

Ex-Ante Evaluation (For Japanese ODA Loan)

South Asia Division 2, South Asia Department

Japan International Cooperation Agency

1. Basic Information

Country: Nepal

Program: The Policy Loan for Economic Growth and Resilience

Loan Agreement: January 25, 2022

2. Background and Necessity of the Program

(1) Current State and Issues of the Country's Economy and the Priority of the Program in Nepal

Nepal's economy has continued to grow relatively strongly in recent years and has achieved an average GDP growth rate of 7.8% from FY2016/17, when the country pulled out of a temporary recession due to an earthquake disaster in 2015, through to FY18/19 (IMF, 2021). Despite such recent economic growth, the country's economy has been suffering from a structural vulnerability. Specifically, due to tertiary industries accounting for about 53% of the GDP and due to the absence of an internationally competitive core industry, the country relies on importing many goods from India and other countries, and the trade deficit has been increasing. In addition, there are many migrant workers (about 18% of the total working population (IOM, 2020)) due to the vulnerability of industrial infrastructures with high employment absorption capacity (about 16% for secondary industries, and about 28% for primary industries (World Bank, 2021)), and workers' remittances (corresponding to about 24% of the GDP) compensate the trade deficit in the current account balance. On the other hand, from the viewpoint of promoting domestic industry, an increase in the number of migrant workers leads to a shortage of workers who support domestic industries, which hinders the growth of such industries even more. These migrant workers and workers' remittances are also vulnerable to the impact of overseas economies. Given such circumstances, while the development of domestic industries requires promoting inflow of capital from abroad through foreign direct investment (hereinafter referred to as "FDI") and expanding the domestic market, FDI is at a low level, accounting for 0.6% of GDP (whereas among other countries in the region, India and Sri Lanka account for 1.8% and 0.9%, respectively (World Bank, 2021)). This is due partly to the geographical condition of being a landlocked country with many rugged mountainous areas, and due to lack of infrastructure development, as well as due to inefficient regulations related to financing from

FDI and foreign countries. For example, Japanese companies have called out issues such as complicated procedures for remitting profits back to Japan.

It has also been pointed out since before the spread of the COVID-19 pandemic that there are issues in the planning and implementation of public works projects and debt management by the country's government. For example, the ratio of budget execution from FY2015/16 to FY2019/20 remained about 75% on average. Specifically, implementation of public works projects and provision of public services are inefficient and insufficient due partly to the low administrative capabilities of local governments including provincial governments, which provide the core of administrative services, and due to the inefficient mechanism for coordination between local governments and the federal government (IMF, 2020).

Given such circumstances, the spread of the COVID-19 pandemic has once again brought to the fore the vulnerability of the economic structure and the lack of public financial management capabilities among the country's government. In Nepal, COVID-19 infections have been spreading explosively since mid-2020 (the total number of infected as of the end of Dec. 2021 is about 830,000), greatly affecting not only healthcare but also the economy and people's daily lives. Although the GDP growth rate for FY2019/20 was estimated to be about 6.7% before the outbreak of COVID-19, the results fell to -2.1% (IMF, 2021). In addition, unemployment of migrant workers who were affected by the recession in domestic economy and the COVID-19 global pandemic, as well as their returning to Nepal (about 600,000 people, accounting for about 20% of all migrant workers as of June 2020, returned home) have led to a significant reduction in average monthly income (down about 87% among agricultural workers, down about 98% in the manufacturing industry, etc.), loss of jobs by more than 30% of the people in the country (including temporary loss of job), an increase in the number of children suffering from malnutrition, and more (UNDP, 2020; World Bank, 2021).

In response to this situation, the government of Nepal has set out the concept of 3R (Relief, Restructuring, and Resilience) and indicated that it will engage in systemic reforms to achieve mid- to long-term recovery and growth of the economy and society, along with implementing short-term measures to strengthen support for the healthcare field and mitigate the impacts on people's daily lives by payment of unemployment allowances and other measures as the government's response to the wide-ranging impacts caused by the spread of COVID-19. Incorporating this concept into its basic policy, the FY2020/21 budget

plan clearly indicates initiatives, including preparation and expansion of medical supplies and equipment to deal with the pandemic, strengthening of social security for poor and vulnerable groups, enhancement of collaboration between the federal, provincial, and district governments, construction of strong industrial infrastructures, and reforms for highly transparent and efficient administration. On the other hand, to implement these initiatives, the government of Nepal's budget for FY2021/22 requires about USD500 million. At the moment, however, the government has no prospects for securing USD131 million of the budget and has expressed its expectation that Japan provide assistance equivalent to roughly USD100 million.

The Policy Loan for Economic Growth and Resilience (hereinafter referred to as "the Program") aims to support in reforming economic and financial policies and institutions, and strengthening the domestic industrial base and social security for poor and vulnerable, by supporting the government of Nepal's reform effort through providing financial support co-financed with World Bank, in order to address issues revealed by the spread of the COVID-19 pandemic such as structural vulnerabilities in the areas of the economy and finance, specifically, i) domestic industrial infrastructures and ii) public financial management, as well as social security for poor and vulnerable groups.

(2) Japan's and JICA's Cooperation Policy and Operations related to the Program

Japan's Country Development Cooperation Policy for the Federal Democratic Republic of Nepal (September 2016) and the JICA Country Analysis Paper on Nepal (August 2020) has identified "social and economic infrastructure and mechanism development which directly lead to economic growth and the national livelihoods improvement," "poverty reduction and quality of life improvement," "governance enhancement and basic framework development for democracy," as its priority areas. Specifically, the policies focus on solving structural issues in Nepal's economy by developing investment and business environments including infrastructure, fostering industrial human resources, and other measures with the goal of developing and promoting domestic industries. The policies also state that it is important to support Nepal in reducing poverty and improving quality of life by spreading agricultural technology to poor and vulnerable groups as well as by enhancing healthcare, education, and other services. At the same time, it is stated that Japan supports to improve governance among the central and local governments. The Program—which is intended to work to reform economic and financial policies and institutions, to strengthen domestic industrial base and

social security for poor and vulnerable by supporting the government of Nepal's reform effort through financial support—is consistent with these policies. .

At the same time, the Program is also considered to contribute to the achievement of Sustainable Development Goals (SDGs) Goal 1 (No Poverty), Goal 2 (Zero Hunger), Goal 3 (Good Health and Well-Being), Goal 8 (Decent Work and Economic Growth), Goal 10 (Reduced Inequalities), and Goal 13 (Climate Action). Therefore, all these aspects suggest that it is highly relevant to support the implementation of the Program.

(3) Other Donors' Activities

In response to the issues revealed by the spread of COVID-19, the IMF approved a Rapid Credit Facility (USD214 million) in May 2020, and supported financial assistance mainly for enhancing healthcare services and equipment as well as for operating capital of small- to medium-size companies. Currently, the IMF is also considering the approval of additional financial support of about USD400 million under an Extended Credit Facility (ECF) on the condition that public financial management be improved.

As financial support for rebuilding the healthcare system, society, and the economy, the World Bank has approved the COVID-19 Emergency Response and Health Systems Preparedness Project (after approving USD29 million in March 2020, it additionally approved USD75 million in February 2021), providing support for processes involved in COVID-19 from testing to treatment, preparation of facilities and equipment, vaccine procurement, and promotion of vaccination.

In April 2020, the Asian Development Bank approved the COVID-19 Active Response and Expenditure Support Program (USD250 million) to provide poor and vulnerable groups with support for food aid and employment promotion as well as to support improving the employment environment, etc. mainly for female healthcare workers. The Bank also plans to provide support for enhancing healthcare services in the amount of USD169 million during FY2021/22.

3. Program Description

(1) Program Objective

The objective of the Program is to support the Government of Nepal in reforming economic and financial policies and institutions, and strengthening the domestic industrial base and social security for the poor and vulnerable by providing financial support, thereby contributing to promoting mid- to long-term growth and strengthening of the country's economy.

(2) Program Site/Target Area

The entire Nepal

(3) Program Components

The Program will provide financial support to the government of Nepal, which will implement the following reform measures to address issues revealed by the spread of the COVID-19 pandemic such as structural vulnerabilities in the areas of the economy and finance, specifically, i) domestic industrial infrastructures and ii) public financial management, as well as social security for poor and vulnerable groups, based on the policy matrix (attachment). The financial support fund will be incorporated into the country's general budget and the target outcomes will be monitored after the loan is disbursed. Basically, the policy matrix set out by the World Bank is shared as the policy matrix for the Program. However, the policy actions for policy target "2-2 To develop an investment environment for foreign companies" (see 2-2 of the attachment) has been additionally added for the Program in an attempt to clarify the time required for the procedures to bring in foreign currency of foreign companies who perform FDI and to remit money to their home countries in light of Japanese companies' intentions.

(4) Estimated Program Cost (Loan Amount)

10,000 million yen

(5) Program Implementation Schedule

From January to May 2022 (four months). The Program will be completed upon loan disbursement (scheduled for March to May 2022).

(6) Program Implementation Structure

1) Borrower: The Government of Nepal

2) Guarantor: None

3) Executing Agency: International Economic Cooperation Coordination Division (hereinafter referred to as "IECCD")

(7) Cooperation and Sharing of Roles with Other Donors

1) Japan's Assistance Activities

Since FY17, JICA has been providing technical support by individual experts (foreign investment advisors, from 2017 to 2019 and from 2021 to 2023) to Investment Board Nepal with the aim of promoting FDI. As the Program also includes policy actions aimed at promoting FDI, JICA will cooperate in promoting foreign investment in line with the experts' activities, including that from a policy aspect.

2) Other Donors' Assistance Activities

The World Bank provided financial support to households and citizens who lost their livelihoods, faced significant reductions in income, lost their jobs, and so on in terms of providing benefits and reemployment support; to private companies in terms of financing and promoting FDI; and to the government for improving public finance management capabilities. This financial support was approved as the Nepal Programmatic Fiscal Policy for Growth, Recovery and Resilience Development Policy Financing (hereinafter referred to as "FGRR," USD150 million) in June 2021, and the Program will implement co-financing with the World Bank while using this policy matrix (attachment). The World Bank is also planning a second round of financing (USD100 million) under the above FGRR to occur during FY21/22.

(8) Environmental and Social Considerations/Cross-Cutting Issues/Gender Category

1) Environmental and Social Considerations

(i) Category: C

(ii) Reason for categorization:

The Program is likely to have minimal adverse impact on the environment under the JICA Guidelines for Environmental and Social Considerations, released in April 2010.

2) Cross-Cutting Issues

(i) Relevance to climate action: The Program—which includes initiatives related to promoting the implementation of an environmental protection law to strengthen consideration of alternative plans, introduce strategic environmental assessments, and consider schemes for mitigating and adapting to climate change for public projects worth 0.5 billion Nepalese Rupees or more at the federal, provincial, and district levels (the environmental protection regulations regulating bylaws pertaining to enforcement of the law has been approved by the Cabinet) in the policy action—is expected to contribute to mitigating and adapting to climate change.

(ii) Poverty reduction and considerations: The Program is expected to contribute to improvement of access to medical supplies by poor groups through the reduction of import customs duties on medical supplies, improvement of security of livelihoods of those in poor groups through employment creation and provision of benefits as well as other

measures, and more.

(iii) HIV/AIDS and other infectious disease control: None in particular

(iv) Participatory development: None in particular

(v) Disability considerations: None in particular

3) Category of Gender: GI (S) Gender informed (Significant)

<Description of activities and reason for classification>

The Program includes payment of subsidies and other measures to support the development of female entrepreneurs under the Micro-Enterprise Development for Poverty Alleviation (MEDPA) program in the policy matrix, and the number of female beneficiaries has been set as a criterion.

(9) Other Important Issues

None in particular.

4. Targeted Outcomes

(1) Quantitative Effects

1) Outcomes (Operation and Effect Indicators)

For operation and effect indicators, the same indicators as those in the policy matrix of the World Bank (see the attachment), a co-financier, are used. However, JICA's own indicator is used for the following item.

Policy goal	Performance indicator	Baseline (Results for FY19/20)	Target (July 2024)
2-2 To develop an investment environment for foreign companies	% of approval of foreign currency exchange for the repatriation given within 15 working days.	59.57%	100%

(2) Qualitative Effects

Stipulation of rules to manage public works projects implemented using government budgets; clarification of the scope of duties for which federal, provincial, and district governments are responsible and the division of roles among them; development of an investment environment; and so forth

(3) Internal Rate of Return

No internal rate of return has been calculated because this is a program loan.

5. Preconditions and External Factors

(1) Preconditions:

None in particular.

(2) External Factors

One external factor is that problems related to Nepal's debt sustainability, such as an extreme deterioration in the total amount of foreign currency reserves and the ratio of external debts, do not arise.

6. Lessons Learned from Past Programs

The lesson learned from the ex-post evaluation and other analyses of the ODA loan titled "Development Policy Support Program – Investment Climate", a Japanese ODA loan for the Republic of the Philippines (evaluated in FY17), is that monitoring policy reforms while sharing the policy matrix with international organizations and working with them is expected to bring about reform promotion effects, and that this method makes it easier to address even tasks that are difficult for one aid agency alone to support. By monitoring the progress made in the government of Nepal's policy reforms, its performance indicators, etc. together with the World Bank, a co-financier, the Program plans to encourage initiatives for FDI promotion, public finance management, and other reforms that are difficult for JICA alone to support. In particular, plans call for the Program to work with foreign investment promotion advisers sent by JICA for technical cooperation in promoting FDI.

7. Evaluation Results

This Program is consistent with the development issues and policies for Nepal as well as Japan's and JICA's cooperation policies and analyses. It will contribute to promoting mid- to long-term growth and strengthening of the country's economy through financial support. Also the Program will likely contribute to SDGs Goal 1 (No Poverty), Goal 2 (Zero Hunger), Goal 3 (Good Health and Well-Being), Goal 8 (Decent Work and Economic Growth), Goal 10 (Reduced Inequalities), and Goal 13 (Climate Action). All these aspects suggest that it is highly relevant to support the implementation of the Program.

8. Plan for Future Evaluation

(1) Indicators to Be Used for Future Evaluation

As indicated in Section 4.

(2) Timing

Ex-post evaluation: 2 years after program completion

End

Policy Loan for Economic Growth and Resilience: Policy Matrix¹

Pillar	Area	Policy Actions	Performance Indicator	Baselines Indicator (Results for FY2018/19)	Target Indicator (July 2024)
Strengthen the economic and financial regulatory and institutional framework to build back better the economy and society	1-1	To increase debt transparency (i) Ministry of Finance has issued a notification for PDMO to publish (a) biannual debt bulletins containing debt analysis and annual debt information in a portal of the Public Debt Management office's website from FY21 onwards and (b) quarterly debt bulletins consisting of debt statistics of the Government of Nepal from FY22 onwards; and (ii) the PDMO has published the first biannual debt bulletin and the corresponding data on its website.	Nepal's scores in the World Bank's debt transparency heat map categories "Debt Management Strategy", "Annual Borrowing Plan", "Periodicity" and "Data Accessibility"	Debt Management Strategy: Red (not available) Annual Borrowing Plan: Red (not available) Periodicity: Yellow (Annual) Data Accessibility: Yellow(single website/multiple documents) (the end of FY 2019/20)	Debt Management Strategy: Green (available) Annual Borrowing Plan: Orange (partial) Periodicity: Green (< than yearly) Data Accessibility: Green (single website/single documents)
	1-2	To establish mechanisms for enhancing the efficiency and shock-resilience of public capital spending (i) Financial Procedure and Fiscal Responsibility Regulations have been published in the Nepal Gazette; and (ii) the Ministry of Finance has approved "budget working procedures" which require that all projects with budgeted expenditure exceeding NPR 500 million are included in the National Project Bank in order to receive budget.	Share of newly approved public capital projects following the National Project Bank procedures.	0%	Above 85%
	1-3	The Cabinet has adopted the Environmental Protection Rules 2020 to implement the Environmental Protection Act 2019, which contain provisions prescribing measures to: promote climate change adaptation and greenhouse gas reduction at the federal, provincial and local levels of government; strengthen the alternatives analysis in the environmental impact assessment of proposed projects; and introduce strategic environmental analysis of select proposed policies programs, or projects.	Share of environmental impact assessments of federal government capital projects included in the National Project Bank containing alternatives analysis, meeting EPR2020 requirements	0%	100%
	1-4	To reduce carbon emissions from healthcare waste disposal (i) the Cabinet has adopted the Public Health Service Regulations 2020 including a reference to healthcare waste management standards; and (ii) the Ministry of Health and Population has adopted the National Healthcare Waste Management Standards and Operating Procedures 2020.	Percentage of central and regional hospitals equipped with autoclaves according to the National Healthcare Waste Management Standards and Operating Procedure 2020	0%	100%

¹ The order of listing above differs from that of the World Bank because this matrix describes actions for the issues examined by JICA. This matrix also does not include the second and third rounds of policy actions for FGRR planned by the World Bank.

	1-5	To enhance service delivery in areas of concurrent powers, the Recipient has published the Intergovernmental Coordination Act in the Nepal Gazette.	Share of local governments' untied resources (equalization grants, own-source revenue and revenue sharing) spent on education, health and social protection.	2.2 %	4.5 %
Strengthen the domestic business environment for resilient economic growth	2-1	The Ministry of Finance has amended the Provision on Issuance of Bond in Local Currency (Second Amendment, 2020) to: (i) expand the list of sectors in which proceeds from NPR-denominated bond issued in the off-shore market can be invested; (ii) enable proceeds of the bonds to be invested directly in the approved sectors; and (iii) eased the process of repatriating funds (principal, interest and applicable fees) towards the redemption of the bonds on or before maturity.	Number of projects financed by proceeds from offshore local currency bond issuance	0	Above 4
	2-2	The amendment of the "Foreign Investment and Foreign Loan Management Bylaws", which eases the procedures for bringing in foreign currency by foreign investors to prepare for FDI in Nepal and clarifies the procedures for foreign investors to repatriate the foreign investment or amount generated from such investment.	% of approval of foreign currency exchange for the repatriation given within 15 working days.	59.57%	100%
Strengthen the social protection measures for poor and vulnerable people	3-1	To provide relief during COVID-19 (i) amendments to import tax rates for health-related items have been published in the Nepal Gazette as part of the FY21 budget; and (ii) the Cabinet has approved the Customs Bill and has submitted it to Parliament.	Import taxes (including VAT) as a share of total tax revenue.	46%	36%
			Percent of low-risk consignments destined for Nepal proceeding through Customs in a fast-tracked "green lane"	30%	Above 45%
	3-2	To enhance social protection (i) the Cabinet has approved an expansion of the child grant in 117 local levels; (ii) an expansion of the PMEP – including for green jobs – has been approved as part of the FY21 budget and published in the Red Books; and (iii) the Ministry of Industry, Commerce and Supplies has approved new guidelines for the Micro-Enterprise Development for Poverty Alleviation (MEDPA) program targeted at female entrepreneurs.	Number of child grant beneficiaries	900,000	Above 1,200,000
			Number of female beneficiaries supported under the updated Micro-Enterprise Development for Poverty Alleviation program	0	Above 70,000