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Revised

June 13, 2007

Statement by Mr. Larsen and Mr. Rab on Nepal
(Preliminary)
Executive Board Meeting 07/50
June 13, 2007

1. We are grateful to staff for a clear report and Messrs. Warjiyo and Acharya for their insightful statement. There have been significant developments in Nepal since the last PRGF Review with signing of a Comprehensive Peace Accord, adoption of an Interim Constitution and establishment of an Interim Government. There are important logistical and financial challenges ahead to ensure a smooth transition to constituent assembly elections. This is a critical time for Nepal and we strongly support Fund engagement and welcome the flexibility demonstrated by staff in their discussions with the authorities. We support the authorities' request for waivers for nonobservance of performance criteria, completion of the fourth review under the arrangement, and modification of performance criteria.

2. We commend the authorities for their commitment to sound macroeconomic management under the programme despite challenging political circumstances. There has been strong revenue growth through stronger tax administration, exchange rate and monetary stability through sound monetary policy combined with a peg against the Indian Rupee. We are pleased to note that as a result the authorities have comfortably met all quantitative performance criteria under the programme and economic growth is on an upward trajectory.

3. To set the economy on a higher path of sustained growth, further efforts will be needed to tackle constraints to private investment and implementation of public development programmes. But progress on the political front remains a priority over the coming months and adjustments to economic reform plans need to be accommodated. We therefore support the requested waivers on non-observance of structural performance criteria including the Large Taxpayers' Office audit of 30 large taxpayers, establishment of wide-area network by the Customs Department, divestment of shareholding by the Nepal Rastra Bank in various public institutions, and audit of the Nepal Oil Corporation.

We also note that progress is being made in all these areas, including completion of the LTO audit of 30 large taxpayers.

4. Fiscal pressures related to the peace process has led to some adjustments to the 2006/07 budget. Capital spending has been adjusted down to accommodate increased current expenditure. There is also a slight increase in net domestic financing. But strong revenue performance has helped to maintain overall fiscal discipline. We would welcome staff comments on reasons for the slight decline in grants and foreign loans to the revised budget.

5. We commend the authorities' efforts at strengthening revenue mobilisation and agree that this should be a key element of any new programme. We would, however, also encourage the authorities and staff to consider measures under any new programme to strengthen expenditure management. Expenditure needs for the ongoing peace process and development challenges will be significant over the medium-term. The government will have to ensure capacity to adequately assess and prioritise expenditure, put together realistic budgets, and ensure proper budget execution particularly in more remote areas.

6. Finally, we fully support the authorities' request for a follow-up programme and thank staff for taking this forward. The design of the new programme will need to ensure wide ownership in the Interim Government so that there is continuity of reforms beyond the constituent assembly elections. Given the authorities' medium term development plans are still in flux, the National Planning Commission's three-year draft interim plan provides an important anchor for any new programme. But the challenges of ensuring full ownership of the programme by a new government will need to be managed.

7. With these comments, we congratulate the authorities for their achievements, thank staff for their work, and wish them success under the PRGF.