



# External finance for rural development

## Country case study: Nepal

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### Key messages

- Agriculture and rural development are prioritised in Nepal's national development plans, given the large share of the population in rural areas and the agricultural sector's importance for livelihoods, economic growth and food security.
- Policy prioritisation has translated into high public spending, with Nepal one of the world's top 10 countries in terms of its share of public spending on agriculture.
- All of the official development finance received by Nepal for the sector has been concessional, and comes mostly in the form of grants. Most government borrowing to date has focused on high visibility infrastructure projects outside of agriculture.
- Government demand for grants and concessional loans for agriculture and rural development is expected to rise over the next five to 10 years, particularly in the wake of the Covid-19 pandemic. The government is expected to consider concessional borrowing for agricultural value chain development, rural basic infrastructure, access to technologies and rural financial services.
- The government prefers external assistance that is aligned to national priorities, durable, long term and sustainable.

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## Introduction

### Background

Rural development worldwide relies heavily on private funding. Yet the public sector has a key role to play in providing both investment and policy support to tackle persistent market failures. These include the under-provision of public goods (such as infrastructure and research and development), negative externalities (such as the need to adapt to and mitigate the effects of climate change), informational asymmetries (e.g. the development of rural financial services) and the lack of protection for vulnerable people through, for example, social protection.

Far more finance is needed to achieve food security and promote sustainable agriculture in line with Sustainable Development Goal (SDG) 2. The United Nations (n.d.) estimates that an additional \$267 billion per year is needed to achieve every SDG 2 target: almost twice as much as total official development assistance (ODA) each year from all donors combined. Official development finance (ODF)<sup>1</sup> to agriculture and rural development rose slightly from \$10.2 billion in 2015 to \$10.9 billion in 2018. This is only a fraction of the total ODF disbursements of \$254 billion in 2018. Public expenditure on agriculture development also remains low: since 2001, governments have spent, on average, less than 2% of their central budgets on agriculture (FAO, 2019a).

### Objectives, definitions and methodology of this country case study

This country case study summarises key findings from a country analysis of financing for rural development in Nepal. It is one of 20 analyses that is synthesised for comparison in Prizzon et al. (2020).

The case study has two main objectives:

- to map demand from the Government of Nepal over the next five to 10 years for external development assistance to support public investment in inclusive and sustainable rural development
- to analyse the financial and non-financial terms and conditions of such demand, its main preferences and the type of instruments that the government wishes to access or scale-up to support public investment in rural development.

### Definitions

**What we mean by public investment in inclusive and sustainable rural development** (see Prizzon et al., 2020, for more details): Our research has focused on six areas that contribute to such investment: access to agricultural technologies (research and development) and production services; agricultural value-chain development (e.g. crops, livestock, fisheries); climate-resilient agricultural practices; rural basic infrastructure (e.g. water and irrigation systems, local roads, local energy generation and storage facilities); rural financial services; and rural investment environment (e.g. policy, legal and regulatory frameworks).

**What we mean by external assistance for inclusive and sustainable rural development:** We look beyond ODA to include government-to-government funds from bilateral and multilateral donors that do not meet concessionality criteria<sup>2</sup> (usually defined as other official flows, or OOFs). We call this official development finance (ODF). As a proxy for financing rural development, we examine data on external assistance to the agriculture sector and rural development (cross-cutting) based on an Organisation for Economic Co-operation and Development (OECD) definition. This is not a perfect measure,

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1 The sum of ODA and OOFs: the latter flow from bilateral and multilateral donors that do not meet the concessionality criterion for ODA eligibility.

2 The definition of concessionality is based on the share of the grant element. With the 2014 OECD reform, the grant element varies according to the income per capita of the ODA-eligible country to be counted as ODA: at least 45% for low-income countries (LICs), 15% for lower-middle-income countries (LMICs) and 10% for upper-middle-income countries (UMICs). The International Monetary Fund (IMF) discount rate (5%) is also adjusted by income per capita group: 1% for UMICs, 2% for LMICs and 4% for LICs, including least-developed countries (LDCs).

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but given the lack of a sectoral definition or attribution to rural development as such, it is the closest we can get to a consistent, cross-country mapping of external assistance from development partners. As a second-best option, we rely largely on quantitative and qualitative data on agricultural development. While the agriculture sector is a major component of rural development, data on agriculture alone cannot capture important non-farm activities.

### Research questions

This country case study reflects our four main research areas:

- the government's priorities for public investment in inclusive and sustainable rural development
- financing for public investment in inclusive and sustainable rural development
- borrowing (external development assistance) for this public investment
- the government's preferences in relation to external development assistance for public investment, including its demand for specific types of instrument.

As this project took place during the early stages of the Covid-19 pandemic, we also reflect the short- and medium-term implications of the crisis for government priorities and preferences for public investment, as well as the amount and type of external assistance demanded.

### Methodology

We used a qualitative case study approach, with the analysis of individual countries informed by a political economy framework, as developed by Greenhill et al. (2013) for aid negotiations (see Prizzon et al., 2020).

Our approach comprised a critical review of relevant policy literature<sup>3</sup> and data analysis,<sup>4</sup> which also helped us to identify country

stakeholders. This was followed by interviews with key informants, informed by an electronic questionnaire submitted before each interview. For Nepal, we held eight interviews between May and June 2020, and received nine questionnaires (see Annex 1 for a list of those interviewees who agreed to their names being shared).

### Nepal: country context

Nepal was reclassified from a low-income country (LIC) to a lower-middle-income country (LMIC) in July 2020, as a result of the country's gross domestic product (GDP) per capita passing the threshold for LMIC status (reaching \$1,090).<sup>5</sup> Most of the analysis of Nepal in this case study was undertaken when the country was still classified as a LIC. The country is eligible for concessional assistance from international financial institutions, namely the World Bank's International Development Association (IDA) and the Asian Development Bank (ADB), as well as preferential trade agreements. At present, the country retains its status as a least-developed country (LDC), with a decision due on its graduation from this status in 2021.

Nepal has had moderate economic growth since it emerged from its 10-year civil war in 2006. The war – the result of a Maoist insurgency – held back the country's development and saw a temporary suspension of democratic institutions. Between 2007 and 2017, Nepal's GDP growth averaged 4.4% (World Bank, 2018). The economy plunged after a devastating earthquake in 2015, but rebounded with GDP growth averaging 6% between 2017 and 2019, driven by reconstruction support, bumper harvests and improved infrastructure (ADB, 2020).

The basis of Nepal's economic growth has shifted over time, from a predominantly agricultural-based economy to an economy that is service-led. Agriculture contributed to 28.2%

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3 Government strategies, IMF Article IV and World Bank diagnostic tools.

4 Spanning IMF, Food and Agricultural Organization (FAO), Asian Development Bank (ADB), OECD and World Bank sources.

5 The World Bank ceiling for low-income countries is US\$1,035.

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of Nepal's GDP in 2018, compared with the 57.6% contributed by the service sector, and the 14.2% from the industrial sector (ADB, 2019). Growth has been driven largely by consumption, fuelled by remittances that accounted for 26% of GDP in 2017. Imports are high, while exports continue to struggle (ADB, 2019). The country has also made the transition to a fully federal structure with the introduction of a new constitution in 2015.

The number of people living in extreme poverty has fallen dramatically in Nepal from 46% in 1996 to 15% in 2010 (latest available data) (World Bank, 2020b). The fall in extreme poverty has been driven largely by the outmigration of labour and, as with economic growth, a steep increase in private remittances (World Bank, 2018).

Despite this success, 80% of the population still live in rural areas and the agricultural sector accounts for 65% of all jobs, more than double its contribution to the economy, with many people still depending on subsistence farming for their livelihoods (World Bank, 2020b). The country also suffers from geographical variations in the levels of poverty, with high poverty rates in the mid- and far- Western regions (World Bank, 2018). While food security has improved significantly over time, it remains a concern, with 31.5% of children under the age of five stunted in 2019 (GON and UNICEF, 2019).

This mountainous, landlocked country is vulnerable to geological and climate-related disasters, including earthquakes and landslides, floods and droughts (World Bank, 2020a). Nepal is ranked 138 out of 181 countries in terms of its vulnerability to climate change, according to Notre Dame's Climate Vulnerability Index, with a higher ranking indicating greater vulnerability (ND-GAIN, 2020). Data already show that climate change has increased soil erosion, landslides, flash floods and droughts in Nepal as extreme weather events become more frequent (World Bank, 2020a).

## Government priorities for rural development

Agriculture and rural development are high priorities within Nepal's national development plans. This prioritisation is driven by the large share of the population living in rural areas and the agricultural sector's contribution to livelihoods, economic growth and food security. Modernising the agriculture sector is a constant theme within Nepal's national development plans. The Prime Minister's vision for a 'Prosperous Nepal and happy Nepali' (Sharma Oli, 2018) positions it as key for prosperity, while the National Planning Commission's 'Envisioning Nepal 2030' (GON and ADB, 2016) identifies agriculture as one of four areas that will lift Nepal out of its LDC status to become a comfortable, 'middle-class' economy. More recently, the government's '15th National Development Plan (2020–2024)' (GON, 2019a) identifies the need to raise productivity in agriculture (alongside industry) as one of seven key priorities for growth and development (ADB, 2019).<sup>6</sup>

Nepal's 'Long-Term Agricultural Development Strategy 2015–2035' (GON, 2015) aims to improve the self-reliance, sustainability, competitiveness and inclusiveness of the agricultural sector. In particular, it focuses on strengthening institutional coordination and the targeting of food security; driving higher productivity (by expanding and maintaining irrigation, extension services, education and training, and research and development); encouraging profitable commercialisation, in particular, value-chain development, rural roads and energy, and finance and insurance; and greater competitiveness, concentrating on food standards, trade rules and support for small- and medium-sized enterprises.

Nepal's agricultural sector is very domestic-focused, with exports making up only 2.7% of the sector's value added. Agriculture import growth is also far higher than growth in domestic output (IFAD, 2020). The Agricultural

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<sup>6</sup> Other priorities include support for an investment-friendly environment, effective implementation of the federal governance system, scaling up of investment in large infrastructure, building human capital, preserving the environment and ensuring resilience.

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Development Strategy, which is accompanied by a practical, 10-year road map, expects the sector to grow, particularly the agro-based export subsector, and the country to achieve full food grain self-sufficiency. The strategy is also complemented by the Prime Minister's 'Agriculture Modernization' project, which focuses on agricultural technology and production inputs, mechanisation and infrastructure for processing and marketing.

Our interviewees and survey respondents expect that agricultural value-chain development<sup>7</sup> will be the top priority for government public investment in the sector over the next five to 10 years, closely followed by support for rural basic infrastructure and climate-resilient agricultural practices. These expected priorities reflect the government's policy priorities and respond to challenges facing the sector.

Low productivity, fragmented supply chains, high transactions, limited commercialisation and climate change are key obstacles to rural development. The factors that drive low productivity and limited commercialisation include poor infrastructure (irrigation and rural roads), land fragmentation, a lack of human capacity as a result of outmigration, inadequate access to (and utilisation of) agricultural research and technology, and a lack of affordable finance and insurance, as well as weak institutional governance.

All of our interviewees identified institutional issues and weak capacity as the main barriers to effective public sector investment in rural development, with only a few citing a lack of financing. Many noted that the relatively new federal system was still a work in progress and that greater clarity of the roles and responsibilities of the federal government, the provinces and the local government was required to ensure better coordination. It is often unclear, for example, what functions within agriculture lie with which level of government, and only a few are assigned exclusively to the federal government (major irrigation projects, land-use policy, water-use policy and quarantine) (IFAD, 2020).

Capacity was also raised as an issue, with limited technical expertise and a gap between policy and implementation that has been exacerbated under the new system. This is an issue that goes beyond the agricultural sector and is widespread across government, as shown by significant budget under-execution and the back-loading of spending on capital investment projects (IMF, 2020b).

The government has comprehensive targeting policies towards vulnerable groups and disadvantaged regions for agriculture, and interviewees noted progress was being made in their implementation. Nepal's 'Long-Term Agricultural Development Plan (2015–2035)', for example, has inclusion as a key objective and aims to achieve this by tailoring its programmes to meet the needs of different socioeconomic groups of farmers (subsistence farmers, commercial farmers and landless or nearly landless farmers), women, marginalised groups and geographic areas that have been left behind like the country's Mid- and Far-Western regions. The plan is backed by a dedicated 'Gender equity and social inclusion strategy (GESI) framework' (FAO, 2019b), which includes specific targets and funding for dedicated staff on the issue. There are also several programmes for food security and nutrition that are targeted to women, children and poor households.

Nearly all of our interviewees expect the Covid-19 crisis to reinforce the government's focus on rural development to ensure food security, deliver jobs, enhance food exports and gain important foreign exchange. Nepal confirmed its first case of Covid-19 on 23 January 2020 (IMF, 2020a) and imposed a nationwide lockdown, which was eased on 12 June. The government estimates that growth for 2019/20 will be 2.3% below the rate for 2018/19 (7.1%) (ibid.). The Nepalese economy is particularly vulnerable, given its reliance on remittances and tourism for growth and foreign exchange, both of which have been badly affected by the economic impact of the pandemic.

The government has borrowed from the IMF to finance a fiscal stimulus. Its initial policy

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7 The provision of services and inputs to help farmers to add value to their crops, livestock and fisheries.

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response has been to increase health spending and social protection and to start to develop a job creation package for those who are newly unemployed. As the global economic recession results in job losses abroad, many interviewees highlighted the possibility of a large number of migrant workers coming back to Nepal, and the potential opportunity to absorb them into jobs in the agricultural sector. The government has set up a task force to assess how many might return and to explore options around employment in the infrastructure and agriculture sectors.

## Financing rural development

### Public finance

Government expenditure rose sharply from 20% of GDP in 2015 to 32% in 2018, fuelled by reconstruction efforts after the devastating earthquake in Nepal, but seems to have peaked. While government revenues rose from 21% to 25% of GDP over the same period, spending outstripped revenues to fuel a widening fiscal deficit that reach -6.7% in 2017/18 (IMF, 2020b). The fiscal deficit was forecast to be even greater, based on the budget, but it was kept lower by chronic underspending in capital investments as a result of capacity constraints (IMF, 2020b). In 2019, government spending fell, and the fiscal deficit contracted to 4.1%. Before the Covid-19 pandemic, the IMF projected that spending would continue to decline marginally in the medium term, resulting in a reduced fiscal deficit (ibid.). However, the economic impact of the pandemic is likely to widen the fiscal deficit once again, as revenues fall and spending increases to protect the most vulnerable people and stimulate economic growth.

Nepal is one of the world's top 10 countries when it comes to the share of public expenditure going to agriculture, spending an average of 9.8% between 2011 and 2018, according to government data (FAO, 2019a; GON, 2019b).<sup>8,9</sup>

Agriculture's share increased from 9% in 2011/2012 to 11.2% in 2015/2016 but has since declined to 7.3% in 2018/2019.

Recurrent costs accounted for most expenditure on agriculture between 2011/2012 and 2015/2016 as a result of government subsidies to smallholder farmers for seeds and fertiliser. However, capital investments have overtaken recurrent costs since 2016/2017. They now make up the largest share of expenditure (GON, 2019b), and include post-earthquake reconstruction efforts and the expansion of infrastructure to support commercialisation in the sector.

Our interviewees had mixed views on whether government funding to agriculture was likely to rise or fall over the next five to 10 years. While some interviewees said that the budget would increase in the coming years, others were far more sceptical, noting, in particular, the government's increasing prioritisation of expenditure on major infrastructure projects outside the agricultural sector. Others felt that while spending for the sector may increase in the short term, the economic impact of the Covid-19 pandemic will put severe pressure on the government budget in the medium term and may reduce expenditure on agriculture.

### External development assistance

The volume of ODF received by Nepal increased from \$938 million in 2014 to \$1.57 billion in 2018 (constant prices) (see Figure 1), largely in response to the devastating earthquake in 2015 and the need for humanitarian and development assistance. All of the funding received was concessional and most of it, until 2018, came in the form of grants, partly reflecting Nepal's low-income status.

The share of loans has been increasing steadily, however, and they accounted for the majority of concessional finance in 2018, with the World

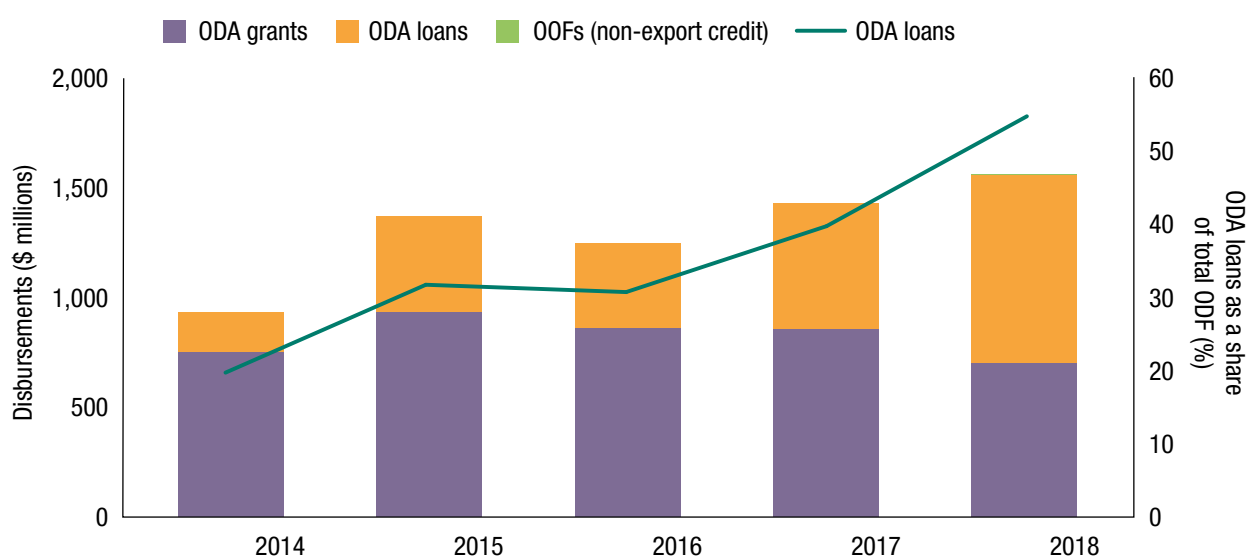
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8 This is based on the Government of Nepal's Economic Survey 2018/19, Annex 3.4 and 3.5, showing functional expenditure of capital and recurrent expenditure.

9 There is a difference between the calculations in this case study and those used by the FAO, whose data show that, on average, Nepal spent 8.7% of its government expenditure on agriculture. This is because the FAO data refer to a different timeframe: 2012 to 2016.



**Figure 1 Official development finance to Nepal across all sectors**



Note: constant 2018 prices. ODA, official development assistance; ODF, official development assistance; OOF, other official flow. Source: OECD (2020)

Bank and the ADB providing a far higher share of their funding via loans than grants. Nepal also received a small amount of non-concessional financing in 2018 from the Organization of the Petroleum Exporting Countries (OPEC) Fund for International Development (OFID) for a hydro-electric power plant. The main providers of ODF between 2014 and 2018 are (in order of volume of financing) the World Bank, the ADB and the United States (US).

It should be noted that these ODF figures do not reflect Nepal’s full access to official concessional and non-concessional external finance, as they do not cover all official donors, such as China or India. China is a long-standing and significant provider, offering grants, interest-free loans and concessional loans. There is a lack of data on how much China has provided to Nepal, but, according to the government’s aid management data, Nepal received \$509 million from China for development projects between 2007 and 2016, with the majority (\$362 million) provided in the form of grants (GON, 2020). India also provides development finance, with Nepal receiving \$469 million between 2006 and 2016, according to government data.<sup>10</sup> Again, the

bulk of this finance came in the form of grants (\$258 million) (GON, 2020).

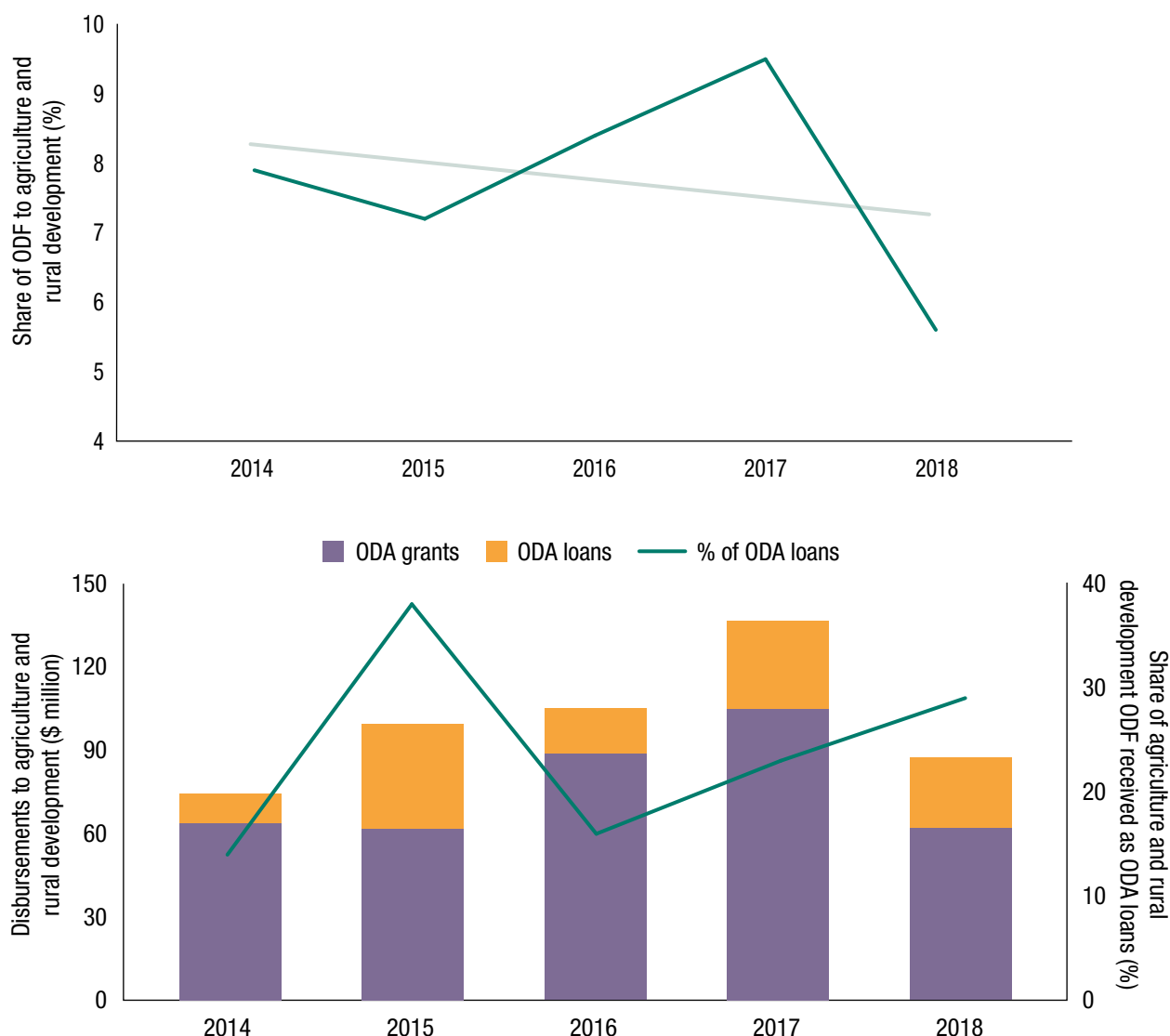
Nepal is not dependent on aid. The country received the equivalent of 4.9% of its gross national income (GNI) as ODA in 2018, a slight rise from 4.3% since 2014 (World Bank, 2020b). This is well below the 10% threshold that is considered a measure of high aid dependency by the OECD (2003). However, while the country may not depend on ODA, it remains an important flow of resources. When measured as a share of government expenditure, for example, ODA flows accounted for just over a quarter of government spending (26%) in 2018.

The share of ODF for agriculture and rural development was just above the global average of 5% in 2018, standing at 5.6% (\$87 million). That figure, however, has been subject to fluctuations over time (Figure 2), with 7.9% of ODF received for agriculture and rural development in 2014, rising to 9.5% in 2017 and then falling to 5.6% in 2018.

Nepal receives a lower share of concessional loans for agriculture and rural development than for all sectors, despite an increase from 14% to 29% of total ODF between 2014 and

<sup>10</sup> Note this includes \$310 million of projects with no date attached.

**Figure 2 Share and composition of official development finance to agriculture and rural development**



Note: ODA, official development assistance; ODF, official development finance; OOF, other official flows.  
Source: OECD (2020)

2018. The share across all sectors was 20% to 55% over the same period. The Government of Nepal’s International Development Co-operation Policy (GON, 2019b) stipulates a preference for grants across all sectors and calls for concessional loans to be prioritised for productive sectors. While agriculture is considered a productive sector by the government, most of its concessional borrowing to date has been for large infrastructure projects outside the sector which, as one interviewee noted, tend to have high visibility.

The lower share of concessional loans to the sector may also reflect the aid modalities of

Nepal’s major donors. The largest donors to the agriculture and rural development sector between 2014 and 2018 were (in order of volume) the World Bank, the US and the ADB. All of the funding from the US has come in form of grants and has focused on: food security; poverty reduction via support for smallholder farmers to add value to their produce; and support for climate-smart agricultural solutions in vulnerable regions.

The World Bank and ADB provided a mixture of grants and concessional loans between 2014 and 2018, with a shift in their funding over this period towards



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more concessional loans than grants. The World Bank's portfolio focused on modernising water irrigation in the far western region (which has high levels of poverty), agricultural commercialisation, trade projects, and agricultural administration and policy, with a mixture of grants and loans, often for the same projects. The ADB's portfolio concentrated on infrastructure – roads and water management – all funded via loans; and government capacity-building and technical assistance, all funded via grants.

According to our respondents, the government values external assistance because it provides access to below market-rate finance and enables learning from developing country peers. This appreciation for peer learning reflects the significant support the country receives from developing countries like China and India, and the fact that some of their lending is focused specifically on training and support for knowledge transfer (GON, 2019c).

Demand for external finance for rural development and agriculture is expected to grow over the next five to 10 years, according to most of our interviewees and survey respondents. However, they were also clear that the demand is for increased grants and highly concessional loans, and not for non-concessional loans. Nearly every interviewee noted that the impact of Covid-19 on Nepal's economy would likely increase government demand for concessional external finance in the coming years.

## Borrowing for rural development

### Debt trends and composition

Nepal continues to be classified as being at low risk of external and overall public debt distress (IMF, 2020b). While general government debt rose from 28% of GDP in 2014 to 33% in 2019 (World Bank, 2020b) it remains well below the thresholds of the World Bank and IMF for debt distress and is below the average for LICs (which is just above 50%) (World Bank, 2019). Before Covid-19, debt was expected to increase in the medium term as a result of fiscal and

current account deficits, but still remain below the thresholds (IMF, 2020b).

The vast majority of Nepal's external public debt is composed of multilateral concessional borrowing, with the share rising over time from 80% in 2014 to 87% in 2018 (World Bank, 2020c). Multilateral concessional borrowing has low interest rates (1% on average) and long maturities (26 years on average) (IMF, 2020b). Nepal has no commercial debt and extremely limited private creditors.

### Policies and preferences for borrowing and debt management

Nepal's laws to manage debt have been fragmented and those in place have not been seen to 'resonate with international best practice', as it emerged in interviews with stakeholders. In addition, the debt management function within the government was, until recently, spread across multiple ministries and institutions, which has hampered coordination (World Bank, 2019).<sup>11</sup> An analysis by the World Bank of Nepal's Debt Management system noted that, 'There is no formal medium-term debt management strategy (DMS) and the decisions on the instrument type, maturities and desired profile of the government debt are taken in an ad-hoc process, mostly driven by a cashflow approach without due consideration for the funding cost [...]. No cost-risk analysis is undertaken.' (ibid.). The government updated its Public Debt Law in 2020, but there is still no medium-term debt management strategy in place.

Even though the government does not have a formal debt management plan, the International Development Co-operation Policy (GON, 2019b) shows a clear preference for grants, with concessional loans prioritised for productive services. This preference was reinforced by all of our interviewees.

The policy stipulates that concessional loans should be used for sectors that contribute to high economic growth, jobs and skills development and that can generate foreign

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11 The laws are the 2015 Constitution, the Loan and Guarantee Acts (1968), the NRB Act (1955), Public Debt Act (2002), and the Fiscal Procedures Act and Regulations (1998 and 2017). The Loan and Guarantee Act refers to external debt and was due to be updated in 2020.

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currency. This includes agriculture, physical infrastructure and tourism (ibid.), although, as noted earlier, the agriculture sector has received a much smaller share of concessional loans than some other sectors. There is also a minimum volume for concessional loans per project of \$10 million and the use of loans to fund technical assistance and the procurement of vehicles is discouraged.

Non-concessional finance can also be mobilised on the basis of national needs and priorities, with major infrastructure such as hydropower generation and transmission, highways, railways and airports identified for non-concessional finance. Commercial loans can also be considered but they must have a high financial rate of return. To date, the government has borrowed very little in terms of non-concessional or commercial finance.

The expectation among most of our respondents is that the government would consider using concessional loans for agricultural value-chain development, followed by rural basic infrastructure, access to technologies and rural financial services – given that all of these areas can boost productivity and generate economic growth and jobs. One recent example in value-chain development is the government’s new programme with the International Fund for Agricultural Development (IFAD): Value Chains for Inclusive Transformation of Agriculture. Signed in 2020 and funded via a concessional loan from IFAD, the project involves a mix of government funding and substantial funding from the private sector, as the government pushes for the greater engagement of the private sector in this area (IFAD, 2020). Our respondents expected very limited appetite of the government for highly concessional loans for climate adaption support, or for an enabling investment environment.

When it comes to the terms and conditions of loans, our research shows that the government’s preference is for low interest rates and long maturity dates, which is in line with the government’s preference for concessional finance. A repayment schedule was also seen as important.

## Preferences and instruments for rural development

Nepal’s aid management policy is centred on international aid principles, calling for all foreign aid to be transparent, aligned to national priorities and untied. There is also a strong preference for budget support – a preference which has increased over time – and sector-wide approaches to avoid fragmentation and reduce the administrative burden on the government (GON, 2019b). The policy also notes caution around the use of technical assistance, with a call for its use only where no government expertise exists.

Our interviewees and survey respondents agreed that the alignment of funding to national priorities was the most preferred attribute of external assistance for the government, noting that it is important for development partners to support the government’s vision and plans. One interviewee noted that the government knows what it wants to do, but just requires the financial assistance to realise its ambitions.

Interviewees and survey respondents also noted a preference for external finance that is durable, long-term and sustainable. The limited use of technical assistance was also raised by our interviewees, with several noting that the government has no interest in borrowing for technical assistance at concessional terms, given the expense of such assistance in the past. There was even some hesitancy around technical assistance provided via grants if it were tied and supplied by the donor. One interviewee, however, noted that this reluctance to use technical assistance was a problem, as there is a need for support in implementing projects as a result of in the under-execution of budgets.

Our respondents expect government demand for access (or greater access) to results-based lending, the Catastrophe Deferred Drawdown Option (CAT-DDO) and project preparation facilities for rural development and agriculture. The government already has experience of results-based lending with the World Bank in education and bridge-building. Evidence from the education sector shows that such lending has concentrated the efforts of the government on the delivery of the key results indicators (World Bank, 2017).

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Respondents also identified demand for CAT-DDO, which provides a contingent credit line for immediate liquidity in the aftermath of a natural disaster. Nepal's experience of a devastating earthquake in 2015 has made such financing particularly relevant, and the government has already embarked on a CAT-DDO with the World Bank for \$50 million (World Bank, 2020d). Finally, respondents noted a demand for financing for project preparation facilities. This was seen as particularly relevant by the development partners interviewed and is, in part, a response to budget underspending and delays in project implementation.

## Conclusions

Our analysis of the experience and perspective of Nepal on financing public investment for inclusive and sustainable rural development, and particularly its demand for external assistance, is summarised as follows.

- The Government of Nepal's national development plans prioritise agriculture and rural development because of the large share of the population living in rural areas and the agricultural sector's significant contribution to livelihoods, economic growth and food security.
- Policy prioritisation has translated into high public spending, with Nepal one of the world's top 10 countries in terms of its share of public spending on agriculture.
- Interviewees and survey respondents for this study expect that the Government of Nepal will focus its public investments on support for agricultural value-chain development over the next five to 10 years, followed by strengthening basic rural infrastructure and ensuring take-up of climate-resilient agricultural practices. These investment priorities reflect the challenges facing the agriculture sector in Nepal, with low productivity, limited commercialisation and the need to bolster climate adaptation efforts.
- At the same time, however, the government faces institutional challenges to the effective implementation of its public expenditure in the sector, with a lack of clarity about the roles and responsibilities of the federal and provincial government, alongside weak capacity that often hinders implementation.
- All of the ODF received by Nepal for agriculture and rural development between 2014 and 2018 was concessional, with the majority given in the form of grants. This reflects the country's access to this type of finance given its status as a low-income income country during this period, and the government's preference for grants.
- The government's policy on borrowing calls for concessional loans to be used for productive sectors, with agriculture seen as one of these sectors. To date, however, the government has borrowed very little concessional finance for agriculture or rural development, with most government borrowing focused on large, highly visible infrastructure projects outside the sector.
- Government demand for grants and concessional loans for agriculture and rural development is expected to rise in the future, particularly as a result of the impact of the Covid-19 pandemic on Nepal's economy. It is expected that concessional borrowing for the sector would be considered for agricultural value-chain development, rural basic infrastructure, access to technologies and rural financial services.
- The government's preference is for external assistance that is aligned to national priorities, durable, long term and sustainable.

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## Annex 1 List of named interviewees

Name	Institution
Purna Bahadur Chhetri	World Bank
Stephane David	European Union (EU)
Tarek Kottb	International Fund for Agricultural Development (IFAD)
Rajendra Prasad Mishra	Ministry of Agriculture and Livestock Development, Government of Nepal
Arun Sumsher Rana	Asian Development Bank (ADB)
Bala Ram Thapa	Local Initiatives for Biodiversity, Research and Development (LI-BIRD)
Srikrishna Upadhaya	Support Activities for Poor Producers (SAPPROS)
Karishma Wasti	World Bank

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