

**Interview by Sukhwinder Singh
IMF Resident Representative in Nepal**

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1. What is the status of the PRGF program, and what are the priority areas of work for IMF in Nepal?

In an important signal that the IMF strongly supports the reform process in Nepal, the IMF Board approved a Poverty Reduction and Growth Facility (PRGF) program on November 14th, which will cover the period 2003/4 to 2005/6. The onus is now on the government to vigorously implement its far reaching reform agenda - set out in its Poverty Reduction Strategy Paper - that is being supported by the IMF, World Bank and other donors. As for priorities, the Fund's focus will be on areas that are important for macroeconomic stability, such as sound fiscal, monetary and exchange rate policies. We are also helping to reform the financial system, including strengthening the central bank, rehabilitating the big banks, and improving the legal framework. Our support for public sector reforms focuses on making the civil service more efficient and improving the management and accountability of state-owned enterprises. Last, but certainly not least, we attach great priority to improvements in governance, including by further strengthening of the anti-corruption effort and the efforts to decentralize delivery of social services.

2. How do you perceive the Nepali Economy?

The economy is in a fragile state. Both the insurgency and political instability are exacting an enormous toll in terms of lost output and forgone investment. If you add to this the structural impediments in the economy that make for an unfavourable investment climate, then my fear is that Nepal could be falling further and further behind its global competitors. Yet the country has enormous potential, in areas such as hydropower, tourism, and agriculture. In terms of recent developments, during the ceasefire, manufacturing and agriculture were beginning to rebound. The favourable monsoon has helped agriculture and there is some evidence that tourism has not been doing as badly as previously expected. We have projected real GDP growth of 3½ percent this year, on the back of a favourable monsoon, some recovery in manufacturing, and a pickup in the external environment. Such growth rates are possible if we look at performance over the second half of the nineties. On the other hand, if the insurgency intensifies and affects manufacturing seriously, we have poor rains, and the global recovery falters, then per capita incomes may decline again.

3. What needs to be done to achieve sustainable growth?

It is critical that peace is restored and a more stable political situation would help. But, there are many reforms that need to be implemented to raise growth rates. These include measures to improve the investment climate such as business regulations; application of the rule of law; investment in infrastructure; greater labour market flexibility; restoration of the health of the financial system; and customs and transport reforms. Basically, these are reforms that will help harness the initiative of the private sector and encourage it to invest. Of course, to achieve "sustainable growth," one has to accord a central place to agricultural development, and here the government's poverty reduction strategy sets out many of the reforms required to raise productivity through implementation of the Agriculture Perspective Plan. These efforts need to be supported by investments in education and health. Here, let me draw your attention to a very good study that has been recently produced by the World Bank, together with the government--The Nepal Trade and Competitiveness Study. This highlights many of the reforms required for improving productivity and competitiveness and on diversifying the economy. These include measures to reduce customs and transshipment delays, reducing high infrastructure costs, especially in power and transport, increased flexibility in the labour market, and improving the policy environment and institutions in taxation, investment and trade promotion. The report is useful because it also [has case studies] of the key economic sectors such as carpets, garments, agriculture, and tourism. I would encourage the business community to take a look at this, and engage the government on how its agenda can be implemented. One final point is that Nepal is fortunate to be surrounded by booming economies and huge markets. This presents enormous opportunities for trade and investment - if these can be seized through the kind of reforms described above, there is no reason why Nepal cannot match the impressive growth rates of its neighbours.

4. The IMF provides countries with 'technical assistance' - what kind of assistance is being provided to Nepal in this context?

Indeed, technical assistance is one of the most important services the IMF provides to its membership. Our technical assistance to Nepal is in three main areas. In the fiscal sphere, we have been advising on improving tax policy and administration, including improving legislation such as the Income Tax Act. For example, an IMF team was here recently to help the government develop detailed steps for customs reform and establishment of an efficient Large Taxpayers Unit in the Inland Revenue Department. The second area is in the financial system. Here, we've helped revise the outdated legislation that governed the central bank and, more recently, brought together many laws governing banks and other institutions that take

deposits. We are also helping to modernize the Nepal Rastra Bank by reforming its organization, strengthening its ability to develop and implement monetary and exchange rate policy, and developing its monetary policy instruments. The final area where we are quite active is in improving macroeconomic statistics, where timely and high-quality data will help with policy formulation and analysis.

5. The 10th plan of Nepal focuses on "Poverty Reduction" - how does the IMF see itself in Nepal through the Poverty Reduction Strategy Paper?

Your question is well phrased - we do indeed see our role in Nepal through the government's Poverty Reduction Strategy Paper (PRSP). What I mean by this is that ownership of reforms is crucial, and we must support the government's priorities. We taken this very seriously; for instance, all the reforms that the government is implementing in the context of the PRGF are drawn from the country's PRSP. In the government's view, which the Fund shares, these are reforms that will place the country on a higher growth path and safeguard macroeconomic stability, both essential - although not necessarily enough - for poverty reduction. This is our contribution to this critical strategy.

6. What kind of relationship does the IMF have with Nepal Rastra Bank? Any areas of emphasis?

We have a very good relationship with the Nepal Rastra Bank. In fact, the IMF office in Nepal, which goes back to 1977, is one of the oldest anywhere in the world. The Rastra Bank is kind enough to provide us with office space and seconded central bank staff. At the policy level we also have a fruitful dialogue. The Rastra Bank frequently turns to the IMF for policy advice on macroeconomic issues and on financial sector policy matters. Likewise, we often draw on the wisdom of the Bank to understand developments in the economy. In the past couple of years the dialogue has intensified as the two institutions are working together to develop a modern, streamlined central bank, and are also cooperating closely in the challenging process of rehabilitating Rastriya Banijya Bank (RBB) and Nepal Bank Limited (NBL).

7. What kind of financial sector reforms does the IMF advocate for Nepal and why? How are these reforms progressing?

Overall, we want to help develop a financial system that supports financial intermediation that contributes to growth. To begin with, we want to restore health to the banking system and avoid a banking crisis that would be extremely costly for the economy, let alone the treasury. This means dealing with the large negative net worth of RBB and NBL and privatizing

them to "fit and proper" bankers, as set out in the Government's Financial Sector Strategy Statement. We also want to have a sound legal framework that supports good corporate governance. We want to see banks operate responsibly, and not put depositors' funds at risk. In this context, we would like to see firm action taken against wilful loan defaulters and to support debt recovery. And we'd like to see an strong central bank capable of effectively supervising and regulating the financial system. We'd also like to see financial market development - the provision of a range of financial services and products to all Nepalis, including through viable micro-credit institutions. All these things are important as there is a close relationship between the development of a country's financial system and its growth performance.

As for progress, I think the financial sector is an area where some of the greatest progress has been made in recent years. The external management teams at RBB and NBL are doing a good job. Both banks have cut their operating losses substantially in 2002/3. Recoveries of non-performing loans have reached almost Rs. 4 billion. Modern banking practices, in treasury for instance, have been introduced and financial accounts are now being produced on a timely basis. The big challenge at this point, however, is to reduce chronic overemployment in these banks, which is both a huge financial drain and also constrains efforts to improve staff performance. In other areas, too, there is progress. New central bank legislation is in place and a new Banking and Financial Institutions Ordinance has recently gone through cabinet and is awaiting royal seal. A new debt recovery tribunal is working. And central bank modernization is proceeding with an important set of measures to be implemented in this fiscal year.