

**Review of Development Partnerships in Nepal:
Review Team's Main Findings and Recommendations**

January 21, 2002

A. Context and objective of the Review

1. As the Government of Nepal (HMG) begins to prepare the Tenth Plan, there is an increasing focus and sense of urgency on improving the effectiveness of its programs and projects aimed at stimulating an accelerated sustainable development, reducing poverty, and contributing to the elimination of violent conflict. HMG's declared intention of making the Tenth Plan its Poverty Reduction Strategy Paper (PRSP) underlines the commitment to reinforcing the poverty focus of its development plan. The recent rise in Maoist insurgency has also given broader segments of Nepali society a strong reason to be concerned with the effectiveness of development programs. Prime Minister Deuba has identified poor public service delivery as one important cause of the insurgency. This collective introspection by the Nepali nation on its development efforts is an important basis for a renewed and more focussed approach. But it is not enough. It is crucial and indispensable that there be greater efforts by all involved partners in implementing national priorities and programs in a way which is inclusive and is likely to gain national support.

2. As HMG is taking stronger responsibility for defining a poverty reduction strategy and managing its public expenditure programs through the Tenth Plan, redefining the relationship between donors and HMG as well as other Nepalese actors will have to be an integral part of this effort. At the imminent Nepal Development Forum (NDF), HMG plans to make the framework for foreign aid and donors' accountability one of the main agenda items. Having long stressed the need for stronger leadership by HMG and a more satisfactory HMG-donors partnership, donors welcome this evolution. In preparation for this important dialogue, a review of donor performance and practices with a particular emphasis on identifying ways to improve the pattern of interaction between donors and HMG has been considered an important basis on which to discuss more effective collaboration in the future.

3. Against this background, and to fulfill the commitment donors made at the last NDF meeting in April 2000 to review donor practices, the donor community in Nepal requested a Review Team to undertake a review of donor performance and practices. The Review Team was composed of Mr. Pietro Veglio, Head of Division, OECD/DAC, Paris; Mr. Basil Kavalsky, Senior Advisor, the World Bank, Washington DC; Mr. Arve Ofstad, Research Director, Chr. Michelsen Institute, Bergen; Ms. Philippa Wood, consultant, Oxford Policy Management, Oxford; and Mr. Binod Bhattarai, consultant, Kathmandu. The work was conducted under the guidance of an Expert Panel, consisting of Mr. Emmanuel Tumusiime-Mutebile, Governor of the Central Bank of Uganda, Kampala; Dr. Devendra Raj Panday, former Finance Secretary and former Finance Minister, HMG, Kathmandu; as well as Messrs. Veglio, Kavalsky and Ofstad. The full Terms of Reference (TOR) for the Review of Development Partnership are described in

[Annex 1](#). Members of the Review Team visited Nepal from November 18 to 30, 2001. Mr. Tumusiime-Mutebile, a member of the Expert Panel, visited Nepal from December 9 to 14, 2001.

4. The main objective of this review is to help donors reflect on their past assistance efforts, particularly the ways in which they worked with the process of Nepal's own development efforts, and to make pragmatic suggestions on how to improve their effectiveness in the near future with respect to the main issues identified in the TOR. The Members of the Review Team would like to thank all the people and organizations they met during their time in Nepal. While the Review Team Members assume the full responsibility for the content of the report, it is noteworthy that the main elements underpinning their analysis were raised by the many stakeholders they met. The Review Team Members would like to especially thank all the persons who organized and facilitated our work and presence in Kathmandu.

B. Consultations with stakeholders groups

5. Thanks to the preparatory work done in Kathmandu by the donor community, the Review Team was able to access a very rich and stimulating range of experiences and perceptions about the nature of past aid efforts in Nepal and identify key actions for improvement in the future. Consultations with various stakeholder groups and interviews with knowledgeable parties were completed by the Review Team Members. The main results of such consultations, including those by Mr. Emmanuel Tumusiime-Mutebile, are reflected in [Annex 2](#) (Donors and other stakeholders); [Annex 3](#) (Emmanuel Tumusiime: Meeting with Donors, December 11, 2001); and, [Annex 4](#) (Emmanuel Tumusiime De-briefing, December 14, 2001). These very rich views are an integral and essential complement to this report.

C. Relationship between donors and Nepal

6. The present relationship between donors and Nepal is far from ideal. From a quantitative perspective, Nepal is heavily dependent on donor assistance because of the extent of poverty, few internal resources, huge needs and the low level of national and local revenues. By tending to supplant Nepali efforts with aid money, and by diverting the attention of Nepalis in positions of power towards new aid commitments, donors have inadvertently and indirectly contributed to the failure of the Nepalis to resolve their own problems. Among the various groups the mission met with, there was a general concern expressed that donors are too dominant and that the impact of aid programs and overall development efforts are not generating satisfactory and sustainable results on the ground.

7. For their part, donors have responded to what they have seen as the ineffectiveness and lack of direction and prioritization of HMG by taking more and more responsibility for designing and implementing programs and projects. Some donors have reduced their aid levels and formulated strong conditions in their aid programs; others

have reduced their efforts to work through the central government and instead work more directly with local governments, NGOs and communities; or engage their own implementing agencies and consultancy companies. Aid has provided important contributions to the improvement in living standards in isolated valleys and hillsides and has resulted in some significant improvements in program implementation (e.g. community forestry, rural development; road construction and maintenance). Nevertheless, without a strong collaboration with national institutions, the sustainability and replicability of many programs remain uncertain. There is a general perception within Nepali civil society that in the past two decades the national institutional capacity for development has eroded due partly to increased donor activism. They consider that in order to reverse this situation, it may be necessary to allow the national actors to make their own mistakes and learn from them.

8. As reflected in the *Annex 2*, HMG, donors and major Nepalese stakeholders agree on some common elements of the analysis on the main weaknesses in the relations between donors and Nepal but also have some different views and perceptions about their respective roles.

9. **HMG** feels it has little choice but to accede to donor pressures on the allocation of resources even if these are not in line with its own priorities. HMG also considers that donor aid is important and has contributed to overall progress. At the same time there is considerable mistrust of the motives of many aid donors. HMG also thinks that donors tend to have their own agendas as well as commercial interests, and do not always accept the government's own priorities and budget choices. Some of them are "pushy" and tend to set unreasonable and/or inconsistent conditions and timeframes, not fully appreciating Nepalese realities, HMG constraints and the challenge of ensuring the sustainability of their efforts and of their outcomes. In particular, some donors have explicitly made Nepal a target country (e.g. 'program country'), in some cases through legislative action, and allocated generous annual grant resources and 'envelopes'. Given the prevailing 'incentive structure' in aid management, this creates a pressure to push money out. Moreover, donors are perceived as not being sufficiently transparent, especially regarding funding of INGOs.

10. **Donors** feel that there is a lack of HMG ownership, poor performance and much "leakage" in the government system. They see a centralized HMG, not strongly interested in development issues and poverty reduction, and failing to reflect national development needs and priorities in an inclusive and transparent way. Although the cabinet is very large, the civil service is arguably bottom heavy, with relatively few senior officers who can really do policy-type work. At the same time, they perceive a "soft state" that is under multiple pressures, unable to take decisions and stick to clear priorities. Deficiencies in quality control, predictability, transparency, and accountability in key government institutions and politicization and frequent transfers in the bureaucracy, have contributed to inappropriate allocation of budget resources, and ineffective implementation of development programs. In spite of this, many donors believe that most of their aid projects are providing support to high priority sectors, and are reasonably successful. The degree of success may vary substantially as even many

community-based projects, after initial success, do often suffer in their sustainability because they require some support from public institutions.

11. **NGOs, professionals and media** are very critical of the dysfunctional relationship between HMG and donors, which they see as a significant component of aid ineffectiveness in Nepal. They argue that aid has generally not delivered the benefits that were hoped for. Many believe that donors have contributed to “failed development” in Nepal. They consider that multilateral development banks set ineffective and unrealistic conditions that undermine development and worsen the conditions for the poor. They also see some bilateral donors as pushing their own commercial interests and believe that over-funding of certain (large) projects, without openness and competition, has contributed to corruption. They argue that the donor community is not sufficiently concerned about the specific circumstances and needs of the poor in rural and isolated areas. There is a strong feeling that donors are not transparent and their reporting and accountability mechanisms are mainly focused on their headquarters’ requirements, rarely on the need to inform and also be accountable to the Nepali public. Nevertheless, it is not always clear whether civil society is ready to be fully transparent in order to enhance its own credibility and effectiveness.

12. The Review Team finds many of the above arguments relevant. They should therefore be seriously considered and addressed by all involved in a joint effort to improve HMG-donor partnerships. It has to be acknowledged, however, that Nepal is confronted with a set of development challenges that will require a focussed and persistent effort over time from all partners:

- Structural weaknesses in governance, the civil service, and management of public spending. Systemic factors, which cut across virtually all sectors and projects/programs, have contributed to poor implementation and weak results on the ground. These systemic factors include: institutional weaknesses that impact negatively on the effectiveness of public spending; an underpaid and poorly motivated civil service; excessive political interference in the bureaucracy and increasing corruption; and deficiencies in budget planning, resource allocation and expenditure management process. For all the above reasons, the public sector has failed to create an enabling environment for promoting private sector development. Overcoming these weaknesses and deficiencies will require important changes in the political environment, behavior and attitudes, and strengthened institutional capacity, in particular improved governance and transparency; greater local ownership of and participation in the public resource management process; and, reforms to create a strong and more decentralized civil service.
- Globalization. There are many hurdles that Nepal faces in an increasingly globalized world and regional economy. Nepal is a landlocked nation with high transportation costs resulting from a poor road and transportation infrastructure within the country and in neighboring countries on which Nepal relies for access to a seaport. In the few areas that Nepal has distinct comparative advantage vis-à-vis its neighbors such as in hydropower and tourism, its success in attracting foreign investment has been limited

so far. Finally, Nepal's small domestic market and a restricted access to markets in neighboring nations make it less attractive to foreign investors. While in the longer run globalization may offer Nepal some new opportunities, the process of greater integration with the global economy will be extremely challenging. Therefore, it is indispensable, both for HMG and the donor community, that an effort be made to create reasonable and not over-optimistic expectations with respect to Nepal's future growth prospects and likely overall performance in reducing poverty.

- Because of the Maoist insurgency, Nepal is now affected by an internal conflict that could fester for a long time. HMG hopes the present state of emergency may be over relatively soon, but the prospects for long-lasting peace appear uncertain and HMG will likely be forced to divert money from development programs for fighting an internal war. There is a real danger that the more development is delayed, the higher will be the frustration among some segments of the population. Under these circumstances, some donors may maintain or even increase their development funding as political support to HMG. However, to do so in the face of increasing security expenditures will obviously cause immediate concerns of fungibility of aid. HMG will have to demonstrate that it is making serious efforts to make its programs more effective in providing critical services to the poor. On their part, donors need to ensure that their aid will indeed contribute to making the overall expenditures of HMG become more poverty focused. Nevertheless, the internal conflict will likely take money away from development, investment and tourism may be badly affected, and slow development may continue to fuel the insurgency. The development goals that HMG needs to pursue with greater vigor today are in fact anticipated in the 1990 Constitution of the Kingdom of Nepal (in Part Four) that provides for the Directive Principles¹ and State Policies².

13. On a positive note, there are some recent promising developments as well as new opportunities for building and reinforcing a more constructive relationship between donors and Nepal:

- HMG's draft Foreign Aid Policy, a document prepared by the Foreign Aid Coordination Division of the Ministry of Finance, sets out the role of foreign aid in the development of the country; the persisting problems relating to foreign aid; the main objectives of the foreign aid policy; and the major strategies for the implementation of such a policy. It states that to realize the national goals of economic development and poverty reduction, there is an urgent need for optimal utilization of resources through the establishment of proper congruence and coordination between development requirements and priorities.

¹ The first Directive Principle is as follows: *It shall be the chief objective of the State to promote conditions of welfare on the basis of the principles of an open society, by establishing a just system in all aspects of national life, including social, economic and political life, while at the same time protecting the lives, property and liberty of the people.*

² The first State Policy is as follows: *The State shall pursue a policy of raising the standard of living of the general public through the development of infrastructures such as education, health, housing and employment of the people of all regions by equitably distributing investment of economic resources for balanced development in the various geographical regions of the country.*

- The 2002 Nepal Development Forum in Kathmandu (planned for 4-7 February, 2002) will be the first NDF held in Nepal. It will be an excellent opportunity for putting the development and reform agenda higher on HMG's priorities and for involving the Parliament, political parties, civil society, NGOs and the media in the national debate on development.
- Donors are generally showing an increasing awareness about the need and urgency to change the ways in which they interact with HMG, not only at each individual level but also collectively. This applies both to the relevance, effectiveness and efficiency of the overall effort of the donor community in Nepal, as well as the ongoing effort of the donor representatives in Kathmandu, aimed at reforming their practices at national and local levels. Active donor coordination in some sectors, in collaboration with line ministries, is also indicative of willingness to change their working habits.
- The integration of the 10th Plan with the PRSP process, together with the introduction of a Medium-Term Expenditure Framework (MTEF), are perceived both by HMG and donors as an opportunity and a challenge to enhance overall aid effectiveness in Nepal. The challenge will be to ensure that both the Tenth Plan and the MTEF are realistic, reflect the development needs and priorities in an inclusive way, and are accepted as a guiding framework for all HMG ministries and entities.

D. Donor approaches and practices

14. While development is ultimately an HMG responsibility, in Nepal the agenda is still mainly driven by donors. The absence of effective collaboration with central Government has led donors to a series of 'coping strategies' for delivering aid in this environment:

- They make extensive use of expensive foreign consultants and engineering companies.
- They sometimes initiate and formulate projects and programs, and implement these without much involvement of national institutions.
- In some cases donors direct resources to and through agencies at the local level which are closer to the ultimate beneficiary and subject to the discipline of the local community.
- Even when donors work at the national level they may set up specialized project implementation units outside the framework of national ministries and institutions or support INGOs and local NGOs to manage projects. This enables higher salaries to be paid to motivate the concerned individuals.
- They stipulate a number of reforms and conditions at sectoral and/or national levels that HMG feels it has to accommodate without itself fully "owning" these reforms and conditions.
- They introduce their own concept of development and the latest "aid fashion" without ensuring that these new ideas are strongly grounded in Nepal realities and institutions.

Box I: Main Findings of a mission of Mr Emmanuel Tumusiime-Mutebile, Governor of the Central Bank of Uganda.

Mr Tumusiime-Mutebile highlighted the political dimension of Nepal's record in using aid. He noted in particular that the tenure of Nepalese Prime Ministers in recent years was so short that it did not give any Prime Minister or his colleagues the right incentives to focus on the longer term. Related to this there was an emphasis on both the donor and recipient side on levels of commitment of new aid rather than on the quality of programs. Mr Tumusiime-Mutebile felt that donors bore a special responsibility for having offered new assistance regardless of the outcomes of existing programs and that it was difficult from a political perspective for HMG to decline such assistance when offered. He urged HMG to take the difficult course of creating a greater political consensus about major development issues, and sticking with them and donors to link aid more closely to priorities and to development outcomes.

(More details in Annexes 3 and 4)

15. Despite these strategies and mechanisms, the record of aid implementation remains mixed. It is very difficult to design and implement development programs without effective national involvement. Most programs require some input of counterpart funding – and this has been a serious problem given the low tax collections – as well as a sound and sustainable institutional setting. In addition, there are key policy and legislative changes required to support many programs and delays have seriously hampered project implementation and outcomes. Finally, when public institutions lack effective accountability mechanisms, even “well designed and well implemented” projects cannot escape the concerns of fungibility. Experience worldwide shows that a hard budget constraint, or a fiscal crisis, has often catalyzed severe prioritization in budget and structural reform. In Nepal, generous provision of aid has tended to keep the budget constraint very soft, thereby weakening the much-needed discipline in public expenditure management and delaying some important reforms. Through such aid, donors have arguably helped to entrench the system of public spending in which politically motivated projects and corrupt practices eat away large portions of the public resources. The “benefits” of specific donor funded projects must be measured against the enormous costs of the systemic waste and institutional decay that may have resulted at the aggregate level.

16. The system of donor co-ordination which has evolved on the ground in Kathmandu is quite impressive. In addition to the general coordination meetings, a series of thematic groups have been formed, many of these with HMG participation and some chaired by HMG. Unfortunately those thematic groups where HMG takes the lead, have often been those which were least effective. However, in the Basic and Primary Education Project (BPEP), donors have been successful in coordinating their expenditures within an HMG-established sector strategy and framework. This is an important experience that donors should expand further. In many other sectors, donors work in parallel but without a foundation of HMG-owned framework or without express

willingness to 'underwrite' part of that framework in a way that maintains the integrity of the expenditure allocation. One obvious way to do this would be through basket funding or sector budget support.

17. One area where donor coordination has not been effective is in harmonization of their approaches to the logistics of development assistance – procurement procedures, financial management, audits, reporting requirements, etc. As in many other developing countries, the different donor approaches put a very heavy burden on a government which is poorly equipped to deal with them. It is fundamental that donors, with the full involvement of their headquarters, focus on this problem. A special committee of donors should be constituted in Kathmandu to go through these areas and review the options.

18. There is a general perception that the “institutional memory” of many experiences and lessons of past years is not effectively built up or is largely “lost” and that HMG, donors and international and sometimes local consultants tend to “reinvent the wheel”. This weakness has been exacerbated by high rotation of expatriate staff within local donor agencies. Despite coordination in Kathmandu, donors also do not seem to make much effort to learn from the experience of other donors – either by avoiding mistakes or by replicating successes. As discussed below, part of this results from lack of effective evaluation and information management, but there is also an element of self-centered behavior which donors need to address through their internal incentive systems. For some donors there is too much concern for having their own label and “flag” on particular programs and projects. It may be important for Nepal, however, that donors continue to present alternative approaches and ideas, built on different experiences from donor programs in other developing countries, and their respective home countries and headquarters. There seems to be a large variation in the sector policy environment different donors find adequate to underpin their assistance. Various HMG ministries seem to adeptly exploit this to gain assistance from donors that set the “lowest policy hurdle.” Especially in an environment where relatively large amounts of aid tend to “compete for good projects”, close donor coordination on policy issues is critical. Mixed policy messages do not facilitate HMG’s own reform efforts.

19. An important point raised frequently in meetings was a perception of lack of transparency in donor programs. There was a sense among HMG and NGOs that there were a number of ‘black boxes’ concerning, for example, overall costs, selection of companies and consultants, evaluation and impact studies, and the use and financing of INGOs and local NGOs. Donors need to consider how they can deal with this perception through increasing both individually and collectively the information about and transparency of their aid programs and projects, including easy access to available supervision reports and evaluations.

20. A final dimension of donor coordination concerns strategic and high-level co-ordination. While the NDF provides a mechanism for this, in many cases the broad commitments which are made do not translate into consistent steps at the program level. There seems to be more consistency when donor representation in Kathmandu is at a sufficiently senior level to enable decisions to be made on the ground. Such an approach gives a much higher probability of aid effectiveness and country impact being the driver for decisions, rather than unadjusted agency policy and procedures. Hopefully the outcomes of the imminent NDF will provide an opportunity for more explicit commitments to achieving country level outcomes and donors should be urged at the NDF to commit themselves to following this approach.

E. HMG approaches and practices

21. The HMG process of monitoring and evaluation is weak as the politicians and senior officials focus more on aid commitment levels than quality and development outcomes. Supervision and monitoring of ongoing activities seem to depend excessively on donors alerting the concerned line ministry or the Ministry of Finance about delays and implementation problems. Evaluation mechanisms for past projects are weak or virtually non-existent within the Ministry of Finance as well as in the National Planning Commission, line ministries and District Development Committees. Some good practices of the past aimed at involving ministers and parliamentarians in assessing the effectiveness and efficiency of both HMG and donor-supported programs and projects have unfortunately been abandoned.

F. Broad recommendations

22. A successful partnership for development requires that HMG and Nepalese institutions be in the driver's seat. This requires a more active participation and strong leadership by the involved Nepalese institutions, while the donors may have to restrain their direct involvement and take a more facilitating role. Of course, this will not happen without a strong Nepalese institution that directs and takes responsibility for planning, implementation, monitoring and evaluation. It also requires an overall agreement on basic development issues, and mutual trust between the partners. Given the less-than-ideal past relationship, this will demand a willingness to change both among donors and by HMG.

23. The Review Team finds that there is now an opportunity to initiate a new "compact" between donors and HMG. The imminent NDF could be used to orient this process around the new Foreign Aid Policy document, the Tenth Plan based on a PRSP process, a Medium-Term Expenditure Framework, effective decentralization, and sectoral plans and programs with broad participation. Taken together, these should address the multiple challenges of ensuring national ownership, reducing counterproductive competition among donors, and reducing inconsistent conditionalities. Both donors and HMG should be expected to implement reforms in their approaches and practices to turn these plans and programs into reality for the benefit of the Nepalese people.

24. The development of the 10th Plan as HMG's Poverty Reduction Strategy Paper (PRSP) represents a welcome opportunity. This could allow for the broader involvement of important stakeholders in planning the development, direction and priorities in a medium term perspective. This is also a chance to confirm that poverty reduction has become the central focus of the HMG policies and budgets in recognition of real needs, not just to a "wave of fashion" in the international community. As in other developing countries, pro-poor growth is necessary to make serious inroads on poverty over time. Pro-poor growth requires effective use of the economic policy tools in the

hands of HMG – monetary, fiscal and structural policies – to encourage investment as well as gains in labor productivity by the poor. At the same time, key complementary policies are needed to build productive assets of the poor – by providing such services as education and health, by supporting the accumulation of assets such as land or livestock, and by increasing their access to markets.

25. The planned MTEF will be crucial to address the critical issue of sharp prioritization of expenditures to focus the limited resources on poverty related programs, and ensure consistency between the 10th Plan and annual budgets. If implemented properly, the MTEF should also address the issues of effective implementation of the budget, including monitoring and evaluation, and accountability for outcomes, thereby improving the quality of public service delivery. An effective MTEF will, therefore, also provide a framework within which donors can make medium-term commitments of funding, with annual adjustments based on performance.

26. In recent years, increased powers and duties have been devolved to locally elected bodies. However, the experience so far with the implementation has been mixed. The main issues at stake in the decentralization process are (i) the need for improved governance and transparency; and, (ii) for enhancing management and technical capability. The first priority should therefore be to increase transparency and accountability of local governments to their constituencies. In parallel, the institutional and management capacity to formulate and carry out projects and programs by local governments need to be strengthened. Decentralisation should not be seen by HMG and by the concerned donors as merely a technocratic task. Substantive powers, not just aid funds, must be devolved to the local government bodies who in turn will be held accountable to their constituencies. In particular, promoting greater participation of local level beneficiaries and community groups is essential for strengthening accountability and transparency.

27. The future of sectoral aid coordination in Nepal depends on a stronger HMG involvement. HMG needs to establish accountability in the concerned sector ministry for leadership of the thematic groups, and develop sector plans and programs within the framework of the Tenth Plan and the MTEF, based on realistic assumptions about resources available. Donors could support a secretariat for each sector and agree on a program of action for a policy dialogue that should involve broad participation among stakeholders in the sector.

28. The Tenth Plan could offer a new opportunity to strengthen the overall monitoring and evaluation mechanisms for all investment programs including those which are aid-supported. A good system has to provide information useful for action in terms of its timeliness and the indicators used. Traditional monitoring tools – household surveys and participatory assessments – can produce detailed results on impacts but often with a time lag and without immediate policy relevance. There is therefore a key role for tools that provide quick feedback on processes and outcomes, and that can be used to inform decisions. It is important to note, however, that assessing performance of donor and HMG interventions will require substantial work, in building appropriate capacity and in

changing from an “input-oriented culture” towards an “implementation and results-oriented culture”. It would be extremely important that donors focus on this dimension. Unless the level of donor assistance is meaningfully linked to implementation and results, this critical change in culture will not easily come about.

29. It is important to point out, however, that the present process of preparing the Tenth Plan with stronger involvement of line ministries and stronger insistence on consistency and priorities, will not be sufficient to achieve the ambitious goals established for achieving a consolidated, resilient and sustainable development plan focussed on poverty reduction. HMG may be underestimating the degree to which line ministries and NPC have to be substantially involved in changing their way of thinking and their practices. If HMG is so ambitious as to make its Tenth Plan a more relevant and effective document, a revamping of the NPC – both in terms of its staff and political accountability – may be necessary. By arguing that the Tenth Plan can stand in for the PRSP with a small amount of increased donor coordination and with most of the preparatory work done by consultants outside the government, HMG runs a risk that the result will be "business as usual" and therefore no significant change. **In this case a major opportunity will be foregone.** This issue needs to be central to the agenda of the upcoming NDF.

30. In particular, with revenues at 11% of GDP and with aid constituting more than 70% of development expenditures, a serious effort will be necessary to avoid a situation in which tax resources will continue being diverted through corruption and aid expenditures and remittances from abroad will not be yielding their potential return to the economy as a consequence of diversion into rents.

G. Specific Recommendations for short-term follow-up

31. Specific recommendations to HMG:

- Revise and adopt the Foreign Aid Policy taking into account the comments received.
- Prepare an inclusive and well-prioritized Tenth Plan based on the PRSP process and a broad consensus on real priority development needs.
- Use the upcoming NDF as an opportunity to involve a broad spectrum of stakeholders in a public discussion to develop a national position for the Forum. The objective should be to achieve a consensus which puts poverty reduction, solution to the conflict and better public service delivery in the forefront of the political agenda.
- Present to the Forum proposals as to how HMG will follow up further on the reform program presented at NDF 2000 and address the deficiencies in public resource management, in particular budget planning, tax administration, and expenditure management. Planning should be based on realistic assumptions so that commitments

on counterpart funding once made, can be kept – taking into account uncertainties and special requirements due to the insurrection.

- The government budget is the central tool of public policy. In the Tenth Plan, pro-poor expenditure allocations would require not only an identification of the broad spending categories that are more important for the poor, but also an understanding of the impact and efficiency of these expenditures in reducing poverty.
- Present a realistic and effective program for improving the performance and quality of the civil service, reducing politicization and combating corruption. The timing and modalities of the preparatory work for this should be announced at the Forum.
- Present a realistic and comprehensive program for effective decentralization to locally elected and accountable government bodies, that may mobilize local resources and involve local communities.
- Involve and facilitate the development efforts funded and implemented by all development partners, including private business, local and national charities, national and international non-government organizations.
- In the context of the Tenth Plan, the Government needs to set up new mechanisms for monitoring and evaluation as a key element in improving the quality and sustainability of aid-supported programs. The modalities of this should be presented for discussion at the Forum.
- Finally, HMG needs to consider all donor-funded projects as international contributions to Nepal's own development, and take responsibility for their maintenance and integration into national programs. As steps in this transition, HMG should co-chair the sector coordination groups with the donors. It should also not just co-chair, but prepare and chair the NDF which will be scheduled after the upcoming one this February.

32. More specific recommendations to donors:

The difficult and far-reaching commitments and performance which will be required from HMG in the new context need to be matched by donors. They will need to:

- Accept the revised Foreign Aid Policy, the Tenth Plan and the MTEF as the basic framework for their strategic aid priorities and programs.
- Comment on, and provide support to (but not substitute for) HMG's efforts to formulate a prioritized three-year expenditure program as well as sectoral strategies and investments consistent with those priorities.
- Realign their own programs according to the new priorities and framework. While there are limits in the extent to which ongoing programs can be revised, if there are

cases where these have just begun, they should be re-evaluated in terms of the Tenth Plan priorities. For all new commitments, there should be an explicit agreement between the donor concerned and HMG that they are consistent with the Tenth Plan and fit within HMG's budgetary framework, i.e., MTEF.

- Expand present efforts to cooperate within sectors, and build upon positive experiences. Work together and agree on multi-donor financing of sectoral investment programs and projects, and where circumstances allow it, through basket funding.
- Insist on national leadership of project preparation, implementation and monitoring and evaluation, even where this may cause significant delays in processing; This may require donors to get away from any “lending” or “funding” targets.
- Take specific action to reduce risk of corruption in donor-funded programs and projects. Put appropriate mechanisms in place to improve aid resource management to reduce misuse, corruption and other leakage.
- Use flexibility in the choice of different aid instruments while remaining focused on key poverty reduction outcomes. If appropriate, consider the use of well-conceived partnership agreements with local governments, NGOs and business actors.
- Focus on the quality and sustainability of aid interventions as well their outcomes and impact more than on the quantity of aid resources delivered. Donors should be asked to report to the NDF on how they rate their existing portfolio in terms of its quality and sustainability, and its impact on development and poverty reduction.
- Strengthen donor coordination at the policy and strategic levels, in terms of donors' collective assessment of HMG's policy performance, and agreed strategies and policies in key sectors. Collective and consistent donor messages at the policy level are often helpful to the internal reform efforts in the government itself.
- Develop an active policy for improved transparency for all donor-funded programs. Donors as well as INGOs should individually and collectively make information on their programs and projects easily available for stakeholders and interested public. This should include information on plans, ongoing projects, budgets, monitoring reports, evaluations, etc. There may be a need for a depository library, as well as a website.
- Be realistic when establishing conditionalities, and pay attention to Nepali realities and distributional effects. Consider the use of conditionality that is focused on outcomes rather than on ex-ante promises.

- Use agreed M&E mechanisms for monitoring, accounting and auditing the use of aid resources and HMG public resources.
- Donors should develop a common ‘code of conduct’ in relation to certain practices relating to incentive payments of various kinds to public officials as well as payments to ex-officials through consultancy assignments and recruitment to aid agency staffs. Whenever possible, priority should be given to institutions (whether consulting firms or NGOs) instead of individuals in seeking consulting services.
- While there are limits to the degree to which donors can harmonize and simplify their reporting, financial management, accounting and auditing and procurement practices, given current rules of different multilateral and bilateral agencies, it is not clear that the potential which remains is being properly exploited. It is suggested that the donor representatives in Kathmandu form a working group to explore the degree to which they could proceed with such harmonization and simplification.