

NEPAL

Country Strategy Paper

2007 – 2013

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LIST OF ACRONYMS /GLOSSARY

ADB	Asian Development Bank
ALA	Asia/Latin America
BIMSTEC	Bay of Bengal Initiative for Multi -Sectoral Technical and Economic Cooperation
COA	Court of Auditors
COM	Communication from the Commission
CPN (M)	Communist Party of Nepal (Maoist)
CPN (UML)	Communist Party of Nepal (Unified Marxist -Leninist)
CSP	Country Strategy Paper
DDA	Doha Development Agenda
DFID	Department for International Development (UK)
EBA	Everything But Arms
EC	European Commission
EFA	Education for All
EIDHR	European Initiative for Democracy and Human Rights
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GON	Government of Nepal
HDI	Human Development Index
HDR	Human Development Report
IPR	Intellectual Property Rights
IT	Information Technology
ITC	Information Technology and Communication
Jana Andolan	People's Movement
JMM	Joint Ministerial Meeting
LDC	Least Developed Country
MFA	Multifibre Arrangement
MDG	Millennium Development Goals
MIP	Multi-annual Indicative Programme
MOU	Memorandum of Understanding
NG	Nepal Government
NGO	Non-Governmental Organisation
NDP	Nepal Development Partners
NLSS	Nepal Living Standard Survey
NTB	Non-Tariff Barriers
OHCHR	Office of the United Nations High Commissioner for Human Rights
PRSP	Poverty Reduction Strategy Paper
SAARC	South Asian Association for Regional Cooperation
SAFTA	South Asia Free Trade Area
SME	Small and Medium Sized Enterprise
SPA	Seven Political Parties Alliance
SPS/TBT	Sanitary/Phyto-Sanitary / Technical Barriers to Trade
SWAP	Sector Wide Approach
TRTA	Trade Related Technical Assistance
TVET	Technical and Vocational Education Training
UNDP	United Nations Development Programme

UNFPA	United Nations Fund for Population Activities
UNHCR	United Nations High Commissioner for Refugees
UNMIN	United Nations Mission in Nepal
WB	World Bank
WFP	World Food Programme
WTO	World Trade Organisation

EXECUTIVE SUMMARY

Nepal is a landlocked country in the eastern Himalayas, extending over an area of 147,181 square kilometres and with an estimated population of 27 million. The country is bordered by the Tibet region of China in the north and by India in the east, west and south. Due to its difficult geography and tormented history, socioeconomic progress has not been rapid and Nepal remains an LDC with a per capita income of \$270. Nepal is the poorest country in South Asia. The country's real annual economic growth has averaged about 4-5 percent over the last two decades, but in the past four years Nepal's GDP has declined, mainly as a result of the intensification of the violent insurgency in the country. The restoration of peace following the successful people's revolution (Jana-Andolan) in April 2006 and the Comprehensive Peace Accord signed in November 2006 has yet to impact positively on the economy, which grew only by about 3 percent in 2006/07. There is huge potential for exporting hydropower and for tourism which is still largely untapped.

Nepal's main difficulty is building the foundations for its new nationhood. Besides achieving lasting peace, the country urgently needs a solid and robust democratic system of good governance and a sustainable economic development strategy based on a comprehensive and inclusive social framework and dialogue. The country will also have to adjust rapidly to post-MFA, to the new India trade policy with LDCs and to WTO obligations. Nepal has to implement the current reform policy in a vigorous manner in order to improve its competitiveness and investment opportunities.

The interim government, which was formed in early April 2007 and represents the Seven Party Alliance and the CPN-Maoist, has to decide on the date for the elections to the Constituent Assembly and to agree on the new political agenda following the failure to hold elections in mid-June 2006 as stipulated in the interim constitution. The role of King Gyanendra as Head of State has been transferred to the Prime Minister, Mr. Girija P. Koirala, and the fate of the monarchy will be decided at the first session of the elected Parliament. A new constitution is due to replace the 1990 Constitution by 2009.

In July 2007, Nepal's 10th Five-Year Plan (2002-2007) will be followed by a Three-Year Interim Plan (2009-2010) which will continue to adhere to the objectives of the existing PRSP. The national poverty rate in Nepal - at 31 percent - remains high. Remittances income, agricultural productivity and satisfactory access to public services (schools, etc.) will play key roles in the transformation process. In the long term, Nepal's development strategy will focus on achieving the MDGs by 2015.

In an effort to support the GON's development objectives and in line with the 1996 EC-Nepal Framework Co-operation Agreement, the EC's assistance to Nepal during the period 2007-2013 will have an estimated budget of €120 million and will target the following three areas:

- Education (with human rights, conflict prevention and good governance as cross-cutting issues): assist Nepal in the education sector, by creating an enabling environment to achieve the MDGs.
- Stability and peace building: the GON has underlined the importance of this sector and is directing the process of change; this will be an important sector for EC support that could be coordinated with other NDPs.
- Trade facilitation and economic capacity building.

Please note that in conformity with the Common Framework for Strategy Papers, Chapters 1 (Framework of Relations between the EC and Nepal) and 2 (Country Diagnosis) are presented in this CSP as Annex I and II respectively.

1. Overview of cooperation and policy dialogue, complementarity and consistency

1.1 Overview of past and present EC cooperation (lessons learned)

The allocation of EC aid to Nepal in the CSP/NIP (2002-2006) amounted to €70 million. The EC aid was only partially implemented due to technical problems encountered during the identification mission for the project on strengthening rural development and promoting good governance (SRD+G), which was later cancelled with the agreement of the GON. In 2005, in response to the royal takeover, the EC suspended all programming activities and the launch of new projects was put on hold. However, in that same year an ad hoc commitment of €5 million was made outside the framework of the CSP for support to the OHCHR. In addition, an ad hoc commitment of €7 million was made as a token of immediate support to the People's Movement and Nepal's return to democracy. The project, the Vulnerable Communities Package, was also programmed outside the CSP framework. Since preparatory work had been put on hold in 2005, the SME project, planned under the CSP 2002-06, had been delayed and was therefore postponed to the CSP 2007-13. As an on-going activity, the Renewable Energy Project was allowed to continue subject to close monitoring, as were the Conflict Mitigation Packages I and II since they dealt with issues of human rights, justice and good governance. All cooperation activities were reactivated in June 2006, marking the EC's support for the democratisation process. The budgets for all significant programmes of EC aid to Nepal under the ALA Regulation are as follows:

§ Renewable Energy Project

One of the most significant contributions has been the € 15 million for the Renewable Energy Project, which started in August 2004. The purpose of this project is to create a renewable energy infrastructure in rural areas which will facilitate income generation, sustainable growth and delivery of social services, thus alleviating poverty. This project has so far been extremely complicated to implement, not least because it involves a tender for the procurement of photovoltaic elements (worth € 10 million - international open tender) which has led to serious delays. Furthermore, the installation of these photovoltaic systems in remote areas is only possible after providing training to local private installers and/or members of the Community Energy Service Provider groups (CESPs). This project needs consistent and intensive monitoring if it is to reach completion.

§ Conflict Mitigation Package I

With a budget of € 3 million, the project's objective is to address the root cause of the conflict by improving socio-economic conditions, and by raising the general awareness of people and minorities living in and around the ex -Kamaiya camps in the Western and Mid -Western regions of Nepal. The project started in January 2006 and is implemented by NGOs selected through a call for proposals. The project activities have made good progress and overall results have been encouraging.

§ Conflict Mitigation Package II

This project (€7 million) aims to enhance the capacity and effectiveness of the NHRC to monitor human rights violations, investigate, and initiate preventive and remedial actions across Nepal; to develop conditions, including provision of legal aid, under which access to justice is afforded to all people in Nepal; and to enhance the capacity of the Nepalese judiciary in accordance with international human rights standards. The project started in May 2007.

§ Office of the High Commission on Human Rights (OHCHR) Monitoring Mission in Nepal (outside the CSP framework)

A financial contribution (of € 5 million) has been provided to OHCHR for this project, which aims to establish accountability for serious and systematic human rights abuses with a view to preventing their occurrence; to work closely with national partners to promote respect for human rights and international humanitarian law and strengthen the rule of law in Nepal, to ensure a consistent and informed approach to human rights in Nepal. The OHCHR has played a key role in the national reconciliation and confidence building process and has thereby ultimately made a significant contribution to Nepal's peace process.

§ Trade Policy Project

This project (€2 million) aims to help Nepal establish and improve the basic conditions for stable and sustained economic growth. Following the return to a democratic regime, the project has been fast-tracked for implementation. The Financing Agreement was signed by the GON on 30 March 2007.

§ Economic Cooperation and Capacity Building Project (Support to SME)

The objectives of the project (€2 million) are to strengthen key financial institutions and the private sector, including SMEs, in the areas of access to finance, trade facilitation and investment, and to promote sector development and enhance awareness, understanding and dialogue in the trade sector (business enabling environment). This project will be implemented in early 2008.

§ Vulnerable Community Package (VCP) (outside CSP framework)

The programme is being implemented through calls for proposals with a total budget of € 7 million. The objectives of the programme are to address the basic needs of vulnerable groups and communities most affected by the conflict by providing them with tangible direct benefits that contribute to local reconciliation efforts and promote group and local community empowerment in sustaining peace.

In addition to EC aid to Nepal in the framework of the CSP/NIP, the country has also participated actively in all thematic programmes (NGO co-financing, EIDHR, AUP, Asia Invest, Asia Link, etc) since 2002. As the EC allowed Nepal to participate in all calls for proposals after February 2005, the result was a continued increase in the level of projects selected. In 2006, Nepal benefited from additional funding of about €5 million from the thematic budget lines.

Lessons learned: EC cooperation with Nepal has traditionally been characterised by the financing of numerous rural development and natural resource management projects, which have tended to have a limited and localised impact, and little influence on national policy. These projects were generally funded on a 'one-off' basis, with complex and time-consuming implementation and monitoring mechanisms. This CSP is therefore bringing about a policy shift

from individual rural development projects towards a sector support programme in education, thus supporting the Government's reform agenda, good governance and effectiveness, always with a view to ensuring that more systematic attention is paid to 'targeting the poor' and 'sustainability' of results, within a context of synergy with other development partners.

With reference to Nepal as a country emerging from a conflict situation, experience shows that , while support to health and education is important; a strong focus on reaching the MDGs may not be the most important priority in a post-conflict situation. Community-driven development can play a significant and positive role in many post -conflict environments. It can be cost-effective and may be quickly scaled up and implemented, once the initial investment in facilitation and support has been made. The EC will therefore continue to make its projects conflict-sensitive and to replicate the successful approach developed under Conflict Mitigation Projects I and II.

1.2 Information on the programmes of other donors

The communication on EC Development Policy¹ has provided a general framework for a co-ordinated effort with other donors (World Bank) and member states (complementarity), designed to promote sustainable development, focusing on the social and human aspects as well as on the sound management of natural resources and the environment. Equally important in this context are the objectives set out in the Action Programme for Development of Nepal (2001-2010) at the third LDC Conference (May 2001) targeting the following major areas: agriculture, private sector development and FDI, trade, industry and tourism, water resources and infrastructure development, social sector development, gender, environment, governance and targeted programmes and employment generation. (Readers are referred to Annex VII for an overview of the programmes of other donors).

1.3 State of political dialogue between the donors and Nepal

The political dialogue between donors and the GON was given fresh momentum with the reinstatement of the House of Representatives after the events of April 2006. The Interim Government is receptive to donors' sensitivities regarding accountability, transparency and combating corruption. Human rights issues have been placed firmly on the agenda and the majority of donors provide support for Nepal's human rights and governance institutions, such as the National Human Rights Commission, the Nepal Bar Association or NGOs.

1.4 Analysis of policy coherence for development

EC assistance to Nepal started in 1977 and, by 2006, it amounted to some €240 million, all aid included. The EC has gradually expanded its co-operation areas, which now include renewable natural resources (energy), rural development, education, health, environment, human rights, conflict mitigation and export diversification.

The EC co-operation strategy is in line with Nepal's approach to development, as set out in the **Tenth Five Year Plan (2002 -2007)**. The GON recently introduced the EC, together with other Nepal Development Partners, to the new Three-Year Interim Plan (2008-2010) which is under preparation and has three priority sectors: i) infrastructure sector, ii) economic sector and iii) social sector.

¹ COM (2000) 212 Final

The EC's overall objective in its cooperation with Nepal is **poverty reduction**, through the promotion of sustainable development and economic growth, with special attention being given to social inclusiveness and the environment. Given the country's situation, the vast majority of the funds have been allocated for development co-operation through the annual budget of the Development Co-operation Instrument (DCI) in favour of Asian countries.

In line with Nepal's predominant vocation as **an open economy** and now that peace has been restored, the EC has chosen to focus its activities on:

- Improving **education** by strengthening the current policy and capacity for decentralisation with a view to improving governance and the school management community, quality of education, etc.
- Improving **rural incomes**, especially those of vulnerable communities and disadvantaged minorities, by increasing added value in agricultural outputs, livelihood opportunities and trade.
- Improving the country's **institutional capacity** to manage sustainable development.

Education Sector Development (including support for the Basic and Primary Education Programme – Phase 2) is the most important sector covered by the EC cooperation strategy; the funding of education programmes dates back to 1998. Other areas of co-operation include support for Nepal's efforts in Human Rights and Conflict Mitigation in all its rural development activities

Furthermore, the EC provides assistance to Nepal in the areas of trade and export diversification in order to support Nepal in its efforts to enhance its trade and investment environment and help it participate effectively in the multilateral trading system and the global economy. In addition, the EC has provided support to the Bhutanese refugees currently living in camps in Nepal. Financial contributions have been allocated to UNHCR (through the budget line for Aid to Uprooted People) and to WFP (through the ECHO humanitarian office).

The communication on EC Development Policy² has provided the general framework for a co-ordinated effort with other donors (World Bank) and member states (complementarity) designed to promote sustainable development, focusing on the social and human aspects as well as on the sound management of natural resources and the environment. Equally important in this context are the objectives set out in the Action Programme for Development of Nepal (2001-2010) at the third LDC Conference (May 2001), targeting the following major areas: agriculture, private sector development and FDI, trade, industry and tourism, water resources and infrastructure development, social sector development, gender, environment, governance and targeted programmes and employment generation.

Environmental issues have been a major concern and have been taken fully into account in all EC-funded activities. In particular, several of the EC's development initiatives include specific environmentally sustainable objectives (an example being the renewable energy project).

2. The European Commission's Response Strategy

2.1 Justification of the choice of the focal sectors

² COM (2000) 212 Final

Nepal has expressed interest in the continuation of EC support for the Education Sector. The focus of EC support (2007-2013) will be on the priority areas identified by the Development Partners that are providing support to education. The EC will also target capacity development and governance issues in the education sector at all levels. The ultimate goal will be to strengthen Nepal's development policy so that it can address the social, economic and political disparities which caused the conflict, and this will include education provision. Accelerating progress in improving service delivery in MDG-sectors such as education is therefore bound to contribute significantly to peace. The implementing procedures will involve sector budget support and pool funding. Nepal also faces several challenges posed by the rapid growth of its population, violations of human rights including those of the children and indigenous peoples, gender inequalities, the risk of HIV/AIDS, TVET access and social exclusion. All the above will be addressed as cross-cutting issues in the EC's support for the education sector.

At Nepal's request, EC support for Stability and Peace Building will be the second focal sector, as this area is becoming more significant due to Nepal's current peace process, social challenges and drastic changes in the political situation. Established by GON, the Peace Trust Fund has been presented to Development Partners as the preferred instrument for channelling support for the peace process. The EC will examine this option as well as other implementing procedures in response to the GON's request for support to the peace process and to build a New Nepal. With the Parliament revived, the election commission restructured, Maoist rebels in the parliament, laws drafted and passed, Maoist leaders joining the interim government, etc., the state system has been re-established and is functioning again. Nepal is undergoing a resolute movement towards a multi-party democracy and a new constitutional state after a long period of royal interference and political instability.

Nepal is a member of SAARC, WTO and BIMSTEC. WTO membership presents special challenges for Nepal in terms of global competition, higher standards and lower prices. In addition, the GON's plans to improve trade and the environment for investment and to facilitate access to productive resources are constantly frustrated by a lack of know-how and weak institutional capacity, by the problems of a narrow export base and by the lack of a comprehensive export strategy. These issues will be addressed in the third focal sector on trade facilitation and economic capacity building.

In the light of these rapid changes that are taking place in Nepal, the CSP (2007-2013) will focus on the following three sectors: Education (with human rights, gender, conflict prevention and the environment as cross-cutting issues); Stability and Peace Building; and trade facilitation and promotion of trade and economic activities.

Consistency and coordination will be ensured with the return of the EC in the sector budget support group of donors, which includes three EU Member States (Denmark, Finland and United Kingdom). The EC will introduce flexible methods of implementation linked to improvements in system performance. Performance indicators will be devised that draw on EC experience and the lessons learned in the recent implementation of programmes/projects in Nepal (e.g. the renewable energy project) and elsewhere. The Development Partners and the GON acknowledge the added value of the EC initiative. The EC continues to play an active part in other harmonisation groupings of donors, such as the Uttstein group and those coordinated by the United Nations and by the GON. Key members of the Uttstein group (Denmark, United Kingdom, Germany and Finland) have already indicated their commitment to support GON peace building efforts, and three EU Member States (Denmark, United Kingdom and Finland) had already signed up to the Peace Trust Fund.

The Development Cooperation Instrument will be mainly used to support the EC response strategy in Nepal. Nevertheless, some other instruments, such as the Stability Instrument, could be strategically mobilised to test some pilot projects, especially in the context of the GON's request for support to the peace process. If the pilot phase proves successful, more substantial and long-term support programme could be planned under the DCI. The EC will continue to provide humanitarian aid to Nepal through ECHO assistance.

Development partners agree with the assessment that Nepal is not a fragile state in the conventional sense, as all national systems are still in place and functioning, albeit not in a satisfactory manner. Therefore, the risks in Nepal are not as high as in other post-conflict states. In fact, the risks are manageable, as the Maoists have now joined mainstream political life and the GON has endorsed the diagnosis of the situation by the Development Partners - especially that of the head of the United Nations Mission in Nepal (UNMIN) - and has begun preparing the required programmes and actions.

2.3 Implementation: the work programme

Focal Sector 1:

Education

EC support for the education sector will amount to approximately 60 percent of the CSP allocation. In terms of funding mechanisms, during the identification phase, current conditions and the institutional set-up in Nepal should be examined to see if they are still conducive to a sector-wide approach and sector budgetary support, and thus whether it is feasible to enhance other sector policies in order to achieve the MDGs.

The EC recognises that activities under a proposed Education sector programme should be in line with the policies and priorities of the government of Nepal, contained in the Tenth Five Year Plan 2002-2007 and those currently under preparation for the Three-Year Interim Plan (2008-2010), and is thus following an integrated approach to the development of the social sector.

The goals of the plan are: (1) improving enrolment, equity and inclusion, (2) improving quality and access to education, especially for girls, the poor and people from disadvantaged communities; (3) strengthening good governance and community management of schools; (4) ensuring the recruitment of school teachers; (5) promoting private sector involvement and growth; (5) preserving and promoting cultural diversity and heritage and environmental conservation; (6) contributing to peace and stability, and (7) achieving rapid economic growth and transformation.

The EC support will form part of a comprehensive sector policy support programme, which would ensure capacity development, and intra-sectoral consistency between the different education sub-sectors, such as vocational training and others. Support will also aim at inter-sectoral coherence between the education and other sectors that have an impact on resource management, such as health, tourism, trade, roads, transport etc. The EC's assistance will reflect Nepal's approach to development in the context of combining social inclusiveness and harmony, pluralism and management of human resources for sustainable economic development.

Focal Sector 2:

Stability and Peace Building

The EC welcomes the return to peace and democracy and the efforts made by the interim government to address the immediate needs and high expectations of the people expressed during the Jana-Andolan II. In that context, the EC, through appropriate financing procedures, will contribute to peace building and the process of consolidation of peace and democratization in Nepal through technical and financial assistance. The EC will encourage dialogue and cooperation with all stakeholders along cross-cutting themes, such as the supply and accessibility of services, accountability, transparency at all levels, predictability and the rule of law, as well as other root causes of conflict. The EC will focus on best practices in good governance, development and decentralised decision-making, including innovative methods to improve delivery of services to address poverty, inclusiveness, gender issues, institutional reforms and management of the public sector (including of the security services) in a context of restructuring of the state and/or a new federal system.

In the short term, the aim of the EC's support will be to combine the efforts of Development Partners to deliver a peace dividend for the people of Nepal, taking into account the GON strategy and the need for a balance to be struck between high expectations of early results and the many needs that will take time to be addressed fully. Besides the strategic support to the Election Commission in order to enhance its capacity to conduct transparent and efficient elections - starting with the elections to a Constituent Assembly in late 2007 -, the EC will also aim to provide assistance and funding to potential areas of support for Nepal, such as outreach and capacity of the State, reconciliation, reintegration, demobilisation aspects, security reform, and participatory dialogue processes, including at the regional and local levels. This process should include a clear gender and child rights perspective. EC support for Stability and Peace Building will be approximately 30 per cent of the total CSP allocation. Nevertheless, other funding instruments could be mobilised to provide some strategic support to this focal sector.

Focal Sector 3:

Trade Facilitation and Economic Capacity Building

EC support for economic capacity building should be extended alongside government efforts to encourage foreign investment in areas of comparative advantage. One of the project's objectives is to establish an enabling environment for the private sector and to foster improvement in labour productivity through regulatory streamlining and transparency. Concerning the export sector, Nepal continues to face problems of a narrow export base and limited country focus. The GON's efforts to promote a sustainable export strategy in conjunction with the private sector should also be supported, with a view to increasing the competitiveness of Nepali products in particular. This focal sector will take up approximately 10 per cent of the total CSP allocation.

Coherence with regional and thematic programmes: In the context of cooperation with Nepal, alongside the activities planned under this CSP, the EC may pursue thematic interventions in the following areas: democracy and human rights, migration and asylum, human and social development, higher education, the environment and sustainable management of natural resources, including energy. These thematic activities are complementary to the strategic objectives pursued by the Commission under the CSP and form part of the policy dialogue with Nepal. The financing of these thematic activities will be additional to the financial resources provided under the MIPs.

ANNEXES

ANNEX I: Framework of Relations between the EC and Nepal

1. General Objectives of EU External Policy

The EU Treaty Objectives for External Cooperation

In accordance with Article 177 of the Consolidated Treaty Establishing the European Community,³ the Community's development cooperation policy shall foster the sustainable economic and social development of the developing countries, the smooth and gradual integration of these countries into the global economy and the fight against poverty. The Community's policy in this area shall contribute to the general objective of developing and consolidating democracy and the rule of law, and to that of respecting human rights and fundamental freedoms.

On the basis of Article 179 of the same Treaty, a new Development Cooperation Instrument (DCI) was adopted in December 2006. Nepal is eligible to participate in cooperation programmes financed under Regulation (EC) No1905/2006 of the European Parliament and of the Council of 18 December 2006, establishing a financial instrument for development cooperation.⁴

2. Strategic Objectives for Cooperation with Nepal

2.1 Asia Regional Strategy Paper

In the Asia Regional Strategy Paper⁵ the EU emphasises its realisation of the difficulties SAARC has in discussing political issues. However, the EU can help consolidate the ongoing integration process through its economic influence in the region, its own historical experience in dealing with diversity, and its interest in crisis prevention. The EU remains convinced that SAARC could play a useful role in strengthening regional co-operation and dialogue.

2.2 The 2000 Statement on Development Policy

In their statement on the European Community's Development Policy⁶ of 10 November 2000, the Council of the European Union and the European Commission recalled that development policy is based on the principle of sustainable, equitable and participatory human and social development, and that the promotion of human rights, democracy, the rule of law and good governance are an integral part of it. They further determined a number of areas, selected on the basis of their contribution towards reducing poverty and for which Community action provides added value. These are:

- the link between trade and development;
- support for regional integration and cooperation;
- support for macro-economic policies and promotion of equitable access to social services;
- transport;
- food security and sustainable rural development;
- institutional capacity building, particularly in the area of good governance and the rule of law.

³ OJ C 325 24/12/2002

⁴ OJ L 378 27/12/2006, p. 41

⁵ http://europa.eu.int/comm/external_relations/asia/rsp/rsp_asia.pdf

⁶ http://europa.eu.int/comm/development/body/legislation/docs/council_statement.pdf

The Statement also specifies that the Community must continue its support in the social sectors (health and education), particularly with a view to ensuring equitable access to social services.

2.3 The 2005 Communication on Speeding up Progress towards the Millennium Development Goals

In its Communication of 12 April 2005 on speeding up progress towards the Millennium Development Goals,⁷ the Commission takes stock of the EU's contribution to development and identifies the necessary measures to accelerate the achievement of the MDGs. The Commission aims at (a) setting new intermediate targets for growth in official aid budgets by 2010 for both the EU and the Member States, ultimately achieving the 0.7% target of gross national income (GNI) by 2015, (b) speeding up reforms to improve aid quality, (c) re-evaluating the EU's influence on the conditions for development and (d) ensuring Africa's primacy as the beneficiary of these approaches with renewed impetus being given to partnership between the two continents. The proposals on Development Financing and Policy Coherence are set out in detail in two other communications. Together these contribute to the three pillars of sustainable development (economic, social and environmental).

2.4 The 2005 Communication on Financing for Development and Aid Effectiveness

In its Communication of 12 April 2005 on Financing for Development and Aid Effectiveness,⁸ the Commission outlines the means of achieving the interim targets of increased ODA volumes by 2010 and of moving towards the UN target of 0.7% GNI by 2015. It suggests new aid procedures and innovative sources of finance, and includes proposals for addressing the remaining post-HIPC debt problem of low-income countries. It suggests redefining the EU commitment regarding GPG. The main challenge on co-ordination and harmonisation is the credible implementation of the EU framework and the results of the High Level Forum on aid effectiveness, and complementarity in aid delivery. Commitment to reforming the International Finance System must be strengthened.

2.5 The 2005 Communication on Policy Coherence for Development

In its Communication of 12 April 2005 on Policy Coherence for Development,⁹ the Commission defined coherence commitments in the overall framework of the EU sustainable development strategy and identified the following priority areas with a high potential for attaining synergies with development policy objectives: trade; environment; security; agriculture and fisheries; social dimension of globalisation, employment and decent work; migration; research and innovation; information society; transport and energy. These commitments were endorsed by the Council (GAERC) on 24 May 2005. The Communication further calls on non-development policies to respect development policy objectives and on development cooperation to also contribute, where possible, to reaching the objectives of other EU policies.

2.6 The Joint Statement on EU Development Policy ('The European Consensus')

⁷ COM 2005/0132 final

⁸ COM 2005/0133 final

⁹ COM2005/0134 final

At its meeting of 22 November 2005, the General Affairs and External Relations Council adopted the EU Development Policy Statement, also known as “the European Consensus”. The “European Consensus on Development ” provides, for the first time, a common vision that guides the action of the EU, both at the level of its Member States and at Community level, in development cooperation. The Statement identifies the eradication of poverty in the context of sustainable development, including pursuit of the MDGs, as the primary and overarching objective of EU development cooperation. The Statement also emphasises that EU partnership and dialogue with third countries will promote common values of respect for human rights, fundamental freedoms, peace, democracy, good governance, gender equality, the rule of law, solidarity and justice and the EU’s commitment to effective multilateralism.

2.7 The 2005 UN Summit Conclusions on Human and Social Development

The importance of strengthening the social dimension of globalisation and of promoting productive employment and decent work opportunities was highlighted in §47 of the UN Summit conclusions of September 2005 regarding human and social development. UN member states committed themselves in particular to “strongly support fair globalisation and resolve to make the goals of full and productive employment and decent work for all, including for women and young people, a central objective of our national and international policies as well as our national development strategies, including poverty reduction strategies, as part of our efforts to achieve the MDGs. ”

3. Main Bilateral Agreements

The 1996 EC-Nepal Cooperation Agreement

EC assistance to Nepal dates back to 1977. In June 19 96, the EC-Nepal Framework Co-operation Agreement came into force, outlining the general conditions for providing EC technical assistance and co-operation. The Agreement is based on Nepal’s respect for human rights and democratic principles. The principal objectives of this Agreement are to enhance and develop the various aspects of co-operation between the Parties, in particular:

- a) To secure the conditions and to promote the increase and development of two -way trade and investment between the two Parties ;
- b) To support the sustainable economic development of Nepal, taking into account its current least developed status;
- c) To promote economic, technical and cultural links in their mutual interest;
- d) To support environmental protection and sustainable management of natural resources;
- e) To assist Nepal in developing its trading capacity, taking into account its land -locked nature.

ANNEX II: Country Diagnosis

1. Analysis of the political, economic, social, and environmental situation

1.1 Political situation

Nepal today stands at a historic crossroads since the 12-year armed conflict came to an end and a new, democratic Nepal is in the making.¹⁰ Since 1990, Nepal's democracy has been fragile: feudal structures and a powerful monarch persisted, and only an elite enjoyed socio-economic prosperity. The erosion of public trust in the political system provided fertile ground for a Maoist-led guerrilla struggle in the countryside, committed to socio-economic redistribution, development and attacking the roots of privilege of the high castes/classes. It is estimated that over 12,000 Nepalis lost their lives in the armed conflict.

Nepal was virtually ungovernable for several years, but when the King assumed direct executive control in February 2005 this provoked a constitutional crisis. There was a widespread popular uprising against the King in April 2006. These ongoing protests, combined with disillusionment by political parties in the King and the Maoists' shift to support competitive, multi-party democracy, created a critical mass of forces demanding a Constituent Assembly. In June 2006 the governing Seven Party Alliance (SPA) and the Maoists reached an agreement that effectively ended the guerrilla struggle and protests.

Although an interim constitution has been drafted, the SPA and Maoists have failed to agree on key issues such as the future of the Monarchy (an issue on which the interim constitution provides for a referendum) or the interim legislature, which should be in place while a new electoral roll is drawn up and electoral system created. This has compounded the prevailing mutual suspicion about strategic interests, goals and levels of sincerity. There are diverse public views on what politicians must deliver, but expectations are high as the promised Constituent Assembly was seen as a cure-all. Politicians will have to start delivering quickly if people are not to become disillusioned. While many promised inclusive representation in the new Nepal, little thought has yet been given to how to achieve these levels of inclusion in the areas of gender, caste, ethnicity and class.

Issues such as how the State will be structured and the extent to which local communities will have a voice and a stake in managing their affairs remain uncertain. This is a crucial issue as, in Nepal, identity is not territorially bounded. The recent uprisings in the lowlands of southern Nepal (also known as the Terai) are but one manifestation of hitherto excluded groups (in the Terai they are known as the Madhesis) claiming their right to inclusion and fair representation in a federal setting.

The capacity to take such important and fundamental decisions about the future of Nepal can only come from an informed understanding of the available institutional choices and processes, their applicability and implications. It is important that political parties, Maoists, civil society, government and NGOs remain committed to the democratic process over the long term. The Maoists must demonstrate their ability to become a political actor that respects multi-party, parliamentary democracy in line with their pledges.

Bhutanese refugees

¹⁰ Please see Annex IV for a timeline of key political events in Nepal.

Nepal's relations with Bhutan became problematic in early 1991 when approximately 93,000 people of Nepalese origin fled Bhutan and entered Nepal as refugees. The origin of this exodus from Bhutan dates back to the 1988 census, when the Government of Bhutan declared that a large number of Nepali-speaking Lhotsampas of southern Bhutan were illegal residents. The refugees, whose numbers had increased to more than 106,000 in 2005, are currently housed in seven camps in the districts of Jhapa and Morang in Eastern Nepal. Bilateral talks between Nepal and Bhutan were stalled as a result of the incident in the Khudunabari camp on 22 December 2003, where Bhutanese members of the verification team were allegedly pelted with stones. Several attempts have been made to revive the talks, but have all proved inconclusive.

EU initiatives included the launching of the trilateral dialogue (UN/EU/US) at the end of 2004. In March 2007, the GoN authorised the US government to process the resettlement applications of over 60,000 refugees in Nepal. The first batch of about 6,000 refugees is expected to leave Nepal by early 2008. The process is expected to take about five years. Other countries, such as Australia, Canada and Denmark have expressed willingness to resettle Bhutanese refugees in their respective countries. However, for the GoN, repatriation remains the priority option that is likely to provide an acceptable and lasting solution to this problem.

Political Risk analysis

The complexities of the situation in Nepal present many challenges to the peace process. Nepal's peace process is trying to address at least three issues of (a) bringing the former Maoist insurgents into mainstream politics, (b) addressing the longstanding issue of inclusion of the historically disadvantaged groups/communities; and (c) drafting a political agenda that will ensure a smooth transition that adequately addresses the first two issues. Much has been achieved in the past year; but important challenges remain.

- The date for the Constituent Assembly elections has been postponed to November 2007. The delay in CA may trigger more unrest in the country and, as a result, may further delay the political process. The threat of delays and derailing of positive developments is illustrated by the riots and ongoing unrest in the eastern Terai. The tensions between dominating groups and minorities might be exploited by the elements that benefit from derailing the political process. If elections were to be further delayed (i.e. beyond 2007) the Interim Government de facto would extend the length of its 'free' term and this could undermine popular confidence.
- The success and legitimacy of the electoral process will depend on its ability to include the hitherto unrepresented parts of the Nepali population. The size (approximately 500 members) and decision making process of the envisaged Constituent Assembly, as well as lack of plans for wide spread consultations and petitions, presents a concern. Much of the conflict mitigating qualities of the CA will depend on the perceptions of the people regarding the process. Inability of the political parties to take their activities outside of Kathmandu and other city areas also pose a threat to the process. The parties' local leadership is ill prepared to take on their political/electoral roles. Furthermore, all political decisions have been being made in a centralised manner, marginalising local leadership from the process.
- Institutional weaknesses deriving from the inaccuracy of the interim constitution might also impose a threat to political stability. For example, the interim constitution lacks precise provisions to specify the competence of the legislative. Thus, it is unclear whether

the CA will, once elected, function as a full legislative and this could cause further delays of the CA elections.

- The slow pace of the process can in itself be a derailing factor. The centralised peace process ensures that too many negotiations, decisions and responsibilities are placed in very few sets of hands. This produces an inertia, which is felt throughout the administration and state bodies. Adding to that, years of instability and frequently shifting governments through the past decade and a half, and 14 months under a royal dictatorship have rendered state authorities ill equipped to take on the challenges of the current process. Another significant risk is that the justice system and law enforcement sector does not manage to establish a relationship of confidence with the population and fails to address the many issues, which may lure the majority of the population to seek justice and security elsewhere. This may encourage lawlessness and disrespect to the state security apparatus. Security forces such as the Nepal Police and the Armed Police Force face a huge capacity gap in providing security arrangements to ensure a safe environment for the elections.
- Strategies for reintegration of CPN-M combatants seem currently to be inadequately addressed. Problems linked to successfully reintegrate the Peoples Liberation Army could present a risk locally and even regionally. The failure of the CPN -M leadership to maintain authority over the organisation presents an additional risk
- The risk factor closest to the root of the conflict is the endemic poverty in Nepal. Lack of tangible economic and infrastructural progress could destabilise the process significantly.

1.2 Economic Situation

The Nepalese economy is one of South Asia's most open and trade-dependent economies. The share of trade in GDP and in world exports has almost doubled over the last two decades; the share of agriculture has dropped from 60 to 40 percent and the share of industry has increased from 13 to 21 percent. Despite these achievements, Nepal is still one of the poorest countries in the world and the poorest country in South Asia due to its difficult topography, its poor infrastructure and its landlocked location. It is categorised as a Least Developed Country.

Water and hydropower are Nepal's most important natural resources. There are about 45 000 km of rivers and streams and an estimated power potential of 83 000 megawatts, of which 50 percent is economically viable. However, only 0.5 percent has so far been exploited. Nepal has the potential to produce more than 40 000 MW of hydropower, most of which could be exported to India. With the restoration of peace and democracy, Indian investors have recently floated proposals to build hydropower plants in Nepal.

The largest project is the 750 MW West Seti hydropower dam, which is currently being developed by an Australian consortium. The electricity generated will be for export to India as well as for local demand. At present, only 40 percent of Nepalese households have access to electricity and Nepal's power costs are among the highest in South Asia.

The industry sector is driven by the production of goods for export markets mainly in the US, Germany and India, such as garments, carpets, pashmina, textiles, food items and chemicals. Tourism is a key economic sector for Nepal. Although it has rebounded significantly in early

2007, the industry is still below the peak level of 495,000 arrivals reached in 1999. It has to be noted that 80 percent of Nepal's tourists arrive by air.

Per capita income has increased from US\$ 130 in 1965 to US\$ 270 in 2005. The country's real annual economic growth averaged about 4 -5 percent over the last two decades and grew by about 3 percent in 2006/07.

Economic growth performance

Nepal recorded good economic growth performance during the 80s and 90s, but began to falter at the end of 2001 due to the intensification of the Maoist insurgency and the global slowdown that led to a collapse in exports. In 2002, Nepal posted its first negative economic growth rate (-0.6 percent). The country avoided an economic collapse thanks to a sharp increase in foreign remittances. Economic growth is mainly driven by the non-agricultural sectors which account for the major share of GDP - 61 per cent. However, agriculture still plays a critical role, as more than 75 percent of the population is directly involved in agricultural activities. Agriculture still constitutes the main source of income of the poorest households. In the non-agriculture sub-sectors, the GDP shares of financial and real estate, construction, restaurant and hotels, transport and communications, and manufacturing have remained unchanged over the past five years. It is likely that finance and real estate, construction, manufacturing and tourism will remain the fastest-growing sectors of Nepal's economy in the years to come.

Although Nepal has achieved considerable socio-economic progress in the past 15 years in terms of education and health, the current model of economic growth and social development has serious flaws. Among the most critical development failures is the exclusion of caste and ethnic groups (e.g. Dalits, Madhesis and Janajatis) and certain regions (mid- and far-Western hills and the Terai) from the benefits of growth and human development. Moreover, a lack of control and accountability has led to serious problems of corruption and abuses. Recently, tensions have risen in the Terai (southern plains) between the Madheshis (local to the Terai) and Pahadis (originally from the hills and mountains). During January 2007 the situation became highly volatile and dozens of people were killed and injured in violent clashes. Exclusion may also have contributed to the rapid rise of the Maoist insurgency in the late 1990s. External assistance still plays a critical role in Nepal's development strategy. Discussions with the development partners take place in the framework of the Nepal Development Forum, which is held once every two years. The last NDF was in May 2004.

Remittances

A major economic development in the 1990s that was critical in terms of helping Nepal's economy was the growth in foreign employment for the Nepalese. Currently, over 800,000 Nepalese are working abroad and their remittances represent over five times the tourism receipts and about 30 percent more than the total value of merchandise exports in 2004. Most of them are now working in Malaysia, Qatar and Saudi Arabia, rather than India, which used to be the 'traditional destination'. A recent phenomenon which emerged in 2003 is the trend of Nepalese women going to work abroad, mainly in Hong Kong and Israel. The country can certainly continue to increase the number of Nepalese working abroad, but the GoN will have to invest more in education, expand foreign employment opportunities in countries like Japan and develop efficient and attractive financial instruments for the transfer of workers' salaries. The average annual remittance per recipient household in nominal terms increased from NPR 15,160 in 1996 to NPR 34,698 in 2004.

Public finance management and private investment

Despite frequent changes of government and the escalation of the Maoist insurgency up to 2006, Nepal has made significant progress in improving its public finance management. Nevertheless, Nepal's weak efforts in the areas of tax collection, resulting in the lowest tax revenue in South Asia, have caused serious concern. Overall revenue collection remains at 12.6 percent of GDP, covering only 70 percent of the government's expenditure. However, the situation has improved significantly since the beginning of 2007. The gap is mainly financed by external aid which helps Nepal to ensure fiscal stability, maintain development spending and keep up its efforts to reduce poverty. The royal takeover of February 2005 caused some anxiety, as development partners decided to halt their commitments, especially grants, while they reviewed the situation.

Nepal is implementing its 10th Five-Year Plan (2002-2007), relying on foreign assistance as the main source of funds for much of its capital expenditure. This feature is to be continued with the Three-Year Interim Plan (2008-2010).

Owing to many constraints, the involvement of the private sector in Nepal's socio-economic development process is still limited. The country's investment climate, which worsened in recent years due to the insurgency, has not improved much with the restoration of peace. The Maoist's violence and threats continue with the Young Communists League's activities and the situation of law and order has worsened in the Terai. Power development and telecommunications have emerged as two sectors that do attract private interest and investment. Nepal has liberalised the telephone and internet markets. There is no private involvement in the transport sector, which is massively underdeveloped and a major constraint on both private sector activities and the delivery of public services

Since 1992, the Nepalese currency has had a fixed exchange rate with the Indian rupee. After a short period of decline (1999-2002), the prime lending rate is now rising. On 22 July 2005, the Nepal Rastra Bank (Central Bank) rate was increased from 5.5 percent to 6 percent. Inflation (the rise in the consumer price index) grew steeply from 4.1 percent in 2004 to 7.3 percent in 2005. The fiscal deficit (3.2 percent in 2004) and public debt (61 percent of GDP in 2004, taking foreign and internal debt together) have declined in recent years.

Nepal benefits from foreign grants and soft foreign loans on highly favourable terms which, combined with the hard currency remitted by Nepalese working abroad, have enabled Nepal to accumulate an amount of over US\$1.8 billion (in September 2005), which is sufficient to cover 10.8 months of the country's imports.

Trade with India

The GoN recognises that foreign trade has not been very encouraging in recent years, but the balance of payments has remained manageable thanks to remittances. The garment industries have been facing serious problems since the Multi-Fibre Agreement ended on 31 December 2004. To facilitate trade, Nepal implemented a 3-year customs reform programme in 2003 in order to modernise the customs administration and infrastructures.

India is Nepal's largest trading partner, absorbing over 69 percent of Nepal's exports. Imports from India account for nearly 64 percent of total imports. Nepal and India share a free trade agreement. As for other countries, the EU is the second largest exporter to Nepal followed by the US, and the second importer of Nepalese goods, after the People's Republic of China (2006). Trade between Nepal and China is expected to increase with the linkage by train of Lhasa, the capital of Tibet, with Chinese port-cities such as Shanghai and Guangzhou in July 2006.

Nepal's share of world trade in goods and services has so far been negligible, given the size of its economy. Its merchandise exports were about \$ 811.5 million in 2005, representing a 10.6 percent increase on the 2004 figure. The annual percentage growth in exports was 8.6 percent between 1995 and 2005. Imports, on the other hand, totalled \$1.842 billion, a decrease of 0.7 percent compared to 2004. The annual growth in imports between 1995 and 2005 was 3.7 percent. Informal trade with India is an important feature of Nepal's trade landscape. By some estimates, it represents about \$400 million, or about 15 percent of total trade.

Nepal's customs tariffs were reformed in the early 1990s. The level of and variation in rates were substantially reduced. Most rates now fall between 5 and 25 percent and the unweighted average tariff rate was 13.8 percent in 2002. Nepal grants tariff preferences for regional neighbours. During its process of accession to WTO, Nepal has been able to maintain a certain amount of flexibility by binding its tariffs above currently applied levels. Import duties as a percentage of total tax revenues amounted to about 24 percent on average between 2002 and 2004, indicating that it would be difficult for Nepal to forego customs revenue.

The main exports from Nepal are manufactures, which account for 70.2 percent of total exports, followed by agricultural goods at 20.8 percent and chemicals and drugs at 8.6 percent. The main destinations of these exports are India (accounting for about 69.2 percent), EU (12.4 percent) and US (11.8 percent). On the import side, manufactures account for 33.3 percent of Nepal's total imports, machinery and transport equipment for 16.6 percent, petroleum products for 16.1 percent, agricultural products for 13.8 percent, chemicals and drugs for 11.5 percent, and mining products for 6.8 percent. The main importing countries/regions are India (accounting for about 64.1 percent), People's Republic of China (5.0 percent), EU (4.7 percent) and the US (1.3 percent).

Nepal is one of the countries which benefits from the EBA initiative under the EU GSP and is also part of the regional accumulation of origin scheme in the South Asia grouping, comprising Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka.

FDI

India plays an important role in Foreign Direct Investment (FDI) in Nepal. By some accounts, the number of joint ventures with India account for more than a third of all FDI in Nepal. In recent years, China has also emerged as a key player in FDI, along with Japan and South Korea. In 2004, China headed the group of countries, with 16 industries approved, followed by India (9), Japan (9) and South Korea (9). Among the EU countries, the UK led (with 4 industries), followed by France (3). Investors were mainly attracted to the tourism sector (27 joint ventures), industrial production and the services sector. Nepal has recently removed travel agencies from the list and is gradually moving away from the negative list for FDI.

1.3 Social situation, including decent work and employment

Nepal's social indicators, as indicated in the Housing Population Census 2001, show that the country has made considerable progress in terms of human development. As a late starter in development, Nepal's social statistics now compare favourably with those of its richer South Asian neighbours. In the global HDI for 2006, Nepal is ranked 138 out of 177 countries. Nepal's Gross National Income per capita, on a PPP basis, was \$ 1 675 in 2006.

However, further significant improvements on human development are unlikely to occur unless Nepal vigorously tackles the social exclusion issue. Nepal's ethnic and caste groups represent a

unique and complex social mix. Brahmins are at the top of the social hierarchy, followed by Chetris, Newars, Janajati, Madhesis and, finally, the Dalits. The Newars, who are the people of the Kathmandu valley, are more oriented towards trade and artistic activities; the last two groups, which represent the indigenous peoples of Nepal, are the poorest and do menial work. Together, they account for about 47 percent of Nepal's total population of 27 million. A small group of upper caste elites and those in the Kathmandu valley enjoy most of the gains of the economic growth by controlling the political and economic power of the whole country.

Millennium Development Goals (MDG)

Nepal's performance in achieving the MDGs varies from one goal to another. Given the current trend and assuming that the statistics are reliable, it is reasonable to believe that the country will achieve goals 1 (poverty), 3 (gender) and 4 (child mortality). For the remaining four goals (primary education, maternal health, HIV/AIDS, and environmental sustainability) progress has not been satisfactory. A needs assessment recently carried out by UNPD and the National Planning Commission in 2005/2006 called for a "better alignment between the MDGs and PRSP policies and activities". The report also indicated that Nepal will have to rely on Development Partners to achieve the MDGs, although perhaps to a lesser extent now that peace is restored in Nepal and economic growth is expected to rebound vigorously. Comments on selected MDGs illustrated some of the challenges facing Nepal, including that of the quality of data and information used, the collection of which was seriously affected by the decade-long Maoist insurgency.

Gender

Despite the government's efforts to empower women, discrimination against women is still an important issue in Nepal. Women face violence both in the public and private spheres, often with impunity. Trafficking of women and female children remains an ingrained social problem. Girls and women IDPs are often forced into sex work. Indigenous and Dalit women are in an extremely disadvantaged position as they are victims of multiple forms of discrimination. Women have a lower outcome than men in almost all poverty indicators. Over the last fifteen years, there has been a steady increase in female school enrolment rates. Achievements at primary level were remarkable, but gender discrimination at secondary level is more pronounced, probably due to the high drop-out caused by early marriage as well as women's work burden.

The number of Nepalese women in the civil service is still low compared to the levels reached by other South Asian countries: women make up less than 8 percent of the overall staff and only 4 percent at officer level. Women are also under-represented in Nepal's elected government. In the interim House of Representatives, women account for less than 10 percent of the total number of MPs. Securing the achievement of MDG 3 by 2015 would certainly need strong leadership and sincere commitments by all stakeholders.

Health

Seventy-nine percent of the rural population has access to safe drinking water and 30 percent to sanitation (2005), which means that Nepal has partly achieved MGD 7 (Target 10), i.e. to halve the proportion of people without access to safe drinking water. However, as water quality varies greatly in Nepal, the data on 'safe' drinking water certainly need to be revised. Access to health facilities varies greatly depending not only on income group and location, but also on caste, ethnic group and gender. At present there are 87 hospitals, 6 health centres, 699 health posts, 287 Ayurvedic dispensaries, 3,132 sub-health posts and 180 primary health posts. Around 20 percent

of women are attended by trained personnel during childbirth. Data on the maternal mortality rate (MMR) are extremely unreliable, making it difficult to assess the progress in MDG 5. Nevertheless, the figures estimated by UN specialised bodies, such as WHO, UNICEF and UNFPA (740 in 2000), and by the National Planning Commission (415 in 2002) reveal that MMR in Nepal is one of the highest in the world. For MDG 4, the trend is encouraging: the infant mortality rate fell from 7.9 percent in 1995 to 6.1 percent in 2005. From the indicator perspective, Nepal is on-track to reach the goal, but the quality of child health services needs to be improved. Life expectancy at birth has increased from 52.8 years for males and 51.2 for females in 1990 to 60.6 and 59.6 respectively in 2005.

On MDG 6, epidemiological data on HIV/AIDS suggest that Nepal has entered the stage of a concentrated epidemic. It is estimated that by the end of the decade 100,000-200,000 young adults will be infected with HIV, and that 10,000 -15,000 may die of AIDS, making it the leading cause of death among the 15 -49 age group. Nepal has established a high-level National AIDS Council to generate a multi-sectoral response. Malaria is among the top five public health priority programmes in Nepal. Although the incidence of malaria within the risk population has fallen over the last fifteen years, more resources are needed to achieve the MDG on malaria. As far as tuberculosis is concerned, Nepal is on-track to achieve this target.

Education

Compared to the remarkable achievements between 1990 and 2000, progress in the education sector over the last five years has been disappointing. If the recent trend continues, it seems unlikely that Nepal will achieve MDG 2 on primary education, in terms of net enrolment rates (NER). NER now stands at 84 percent according to the Ministry of Education but the 2nd NLSS indicated a much lower figure (72 percent). One factor affecting enrolment is child labour (one in three children aged 5-14 years in Nepal is working as a child labourer). The right to education has also been undermined by the parties to the conflict using schools for military and political purposes. Indigenous nationalities are especially disadvantaged with regard to access to education as most indigenous children do not have Nepali as their mother tongue. Furthermore, the quality of education at primary level is still poor. At the secondary and higher education levels, progress has been slow as much of the funding has been diverted to basic and primary education. During the last decade, expenditures in secondary and higher education decreased from 20 to 10 percent of the total education budget, which receives between 12 and 15 percent of the total government budget.

As of July 2005, there were 24,746 primary schools, 7,436 lower secondary schools, 4,547 secondary schools, 1,000 higher secondary schools and 5 universities in Nepal. About one third of all primary and lower secondary schools belong to the private sector. Generally, these perform better than the public schools. In the last School Leaving Certificate examination, the pass rate was 85 percent for the private sector, compared to 15 percent for the public schools.

Employment

Not only is job growth very limited in Nepal; it has also failed to meet the demands of young people, especially those in the lower echelons of the social hierarchy. Given the slow economic growth in recent years, it is unlikely that Nepal will be able to satisfy such a demand. Generating employment is probably one of the major challenges facing Nepal in the years to come, as the population is expected to grow to 77 million in the next four decades.

To meet this challenge, the GoN has targeted economically disadvantaged regions, peoples and communities as priority areas for its social and development actions. It also promulgated a new labour law in 2005 in order to increase business efficiency and protect the basic rights of workers and has funded new training programmes through 14 skill development training centres (SDTC) and two vocational training centres (VTC).

In the Tenth Five-Year plan (2002-2007), the government has made human resource development a priority area in its development policy.

1.4 Environmental situation

The state of Nepal's environment has many facets, determined by the physiography, climate, poverty, population growth, institutional weaknesses, the government's late start in addressing environmental issues, and the decade-long insurgency. Much of Nepal's land surface is still covered by forest, although there has been significant deforestation. Nepal has some 118 forest ecosystem types. The GoN's strategy is to achieve sustainable forest management through community participation programmes and. The country's strategy is to place medicinal and aromatic plants at the heart of its conservation efforts.

Nepal's natural environment has been greatly affected by climate change. Glaciers in Nepal – which is home to eight of the ten highest peaks in the world – are retreating. Many areas of Nepal are increasingly at risk from glacial lake outburst floods (GLOF) in addition to other natural disasters, such as earthquakes, inundation and flash flooding. In 2004, the UNDP ranked Nepal 5th in its risk rating scale regarding the vulnerability of its population to flooding.

Although peace is now restored, the country is still facing serious challenges for its environment. Wildlife poaching is continuing as an indirect consequence of the fact that government control outside the cities and district headquarters is limited. Living conditions in the Kathmandu valley are deteriorating alarmingly as a result of significant population growth. Rivers and tributary streams in the valley are open sewers and ambient air quality is poor, failing to meet the required standards.

Nepal's lack of a funded independent national environmental agency is a source of major concern and undermines environmental management. No fewer than eight ministries are involved in the various steps of policy formulation, implementation and legislation. Nepal has declared 18 percent of its territory as national parks and other protected areas. Together with India, Nepal has established the trans-national Terai Arc Landscape, covering an area of 49,500 sq. km (47 percent of this being in Nepal), which is one of the most biologically diverse habitats on earth.

1.5 Nepal's regional integration

Nepal is one of the strongest advocates of the South Asian Association for Regional Co-operation (SAARC) and hosts its headquarters in Kathmandu. For Nepal, SAARC provides not only a strategic instrument to ensure its security and promote its political role in the region, but also a framework to expand the number of partners to exploit its vast water and hydropower resources. Nepal has recently taken initiatives to promote dialogue on wider economic issues such as investment, services, energy and macro economic policies. As an LDC member state in SAFTA, Nepal is a beneficiary of the "Mechanism for Compensation of Revenue Loss" and the "Technical Assistance to LDC".

2 Poverty reduction analyses

Despite decades of development supported by large aid flows, Nepal remains one of the poorest countries in Asia. The country is going through a critical period in its history. The main challenges facing Nepal today are to restore democracy, to launch an effective peace process, and to build the basis for a lasting peace by directly addressing the root causes of the conflict and accelerating the pace of economic reform. The deep-rooted nature of social exclusion in Nepal makes it harder to achieve the MDGs. Political commitment and well-championed strategies are needed to tackle this. Although there has been some progress on the MDGs, a great deal still remains to be done.

3. Nepal's development strategy

Nepal's development strategy has been driven by the need to open the country to the rest of the world. As recently as the early 1980s, the country was still closed and undiversified, with construction, restaurants and hotels representing the main source of growth. The Green Revolution which spread across the South Asian continent had by-passed Nepal. The policy reforms of the 1990s have to a large extent corrected these deficiencies. However, progress in the social sector is now under threat due to the effects of the development strategy failures highlighted by the World Bank and other aid agencies.

Against this background, the GoN has developed a poverty reduction strategy. The 10th Five Year Plan (2002-2007) currently tackles the main causes and determinants of poverty in Nepal by focussing on the following four pillars:

- the rural economy
- human development and economic infrastructure
- social and economic inclusion
- good governance

The plan is being implemented using a new set of methods and procedures, which include close partnerships with the private sector, civil society and local communities. The GoN also introduced a rolling annual resource allocation system, known as the Medium Term Expenditure Framework, in order to protect the key actions to reduce poverty in the event of a shortfall in financial resources.

The Government is currently drafting a new Three Year Plan (2008-2010) to be endorsed by the Interim Government. The Plan will focus on delivering a post-conflict peace dividend to the people of Nepal and will determine the country's policy agenda up to the first General Election and the installation of a stable democratic government - a process that is expected to take three years. The Interim Plan's strategic focus includes:

- Employment generation and kick-starting the economy;
- Investing in infrastructure;
- Major investment in the public sector;
- Encouraging the private sector to follow suit.

This will be implemented as follows:

- Developing a reconstruction agenda, which includes post-conflict needs;
- Decentralisation of rural infrastructure projects which are identified, owned and operated by the local communities.

- Launching of selected visible, large-scale, high-profile infrastructure projects for confidence building in areas such as:
 - Strategic roads
 - Irrigation
 - Hydropower
- Focusing on employment, including special programmes for youth, training and mobilisation.
- Health/education.
- Tourism sector.
- Agriculture sector.

4 Medium-term challenges

The Millennium Development Goals Needs Assessment Report for Nepal, produced jointly by the Government of Nepal and UNDP was launched at national level in October 2006. The 2006 needs assessment report shows that the government must make public investment of US\$ 1 2.6 billion over the next decade if the goals are to be reached. More than half of that money must be channelled into reducing hunger, improving education and, critically, developing infrastructure. A poor transport network, lack of market access and limited electricity are hindering growth, especially in rural areas where most Nepalese live. The Report shows that donors must double their funding for development in Nepal over the next ten years.

From a governance perspective, the importance of re-establishing local bodies and the process of decentralisation should be given priority attention. There are major gaps in service delivery, and key administrative responsibilities at the local level need to be stabilised. Now that it is likely that Nepal will be moving to a federal system, the situation will be complicated by technical factors which donors will need to take into consideration, especially new mechanisms linked to the transfer of funds from the central to the local level. This will be a lengthy process; Village Development Committees will need to be restructured and de facto land reform needs to be carried out in Maoist areas. At present there is considerable absorption capacity for large investments, but donors will also need to analyse the possibility of contributing to recurring costs.

The WB, IMF and ADB had projected Nepal's economic growth at an annual rate of as low as 2 -3 percent as a result of the insurgency and the political instability. Following the return to democracy that began in April 2006, there are now prospects for a speedy recovery and strong economic growth. By IMF estimates, a return to political stability will add ¾ percentage of GDP growth on average per year. With the country out of the insurgency and living peacefully, GDP growth would gain a further 2 percentage points on average per year. In summary, with political stability and the country at peace, it is predicted that GDP growth could return to the pattern of the 1990s, with rates of 4-6 percent per annum. The changes in the international environment also have to be taken into consideration. The economies of China and India are growing at rates of 8 - 10 percent per annum. Therefore, Nepal's economy can aim for higher growth rates in the coming years and decades. To achieve this goal, Nepal needs not only to develop efficient and reliable infrastructure services, sound macro-economic policies and a strong domestic revenue base, but also to achieve just and equitable growth with social inclusion and without neglecting the agricultural sector and the economically disadvantaged regions.

In his first address to the donor community on 17 May 2006, the Nepalese Minister of Finance indicated that the rebuilding of the infrastructure destroyed by the Maoists, as well as the

development of new infrastructure is being given the highest priority in order to create productive capacity in the economy and among the people. Emphasis is placed on developing medium-sized power projects to overcome the energy crisis, on restoring and improving the national road network and the telecommunications network, and on constructing irrigation channels and bridges. In addition, the government will focus on urban development and housing, the expansion of power transmission lines and grids, and increasing rural electricity coverage. In the social sector, the government will concentrate on the consolidation and improvement of the quality of services in all districts and for all ethnic and caste groups.

As 80 percent of the population is engaged in the agricultural sector and Nepal is an open economy, agricultural exports may be seen as an option to generate additional foreign currency revenue. At the same time, Nepal needs to enhance rural revenue and improve the standard of living. In recent years, the GoN has been encouraging the production of tea, honey and vegetable ghee for the Indian market as well as for western markets such as Norway and Germany. A new important issue in its international economic relations has been the negotiation with the Chinese government of duty-free tariffs on a wide range of Nepalese products.

The Nepalese government is continuing with its privatisation policy. State-run enterprises in the cement, fertiliser and financial sectors have recently been privatised. The GoN is also encouraging the formation of an entrepreneurial class; however, this has been slow due to the lack of qualified human resources, infrastructure and services.

Trade

As far as international trade is concerned, Nepal is a member of the WTO, BIMST-EC and SAFTA. The GoN has set itself the objective to develop free trade relations with the People's Republic of China. A preliminary list of 1 500 products was submitted to China during Mr. Chan's visit in March 2006. The agreement was that the PRC would review the list and then start negotiations with Nepal.

5 Policy Mix

The policies underlying Nepal's response strategy are consistent with the main priorities of the Community's policies directly related to the key areas of cooperation with third countries. As an LDC that has been through a bloody insurgency, the policy mix in Nepal has benefited from the existing cooperation between EU member states and non-EU donors which has allowed resources to be spent in a wider context of aid and non-aid policies: strategic support is thus provided not only to poverty alleviation programmes but also to critical issues such as good governance, human rights, social exclusion, democratization and conflict resolution.

Priorities proposed in the social sector, especially education, and peace building are integrated with social inclusion and conflict mitigation objectives given that development tools are the most powerful instruments to treat and eradicate the root causes of the conflict and to promote social harmony. The main principles of the Conflict Prevention Commission's Policy continue to apply to Nepal as the present political situation urgently requires a better level of security for all citizens. Simultaneously, a higher degree of protection of human and civil rights will also determine further advances in cooperation areas. With peace now being restored, the consolidation of a democratic environment in Nepal is urgent and in line with the EU Council's conclusions on the EU's role in promoting human rights and democracy in third countries. The activities of peace building proposed by this strategy should facilitate the achievement of peace and democracy in Nepal.

The coherence of the policy mix is also ensured between development policy and other areas of external action, including trade policy. The combination of development and trade/economic capacity building with a global projection of democratic and social justice values should contribute to economic growth while facilitating social stability and promoting efforts towards the realisation of the Millennium Development Goals by 2015 through better resource availability and allocation. Furthermore, the development and cooperation strategy set out in this document is in line with the achievement of the Community's objectives of facilitating exports from LDCs to the EU through the EBA scheme and supporting LDCs' integration into the world economy and trading system.

Coherence is also ensured with other Community (internal) policies which are likely to affect Nepal and the South Asia region, including the environment (and climate change), transport and energy, economic and financial policies and research. The dialogue that will probably take place with SAARC as EU has now become an observer should also contribute to ensure coherence.

Continued assistance provided to uprooted people in Nepal will contribute to the survival of the Bhutanese refugees in the camps of Eastern Nepal and it has been complemented by urgent humanitarian services in line with ECHO policy in favour of this 'forgotten crisis' and in view of an exit strategy (settlement of refugees in the US, Canada, Australia and other countries).

ANNEX III: MIP Table

MIP I (2007-10)	PERCENTAGE
Priority I: Education	60
Priority II: Stability and Peace Building	37
Priority III: Trade Facilitation and Economic Capacity Building	3
Total MIP I	100
MIP II (2011-13)	
Priority I: Education	60
Priority II: Governance and Peace Building	27 - 35
Priority III: Trade Facilitation and Economic Capacity Building	5 - 13
Total MIP II	100
Total CSP	100

The amount of the MIP 2007-2010 will be a total of € 60 million for Nepal

ANNEX IV: Nepal at a Glance

Excerpts from "Country Fact File for Nepal, 2006"

1. Introductory statement and basic data

Nepal is a landlocked country in the Eastern Himalayas, bordered by Tibet in the North and India in the east, south and west. It is classified as a Least Developed Country (LDC). The population is estimated at about 27 million, living mostly in rural areas (88%). Nepal's GDP per capita is approximately €270 in 2005. Major trading links include India, the EU and the US. Nepal receives substantial aid from the Community and its Member States. The country's economic performance is weak and the situation has failed to improve in recent years due to the Maoists' insurgency. Social problems and social tensions are increasing as the poor, Nepali women and marginalized groups (i.e. Madhesis, Janajatis, Dalits, Kamayas, etc.) continue to face discrimination in various aspects of life.

In 2006, Nepal moved from an autocratic regime to a parliamentary system as a result of the second people's movement (Jana-Andolan). The country is in the process of preparing a new constitution which will replace the 1990 Constitution.

2. Indicators related to the Millennium Declaration

Indicators	1990	1995	2000	2005
1. Total population (million)	<u>N.A.</u>	<u>N.A.</u>	<u>24.4</u>	<u>27.1</u>
2. Proportion of population below \$1 per day	<u>N.A.</u>	<u>N.A.</u>	<u>N.A.</u>	<u>N.A.</u>
3. Prevalence of underweight children (under -five years of age)	<u>N.A.</u>	<u>46.1.</u>	<u>43.1</u>	<u>N.A.</u>
4. Net enrolment ratio in primary education	<u>N.A.</u>	<u>N.A.</u>	<u>70</u>	<u>78</u>
5. Primary Completion Rate	<u>60</u>	<u>N.A.</u>	<u>66</u>	<u>74</u>
6. Ratio girls to boys in primary and secondary education	<u>N.A.</u>	<u>N.A.</u>	<u>81</u>	<u>87</u>
7. Under 5 mortality rate	<u>147</u>	<u>136</u>	<u>126</u>	<u>114</u>
8. Proportion of 1-2 year old children immunised against measles	<u>58</u>	<u>65</u>	<u>59</u>	<u>65</u>
9. Proportion of births attended by skilled health personnel	<u>33</u>	<u>33</u>		<u>41</u>
10. HIV prevalence among 15-24 year old women	<u>N.A.</u>	<u>N.A.</u>	<u>N.A.</u>	<u>N.A.</u>
11. Prop. of pop. with sustainable access to improved water source	<u>64</u>	<u>N.A.</u>		<u>75</u>
12. CO2 emissions (metric tons per capita)	<u>N.A.</u>			

Source: World Development Country Data Profile, April 2007, World Bank

3. Political situation

Since May 2006, Nepal has entered a new phase which should provide the country with a new constitution replacing that of November 1990, which established a constitutional monarchy and a multi-party democracy. The 1990 constitution recognised the king as Nepal's Head of State. It established a two-tier legislature, the National Council (60 members) and the House of Representatives (205 members). The members of the House of Representatives were directly elected for five years. The king appointed the leader of the party which commanded a majority in the House of Representatives as Prime Minister. In the 1990s, although prime ministers changed frequently, the constitutional monarchy was never seriously endangered or rejected. However, with the intensification of the Maoist 'People's war', mainly since 2001, and the royal tragedy of 1 June 2001, the political situation has rapidly deteriorated. The lack of consensus in the ruling party on the handling of the state of emergency led King Gyanendra Bir Bikram Shah to dissolve

parliament in May 2002 and appoint S.B. Deuba as 'caretaker' prime minister until new general elections could be held in November 2002. When S.B. Deuba failed to hold general elections as scheduled, the king replaced him with L.B. Chand in October 2002.

L.B. Chand was followed by two other king-appointed prime ministers: S.B. Thapa and again S.B. Deuba. The situation deteriorated further and on 1 February 2005, the king dissolved the multi-party government and assumed direct power. He explained his actions as the consequence of the failure of successive governments to bring about peace and elections, and charged the parties with pursuing their own petty interests rather than addressing the people's needs and aspirations. In a statement on 2 February 2005, the EU made it clear that it viewed the king's action as a serious setback to multiparty democracy and called on the king to take early measures to restore democratic freedoms and civil liberties.

With the restoration of the House of Representatives on 25 April following three weeks of civil disobedience (Jana-andolan), the king recognised that the source of authority and sovereignty of Nepal rests with the people. On 15 January 2007 the interim constitution was passed and on 1 April 2007, the interim government with the inclusion of the CPN -M was formed. The elections for the Constituent Assembly which were planned for mid-June 2007 were postponed to the last week of November 2007.

Membership of regional organisations:

SAARC and BIMSTEC.

4. Economic situation

The regional average refers to South Asia (as per the World Bank Development Indicators Database)

Macro indicators	Country	Region	Public expenditure indicators	Country	Region
Growth of GDP %	<u>3.0</u>	<u>8.6</u>	Government Expenditure/GDP %	17.4 (b)	N.A.
Investment/GDP %	<u>27.7</u>	<u>30.7</u>	Expend. Surplus/deficit/GDP %	-1.1 (b)	N.A.
Exports/GDP %	<u>16.0</u>	<u>22.3</u>	EU Aid/Total Gov Expenditure %	<u>15.4 (b)</u>	<u>N.A.</u>
Imports/GDP %	<u>31.2</u>	<u>27.4</u>	Total Aid/Total Gov Expend. %	N.A.	N.A.
FDI/GDP %	<u>Negl.</u>	<u>3.60</u>	Health exp/GDP. %	<u>1.0 (b)</u>	<u>N.A.</u>
Debt service/GDP %	1.56	N.A.	Education exp/GDP.%	<u>3.2 (b)</u>	<u>N.A.</u>
Rate of Inflation %	<u>7.9%(a)</u>	<u>N.A.</u>	Defence exp./Total Gov. Expend. %	<u>11.9 (b)</u>	<u>N.A.</u>
Unemployment %	<u>N.A.</u>	<u>N.A.</u>	Debt service/Total Gov. Expend. %	<u>7.4 (b)</u>	<u>N.A.</u>
Living less 2 \$/day %	<u>N.A.</u>	<u>N.A.</u>	Total revenue/Total Gov. Expend. %	<u>82.2 (b)</u>	<u>N.A.</u>

Source: World Development Indicators database, April 2007, (a) April 2006. ADB Key Indicators, 2006

Despite four decades of development efforts, Nepal remains one of the poorest countries in the world. It is classified as a Least Developed Country. The economy is characterised by a large rural sector based on subsistence agriculture and small industries focused on manufacturing activities and tourism. A huge part of the population (80%) is directly involved in agriculture. The manufacturing sector is dominated by carpets, ready-made garments, hides and skins. Water and hydroelectricity potential are the most important natural resources. A process of economic liberalisation was initiated in the early nineties and the government has confirmed its commitment to further encourage private initiative and foreign investments. The political uncertainty, the situation in the Terai and the Maoist movement have seriously affected the Nepali economy. GDP growth declined to less than 1% in 2001/2002 after averaging 4.5 % during 1995 through 2000. An improvement has not been observed in 2006 as a result of the poor performance of the agricultural sector. The non-agricultural sector performed well with the recovery of the tourism sector.

The renewal of the 1996 Nepal-India Trade Treaty has ended the uncertainty surrounding Nepal's exports to India, which is the country's largest trading partner. Nepal's exports consisting mainly of vegetable ghee, polyester yarn, chemicals, copper wire and rods, readymade garments, zinc sheet and galvanised iron pipe. The bulk of Nepal's imports consists of petroleum products, machinery, transport equipment, electrical goods, telecommunications and computer equipment, chemicals and drugs. Nepal's principal exports are

three commodities – carpets, garments and pashmina products – which accounted for 65% of total exports in 200500. Foreign aid dependence increased sharply in 2001, from an average of 47% over the previous five years to 58% of development expenditure.

Widespread poverty and social exclusion of the backward and vulnerable communities remain a major economic and policy challenge for Nepal.

Tariff schedule facing EU exporters to Nepalese

Not Available

Tariff schedule facing Nepalese exporters to EU

Since Nepal is a LDC, it is covered by the Everything But Arms (EBA) arrangement under the EU's GSP Scheme. This means a duty free-quota free regime for Nepalese exports to EU.

Non-tariff barriers facing EU exporters to Nepal

Not Available

Non-tariff barriers facing Nepalese exporters to EU

Not Available

ANNEX V: Chronology of Key Events

Years	Events
1768	<ul style="list-style-type: none"> Gurkha ruler Prithvi Narayan Shah conquers Kathmandu and lays foundations for unified kingdom.
1792	<ul style="list-style-type: none"> Nepalese expansion halted by defeat at hands of Chinese in Tibet.
1814-16	<ul style="list-style-type: none"> Anglo-Nepalese War; culminates in treaty which establishes Nepal's current boundaries
1846	<ul style="list-style-type: none"> Nepal falls under sway of hereditary chief ministers known as Ranas, who dominate the monarchy and cut off country from outside world.
1923	<ul style="list-style-type: none"> Treaty with Britain affirms Nepal's sovereignty. (Absolute monarchy)
1950	<ul style="list-style-type: none"> Anti-Rana forces based in India form alliance with monarch.
1951	<ul style="list-style-type: none"> End of Rana rule. Sovereignty of crown restored and anti-Rana rebels in Nepalese Congress Party form government.
1955	<ul style="list-style-type: none"> Nepal joins the United Nations. King Tribhuvan dies, King Mahendra ascends to the throne.
1959	<ul style="list-style-type: none"> Multi-party constitution adopted.
1960	<ul style="list-style-type: none"> King Mahendra seizes control and suspends parliament, constitution and party politics after Nepali Congress Party (NCP) wins elections with B. P. Koirala as premier.
1962	<ul style="list-style-type: none"> New constitution provides for non-party system of councils known as "panchayat", under which the king exercises sole power.
1973	<ul style="list-style-type: none"> First elections to Rastriya Panchayat held in 1963.
1972	<ul style="list-style-type: none"> King Mahendra dies, succeeded by Birendra.
1980	<ul style="list-style-type: none"> Constitutional referendum follows agitation for reform. Small majority favours keeping existing panchayat system. King agrees to allow direct elections to national assembly - but on a non-party basis.
1985	<ul style="list-style-type: none"> NCP begins civil disobedience campaign for restoration of multi-party system.
1986	<ul style="list-style-type: none"> New elections boycotted by NCP.
1989	<ul style="list-style-type: none"> Trade and transit dispute with India leads to border blockade by Delhi resulting in worsening economic situation.
1990	<ul style="list-style-type: none"> Pro-democracy agitation co-ordinated by NCP and leftist groups. Street protests suppressed by security forces resulting in deaths and mass arrests. King Birendra eventually bows to pressure and agrees to new democratic constitution.
1991	<ul style="list-style-type: none"> Nepali Congress Party wins first democratic elections. Girija Prasad Koirala becomes prime minister.
1994	<ul style="list-style-type: none"> Koirala's government defeated in no-confidence motion. New elections lead to formation of Communist government.
1995	<ul style="list-style-type: none"> Communist government dissolved. Radical leftist group, the Nepal Communist Party (Maoist), begins insurrection in rural areas aimed at abolishing monarch and establishing people's republic, sparking a conflict that would drag on for 12 years.
1997	<ul style="list-style-type: none"> Prime Minister Sher Bahadur Deuba loses no-confidence vote, ushering in period of increased political instability, with frequent changes of prime minister.
2000	<ul style="list-style-type: none"> GP Koirala returns as prime minister, heading the ninth government in 10 years.
2001	<ul style="list-style-type: none"> 1 June - King Birendra, Queen Aishwarya and other close relatives killed in shooting spree by drunken Crown Prince Dipendra, who then shoots himself.

2001	<ul style="list-style-type: none"> • 4 June - Prince Gyanendra crowned King of Nepal after Dipendra dies of his injuries. • July - Maoist rebels step up campaign of violence. Prime Minister GP Koirala quits over the violence; succeeded by Sher Bahadur Deuba. • November - Maoists end four-month old truce with government, declare peace talks with government failed. Launch coordinated attacks on army and police posts. • November - State of emergency declared after more than 100 people are killed in four days of violence. King Gyanendra orders army to crush the Maoist rebels. Many hundreds are killed in rebel and government operations in the following months.
2002	<ul style="list-style-type: none"> • May - Parliament dissolved, fresh elections called amid political confrontation over extending the state of emergency. Sher Bahadur Deuba heads interim government, renews emergency. • October - King Gyanendra dismisses Deuba and indefinitely puts off elections set for November. Lokendra Bahadur Chand appointed as PM.
2003	<ul style="list-style-type: none"> • January - Rebels, government declare ceasefire. • May-June - Lokendra Bahadur Chand resigns as PM; king appoints his own nominee Surya Bahadur Thapa as new premier. • August - Rebels pull out of peace talks with government and end seven-month truce. The following months see resurgence of violence and frequent clashes between students/activists and police.
2004	<ul style="list-style-type: none"> • April - Nepal joins the World Trade Organisation (WTO). • May - Royalist Prime Minister Surya Bahadur Thapa resigns following weeks of street protests by opposition groups. • June - King Gyanendra reappoints Sher Bahadur Deuba as prime minister with the task of holding elections.
2005	<ul style="list-style-type: none"> • 1 February - King Gyanendra dismisses Prime Minister Deuba and his government, declares a state of emergency and assumes direct power, citing the need to defeat Maoist rebels. • 30 April - King lifts the state of emergency amid international pressure. • November - Maoist rebels and main opposition parties agree on a programme intended to restore democracy.
2006	<ul style="list-style-type: none"> • April - King Gyanendra agrees to reinstate parliament following weeks of violent strikes and protests against direct royal rule. GP Koirala is appointed as prime minister. Maoist rebels call a three-month ceasefire. • May - Parliament votes unanimously to curtail the king's political powers. The government and Maoist rebels begin peace talks, the first in nearly three years. • 16 June - Rebel leader Prachanda and PM Koirala hold talks - the first such meeting between the two sides - and agree that the Maoists should be brought into an interim government. • 21 November - The government and Maoists sign a Comprehensive Peace Agreement, declaring a formal end to a 10-year rebel insurgency. The rebels are to join a transitional government and their weapons will be placed under UN supervision.
2007	<ul style="list-style-type: none"> • January - Maoist leaders enter parliament under the terms of a temporary constitution. Violent ethnic protests erupt in the south-east; demonstrators demand autonomy for the region.

ANNEX VI: Country Environment Profile

The environment of Nepal is affected by many factors, such as physiography, climate, poverty, population growth, institutional weaknesses, the infancy of environmental considerations by government, and the decade-long insurgency. Physiographic and climatic variations are very common in Nepal owing to the Himalaya in the northern parts of the country, the sub-tropical Terai plains in the southern parts and the hills in the middle. Both in the past and in the present, the steep terrain of the forested hills and mountains have posed extreme difficulties in terms of transport, resulting in economic isolation. In addition, agriculture, as the main economic activity, was to a large degree replaced by foraging in the forests. The agriculturally productive Terai plains were home to a vast array of wildlife and were plagued by malaria up to the 1950s. Since then, they have been increasingly colonised by migrants from the hills and from India and, as a result, almost half of the population of Nepal now lives in the Terai. A certain amount of industrial activity has also developed in the Terai due to its proximity to India and its access to international markets.

In most of the country the climate is dominated by the monsoon, causing heavy rains during June-September. In the hills and mountains this results in local shortages of water for domestic use and agriculture outside of the monsoon season and the risk of landslides and flash-floods during the monsoon period. In the Terai plains the annual monsoon brings risks of inundation flooding. Glacier melt-water provides the basis for the major rivers flowing in Nepal, all of which form part of the greater Ganges basin.

Poverty, along with low nutrition due to subsistence agriculture, limited availability of clean water and sanitation facilities contributes to the rural population having especially high levels of morbidity and premature death. Environmental health is poor, and diarrhoea-related as well as respiratory diseases are major causes of death in early childhood. Increasing urbanisation resulting from migration and organic growth is a notable, new feature of Nepal's environment. Some estimates suggest the urban population will rise from 14% to 23% of the national total by 2011. However, investment in urban, environmental-related infrastructure and service provision has failed to match the increase in urban population. The results are most evident in the Kathmandu Valley, where the population has tripled in the past 30 years. Tributary streams to the Basmati River in Kathmandu are open sewers, heavily polluted also by household and other solid wastes. The water supply system has failed to meet the demands of the residents in terms of quantity and quality, resulting in a situation where many residents are obliged to use polluted groundwater. Though satisfactory short-to-medium term measures are in place, solid waste management is currently far from satisfactory. Furthermore, no separate system exists for managing hazardous wastes, including clinical wastes arising at health-care facilities, the presumption being that these wastes find their way into the general solid waste stream and are disposed of accordingly. Ambient air quality is poor, failing to meet standards for particulate material, with significant implications for urban morbidity and mortality.

Emissions from brick manufacturing and especially from road vehicle traffic are the main sources of air pollution. Legislative effort has been directed at both sources of pollution, involving bans on the most polluting brick production technologies and diesel three-wheeler vehicles and the introduction of vehicle emission standards. The need for increased agricultural output and firewood has put pressure on the forests, grasslands and wetland habitats of Nepal. Major conservation initiatives that have been put in place to protect the flora and fauna have achieved some success, but more needs to be done. Wildlife poaching in reserves and protected areas – of the tiger and rhinoceros especially – has increased due to poverty exacerbated by the insurgency.

Poaching now threatens the achievements of many on rhinoceros conservation in the Royal Chitwan National Park.

Many areas of Nepal are at risk from flood (flash-flooding and inundation), earthquake, and glacier lake outburst floods (GLOF) - the latter being a consequence of climate change. Nepal's has a high risk rating as regards the vulnerability of its population to flooding. The UNDP's equivalent risk rating of Nepal regarding its vulnerability to earthquakes is less critical, but the methodology potentially understates the significant impact of a major earthquake affecting Kathmandu. Most buildings are not designed or constructed to withstand earthquake damage and would be likely to collapse if a major earthquake were to occur – as it did in 1934. Much work is needed on mitigating the worst effects of earthquake damage and on contingency planning to reduce the risks of a possible future disaster.

Institutional weaknesses undermine environmental management in Nepal. In particular the lack of an effective agency to implement government policies and monitor and enforce compliance is likely to further exacerbate the problems. Suggestions for improvement include: (i) introducing strategic environmental assessment (SEA) and requiring its application to all major plans and programmes before their adoption and (ii) introducing river catchment planning as a means of helping to balance competing interests and needs for river water in terms of both quantity and quality. A number of key areas where the EC might consider cooperation as part of its country strategy are identified, such as: (i) environmental institution capacity building at the national level; (ii) capacity building in SEA applied to sectoral plans and programmes; (iii) capacity building in river catchment planning and its application in selected catchments; (iv) urban land use planning involving policy design and capacity building; (v) disaster prevention and mitigation involving policy design, capacity building and implementation in selected high-risk areas; (vi) clinical waste management involving capacity building through the development of national guidelines and assisting their implementation in selected areas. All those measures are compatible with Nepal's sustainable development agenda.

ANNEX VII: MDG Table

Progress on MDGs¹¹

MDG goal	Trends				Status
	1990	1995	2000	2005	
Goal 1: Eradicate extreme poverty and hunger (% population below national poverty line)	42		38	31	On track
Goal 2: Achieve universal primary education (net enrolment in primary education (%))	64	69	81	84	Off track
Goal 3: Promote gender equality and empower women (ratio of girls to boys at secondary level)	0.43	0.56	0.70	0.82	On track
Goal 4: Reduce child mortality (under 5 mortality rate (per 1000 live births))	162	118	91	82	On track
Goal 5: Improve maternal health (MMR)	515	539	415	NA	Off track
Goal 6: Combat HIV/AIDS, malaria and other disease	No single indicator for the goal. Focus on HIV/AIDS: halt and reverse the spread of HIV/AIDS by 2015				Off track
Goal 7: Ensure environmental stability	No single indicator				Potential

*The progress against many indicators for goal 6 and goal 7 varies, so it is difficult to make a hard and fast judgement

¹¹ *Source: GON/UN, 2005. Nepal Millennium Development Goals: Progress Report 2005

ANNEX VIII: Donor Matrix

Sector	EC	D	Dk	FR	NL	FIN	UK	OTH	M€	Details of intervention
Agriculture, Rural Development, Food Security		P							21.09	D Capacity building at district institutions and grassroots level. Strengthening of Local Self-Governance and Civil Society. Infrastructure for Food for Work. Poverty alleviation in selected rural areas. Food Security. Project. Churia Forest (ended 3.83 Mio. €)
							P		167.99	UK Major programmes/projects: Rural Access Programme (2001-2008), Livelihood and Forestry Programme (2001-2011), Agriculture Perspective Plan II (2002-2007), Hill Agriculture Research Project (1996-2004), Support to Helvetas Programme (2001-2006)
				P				ADB	1.30	FR Food Security Programme
								ADB		ADB infrastructure, support for market-oriented and livestock development
								AUS		AUS capacity building, income growth, increased access to resources
								CAN	1.88	CAN access to basic needs and rural infrastructure, service delivery, focus on poor
								FAO		FAO introduce and sustain innovative approach to rural development/agriculture
								JAP		JAP support food security for food-deficit and conflict affected areas
								CH		CH district and rural road development focused on livelihood and access
								WB		WB commercial agriculture and growth, irrigation, electrification, poverty alleviation fund, rural infrastructure loan
							WFP		WFP improved food security, rural community infrastructures, quick impact project	
Education	P								20.50	EC Basic and Primary Education Programme BPEP 2 (1999-2005)
			P						65.30	Dk BPEP 1998-2003, Secondary Education Support Programme 2003-2008, Education For All 2004-2009
						P			13.80	FIN BPEP, EFA 2004-2010 12 MEUR , Bi-lingual project 2006-2008 1 MEUR
							P		32.48	UK Nepal Education for All (2004-2009), Community Literacy Project (1996-2004)
								ADB	22.26	ADB Education Sector Programme I
								CH	0.56	CH National Skill Testing Center
								JAP		JAP Advisor to Dept Education, Community Based Alternative Schooling Project, Construction primary Schools (support to EFA,) Senior Volunteers Program
								N	19.20	N BPEP, EFA 2004-2009

						WB	41.12	WB	BPEP, EFA 2004-2009, School Support Learning and Innovation loan
						WFP		WFP	Food for Education
Health	P						19.57	D	Health Sector Support Program, Family Planning, Basic Health Program
					P		136.41	UK	Nepal Health Sector Programme (2004-2009). Support to National Safer Motherhood Programme (2004-2009), Support for HIV/Aids Response (2004-2009), Tuberculosis Programme (2001-2007), Reproductive Health Programme (1997-2006), Nepal Safe Motherhood Project (1997-2004), District Health Strengthening Project (1997-2004), Polio Eradication Programme in Nepal (2002-2004)
						WB	37.00	WB	Nepal Health Sector Program Project
Energy	P						15.00	EC	Renewable energy project (<i>photovoltaic</i>) in rural areas
		P					219.75	D	Biogas Support Program, Middle Marsyangdi Hydroelectric Project, Small Hydropower Promotion Project. Load Dispatch Center
			P				45.80	Dk	Energy Sector Assistance Programme (<i>with Norway</i>) 1999-2011. Rural electrification 2007-2008
						JAP	2.42	JAP	Advisor to NEA, expansion of power distribution in Kathmandu, Feasibility study, Kulekhani III Project
						N	13.10	N	Energy Sector Assistance Programme (with Denmark)
						UNDP		UNDP	Capacity building for rural energy operationalisation, support for policy and framework, rural energy services centers, support for decentralized small scale rural energy system
						USA		USA	Capacity building, (formation of independent regulator), Institutional Strengthening of Dept of Electricity, Regional Energy Trade and Exchange
						WB		WB	Reinforcement of infrastructure, promotion of private sector participation, improvement of viability of NEA, integration of rural electrification in rural development, promote cooperative based, grid-based rural electrification
Environment, Management of Natural Resources, Disaster Preparedness	P							EC	Priority cross-cutting issues
		P					3.775	D	Collaboration with ICIMOD
			P				41.90	Dk	Natural Resource Management Sector Assistance Support Programme (NARMSAP) 1998-2005, Environmental Sector Program Support (ESPS) 1999-2008,
				P				NL	Capacity Development, Biogas, Improved Water Mills, Biodiversity and Forestry, Tourism for Rural Poverty Alleviation Program
					P		8.00	FIN	Strengthening of environmental administration at regional level

									(SEAM-N) 2003-2007) 8 MEUR
						AUS			AUS Community Resource Management and Livelihood Project
						CAN			CAN Rural Communities Capacity Building, Community Environment Awareness and Management, Strengthening of Water and Energy Commission
						CH			CH Community Forestry, Conservation of Biodiversity Parks, Soils Management
						ICIMOD			ICIMOD Natural Resources Management, Agriculture and Rural Income Diversification, Water, Hazards and Environmental Management; Culture, Equity, Gender and Governance; Information and Knowledge Management; and Policy and Partnership Development.
						N			N Assistance to ICIMOD
						JAP			JAP Community Development and Forest/Watershed Conservation, Phewa Lake Conservation Study for waste management action plan in Kathmandu, Water induced Disaster Mitigation Support
Finance		P						2.27	D Support for ADBN's small farmers' cooperatives
				P					NL Sub-sector market development, agro-forestry, non-timber forest products, pro-poor sustainable tourism, business development services and local economic environment
					P			10.90	UK Finance Sector Study and TA/ to WB/Integrated Financial System and Financial Classification to FCGO (2003-2007)
						ADB		48.90	ADB Rural Finance Sector Development Cluster Programme
						IMF			IMF Policy advice on restructuring two commercial banks, support to re-engineering Nepal Rastra Bank, TA in Monetary Exchange System, in Reserves Management, in Tax Administration Governance and in State-owned Enterprise Reform
						WB			WB Financial Sector Study and TA
Gender Human Rights	P							5.00	EC Cross-cutting issue
		P						1.94	D Improvement of the situation of Child Labourers
			P					15.90	Dk Human Rights and Good Governance (HUGOU) with several components: Human Rights Organisations, Media, Justice, Social inclusion, Anti-corruption, Elections and Democratic Processes and Local Governance (1999-2008)
					P			1.31	FIN Contribution 1.2 MEUR to OHCHR 2005-2007: support to Capacity Development of NHRC, 150000USD: Embassy funded projects on gender, inclusion and human rights 0.5 MEUR/Yr.
				P				1.20	FR Contribution to OHCHR and ICRC. Support to INGO activities
								3.71	UK Social Inclusion Action Plan with different partners/Support to UN OCHA

								CAN		CAN	Capacity building for civil society institutions	
								ILO	0.48	ILO	Combat trafficking of women and children ; employment through micro/small enterprises in the informal sector	
								UNDP		UNDP	Anti-trafficking, gender mapping at local level, capacity building in legislative and judiciary	
								USA		USA	Access to Justice for women, support to anti-trafficking, training of women (<i>community leadership, Local Government Representative, Civil Service competition</i>)	
Governance, Peace Support, Conflict Mitigation	P								10.00	EC	Conflict Mitigation	
		P							1.69	D	Reintegration and reconstruction. Civic education/election process (furthermore governance support via urban and rural development programs. Two more projects in the governance sector – support for NGO, taxation – have already ended total volume of 2.176 Mio. €)	
			P						18.40	Dk	Contribution to the Peace Trust Funds (<i>GoN, UN</i>), Peace Support through NGOs, Protection to HR and promotion of rule of law (<i>through OHCHR, UNHCR</i>) 2007-2008, Decentralization Advisory Support Unit 1999-2005, Revenue Administration Support 2001-2008.	
				P						NL	Capacity building of meso-level organizations in towards decentralization and local governance	
					P				5.50	FIN	Contribution to the Nepal Peace Trust Fund (2007-2009), 3MEUR local fund for democracy, governance and HR 0.5 MEUR/yr	
						P			87.84	UK	General Contribution to the Peace Process Framework (2001-2008): and Governance (major programme: Enabling State Programme 1997-2008): Trust Funds (<i>GoN, UN</i>), community mediation (<i>jointly with UNCDF and Norway</i>), institutional reforms (<i>Financial, Nepal Police, Prison</i>), Public expenditure management privatization, support to anti-corruption (<i>CIAA, FNCI</i>)	
										CAN	CAN	Capacity building to civil society for delivery of services to communities, local development
										CH	CH	Contribution to the Peace Trust Funds (<i>GoN, UN</i>), Anti-corruption, Civil Society Support to Governance Reform, Good Governance, Capacity Building for HRC, Local Governance and Decentralization
										UNDP	UNDP	Decentralized Financing and Development, Local Governance, Participatory Development
										USA	USA	Public Defender System, Anticorruption, access to Justice, enforcement of rule of law, strengthening capacity of Courts, of Electoral Commission, of capacity of Civil Society, of good governance in community-based natural resource management
									WB	WB	Country Procurement Assessment, Public Expenditure Review, Country Financial Accountability, Joint Staff Assessment of Poverty Reduction Strategy, Medium-Term Expenditure, Poverty Reduction Support	

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IB :

- Sources : Ministry of Finance (*30 April 2007*), ADB
- Indicated amounts refer to Foreign Commitment for projects for the Nepali FY 2063/64 (*15 June 2006/14 June 2007*)
- Total ODA including other sectors/other Donors not mentioned above: 346 M €

ANNEX IX: EU-Nepal Trade and Investment, Key Facts and Figures

(See attached EXCEL FILE)