conducive to enhancing EU-Nepal economic relations (i.e. in the areas of trade, investment and finance) and to creating a dynamic private sector in Nepal in the context of new challenges caused by the global economic slowdown and financial crisis, climate change, etc.

Financial Instruments and Indicative Budget Allocation

The Nepal CSP 2007-2013 is financed under the **EU-Development Cooperation Instrument**. The financial allocation for 2011-2013 is €60 million and will indicatively be allocated as follows among priority sectors of intervention:

Sector of Intervention	Indicative allocation (as a % of total IP)
Priority 1 - Support for education (2 nd phase): School Sector Reform Programme	€30 – 36 million (50 – 60%)
Priority 2 - Support for stability and peace building (2 nd phase): Stability and Peace Building Programme	€15 – 21 million (25 – 35%)
Priority 3 - Support for trade and economic capacity building: Trade Facilitation and Economic Capacity Building Programme	€3 – 9 million (5 – 15%)

In addition, Nepal will be eligible for financing cooperation projects and actions under the following complementary financial instruments:

- 1) **European thematic programmes** set up to achieve policy objectives that are not geographically limited, by supporting non-state actors (i.e. Environment/climate change and sustainable management of natural resources including energy; food security; investing in people; non-state actors and local authorities in development; migration and asylum);
- 2) **European Instrument for Democracy and Human Rights:** strengthening the role of civil society in promoting democracy, human rights, the rule of law and fundamental freedoms;
- 3) **Instrument for Stability:** a strategic tool to help stabilise countries in crisis or emerging crisis. This tool also helps to build capacity for tackling specific global and trans-regional threats, such as the proliferation of weapons of mass destruction, terrorism and organised crime, and to ensure preparedness for addressing pre- and post-crisis situations;
- 4) **Instrument for Humanitarian Aid:** providing assistance to victims of natural or man-made disasters;

- 5) **Food Facility:** under an EU € 1 billion package announced in 2008 in the wake of rising food prices and the pressing need to make rapid responses to growing food scarcity in 50 countries, € 23.5 million were earmarked for Nepal to run food security related projects in the country's eastern, central, mid-western and far-western regions.
- 6) **Regional Country Strategy Paper for Asia:** providing support for Nepal's regional integration in South Asia in various sectors.

In line with EU commitments under the Paris Declaration for Aid Effectiveness and the subsequent EU Consensus for Development, the EU will ensure that the IP 2011-2013 complies with the following fundamental principles underlying EU cooperation policy:

- Acknowledging poverty alleviation and the achievement of the MDGs as the central objective for development cooperation;
- Ensuring political dialogue with the GoN as well as consultation with civil society, EU Member States and other international donors;
- Enhancing aid effectiveness through greater donor coordination and harmonisation as well as alignment with Nepal's policies, systems and procedures and, in particular, the main development priorities defined in the Three Year National Development Plan (FY2009/10 - 2011/12);
- Mainstreaming cross-cutting issues such as the promotion of human rights, democracy, good governance, gender equality, conflict prevention, the rights of children and indigenous peoples, environmental sustainability and combating HIV/AIDS to make cooperation more effective and sustainable.

Priorities and Actions

Priority 1 - Education Sector Programme

Strategy context/justification: The origin of the present sector programme is in keeping with Nepal's commitment to achieving the EFA goals by 2015. Supporting the basic and primary education sub-sector is crucial in enabling the government of Nepal to meet its poverty reduction commitments and goals. National plans and policies form the basis for the design of Education for All 2004-09. The Ministry of Education has developed a Core Document for School Sector Reform with policy directions, strategies and action to improve the governance, management and resourcing of school education. The Cabinet approved the Core Plan in mid-2008, and a two-volume SSR Plan (2009-15) was then approved by all stakeholders including pooling and non-pooling donors. The EC has been supporting the Education Sector since the start of the EFA Programme and, in view of the positive results, is committed to giving continued support to school sector reforms. Some evidence of this positive result includes the improvement in gender disparity - as measured by the gender parity index in the net enrolment ratio (NER), which has increased from 0.87 in 2002 to 0.98 in 2009-2010. The NER for primary education has also improved from 82.3 in 2002 to 93.7 in 2009-2010.

Objectives: The overall objective of EU support is to contribute to poverty reduction and socio-economic development in Nepal. The specific objective is to increase access to good quality basic education for all children, particularly girls and disadvantaged children, by supporting early childhood education, secondary education, vocational education and adult literacy.

Expected results: The overall expected result of the SSRP is improved sector performance and progress towards a more inclusive and efficient elementary education system of satisfactory quality.

Expected educational results include increases in school enrolment, completion and student attainment. Expected social benefits include increased gender and social parity, and equal opportunities for girls and children from disadvantaged backgrounds to have access to quality education. Expected institutional benefits include giving national, district and community institutions a greater capacity to plan implement and monitor programmes, and a greater technical capacity to improve the quality and financial management of education.

Activities: The main activities of the SSRP include:

- expanding early childhood education and development;
- providing additional schools and classrooms that meet minimum standards;
- providing scholarships and incentives to girls and to children from marginalised communities, in order to increase their participation in basic and secondary education;
- providing teacher training and teacher development;
- ensuring per capita funding and grants to schools so that they can recruit more teachers and provide students with more textbooks and other facilities;
- updating the curriculum, textbooks and teaching guides for school education;
- providing continuing education and life-long learning;
- introducing work-oriented vocational and technical education in secondary schools and piloting the teaching of new trades and skills, with help from businesses;
- providing training and institutional activities to develop capacity in the education sector.

Implementation: Sector Policy Support Programme.

Cross-cutting issues: SSRP will include a range of measures to promote equity and inclusion, including scholarships and incentives for girls, Dalits and Janajatis. A Vulnerable Community Development Plan has been prepared to give greater educational opportunities to the most vulnerable groups like Dalits, ethnic minorities, girls and disabled children. Nepal is a priority country for implementing the EU Guidelines on Children and Armed Conflicts. A detailed Governance and Accountability Action Plan has also been prepared.

Risks and assumptions: By far the biggest risk relates to the continuation of a stable government and the peace process. However, all political parties have pledged to support school reform and no reversals are expected. There is also the potential risk of inadequate financing.

Main indicators: The development partners and the GoN have developed three key instruments for the SSRP:

- A policy matrix that outlines the key parameters underpinning the SSRP and enables the partners and GoN to regularly check that these policies are being implemented and further developed;
- A results matrix with key performance indicators (KPIs) and arrangements for monitoring, including sources of verification and frequency of reporting; and
- A governance and accountability action plan (GAAP) which tracks progress in improving education service delivery, strengthening financial management and carrying out audits.

Coordination with MS and other donors: Donor coordination in the education sector is acknowledged as a model for other sectors in Nepal. Working together since 1999, the donors' group has devised and agreed on a set of tools (e.g. the Joint Financing Arrangement – JFA) and mechanisms (e.g. the Joint Review Mission - JRM) to coordinate and harmonise aid for education. Currently, Denmark and UNICEF have been elected for one year (July 2009-June 2010) to act as the local donors' contact point. The JFA has thus far ensured that DPs' contributions are fully synchronised with government budgeting processes and disbursed to a common account in the Treasury. The GoN plans to develop a common and more strategic approach to capacity development, and to streamline TA into a common fund. A Code of Conduct has also been approved for the participation of a larger group in education.

Priority 2 - Stability and Peace Building

Objectives: The programme aims to support efforts to build and consolidate peace, and to re-establish, consolidate and safeguard conditions in which the country can continue to build a functioning democratic system and a stable and new Nepal. The shared vision of this new Nepal is of an inclusive, equal society; a law-abiding country respecting human rights; secure conditions (including food sovereignty/security, etc.) that enable vulnerable communities to sustain their livelihoods. The programme may also support the peace process and assist policy and strategic initiatives such as the Nepal Peace Trust Fund, which was set up to help implement the CPA and subsequent peace agreements.

Expected results:

Overall, the programme is expected to make it much less likely that Nepal will return to the insurgency and conflict situation in which it found itself before Jana-Andolan 2006. The programme is also expected to strengthen the conditions for achieving a long-lasting peace.

Expected main results include:

- (a) an improved framework and climate for dialogue and negotiations between stakeholders in the peace process, thus encouraging sustained efforts to support and develop programmes and systems that will promote democratic values and processes such as elections, censuses and awareness campaigns;
- (b) benefits to society which may include the restoration of law and order, with reformed security forces, and a civil society fully aware of citizens' legal rights and obligations;
- (c) an improved law implementation system, improved access for all to a more independent judiciary, institutions having a greater capacity to build the New Nepal and a judiciary that is substantially less corrupt and more transparent;
- (d) last but not the least, benefits for conflict-affected people as well as marginalised and excluded people living in remote districts. These benefits may include: better economic development in Nepal's far-flung districts; less migration from economically backward and food-insecure districts; appropriate economic and livelihood activities for conflict-affected people, the disadvantaged and excluded; improved basic service delivery in health, education, etc. for conflict-affected people.

Activities may include:

- (a) support for the peace process, including some areas identified in the NPTF such as the rehabilitation of internationally displaced persons;

(b) support for measures to develop a democratic and inclusive system, such as the recommendations made by the EU Election Observation Mission in 2008; support for elections and election observation; support for measures to ensure that all Nepalese people can vote, etc.;

(c) support for developing a system to restore law and order and to ensure that all stakeholders respect it - including measures to promote conflict prevention and to improve the conditions for conflict resolution;

(d) support for setting up an impartial judiciary with a strengthened Judicial Council and strong emphasis on transparency and anti-corruption measures. Other possible activities include permanent training for Ministry of Justice employees, judges, lawyers, prosecutors and civil society.

Implementation: SWAP for the MoPR and others will be considered. Implementation of the programme will build on the activities being carried out through the NPTF and other initiatives. The exact methods will be defined at later stages.

Cross-cutting issues include respect for minorities, gender sensitivity, environmental justice and child protection, as provided for in the Constitution.

Risks and assumptions: The success of the programme depends on parallel achievements in reforming the security forces and on the government's attitude to promoting full political and social inclusiveness and democracy. The main risk is possible interference by the security forces at a time of political instability. One of the key mitigation measures is to enhance the GoN's institutional and organisational capacity to tackle these risks.

Main Performance Indicators:

- All project deliverables produced within budget and on schedule, interim outputs and final reports accepted by key public and private stakeholders;
- All projects approved by the Board of the NPTF for financing are completed on time within the budgeted financial resources with a substantial number of duly entitled IDP and CAP benefit from the support provided for through the National Policies and Procedural Directives of February 2007;
- Free and fair elections have taken place within the provision of the new Constitution;
- The Special Security Plan and other instruments designed by and put in place by the Ministry of Home Affairs to maintain Law and Order are enforced; the number of trainings related to peace and human rights for the Security Forces; reforms of the Nepal Police, of the Armed Police Force, and of other security forces are duly implemented; the rehabilitation of the 19,000 Maoist combatants is progressing satisfactorily, and
- Acts and other legal provisions that guarantee the appointment and recruitment of the Judges exempt from Parliamentary scrutiny.

Coordination with MS and other donors: Donor coordination in helping the government to build stability and peace, and the new Nepal will need to follow examples of SBS in Nepal. (The Education Sector is a good reference). Currently the main donors who have shown interest in supporting peace building are Denmark, Finland, DFID, UNDP, SDC and Germany. A Joint Financing Arrangement/Agreement may be envisaged.

Priority 3 - Trade Facilitation and Economic Capacity Building

Objective: The objective is to promote inclusive economic growth, job creation and poverty reduction in Nepal by increasing the capacity of key stakeholders, especially in the GoN and the private sector, and expanding trade relations. The EC has been supporting the integration of Nepal into the international economy since the implementation of the WTO assistance programme in 2008, and, in view of encouraging achievements, is committed to providing continued assistance to trade and economic sectors. Examples of positive achievements include improved capacity of the Nepal Bureau of Standards and Metrology and the Department of Food Technology and Quality Control.

Expected Results: The Trade Facilitation and Economic Capacity Building Programme should:

- (a) improve the policy framework for trade and inclusive private sector development;
- (b) provide a better legal, regulatory and institutional framework for trade in the area of standards and conformity assessment, etc. and make it easier for the government and business people to take decisions on trade-related issues;
- (c) develop a business-friendly environment that is more supportive of private sector growth and gives SMEs, especially those owned by marginalised groups, better access to finance and business development services.

Activities may include:

- (a) helping to modernise trade support organisations and to raise private sector awareness of issues such as SPS, TBT, customs procedures, competition, social inclusiveness and possibly also including support to laboratories and certification bodies;
- (b) facilitating regional trade, strengthening business development services and business associations, and training financial institutions and small businesses to ensure that SMEs, especially those owned by marginalised groups, have better access to funding;
- (c) providing assistance with vocational training, trade skills development, rural employment generation, etc., possibly through new frameworks and mechanisms such as ‘trade schools’, links to the education sector, etc.

Implementation: The implementation of the programme will be defined at the formulation stage. A possible SWAP approach in a multi-donor context could be explored on the basis of the new Nepal Trade Integration Study expected to be published in April 2010.

Cross-cutting issues: gender, youth, human rights, good governance and the environment.

Risks and Assumptions: The activities planned under this priority are highly dependent on the progress made in legal and policy reform and on the political climate and the willingness of the Government of Nepal to develop a fair, open and competitive market economy. Risks and assumptions regarding these activities are again linked to the law and order situation, the functioning of institutions and the extent to which businesses really can benefit from the incentives and ‘attractiveness’ measures already in place. One of the major risks is that the current global financial crisis could seriously reduce foreign direct investment, trade opportunities and overseas job opportunities for Nepali migrant workers. A key mitigation measure is to enhance the GoN’s institutional and organisational capacity to tackle these risks.

Main Performance Indicators: In addition to all project deliverables produced within budget and on schedule; interim outputs and final reports accepted by key public and private stakeholders:

- A policy matrix that outlines key parameters of a capacity development programme for trade and economic sectors, and enables stakeholders to regularly check that policies are being implemented and further developed;

- A results matrix with key performance indicators, such as number of trade and economy liaison offices established with adequate equipment and staffing, number of business development services providers, funds allocated in national budget, etc. and arrangements for monitoring,
- A governance action plan which tracks progress in improving business friendly environment, strengthening government management capacity for trade and economic sector development.

Coordination with Member States and other donors: it is essential to ensure good coordination with donors, particularly with the four main donors who are active in Nepal: DFID, Germany, World Bank and ADB. Identification and formulation of the programme should clarify whether the EC should join forces with other donors, especially in the context of the SWAP (see above).

ANNEX 1: CSP AND MIP TABLES

Table 1: CSP 2007-13

Sector of Concentration	Amounts	% of MIP
<u>MIP I (2007-10)</u>	60 million	100
Priority 1: Support to Education	36 million	60
Priority 2: Stability and Peace Building	22 million	36.6
Priority 3: Trade and Economic Capacity Building	2 million	3.4
<u>MIP II (2011-13)</u>	60 million	100
Priority 1: Support to Education	30 - 36 million	50 - 60
Priority 2: Stability and Peace Building	15 - 21 million	25 - 35
Priority 3: Trade and Economic Capacity Building	3 - 9 million	5 - 15
Total CSP	120 million	

Table 2: MIP 1 (2007-10)

The financial allocation for the 2007-2010 period is **€ 60 million**, or € 15 million per year.

Sector of Concentration	Amounts	% of total MIP
Priority 1: Support to Education	36 million	36
Priority 2: Stability and Peace Building	22 million	36.6
Priority 3: Trade and Economic Capacity Building*	2 million	3.4
<u>Total</u>	60 million	100

*During the MTR conducted in Nepal in March 2009, the MoF requested the EC to transfer € 2 million budget allocated for the project for SMEs to Education to give greater support to SSRP. Therefore, the € 2 million intended for SMEs have been added to Priority 1. However, Priority 3 is expected to receive 5 to 15 per cent of the total MIP 2 budget.

Table 3: MIP 2 (2011-13)

The financial allocation for the 2010-2013 period is **€ 60 million**, or € 20 million per year.

Sector of Concentration	Amounts	Percentages
Priority 1: Support to Education	30 - 36 million	50 - 60
Priority 2: Stability and Peace Building	15 - 21 million	25 - 35
Priority 3: Trade and Economic Capacity Building	3 - 9 million	5 - 15
<u>Total</u>	60 million	100