Project 367021062

PD-AAD-056-B1

DEPARTMENT OF STATE
AGENCY FOR INTERNATIONAL DEVELOPMENT
Washington, D.C. 20523

CAPITAL ASSISTANCE PAPER

Proposal and Recommendations For the Review of the Development Loan Committee

DEPARTMENT OF STATE
AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

UNCLASSIFIED

AID-DLC/P-2001

June 15, 1973

MEMORANDUM FOR THE DEVELOPMENT LOAN COMMITTEE

SUBJECT: Nepal - Western Hills Road

Attached for your review are the recommendations for authorization of a loan in an amount not to exceed $7,000,000 to His Majesty's Government of Nepal to assist in financing the foreign exchange and local currency costs for construction of 143 kilometers all-weather road, related ancillary structures, training, and technical services.

This loan proposal is scheduled for consideration by the Development Loan Staff Committee at a meeting on Friday, June 22, 1973.

Development Loan Committee
Office of Development
Program Review

Attachments:
Summary and Recommendations
Project Analysis
ANNEXES - I - XII

SUMMARY AND RECOMMENDATIONS

1.	Borrower	: His Majesty's Government of Nepal
2.	Amount	: $7.0 Million
3.	Loan Terms	: (a) 40 year maturity including a 10 year grace period; (b) 2 percent per annum interest during grace period and 3 percent per annum thereafter.
4.	Project Costs	: Total project costs are estimated at $8.8 million. The proposed loan will finance the foreign exchange costs and 70% of the local currency costs, or $7.0 million. His Majesty's Government (HMG) will contribute the remainder.
5.	Project Description	: The completion of approximately 143 kilometers (88.8 miles) of all-weather motorable road, bridges, and other ancillary structures in the western region of Nepal.
6.	Background of Project	: Since 1969 the U.S. Government has been providing financial assistance in the form of PL 480 Indian Rupees to HMG for the construction of an all-weather road in western Nepal. The road is approximately 40% complete. Due to the present limitations on the availability of PL 480 Rupees, the U.S. Rupee financing of this project will terminate at the end of September, 1973. Therefore, HMG requested a dollar loan in order to complete the road.
7.	Purpose of Loan	: To assist HMG finance the completion of a 143 kilometer road.
8.	EXIM Bank Interest	: EXIM Bank has indicated it has no interest in the project.
9.	Mission Views	: The Mission endorses the proposed loan.
10.	Statutory Criteria	: Satisfied
11.	Issues	: None

12. Recommendations : That a loan in the amount of $7.0 million be authorized on the terms and conditions set forth in the draft loan authorization (Annex IX).

USAID CAPITAL ASSISTANCE COMMITTEE

Chairman - Jake Crane
Engineer - George Reasonover
Economist - Carol Peasley

AID/W CAPITAL ASSISTANCE COMMITTEE

Chairman	- Thomas A. Sterner
Loan Officer	- B. Donald Reese
Engineer	- B. Watkins/
	- J. Nelson
Desk Officer (Acting)	- J. Shepard

AID-DLC/P-2001
June 1973

NEPAL - WESTERN HILLS ROAD

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1. BACKGROUND

A. The Country Setting:

The Kingdom of Nepal is a land-locked nation bordering on Tibet in the north and India in the east, south, and west. Nepal is roughly 800 km long and 170 km wide encompassing a total land area of approximately 54,362 square miles. The country is divided into three distinct physical regions: (i) the Terai, an extension of the Gangetic Plain stretching across the southern portion of Nepal; (ii) the central hills, an intermediate range of mountains running in an east to west direction; and (iii) the Himalayas, the world's highest mountains, in the north. Nepal is dissected by deep river valleys running generally in a north to south direction.

The population of Nepal is estimated to be approximately 11.5 million with an annual growth rate estimated to be between 1.8 and 2.0 percent. Over 90% of the population is engaged in agricultural activities. The population is unevenly distributed with about 42% of the people living in the Terai which comprises only 27 percent of the total land area of Nepal but contains 67 percent of its total cultivated land. Approximately 58% of the population is concentrated in the central hills area and Kathmandu Valley with only 30% of the country's arable land. Consequently, the population pressure in the hills has resulted in a southward migration. In recent years economic growth has about kept pace with the growth in population. Even so, Nepal has one of the lowest per capita incomes (estimated at $70 - $80 equivalent) of any of the relatively lesser developed countries in the world today.

The Nepalese economy is largely based on subsistence agriculture with rice, corn, wheat, millet, oil seeds, sugar cane, tobacco, jute and pulses as the major crops. Industrial activity which is mainly concentrated in the Kathmandu Valley, is of minor significance, as are mining and metallurgy.

It is estimated that more than 90% of Nepal's foreign trade is with India and trade with other foreign countries, except mainland China, must transit India. Exports consist primarily of food grains, timber, hides and skins, vegetable and animal oils, and jute. Imports, primarily from India, are comprised of manufactured consumer goods, food products, and petroleum products.

Nepal's economic development has been severely hindered by its physical characteristics, poor internal communications, and a modern history of almost total isolation. Up until 1951 contacts with the outside world were restricted as a matter of Government policy. The Himalayas in the north and malarial forests in the south enhanced the Government's ability to preserve its self-imposed isolation. Internally, Nepal's topography and resultant poor internal communications has precluded the emergence of an integrated economy. The nation is composed of many loosely linked valley economies physically compart-

mentalized and isolated by numerous rivers and intervening mountain ranges. The existing embryonic transport system plays a unique and indispensable role in beginning a linking of Nepal's regions into a viable economy. However, unti the system is improved and expanded, further economic development on a national scale will be severely impaired.

B. Transport Sector:

1. General:

Traditionally, transport in Nepal has been by means of porters and pack animals in the hills and bullock carts in the Terai, and these means of transport are still of great importance. For millions of persons scattered over far-flung and isolated areas in the hills the only available means of transportation are steep, narrow, and rugged foot trails. This network of porter trails, developed over the centuries, is estimated at about 10,000 kilometers. Consequently, even today, distance in the hills is not measured in miles or kilometers but rather by the number of days it takes to walk from one point to another.

Topographic and climatic conditions are major obstacles to reliable, inexpensive tranport in Nepal. The rugged terrain and large number of rivers and streams, together with heavy monsoon rains create great difficulty in the development of a transport system. There are few countries whose economic and social development is so dependent on the solution of difficult transport problems.

2. The Road Systems:

The road network in Nepal is very limited. In 1970 it was estimated that there was 1 km. of road per 4,000 people which was considerably less than that of other countries having a similar per capita income like Afghanistan (1 km. per 1,000 people) and Malawi (1 km. per 400 people.) The first road of any importance was completed in 1956 and connects the Kathmandu Valley with India. This 130 km. road (Kathmandu-Birganj) continues to be the main artery of the country. In 1970, over two-thirds of the estimated 212,000 tons of freight which moved over all-weather roads in Nepal were carried on the Kathmandu-Birgunj road.

The total length of the road network in Nepal is about 2,800 km. of all classes of roads, of which 1,600 km. are "international" and consisting of paved and gravelled roads and 1,200 km. are local unpaved or ungravelled roads most of which are concentrated in eastern and central Nepal. In the Western 40% of the country there is not a single all-weather road, in the Terai or hills. The road network is expanding more or less in accordance with the recommendations of a 1965 Transport Survey conducted by the IBRD. The IBRD recommended (i) development of an east-west cross-country arterial road in the Terai, generally following the foot hills; and (ii) construction of other trunk roads and secondary roads in a north-south direction off this cross-country road. The average annual number of kilometers of all-weather roads constructed from 1955 to 1965 was 44.6. From 1965 to

1972 the average annual number of kilometers of all-weather roads constructed was 150.0.

HMG has attached high priority to the development of an integrated road network. During the Fourth Plan (1972-76) over one billion Nepalese Rupees, or 40 percent of the public sector expenditures, is to be invested in transport, 80 percent of which being allocated to roads. In keeping with the IBRD recommendations, HMG's primary objective is to complete a 1,040 km. road (East-West Highway) which will traverse the entire length of Nepal from its eastern to western borders and North-South roads connecting the Terai and Hills. Substantial sections of the East-West Highway are under construction. A UNDP-financed feasibility study of feeder roads totaling about 1,000 km. has been underway since 1970 and is expected to be released in the near future. In Nepal, feeder roads do not imply short roads from farms to market or from farm to main roads. What is required is somewhat longer roads over relatively difficult terrain from the "roadhead" to a collection and distribution center in a nearby valley. The roads being studied by the UN, and the one being financed here, more or less meet this definition of "feeder road". The roads generally run in a north-south direction and many are planned to connect with the East-West Highway.

The tertiary road network (fair-weather earth roads) are being developed mostly through the efforts of local communities and are confined primarily to the Terai. Because the topography of the Terai is comparatively flat, such roads can be constructed at low costs with minimal financial assistance from the central Government.

With the development of the road network, its utilization will rapidly expand. In 1972, there were 12,300 motor vehicles in Nepal. Of that number, automobiles represented 57 percent, trucks 37 percent, and buses 6 percent. The growth in the number of registered vehicles exceeded 17 percent per annum during 1965-1971; traffic growth is estimated to have been at a higher rate. While this high rate of traffic growth can be partially attributed to the low initial base, it is also due to the transport needs of a country of Nepal's size, with its dependence on external trade for obtaining most of its requirements other than food-grains.

The available transport network in Nepal is quite limited in relation to the present and prospective needs of the country. An extensive road network, consisting of all classes of roads, will need to be developed over a period of time as a vital factor to the development of the Nepalese economy on an integrated basis.

3. Air Transport:

Air Transport began in Nepal in 1950. Royal Nepal Airlines Corporation (RNAC) now provides international services linking Kathmandu with Bangkok, New Delhi, Calcutta and Patna. Domestically, RNAC serves 14 or 15 small airports and eight STOL strips. The STOL strips are located in mountain areas where population centers are small and traffic density low.

Passenger traffic increased from 25,000 persons in 1966 to nearly 210,000 in 1970. Since extensive areas of Nepal are not served by the road network, air transport provides the only means of passenger transport between many widely scattered population centers. However, domestic air operations are curtailed for periods up to four months during the rainy season. Since porter transport is also very restricted during the monsoons, access to remote areas is virtually impossible.

Air Transport facilities are being expanded with outside donor assistance. Five major airports are being improved or expanded. The airstrip in Kathmandu is being lengthened from 6,600 feet to 10,000 feet and runway lighting, navigational aids, and communications facilities are being installed with assistance from Asian Development Bank, Australia and A.I.D. A major international airline is providing management expertise to RNAC. In recent years RNAC has modernized its fleet of planes and now operates a Boeing 727, two Hawker Siddley HS-748, four DeHavilland Twin Otters, a DC 3 and several helicopters.

4. Other:

There are two short railways in the Terai which are extensions of the Indian rail system and do not play a significant role in the overall transport system of Nepal. A 41 km. ropeway operates between Kathmandu and Hitaura, which is located at the base of the foot hills in the Terai. The annual amount of goods carried is estimated at 50,000 tons and is used primarily to bring foodstuffs and construction materials to the Kathmandu Valley.

II. PROJECT EVALUATION

A. The Project Past:

In 1969 the U.S. Government and HMG jointly agreed to finance the construction of a 143 km. all-weather road in the far western region of Nepal. Its alignment begins at the Indian border (railhead) near the town of Dhangarhi and runs almost due north to the hill town of Dandeldhura. Neither is a town of special significance, though both are the Nepali equivalent of country seats. Dhangarhi has small airport. The concept of the road began with the interest of

the government in upgrading the western portion of the country, until then without any modern roads. U.S. resources contributed to the project were entirely PL 480 Indian rupees plus the advisory services on a half-time basis of a USAID highway construction engineer who worked at the site. In financial contribution, the U.S. has provided 75% (rupees 56 million) of total costs and HMG provided the balance from its own resources.

While designing the project, USAID saw the opportunity to achieve two additional developmental opportunities other than the physical construction of the road. First, it saw the chance to use the project as a training vehicle to provide, for the first time in Nepal, a medium of actual field construction experience for Nepalese engineers, supervisors, equipment operators, carpenters, etc. Until this time, literally all construction of surfaced roads in Nepal was accomplished by foreign donors who used only expatriate personnel (other than common labor). The result was that although Nepal had a relative abundance of academically trained road engineers, none had practical experience and consequently, none had the ability to undertake Nepalese planning or construction or supervision of road building. Because this project insisted that all of these inputs be Nepalese to the extent possible, it was enthusiastically taken on by the Roads Department, and until today, receives top priority in that institution.

Second, USAID saw the opportunity to provide employment opportunities for local labor for cash in an otherwise non-monetized economy. For that reason USAID insisted (with Nepalese concurrence) that the project proceed as a labor-intensive effort with minimum use of capital equipment. With few exceptions, the project has been so executed.

In 1972 it became apparent that PL 480 generated Indian Rupees would not be available for the completion of the project. At that time HMG, faced with an inability to continue the project with its own resources, requested the USG to loan sufficient dollars to complete construction of this road.

B. <u>The Project Present:</u>

The Western Hills Road is approximately 40% complete. Beginning at the Indian border, the first 23 km. is complete except for surfacing; the next 42 km. is motorable in both wet and dry weather; and an additional 40 km. is motorable in the dry season. A jeepable trail is expected to be completed all the way to Dandeldhura by the end of FY 73. Three of the five major bridges have been completed and construction has started on the fourth. Almost all drainage structures and retaining walls have been completed on the first 42 km. of the road. Two permanent and two temporary con-

struction camps which include shops, maintenance facilities and housing for project personnel have been completed. Quarries have been opened and crushing equipment installed. Nine heavy construction equipment operators and mechanics were trained in Singapore in 1972 and sixteen in India, and all are currently working on the project. The technical analysis section will deal with the quality of present construction.

C The Project Future:

Work on the road will continue along the same basic patterns to completion with some significant but modest changes.

It is anticipated that the loan will finance a number of categories of costs. Foreign exchange costs in the U.S. will consist of a small amount of construction equipment, a small participant training program and expatriate technical assistance. In Code 941 countries foreign exchange will be utilized to purchase construction materials not available in Nepal, e.g. steel, cement and petroleum products. The majority of the loan amount will be converted to Nepalese Rupees to pay for local labor costs.

The road will continue to be constructed on a labor-intensive basis. The construction equipment that will be purchased will consist of machines that do jobs that cannot be done by human labor in any practical manner, (moving large quantitites of earth and rock, excavating rock, compacting base course materials or hauling thousands of gallons of water for compaction.)

Work on the project will continue to be directed almost entirely by Nepalese engineers utilizing local contractors for provision of the labor force. An AID-financed engineering advisor and a heavy equipment maintenance advisor will be employed on the project full time.

D. Technical Analysis:

In April, 1973, A.I.D. contracted with the firm of Hoskins-Western-Sondregger to provide a highway engineer and a structural engineer to conduct a technical review and evaluation of the Western Hills Road project. The evaluation team was requested to report on project standards, construction cost estimates and scheduled completion date, quality of work, equipment selection, construction methodology, and the technical capability of the Roads Department. The team findings and recommendations were submitted to USAID in draft form while one of the consultants remained in Kathmandu. In subsequent meetings with Roads Department officials informal agreement was reached on all of the consultants recommendations. The following is a summary of those findings and recommendations:

1. Design and Construction:

(a) Completion Schedule - Completion of the project by the end of 1976 appears realistic barring unforeseen difficulties such as major landslides, material shortages, and delays in equipment purchases and delivery.

(b) Construction Methodology - A reasonable balance between labor intensive and capital intensive methods has been achieved and should be maintained for the remainder of the construction period.

(c) Project Specifications - Project specifications and design standards have not been formalized in the past. The engineering report contains recommendations for bridge design loading, typical cross sections, gradation specifications for aggregate surfaced roads and quality control recommendations for roadway embankment, subgrade and surfacing construction together with a list of laboratory equipment necessary to verify quality construction.

(d) Width and Alignment - The report recommends a uniform 7.0 meter overall width. Bridges should have a clear width of 6.5 meters with curbs and sidewalks eliminated. The alignment is conservative with respect to gradient, which generally does not exceed 8%, resulting in many sharp horizontal curves. However, since a substantial portion of excavation and earthwork is complete between km. 90 and the end of the road, the report recommends alignment improvement only if future traffic volume indicates such necessity.

(e) Structures - At present the lack of designs for minor structures results in uneconomical construction. The report recommends more study be given to minor drainage structures in an effort to reduce masonry and headwall construction. Of the three major bridges already constructed, only one is satisfactory. Underpinning may be required in the future for one in order to correct movement caused by the settlement of at least one pier. The decking on the third bridge will have to be replaced in the not too distant future. For the remaining bridges, the report recommended bridge design loads be H 15-44 and consideration be given to concinuous and/or composite bridges.

(f) Quality of Construction - Generally construction quality is adequate for the construction methods which have been used. In order to improve subgrade preparation and base and aggregate surfacing construction, additional water haul equipment is essential. Similarly, minimal additional equipment should be procured in order to carry out bituminous road mix surfacing of 23 km. of paving now planned. However, the report recommends against the use of cut-back (liquid) asphalt since the practicality of such a process in Nepal is questionable. Instead of importing concrete pipe from India, the report suggests it would be more economical to set up pipe manufacturing facilities on the project. The quantity of masonry work

in abutments, wing walls, headwalls and retaining walls should be drastically reduced.

(g) Equipment - Proposed equipment lists were reviewed. The consulting team advised against the procurement of some items and recommended certain items be included in the proposed procurement lists such as communications equipment, water, and fuel transport equipment, and dump trucks. Regarding equipment maintenance, the report recommended the services of a heavy duty maintenance advisor be provided in order to maintain project equipment more effectively and train project personnel in the field.

(h) Technical Capabilities of the Roads Department - There is no shortage of engineers with good scholastic background, but these individuals are relatively inexperienced. The report emphasizes the usefulness of the Western Hills Road project as a training vehicle. Short term expatriate assistance in addition to the two full-time advisors is needed in bridge design, equipment utilization, operation and maintenance.

(i) Labor - There is no shortage of labor or labor contractors during the construction season. Contracting procedures seem to be appropriate for the circumstances.

(j) Environmental Impact - Construction in mountainous areas inevitably leads to some ecological disturbances as a result of physically imposing a roadway on existing land forms. However, the present ecosystems will not be seriously disrupted and negative effects on land use patterns, wildlife habitat, and migration routes will be minimal. (See page 19 for further details.)

(k) Road Maintenance - The report strongly recommends a maintenance plan be agreed upon in order to assure adequate maintenance for at least five years after the project is completed. Such a plan should include equipment and personnel requirements, location and quantity of materials to be stockpiled, a plan for work camp and support facilities, and estimated overall costs.

2. Estimated Project Costs and Financial Plan:

The estimated costs to complete the Western Hills Road project are based on estimated quantities for each item of work and actual unit cost experience and work completed to date. Table 1 shows the status of construction to date and remaining work to be completed. These quantity estimates and unit costs were prepared by the Nepalese Government and reviewed by Hoskins-Western-Sondregger, the consulting firm, and are considered a reasonably firm estimate of costs for purpose of Sec. 611 of the Foreign Assistance Act.

Table 2 sets forth the breakdown of the costs for equipment, construction services, engineering and technical assistance needed to complete the project. The total cost of the project is estimated at $8.8 million of which $2.7 million (30%) represents the foreign exchange costs and $6.1 million (70%) the local currency requirements. The financial plan for the project, Table 3, provides A.I.D. financing for the total foreign exchange costs of U.S. and Code 941 procurement, and 70% of the local currency costs for construction materials and labor. HMG will finance 30% of the local cost requirements, including the total costs of Nepalese engineering supervision. Therefore, A.I.D.'s participation in the project will account for 80% of the total costs, or $7 million.

TABLE I
WESTERN HILLS
CONSTRUCTION STATUS as of May 15, 1973
(HMG Estimate)

Item	Quantity	Percent Completed
Clearing	140 km	
Earthwork	8,418,300 C.M.	
Masonry Walls	133,380 C.M.	
Drainage Structures		
(a) Pipe	4,600 L.M.	
(b) R.C.C.	11,300 C.M.	
Bridges	423 L.M.	
Subgrade Prep.	991,500 S.M.	0
Base	192,360 C.M.	2
Surfacing	94,500 S.M.	0
Buildings and Shops	L.S.	45
Maintenance	743 Km-Years	29

(1) The weighted overall completion percentage is 40.0% on the basis of the above HMG quantity estimate prepared August, 1972.

Source: Final Report, Hoskins-Western-Sondregger

TABLE II

COST TO COMPLETION

	Nepal Rupees 1/	Dollars	Total Rupees and Dollars Stated as Dollars
1. Construction			
a. New Equipment	-	$ 366,000	$ 366,000
b. Spares	-	360,000	360,000
c. Cement	-	931,000	931,000
d. R.O.L.	-	257,000	257,000
e. Steel	-	114,000	114,000
f. Local Materials and Labor	Rs. 50,972,000	-	4,854,000
TOTAL	Rs. 50,972,000	$2,028,000	$6,882,000
2. Nepalese Engineering Supervision	Rs. 2,400,000	-	228,000
3. U.S. Technical Assistance (4 man years)	-	177,000	177,000
4. Participant Training	-		
a. U.S.	-	60,000	60,000
b. Other Country	-	25,000	25,000
5. Totals	Rs. 53,372,000 ($5,083,000)	$2,290,000	$7,372,000
6. Contingency (20%)	Rs. 10,674,000 ($1,017,000)	458,000	1,475,000
7. Grand Total	Rs. 64,046,000 ($6,100,000)	$2,748,000	8,847,000
Rounded Totals	$6.1	$2.7	$8.8

1/ (NR. 10.5 - $1.00)

Source: Final Report, Hoskins-Western-Sondregger

TABLE 3

FINANCIAL PLAN

(in thousands of U.S. dollars)

	Foreign Exchange (%)	Local Currency (%)	Total (%)
AID	$2,748 (100%)	$4,270 (70%)	$7,018 (80%)
HMG	--	1,830 (30%)	1,830 (20%)
Total	$2,748 (100%)	$6,100 (100%)	$8,848 (100%)

A.I.D. LOAN AMOUNT $7.0 million

E. SOCIO-ECONOMIC CONSIDERATIONS

1. ECONOMIC FACTORS

In considering the economics of the road, it should be recognized that this is a "penetration" road in a very primitive area and the necessary basic statistics ordinarily used in calculating a b/c ratio and internal rate of return were unavailable or unreliable and the assumptions made about future actions and reactions are necessarily speculative. In most cases, roads are built to meet an already existing demand for improved transport facilities and the economic feasibility of the road is then based upon savings in transportation costs and other user benefits. In Nepal, north/south feeder roads are not built to meet already existing traffic demand but to create such a demand by stimulating economic activity. Under the circumstances, one can only speculate on the degree of economic activity to follow the construction of the Western Hills road.

However, as an economic measure, a Department of Transportation economist prepared a rough calculation of the economic benefits and costs of the project. 1/ The benefits were calculated on the basis of the difference in the value of agricultural production "with" and "without" the road. The basic assumptions for the calculation were as follows: (1) without the road, production in the two Terai districts (Kailali and Kanchanpur) would increase by 2-1/2% p.a.; with the road, production would increase by 5% p.a.; (2) without the road, production in the surrounding hills would stagnate; with the road, production in the hills would increase by 2-1/2% p.a. The projected benefits were then discounted at 8% and adjusted to correspond to the "area of influence" and to compensate for the costs of agriculture imputs. The resulting discounted benefit/cost ratio was Rs 171,764,000 to 128,715,000 or 1.3.

Additionally, there are other economic benefits from road construction which could not be quantified in benefit/cost terms. An important benefit is the potential savings in the cost of transportation in the Western Hills area due to the completed road. The cost of truck transport in Nepal has been calculated at between Rs 1 and Rs 2 per ton mile. Air transport is estimated to cost Rs 23 per ton mile. In comparison, the cost of transporting one ton by porter would be about Rs 20 per mile.

Other important "economic benefits" can be identified from patterns created by other roads in Nepal, especially those linking the Terai and hills. Adequate research on the effect of penetration

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1/ Working Paper on Western Hills Road Project, Technical Assistance Division, U.S. Department of Transportation.

roads in Nepal has not been done; however, existing data indicate such results as the increased utilization of improved seeds and fertilizer, reduced prices and increased monetization, and a changed labor force structure.

The Sonauli-Pokhara Road, opened to the public in April 1968, provides the bulk of the existing information in Nepal. With regard to the increased utilization of improved seed varieties, one can easily see the rapid increase since 1968 as seen in Table 4. In contrast to that, the districts surrounding the Western Hills Road have had little access to improved seed varieties.

TABLE 4

AREA COVERED BY IMPROVED SEEDS
(Area in Hectares)

	MAIZE				WHEAT			
strict	67	68	69	70	67	68	69	70
Kaski	6	16	107	338	346	1832	1660	1736
Syanja	-	1	35	124	-	124	304	610
Palpa	7	30	285	342	108	343	852	1808
Rupendahi	100	58	132	864	400	1700	6224	8500

The above indicates the potential for improvement which could possibly be brought about with the increased accessibility provided by a road. The same holds true for the increased utilization of chemical fertilizers. Present agricultural statistics show virtually no utilization of fertilizers in the Western Hills area.

Another expected impact of the road is a reduction in prices. For example, six months after the opening of the Sonauli-Pokhara Road, the price differential (between Bhairawa and Pokhara) for sugar had dropped from Rs 100 per quintal to Rs 41; from Rs 78 to Rs 25 per quintal for salt; from Rs 24 to Rs 6 per 18 liter tin for kerosene; and from Rs 8 to Rs 2 per 10 yards for cloth. This reduction in prices leads to a release of funds for other consumer goods thereby improving the well-being of the consumer, increasing demand for other commodities, and stimulating economic activity overall.

This increased demand for consumer goods is likely to influence the structure of the labor force. At present, 97% of the economically active population of Kailali and Kanchanpur districts in the Western Hills are involved in farm activities, primarily as subsistence farmers. This can be compared to the far eastern Terai districts of Jhapa and Morang with farmers making up 89% and 80% of the economically active population, respectively. With increased trade, people are likely to move out of the agricultural sector into services and private business, thereby diversifying the economy and providing for more development opportunities, as well as increased investment.

The government has recognized that in themselves roads do not assure economic development. The Fourth Plan states, "The implementation of north-south roads can greatly contribute to the further development of Nepal only if the planning of these roads is complemented by the planning of regional activities in the Hills." Annex II shows the development activities planned for districts surrounding Western Hills Road. It is anticipated that the Fifth Plan (1975-1979) will be based upon the regional approach to development and especially upon north-south growth axes linking the Terai and hills. Transport facilities will be the core of these axes and investment will be planned to optimize development potential in the areas surrounding these facilities.

2. SOCIAL AND POLITICAL FACTORS

In 1969, AID agreed with the Nepalese to play a major role in financing the construction of this road. It is now somewhat less than half complete and has been demonstrated to be a viable project, technically. In addition, it has become a focus of attention in Nepal since it is the only road project in the country which is fully under the control of the Nepalese Road Department.

In looking at the probable benefits from the Western Hills Road, it is necessary to look beyond economics to the broader social and political benefits which contribute to Nepal's development efforts, among which are increased employment, reduced hill/Terai migration, increased consumption of food, reduced inter-regional disparities, and improved national integration.

It is anticipated that the Western Hills Road will promote political as well as social and economic integration within part of Western Nepal, and with the rest of Nepal. As pointed out in Nepal's 1964 Army Handbook, "A fundamental problem in the evolution of a viable political system is the absence of any developed sense of national consciousness or identification among the bulk of population.. the social foundations and emotional bonds of national unity have

yet to develop in anything more than a very rudimentary way, and the country remains a cluster of isolated localities." In western Nepal, this situation has changed little since 1964. The Western Hills Road will facilitiate communications and provide an important link from the Terai to the hills, not only to its end point (Dandeldhura), but its influences will be felt in the districts further north. In addition, after completion of the national east-west highway, it will link the far west region to Kathmandu for the first time in Nepal's history.

The resulting road links will, in turn, help to reduce existing inter-regional disparities. The area surrounding the Western Hills Road is one of the poorest in Nepal. It is the furthest distance from the capital and, as a consequence, has thus far received minimal attention from the Government.

The Western Hills Road should promote employment in the region, in terms of actual construction labor and of increased employment opportunities following completion of the road. During peak periods of construction, the road has offered employment for as many as 6,000 to 7,500 laborers. In the latter stages of construction, the average should be about 2,000 to 3,000 at peak periods. During the early period of construction in the Terai, much of the labor force came from India. However,since 1970 the majority of contractors and laborers have been Nepalese. During 1973, only two of the fifty contractors have been Indian. As construction moves further into the hills, eventually all of the unskilled laborers will be Nepalese. While "employment" per se is a benefit, a more important benefit to the Western Hills is increased monetization. Assuming an average of 2,000 laborers at any given time, some Rs 240,000 in cash will be added to the economy per month during construction. For the basically subsistence economy of Western Nepal, this is a large sum and one which should have a multiplier effect. After construction (but beginning during construction) we would look for the increased cash generated from transport savings to find the way into agricultural inputs such as improved seed and fertilizer, which in turn should increase production and move toward the traditional expectations of increased employment and higher living and health standards and a general increase in economic activity. The role of the government in providing the facilities and services to make this a likelihood is understood by HMG and plans are underway to begin this process. (See Annex II.)

Construction of north/south roads in Nepal will also link the food deficit hills to the food surplus Terai. As pointed out in the "Economic Factors" section, the cost of transporting food grains by porter from the Terai to the hills is extremely high, both to the Government and to the hill consumers who have limited cash

to purchase the foodgrains. In the past, surplus grain produced in the Terai has flowed across the borders to India rather than to the food deficit areas in the hills. By making road transport more economical it is possible to start the slow process of improving the income of the people up-country to begin to turn-around the flow of Terai surpluses.

Related to the general issue of disparate regional development is the migration of hill peoples to the Terai. In addition, this movement of hill peoples into the Terai is a threat to the social and political stability. Until processing of the 1971 census is completed, the Government will not know the true magnitude of the problem. However, one can see indications from the data already available. Migration from the Western Hills into one of the Terai districts (Kanshanpur) has been significant. Of a total population of 68,000 in the district, some 28,000 (or 41%) were born in the eastern Terai. The increased availability of food and increased economic activity in the hill areas should help to alleviate the migration pressure in western Nepal, or at least reduce it to the rate existing in the eastern Terai.

F. INSTITUTIONAL DEVELOPMENT

An additional developmental objective of this project is its role as a training vehicle for a great variety of civil works and road building skills. Since the initiation of the original rupee project, all substantive work on design, planning, construction and maintenance has been done by Nepalese with consultation and supervision by a part-time American engineer. Several hundred engineers, mechanics, equipment operators, carpenters, steel erectors, etc., have been trained as part of the Western Hills Road Project.

The HMG Roads Department has increased its capabilities, but it is not yet able to provide this sort of training in an on-the-job situation. None of the other donors currently financing road construction in Nepal are providing such training. Rather, the emphasis of other donors has been to "do" the job resulting in a larger number of foreign engineers and the consequent low ranking of Nepalese engineers in the project hierarchy. HMG feels that the training aspect of the Western Hills Road Project is important. The developmental effect is obvious in a country which must acquire its own capacity to build roads if a major impediment to development is to be removed.

We see excellent prospects that the training accomplished here will be absorbed as a professional cadre and will upgrade the professional character of the Roads Department. Because of this project the Department has for the first time acquired the confidence

necessary to undertake construction of trunk roads on its own, thus providing continuing employment for its newly trained cadre. Further, it is now able to insist, and it has, that existing and future donor projects include a substantial number of professional Nepalese in substantive positions.

G. ENVIRONMENTAL IMPACT

The project alignment has approximately 16 percent of its length in the Terai and 84 percent in mountainous terrain. Except for portions of the plains section, the alignment occupies land forms which may be characterized as thinly populated, steep slopes, little level land, thin soil and widespread existing errosion through areas which are 25 to 50 percent forrested. Pioneer excavation is complete for 104 kilometers and a trail has been broken for the remainder of the distance. Little, if any, tillable land will have been taken from production or will otherwise be occupied by this road.

The area through which the route passes is drained by the Mahakali and Karnali river systems which flow in a North-South direction paralleling, in effect, the road alignment. Conflicts with natural drainage are minimal and non-destructive.

Construction in mountainous areas inevitably leads to some ecological disturbances as a result of physically imposing a roadway on existing land forms. There is, however, a noticeable difference in effect between construction that is equipment-intensive rather than labor-intensive such as is the case for this project. The "imposition" is done with a much lighter hand. Borrow areas are smaller because room to deploy equipment effectively does not have to be developed and there is less destruction of trees and vegetation owing to the tendency to go around obstacles rather than through them.

The nature of the present ecosystems with respect to the Dhangarhi-Dandeldhura road have been thoroughly explored in a report prepared by The Center for Economic Development and Administration for the Government of Nepal during 1970. Negative impacts were not found with respect to land use patterns, wildlife habitat or migration routes.

The largest single impact of this facility will be that which beneficially affects the human resources during the foreseeable future rather than producing any significant effect on natural resources. The project is located in a food deficit area in which the population cannot support itself through marginal agriculture and for whom food must be imported. The zone of influence of this road has been inaccessible and therefore lacking in social and administrative services. As a result, human resources are under-utilized and non-contributory with respect to the welfare of the country.

The road should lead to the beginning of some concept of forest conservation by the people who inhabit the hills. Trees presently have no value and are obstacles to agriculture. Indiscriminate burning is widespread to stimulate new growth for animal fodder. Road access will contribute to the realization of value with respect

to timber and turpentine production and reduce burning in areas which are unsuitable for agriculture owing to rainfall insufficiency.

III. Project Implementation

A. Implementing Agency

The Roads Department of the Ministry of Public Works and Transport will be the implementing agency for the remainder of the project. Responsibility for the formulation and administration of transport policies rests with the Ministry while the Roads Department is responsible for the planning, design, construction and maintenance of the Western Hills Road.

The Roads Department is composed of eight Divisions--Planning, Construction, Maintenance, Design, Accounts, Western Hills Roads, Suspension Bridges and Administration. Each of the technical divisons is headed by a senior engineer, who is supported by qualified engineers and assistant engineers all of whom have been trained abroad. The Chief Engineer, and Superintending Engineers of the Design, Planning and Maintenance Sections were trained in the U.S. The professional staff in the Roads Department has a total strength of 114 (including 21 administrative officers and accountants) of whom 26 are Senior Engineers and 67 are Assistant Engineers. (See Annex III, Organization Chart).

As already stated, the Roads Department has been responsible for the design and construction of that portion of the road already completed and their performance has been generally good. Because it is the only major road building effort under the control of the Department it gets the best quality professionals and the highest priority administratively. We are confident that the Department will continue to perform at the high level of the past.

B. Implementation Responsibilities

Design and construction roles will remain essentially the same with the U.S. advisor providing technical review and advice. Working with USAID, the Roads Department will process the documentation necessary to arrange for participant training and technical consultants. Procurement abroad for equipment and materials will be handled by the Department with assistance from USAID under general competitive guidelines governing AID-financed procurement, including preparation of tender documents and evaluation of awards. USAID will monitor expenditure of loan funds for local currency costs under a mutually agreeable system which will assure accountability.

C. Implementation Time Table

The work is continuing uninterrupted except for monsoons. We expect that loan financing will be available by October 1, 1973 when the available Indian rupees will be exhausted. Between authorization and October 1 agreements will be reached and arrangements made in order to actually expend loan funds on the latter date. It is estimated that the road will be completed in approximately three years from July 1, 1973 under the labor-intensive methods.

D. Conditions Precedent and Agreements to be reached prior to Initial Disbursement

Agreement has already been reached with HMG and the Roads Department on the basic design of this project and on the role both parties are expected to play. Between the time of authorization and disbursement we will be working with the Nepalese in reaching a series of agreements and understandings necessary for orderly project implementation. Because this road has been under construction for nearly four years, there is in place and operating a set of procedures for continuing design, procurement, and construction. With the transition to loan funding we will require, in a number of instances, new standards and new procedures in project implementation. These will be worked out prior to initial disbursement or thereafter during subsequent implementation if this is appropriate. Conditions precedent to initial disbursement and agreements to be reached are set forth below and will be spelled out in the initial implementation letter.

In addition to the standard CP's, such as the legal opinion, authorized representative, etc., A.I.D. will require the following in the loan agreement as CP's to initial disbursement.

1. Submission of basic design and construction standards to be utilized in future construction, including adoption of the consultant's recommendations.

2. Submission of budget and accounting procedures and reporting requirements.

3. A plan for maintenance of the road, including estimates of personnel, equipment and stockpile materials.

4. A plan setting forth procurement procedures for financing goods and services in the United States, Code 941 countries and Nepal.

The requirements for a procurement plan and agreements to be reached will be spelled out in the first implementation letter and will include:

1. Procurement methods and documentation for foreign exchange procedures in the U.S. and Code 941 countries. Nepal has had no experience in A.I.D. project procurement. More particularly, the Roads Department, which will handle most of the procurement, has had limited experience other than with India.

2. Content of tender documents for foreign procurement and on the substance of award procedures. In the case of domestic procurement financed by A.I.D., we will review existing procedures for reasonableness rather than attempting to force new procedures or content.

3. Methods used in financing purchases in Code 941 countries will be identified. We must know more about the existing procurement procedures in Nepal and have more detail about what is going to be purchased and from which source. We plan to explore the use of letters of credit in U.S. branch banks in supplier countries as an approach to financing Code 941 procurement.

4. Procedures will be established by which loan funds will be utilized to pay local currency costs. Based on present information, it is likely that a reimbursement method will be used whereby, on a quarterly basis, the Roads Department will present detailed accounting of work done and expenditures incurred over the previous quarter. Work done will have been checked by the U.S. highway engineer on the job site on a continuing basis.

E. Road Maintenance

The maintenance of the national highway system is the responsibility of the Roads Department. This responsibility will be expanding rapidly in the next few years as roads now being constructed under various aid programs are transferred to the Roads Department for maintenance. On the basis of the scheduled takeover of completed sections of ongoing projects, by 1975 the Department will be responsible for maintaining about 2,500 km. of roads.

In recognition of the need to strengthen and expand the maintenance organiztion of the Roads Department, $1.62 million of an IDA credit of $2.5 million extended to Nepal in late 1970 has been allocated to a program covering the purchase of road maintenance equipment and the setting up of workshops. The IDA financed project, extending over four years, focuses attention on improvement to the present standards of road maintenance and on strengthening the central and field maintenance organization of the Road Department. Presently there are two maintenance workshops and eight zonal maintenance offices for the existing road network. A proposal is currently under consideration to create four divisional and several district offices, with considerable authority vested in the divisional offices. In addition, the UNDP is financing five advisors in highway engineering and maintenance as well as training, cost accounting and workshop management.

In the case of the Western Hills Road, we expect to reach agreement with the Department on operation, staffing and equipmentizing of 2-3 maintenance facilities along the alignment and stockpiling of two years' supply of surfacing materials (loan financed) when construction is completed.

PROJECT IMPLEMENTATION SCHEDULE

June 30, 1973	- Loan Authorization
July 1, 1973	- Initiate recruitment for highway engineer and maintenance advisor
July 15, 1973	- TDY Loan Officer and Engineer arrive to work out implementation details
September 1, 1973	- Loan Agreement signed
September 1, 1973	- IL No. 1 issued
October 15, 1973	- Initial CP's met
	- Equipment lists for U.S. procurement approved and IFB's prepared
	- IFB's prepared and orders placed for 941 procurement
	- IFB's approved and issued for equipment
	- Participant Program finalized with HMG
November 30, 1973	- Bids received and reviewed for equipment
December 30, 1973	- Awards made for equipment
July 31, 1974	- Equipment arrives
July 31, 1976	- Construction completed

IV. COUNTRY ECONOMIC PERFORMANCE

Since this proposed loan constitutes the beginning of a DL program in Nepal we are presenting a more detailed view of country economics than might otherwise seem necessary for this project.

I. General Background

The economic status of Nepal is very similar to that of a stereotype RLDC: low per capita income, lack of adequate physical infrastructure, limited institutional development, lack of sufficient skilled manpower, limited financial capacity, and "traditional" economic structure. With regard to this last factor, one need look only at the available breakdown of Gross Domestic Product (GDP) to see the traditional structure of the Nepalese economy. (See Annex XII)

During 1970/71 and 1971/72, Nepal's economic growth was probably below the pace of the previous five years (i.e. below 2% p.a. in 1964/65 prices) and therefore barely keeping pace with population growth. In the agricultural sector, poor weather conditions contributed to a near stagnation in food grain production--paddy production increased by 5% from 1969/70 to 1971/72, but other food grain production either decreased or remained at the 1969/70 level. Cash crops, however, did increase by more than 10% from 1969/70 to 1971/72--led by production of sugarcane, jute, and potatoes.

During 1971/72, industrial production decreased sharply, primarily because of new provisions in the August 1971 Trade and Transit Agreement with India. The Agreement stipulated that Nepalese exports must have 50% domestic value added--therefore those industries dependent upon the importation of raw materials (e.g., stainless steel and synthetic textiles) have decreased in importance.

Production of Principal Industries

	67/68	68/69	69/70	70/71	71/72
Jute (1,000 tons)	12.2	14.0	10.5	13.5	12.5
Sugar (1,000 tons)	3.2	9.7	16.2	14.5	7.6
Cigarettes(billion sticks)	11.1	16.8	14.7	20.8	16.3
Leather (tons)	64.2	99.8	138.9	152.0	121.0
Stainless steel utensils (tons)	738	2,419	933	356	200
Synthetic textiles (1,000 m.)	2,493	3,541	2,354	984	48

In addition, tourism is an increasingly important sector of the Nepalese economy. The number of tourists is increasing: from 24,000 in 1968 to nearly 50,000 in 1971. Foreign exchange earnings from tourism increased from less than $1 million in 1968 to nearly $2 million in 1971.

Performance during the first two years of the Fourth Five-Year Plan (1970/71-1974/75) was disappointing, especially in the field of production. Power generation reached its targets for both years; however, the output of food grains in the two years increased by only 0.9% and 0.2%, respectively, instead of the annual targets near 3%.

Nepal's concern with economic development dates only from the 1950's and the accomplishments to date have been commendable given the massive problems with which it has been faced. The problems it will face in the future are just as severe. The Government has devised a development strategy designed to cope with some of its more pressing problems and which emphasize a more equitable distribution of development benefits. The strategy addresses the shortcomings of the present education system and offers reform; recognizes the importance of increased agriculture productions and the creation of surpluses to finance growing import requirements; provides incentives for industrial development; establishes priorities for the development of tourism; increases investment in the transport and power sectors; and gives proper attention to the problems relating to health and nutrition as well as the growing population rate. The pace at which Nepal will succeed in implementing her development programs will depend in large measure on her success in developing effective institutions and the extent to which she can mobilize domestic resources.

An integral part of the development strategy is an integrated development plan for the hills which calls for the creation of four north-south axes or corridors, each with its own growth center. The two major objectives of these growth corridors are to link the highly productive Terai with the less productive and poorer hills area and to distribute the gains of development more equitably throughout the country. The implementation of the plan will require a considerable degree of coordination among the concerned Government agencies. In order to assure this coordination, the Government has created a National Development Council which is chaired by the King and consists of central and local government officials and prominent representatives from the private sector. The National Planning Commission has been reorganized and strengthened and given a more active role in the coordination, implementation, and evaluation of Nepal's development plans. These are positive indicators of Nepal's determination to seek effective solutions to its many development problems.

V. Financial Structure and Prices

Nepal's financial institutional structure is composed of the Nepal Rastra Bank (the central bank), two commercial banks (Nepal Bank

Limited and Rastriya Banijya Bank), three development banks (Nepal Industrial Development Corporation, Agricultural Development Bank, and Land Reform Savings Corporation) and two special intermediaries (Provident Fund Corporation and National Insurance Corporation). The growth of foreign assets has been the single most important expansionary influence on the money supply, while the major contractionary influence has been increases in time and savings deposits. Total assets of the banking system have grown at an annual rate of approximately 20% per annum during the same period. This has resulted in an annual average increase in the money supply of nearly 10%, with 2-3% for economic growth, 5% for price increases and 1% each for monetization and currency unification.

During the past several years, the Nepal Rastra Bank has made efforts to increase private savings in order to increase investment in the priority development sectors. In terms of increased savings and time deposits, these efforts have been successful and the annual increases have been greater than 40% since 1966/67. The difficulty has been to transfer these savings to investment. Although commercial bank credit has increased by 22% per annum during the past five years, the increase in time and savings deposits has been greater. However, as pointed out in the most recent IMF Report (December 1972), the Government has proposed an amendment to the 1965 Banking Act which would allow commercial banks to make longer term loans for agriculture and industrial capital with land and buildings as security. Attempts are being made to channel these private resources into development investment.

As pointed out above, the money supply has increased at approximately 10% per annum during the past several years. It is generally assumed that this is a reasonable annual increase in Nepal and it is not inflationary. Yet, prices have increased significantly during the past several years. As recorded by the Rastra Bank's unweighted price index, prices in 1971/72 increased by 5%, with the prices of food grains increasing by nearly 10%. Between 1962 and 1972, the price of rice, the staple food grain in much of Nepal increased by some 80%.

The major reason for price increases in Nepal is due to its position as a "price-taker" from India. During the past year, the rate of inflation has been increasing in India and, as a result, prices in Nepal have increased. In both countries, food grain prices have increased around 10-15% since July 1971; pulse around 25-30%; edible oils around 6%; and sugar around 25-35% (See Annex IV for Unweighted Price Indices).

VI. Budgetary and Fiscal Policy

In the annual budget of His Majesty's Government, receipts consists of domestic revenue (tax and nontax) and foreign grants and loans, while expenditures are classified as regular or development. Comparing FY 1972

"Revised Estimate" figures and FY 1968 "actuals", total expenditures increased by approximately 100%, while domestic revenue increased by nearly 60%. On a per annum basis, these rates of increase were higher than the annual growth rate of GDP at current prices. Therefore, over the same period, the ratio of domestic revenue to GDP increased from about 4% to slightly more than 5%, while the ratio of total expenditures to GDP increased from 7% to 9%.

HMG Budget Financing and Expenditures

Adjusted According to New HMG Classification
(in million of Nepalese rupees)

	1967/68 Actual	1968/69 Actual	1969/70 Actual	1970/71 Actual	1971/72 Rev. Est.	1972/73 Estimate
Total Expenditure	461	571	684	769	929	1,268
Regular	185	223	236	304	358	410
Development	276	348	448	465	571	850
HMG Revenue	326	413	464	460	518	601
Deficit	(135)	(158)	(220)	(309)	(411)	(667)
Foreign Grants	158	219	244	271	260	291
Foreign Loans	-	-	7	32	39	120
Domestic Borrowing	10	20	20	30	50	171.5
Cash Balances	-	-	-	-	62	84.5
TOTAL	168*	239*	271*	333*	411	667
% Increase of Total Expenditure Over Prior Year	5.3%	23.5%	19.8%	12.5%	20.7%	
% Increase of Regular Expenditure Over Prior Year	4.9%	20.6%	5.6%	29.2%	17.6%	
% Increase of Development Expenditures Over Prior Year	5.5%	25.3%	29.0%	3.7%	22.7%	

* In each of these years, surpluses of receipts over expenditures occurred--surpluses went to government cash balances.

	1967/68 Actual	1968/69 Actual	1969/70 Actual	1970/71 Actual	1971/72 Rev. Est.	1972/73 Estimate
HMG Revenue as % of Total Expenditure	70%	72%	68%	59%	56%	47%
Foreign Grants & Loans as % of Total Expenditure	34%	38%	36%	39%	32%	32%
Total HMG Resources (Rev.+ Borrowing + Cash Balances) as % of Total Expenditure	73%**	76%**	70%**	63%**	68%	68%

Development Expenditures have been increasing at a faster pace than either Regular Expenditures or Total Expenditures--with the exception of FY 71 when HMG "regularized" many expenditures which had previously been covered in the Development Budget. This meant that a significant amount of expenditures for education, panchayat development, agriculture, land reform, and electricity were moved to the Regular Budget. Also, when looking at data from FY 71, it should be remembered that FY 71 was an unusual year due to the expiration of the Trade and Transit Treaty with India in December 1970. This created a slow-down in all Government spending, especially on development expenditures which have a relatively high import component.

HMG appears to have increased its capacity to absorb spending in the development sector as indicated by the increased proportion of expenditures for the social and economic services to total budget expenditures. In FY 1967, 68% of the total HMG Budget was devoted to expenditures in the social and economic services; in FY 1973, it is estimated that this will increase to 77%.

This increased "absorptive capacity" also means added resource mobilization problems. If HMG is able to collect the Rs 600 million revenue estimated in the FY 73 Budget, it will mean an almost two-fold increase since FY 68, although as a percentage of total estimated expenditures for FY 73, HMG revenue would have fallen from 70% in FY 68 to 47% in FY 73. The rapidly increasing level of expenditures has, therefore, necessitated a search for other sources of financing. Foreign assistance has averaged around 35% of total expenditures during the recent past and while it will inevitably increase in absolute terms, it is doubtful that it will increase proportionately to expenditures. Therefore, HMG has had to look inward for further sources of financing. In FY 73, HMG is projecting a drawdown on cash reserves of Rs 170 million. This estimate is more than three times the level of domestic borrowing actually achieved in any prior year.

On the revenue side, the bulk of HMG revenue comes from indirect taxes. In FY 73, 62% of total revenue is projected to come from the three primary sources: customs, excise, and sales taxes. However, it should be noted that HMG has succeeded in reducing the relative importance

**Surpluses in these years mean that percentages of foreign aid and HMG resources add to more than 100%.

of customs duties to overall revenue. In FY 67, customs duties comprised nearly 50% of all revenue, while in FY 73, it is estimated that customs duties will make up less than 37% of total revenue.

Internal Revenue Structure
(millions NC)

	Actual FY 68	Actual FY 69	Actual FY 70	Actual FY 71	Rev. Est. FY 72	Est. FY 73	Avg. Annual % Increase FY 68 to FY 72
Indirect Taxes	180	261	285	278	320	364	19%
Customs	130	183	194	157	190	222	11%
Excise	21	28	38	57	60	65	46%
Sales Tax	27	48	51	62	67	74	37%
Miscellaneous	2	2	2	2	3	3	
Direct Taxes	20	27	39	41	46	57	32%
Income	11	17	20	21	22	24	100%
Registration	5	6	16	16	16	17	55%
Miscellaneous	4	4	3	4	8	16	100%
Land Tax	83	79	88	76	80	82	nil
Total Taxes	283	367	412	395	446	503	15%
Non-Tax Revenue	43	46	52	65	72	98	17%
Total Revenue	326	413	464	460	518	601	15%

The above table shows that total domestic revenue has increased by an average of 15% per annum since FY 68, compared to an average increase in expenditures of more than 20% per annum. However, of perhaps greater importance, more revenue is being realized from individual taxes. Of the four most important taxes (customs, land, sales, and excise), only the latter two are increasing faster than the rate of expenditures. The former two, customs duties and land taxes, are increasing much slower than expenditures and it appears land revenue seems to have reached a plateau near Rs 80 million. This indicates a "real" shortcoming in the Nepalese tax structures. The system appears to be relatively inelastic and not adequately responsive to increased revenue requirements of HMG.

In the near future Nepal will begin to face domestic resource constraints. As recently as FY 1971, Nepal had receipts in excess of expenditures but it is unlikely that such surpluses will occur again in the 1970's. While Nepal is rated low in terms of "tax effort", it should be remembered that Nepal is not a highly monetized economy and that it is therefore a difficult country in which to impose new taxes. In the short run, tax revenue will probably not increase significantly even though the Government has estimated a 16% increase for FY 73, primarily due to projected increases in the collection of customs duties and the creation of a new urban house and land tax.

In recognition of the limited tax base, HMG has tried to increase the use of other domestic resources to finance the budget, especially the use of domestic borrowing through Development Bonds. In recent projections of resource requirements the HMG Ministry of Finance estimated that domestic borrowing for FY 73-75 might reach Rs 220 million. This projected annual average of more than Rs 70 million is greater than for any single year in Nepal. It compares to Rs 50 million in FY 72 which was the previous high. The Government is also considering a greater use of traditional deficit financing.

VII. Debt Service Capability 1/

The external indebtedness of Nepal is relatively low, despite some recent increases. Nepal has been able to maintain its external debt at a very modest level because in the past the transfer of resources from abroad has mainly taken the form of grants. The total outstanding public and publicly guaranteed debt rose from about $7 million at the end of 1967/68 to about $10 million in July 1972. Nearly 39 percent of the total outstanding debt as of July 1972 was repayable in local currency. Less than $1 million was government guaranteed, and the rest was directly owed by the Government.

The total debt service (principal and interest) on external loans in 1971/72 amounted to the equivalent of about $0.3 million (see Annex V). This represents a sharp drop from the 1968/69 level when premature settlements on certain loans were made. The foreign currency portion of the 1971/72 debt service amounted to about $0.13 million. Contractual debt service obligations are projected to rise to about $0.7 million by 1974/75, of which $0.4 million will be in foreign currencies. Future projections indicate debt service obligations will be at their highest in 1981 and 1982 and reach a level of approximately $3.4.

Relating Nepal's external debt obligations to the amount of goods exported to overseas countries, the debt service ratio becomes almost neglible. A recent breakdown of exports is as follows:

1/ Source, IMF Report dated December 21, 1972

Exports to Overseas Countries
(in millions NC)

	1967/68	1968/69	1969/70	1970/71	3 Quarters 1971/72
Jute	49.7	68.4	49.1	33.3	32.7
Jute Manufactures	32.5	36.9	26.2	25.7	19.2
Bristle	6.9	14.2	16.8	8.0	2.0
Mica	1.4	9.3	8.7	0.9	--
Musk & Feathers	0.3	4.5	4.2	3.0	0.6
Curios	1.5	1.9	3.1	1.9	0.7
Miscellaneous	2.5	10.8	13.0	12.2	5.5
TOTAL	94.8	146.0	121.1	85.0	60.7

The Asian Development Bank currently has two loan agreements with Nepal to cover modernization of jute facilities in the Biratnagar area. The Bank's Project Appraisal Report projects increased exports of raw jute to 25,000 MT by 1972/73 as compared to 18,000 MT in 1968/69. The Report also projects significant increases in the production of hessian and sacking. If the Report's projections are correct, Nepal's annual earnings from jute exports could increase by more than $4.5 million in the next few years.

The other major earner of foreign exchange is tourism. The number of foreign tourists, excluding Indians, increased rapidly from about 6,000 in 1962 to nearly 50,000 in 1971. Recorded convertible foreign earnings from tourism for 1971/72 were $2.0 million as compared with $200,000 in 1965. Assuming a steady growth in the number of tourists visiting Nepal and the amount of money spent while in Nepal, earnings from tourism could easily reach $15 million by 1981. (This projection is based upon Nepal receiving 15% of all tourists projected to visit India in 1981 and upon average spending of $100 per tourist.)

Adding possible earnings from exports and tourism, Nepal could be earning some $40 million of foreign exchange by 1981. Relating this to probable debt service payments of $3.4 million in 1981, Nepal's projected 1981 debt service ratio is 8.5%. This is a relatively low ratio and should not be a burden to Nepal, especially when Nepal's other sources of foreign exchange are considered such as Gurkha remittances, interest on investment, and foreign aid.

VIII. Balance of Payments

Since July 1968, total foreign exchange reserves of the banking system have doubled. Most of this increase has been in convertible currency: from Rs 409 million equivalent in July 1968 to Rs 951 million equivalent in December 1972. On the inconvertible currency side (mostly Indian Currency), the banking system held Rs 149 equivalent in July 1968 which increased to Rs 260 million in 1971, but since has fallen to Rs 160 million. (See Annex VI)

Statistics on over-all recorded foreign trade have been compiled only through FY 1969. Over the five-year period FY 65-FY 69, both recorded imports and exports fluctuated in value, although the unfavorable trade balance was reduced in magnitude. In 1965, recorded exports (Rs 440.5 million) covered 53.8% of recorded imports (Rs 818.9 million), while in 1969, recorded exports (Rs 568.1 million) covered 76.3% of recorded imports (Rs 744.2 million).

It is estimated that Nepal's total imports in 1971/72 were valued at Rs 1 billion of which Rs 135 million was from third countries and paid for with convertible currency. (See Annex VII) Therefore, imports from India (recorded and unrecorded) were approximately Rs 865 million. Exports to India rose considerably up to 1971, followed by sharp declines late in that year and during 1972. The main export to India is food grains, the exportable surplus of which was reduced in late 1971 and 1972. It is likely that the 1973 exports will also be below previous levels, partially due to drought conditions in 1972 and partially due to the new nationalization of food grain trade in India.

Nepal's foreign exchange reserves total more than Rs 1 billion equivalent which would finance more than one year's annual imports. However, as already noted, the bulk of Nepal's imports come from India and amounted to an estimated Rs 865 million for 1971/72. This implies a monthly IC requirement of some Rs 70 million. Current official IC reserves (held by Rastra Bank) are Rs 95 million equivalent, adequate to cover less than two months imports from India. Even adding the holdings of the Rastra Bank and the commercial banks, IC reserves will not even cover three months of imports which is the usually accepted reserve minimum.

Furthermore, it appears that the recent deterioration in IC reserves is developing into a trend. The terms of trade with India also seem to have moved against Nepal during the past several years: i.e., since 1966/67, food grain prices have increased an average 1% per year, while prices of manufactured goods have increased 6% per year. Therefore, IC generated from Nepal's major export to India (food grains) has not been able to keep pace with the increased prices of basic import requirements. During the past year, food grain prices have increased at a faster rate. However, the increased prices are due to shortages created by poor weather conditions--Nepal also suffered from these poor conditions and has therefore had little exportable surplus.

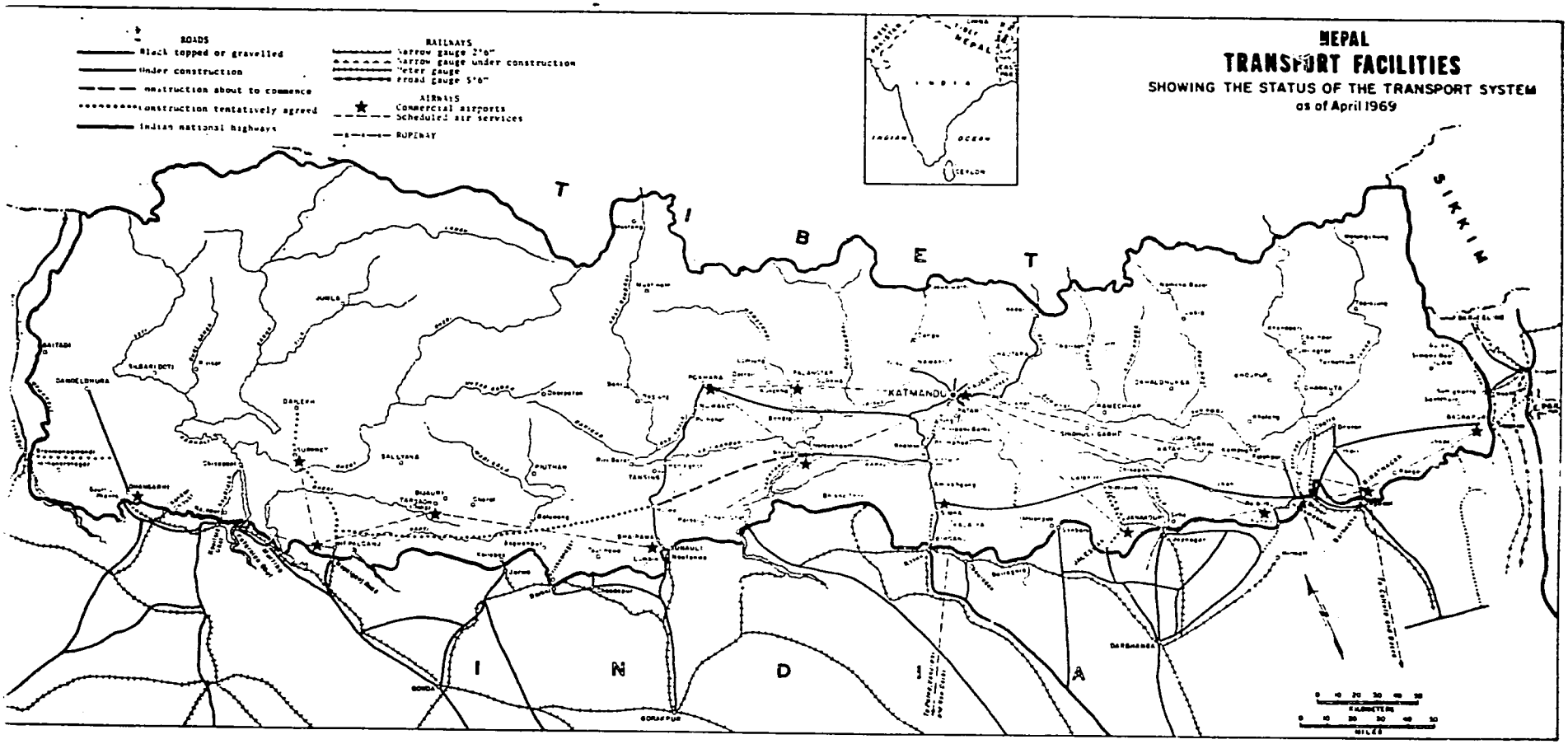
This deterioration in IC balance of payments has encouraged the Government to look to other sources of imports. However, the geographic realities of life will dictate significant IC import requirements in the future. Assuming that Nepal's IC balance of payments position does not improve greatly in the near future, Nepal may have to use convertible currency for imports from India. However, unless Nepal were able to negotiate a favorable rate of exchange with India, Nepal would be paying an additional 30% for Indian imports (imports which are already often more costly than the international price). The official rate of exchange is $1.00 = 7.60 IC, while the "real" rate is closer to $1.00 = 10 IC. If Nepal were to buy a commodity costing Rs 760 IC, it would pay $100 using the official rate, however, using the "real" rate, this same commodity would cost $76.

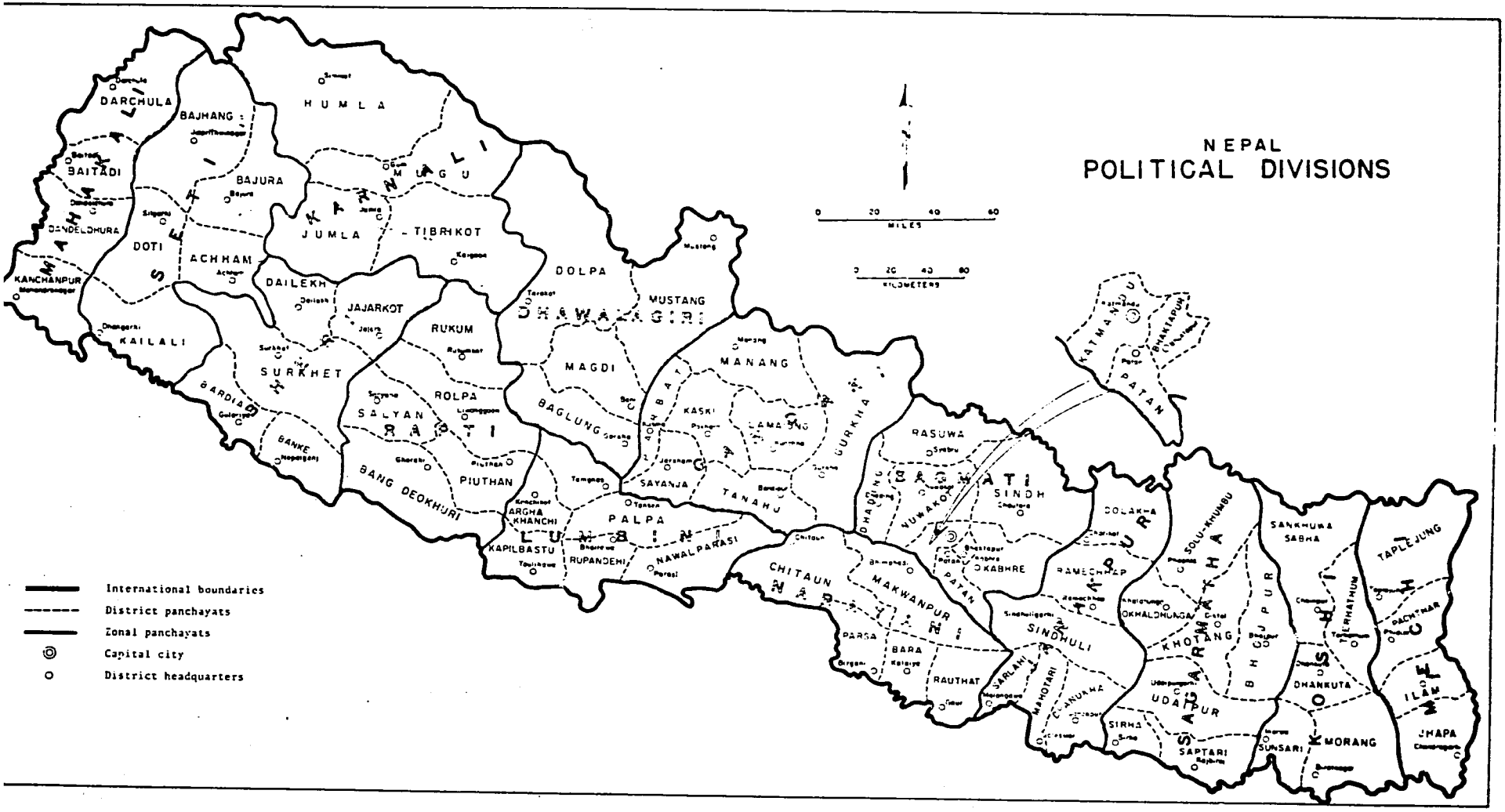
One should also relate Nepal's probable IC balance of payments difficulties to future domestic resource constraints, especially to the future need for deficit financing. Deficit financing will lead to an increased demand for goods and services, including those purchased only from India. This will weaken Nepal's already tenuous IC balance of payments position, thereby increasing Nepal's need for convertible currency.

All of the above factors should be considered when looking at Nepal's balance of payments position. Compared to current total imports, Nepal appears to have excessive foreign exchange reserves, or sufficient reserves to cover one year of imports. However, looking at the composition of dollar and IC trade and at the possible future drawdowns on foreign exchange, Nepal's position looks less excessive.

IX. Alternate Sources of Financing

A large number of road construction projects are either planned or under construction in Nepal and all are partially or totally financed with outside assistance. Most of the major donors are currently involved in road projects or have made commitments for future projects. Therefore, HMG has indicated no other donor has expressed an interest in financing the continuation of this project which has become identified with the U.S. Government's assistance program in Nepal. The EXIM Bank has indicated it has no interest in financing this project.


NEPAL
TRANSPORT FACILITIES
SHOWING THE STATUS OF THE TRANSPORT SYSTEM
as of April 1969
ROADS
Black topped or gravelled
Under construction
Construction about to commence
Construction tentatively agreed
Indian national highways
RAILWAYS
Narrow gauge 2'6"
Narrow gauge under construction
Meter gauge
Broad gauge 5'6"
AIRWAYS
Commercial airports
Scheduled air services
RUPEDIA
T I B E T
INDIA
SIKKIM
KATMANDU
BIRGANJ
BIRATNAGAR
JANAKPUR
GORAKHPUR
KILOMETERS
MILES


NEPAL
POLITICAL DIVISIONS
0 20 40 60
MILES
0 20 40 60
KILOMETERS
MAHAKALI
SETI
KARNALI
DARCHULA
BAITADI
DANDELDHURA
BAJHANG
BAJURA
HUMLA
MUGU
JUMLA
TIBRIKOT
DOTI
ACHHAM
DAILEKH
JAJARKOT
RUKUM
DOLPA
MUSTANG
DHAWALAGIRI
KANCHANPUR
KAILALI
SURKHET
ROLPA
MAGDI
BAGLUNG
MANANG
KASKI
LAMJUNG
GURKHA
GARDIA
BANKE
SALYAN
RAPTI
BANG DEOKHURI
PIUTHAN
SYANJA
TANAHU
DHAULAGIRI
GANDAKI
KATMANDU
BHAKTAPUR
PATAN
RASUWA
NUWAKOT
BAGMATI
SINDH
DOLAKHA
SOLU-KHUMBU
SANKHUWA SABHA
TAPLEJUNG
ARGHA KHANCHI
LUMBINI
KAPILBASTU
RUPANDEHI
PALPA
NAWALPARASI
CHITAUN NARAYANI
MAKWANPUR
PATAN
KABHRE
RAMECHHAP
OKHALDHUNGA
KHOTANG
BHOJPUR
PACHTHAR
ILAM
PARSA
BARA
RAUTHAT
SINDHULI
SARLAHI
MAHOTARI
DHANUSHA
UDAYAPUR
SARMATHA
SIRHA
SAPTARI
SUNSARI
MORANG
DHANKUTA
SAGARMATHA
TERHATHUM
JHAPA
International boundaries
District panchayats
Zonal panchayats
Capital city
District headquarters

ANNEX II

Development Activities for Five Districts in Western Hills Regions

Kailali District

1. Resettlement Program
2. Upgrading of Agriculture Marketing Cooperative Center to Depot status.
3. Complete auditing of Compulsory Savings Program, create Village Committees (credit), and distribute savings remunerations -- al FY 1973.
4. Complete land tenancy registration and acquire lands above ceiling from landlords by end of FY 73.
5. Groundwater survey and well drilling Dhangarhi area.
6. Creation of National Trading, Ltd. godown in Dhangarhi.
7. Dhangarhi electrification
8. Drinking water project, Dhangarhi
9. Implementation National Education Plan
10. Construction of 50-bed hospital
11. Improvement of Dhangarhi STOL field
12. Feasibility survey of Catachu Mill
13. Resin and Turpentine Factory, Dhangarhi
14. Intensive agricultural development program

Kanchanpur District

1. Resettlement Program
2. Complete auditing of Compulsory Savings Program, create Village Committees, and distribute savings remunerations (FY 73).
3. Complete land tenancy registration and acquire lands above ceiling from landlords by end of FY 1973.

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* Source: Nepal, Fourth Plan

4. Sharada irrigation project -- to cover 25,000 hectares

5. Drinking water project, Mahendranagar

6. Implementation of National Education Plan

7. Creation of sub-post office, Kanchanpur

8. Mahendranagar electrification

9. Western Nepal petroleum exploration project

Dandeldhura District

1. Creation Agriculture Marketing Cooperative Center, Dandeldhura

2. Complete auditing of Compulsory Savings Program, create Village Committees, and distribute savings remunerations (FY 74).

3. Trigonometrical Survey, FY 74

4. Topographical Survey, FY 74

5. Wireless Satellite Center, Dandeldhura

6. Intensive agricultural development program

7. Construction 15-bed hospital, Dandeldhura

8. Horticulture Station, Dandeldhura

9. Rastriya Vanijya Bank Branch, Dandeldhura

Baitadi District

1. Chaulahi suspension bridge

2. Minor irrigation feasibility studies

3. Food deficit region -- Agriculture Extension Program

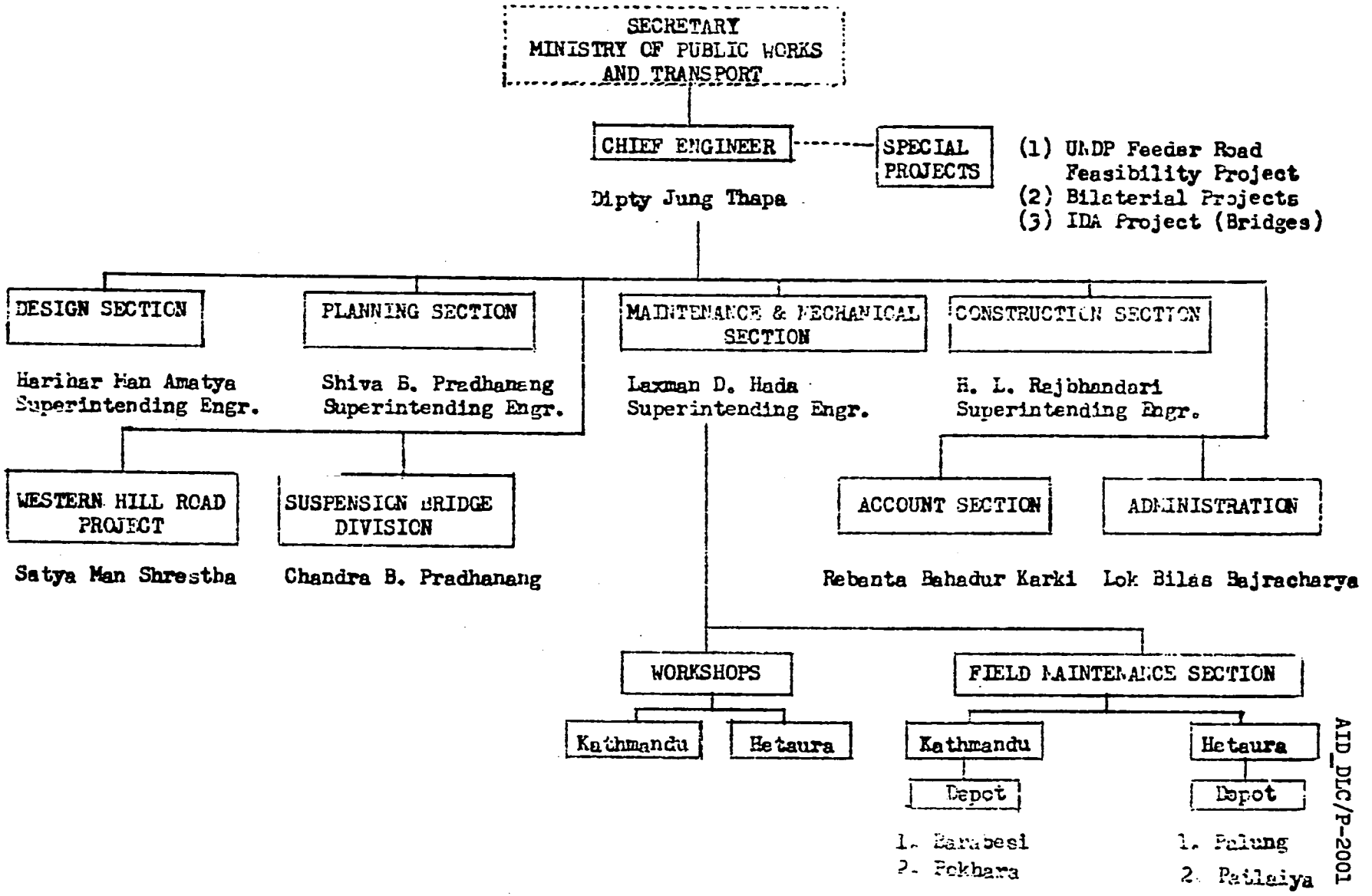
4. Horticulture Center (running)

5. Cottage Industries Center (running)

Doti District

1. Creation Agriculture Marketing Cooperative Center, Doti
2. Complete auditing of Compulsory Savings Program, create Village Committees, and distribute savings remunerations (FY 74)
3. Trigonometrical Survey, FY 74
4. Topographical Survey, FY 74
5. Construction 15-bed hospital
6. Food deficit region -- Agriculture Extension Program
7. Doti Agriculture Station (running)
8. Intensive agricultural development program

ORGANIZATION CHART OF ROADS DEPARTMENT
MINISTRY OF PUBLIC WORKS AND TRANSPORT



ANNEX III
Page 1

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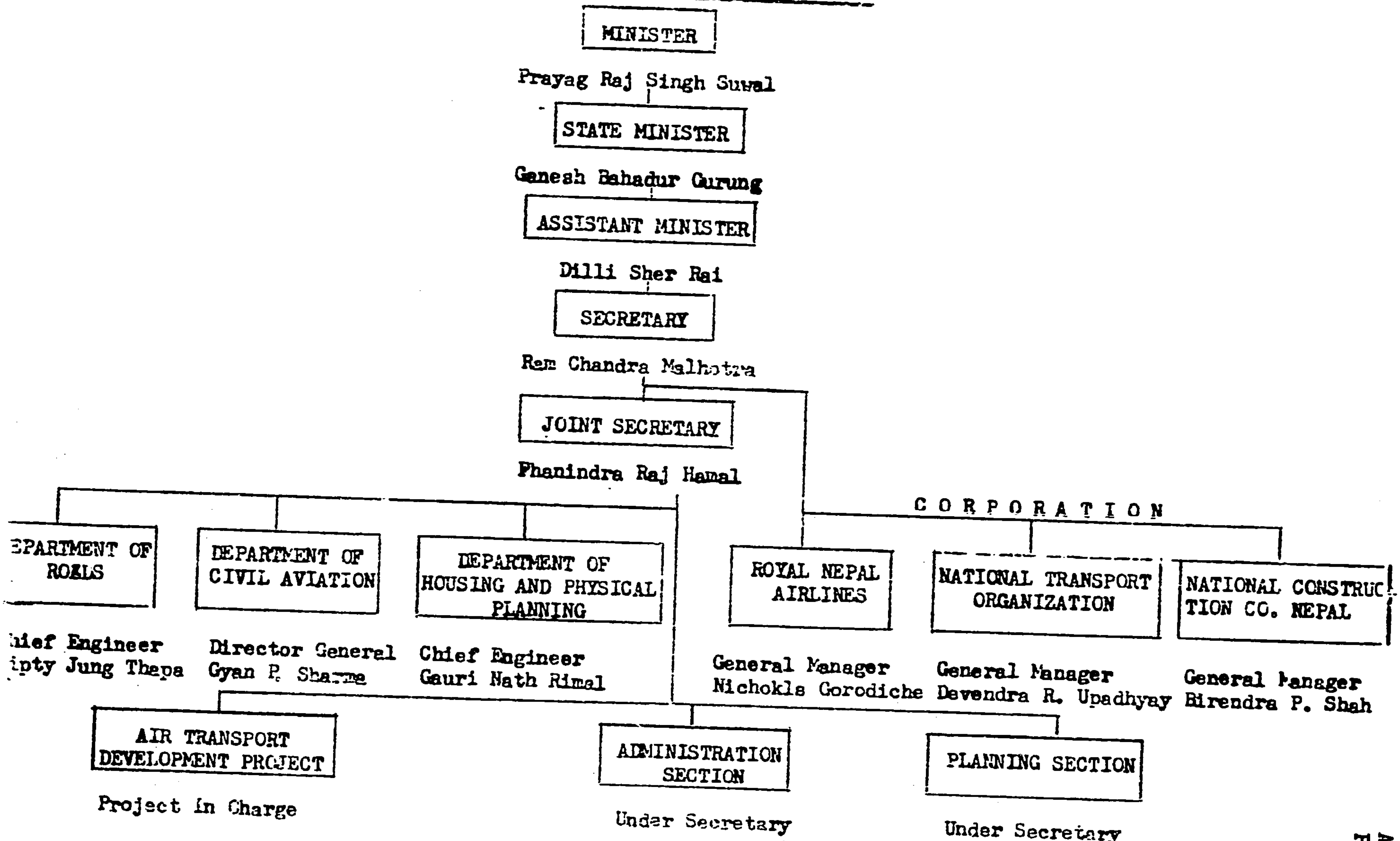
MINISTRY OF PUBLIC WO[illegible] AND TRANSPORT ORGANIZATI[illegible] [illegible]HART



Nepal: Unweighted Price Indices for all Nepal and Principal Regions, 1967/68-1971/72

(1961/62 = 100)

	1967/68	1968/69	1969/70	1970/71	1971/72
Nepal					
Foodstuff	171	160	158	165	178
Foodgrain	210	182	172	176	193
Other	132	138	144	154	162
Kerosene	140	158	156	161	163
Cotton textiles	114	126	126	150	158
All commodities	142	147	147	159	167
Regional (All Commodities					
Kathmandu	138	148	151	163	172
Terai region	156	156	157	169	173
Hilly region	131	137	132	144	155

Sources: Nepal Rastra Bank and 1972 IMF Report.

ANNEX IV

AID-DLC/P-2001

NEPAL: EXTERNAL DEBT SERVICE OBLIGATIONS, 1970/71-1974/75[1]
(In millions of Nepalese rupees)

	1970/71[1]		1971/72[2]		1972/73[2]		1973/74[2]		1974/75[2]	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
1. Repayable in foreign currency	0.6	0.4	1.0	0.3	2.6	0.3	3.1	0.3	3.6	0.3
Direct government obligations	0.2	0.1	0.5	--	0.8	--	1.3	--	1.8	--
Government-guaranteed obligations	0.4	0.3	0.5	0.3	1.8	0.3	1.8	0.3	1.8	0.3
2. Repayable in local currency	1.4	0.5	1.5	0.5	1.6	0.5	1.7	0.5	1.9	0.4
Direct government obligations	1.2	0.4	1.3	0.4	1.4	0.4	1.5	0.4	1.7	0.3
Government-guaranteed obligations	0.2	0.1	0.2	0.1	0.2	0.1	0.2	0.1	0.2	0.1
Grand total (1 + 2)	2.0	0.9	2.5	0.8	4.2	0.8	4.8	0.8	5.5	0.7

Source: IMF Report Dated Dec. 21, 1972
1/ Actually made payments.
2/ Scheduled contractual payments.

ANNEX V
AID-DLC/P-2001

FOREIGN EXCHANGE RESERVES WITH THE BANKING SYSTEM

(in millions of NC)

Year/mid-month	TOTAL		NEPAL RASTRA BANK		COMMERCIAL BANKS	
	Con-vertible	Incon-vertible	Con-vertible	Incon-vertible	Con-vertible	Incon-vertible
1968 July	409.2	148.6	402.8	119.0	6.4	29.6
1969 July	563.4	235.4	524.1	174.0	39.3	61.4
1970 July	644.3	265.5	602.2	215.1	42.1	50.4
1971 July	759.0	262.7	719.1	226.2	39.9	36.5
1972 January	851.6	234.0	810.6	188.7	41.0	45.3
February	860.4	251.7	812.6	204.7	47.8	47.0
March	854.8	248.8	808.6	200.6	46.2	48.2
April	869.2	227.4	820.8	181.4	48.4	46.0
May	898.8	236.2	837.9	178.2	60.9	58.0
June	916.1	232.9	860.4	166.1	55.7	66.8
July	894.0	240.0	833.2	178.5	60.8	61.5
August	899.2	111.0	823.4	150.0	75.8	61.0
September	883.5	209.7	793.8	134.0	89.7	75.7
October	929.3	194.5	814.1	122.0	115.2	72.5
November	939.3	106.4	824.9	108.1	114.4	78.3
December	951.2	159.7	836.1	95.1	115.1	64.6

Source: Nepal Rastra Bank

ANNEX VII

AID-DLC/P-2001

NEPAL'S RECEIPT & EXPENDITURE OF CONVERTIBLE FOREIGN EXCHANGE

(In Millions of N.C.)

	1968-69	1969-70	1970-71	1971-72
RECEIPTS	262.6	280.7	255.4	301.8
Invisible Exports	78.6	100.4	106.4	129.4
Gorkha Remittances	44.5	46.5	48.8	65.7
Tourists' Expenditures	9.4	13.2	16.7	21.0
Interests on Investments	24.7	40.7	40.9	42.7
Visible Exports	136.8	108.8	87.4	89.3
Foreign Aid	1.9	22.4	6.8	22.4
Miscellaneous	45.3	49.1	54.8	60.7
EXPENDITURE	116.6	189.0	171.3	254.0
Invisible Imports	10.9	11.6	13.6	20.5
Visible Imports a/	76.2	134.8	79.3	113.4
Miscellaneous	29.5	42.6	78.4	120.1
SURPLUS (+) or DEFICIT (-)	+146.0	+91.7	+84.1	+47.8

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a/ Includes the goods imported under the bonus scheme.

Note: On December 8, 1967 Nepalese Currency was devalued by 24.78 percent. Foreign currencies have been converted into rupees at buying rates.

Source: Nepal Rastra Bank.

STATUTORY CHECKLIST

I. COUNTRY PERFORMANCE

A. Progress Towards Country Goals

1.* FAA §§201(b)(5), 201 (b)(7), 201 (b)(8), 208

a. Making appropriate efforts to increase food production and improve means for food storage and distribution.

Nepal is giving priority attention to increasing food production. For the past several years, the Government has devoted approximately 12% of its total expenditures to the agriculture sector. Complementary to its domestic efforts, the Government has been working with USAID and other donors in an effort to increase agricultural production -- e.g., USAID's Food Grain Technology Project, the Indian Cooperation Mission's agricultural and irrigation assistance, the German Gandaki Regional Project, and the UNDP/FAO's agricultural assistance. With regard to food distribution, in 1972, the Government of Nepal created the Agricultural Marketing Corporation to handle the distribution of food and agricultural inputs. In addition, a national grain storage network is being designed and constructed.

b. Creating a favorable climate for foreign and domestic private enterprise and investment.

The Industrial Enterprise Act of Nepal provides the following incentives to investors in Nepal (for investment in basic industry, export industries, cottage industries, and/or tourism): (1) ten years' tax holiday; (2) protective import duties for a minimum of five years; (3) customs concessions on imported machinery and raw materials; and (4) repatriation of capital and profit in the form of convertible foreign currency up to 10% and 25%, respectively. The only restrictions against foreign investors involve cottage or small industries (with capital investment less than Rs 500,000) and defense industries. For medium and large scale industries, there are no restrictions against foreign investment.

c. Increasing the people's role in the developmental process.

The political structure of Nepal is based upon maximizing the role of the people in development. The people vote directly for their village panchayat representatives -- the district, zonal, and national panchayat members are then elected indirectly from the next lower body's membership.

Abbreviations: * FAA - Foreign Assistance Act of 1961, as amended, incorporating amendments effected by the Foreign Assistance Act of 1971

In addition, the national planning effort emphasizes a more equitable regional distribution of development benefits -- and is based upon the creation of four north/south growth axes. It is also anticipated that this regional emphasis will de-centralize some of the decision-making and increase the role of the village and district panchayats in the development process.

d. Allocating expenditures to development rather than to unnecessary military purposes or intervention in other free countries' affairs.

In the FY 1973 Budget Estimate, less than 6% of total expenditures were planned in the defense area. Nepal has not intervened in the affairs of any other free countries.

e. Willingness to contribute funds to the project or program.

The cooperating Government will countribute up to 20% of the local currency requirements from the development budget.

f. Making economic, social, political reforms such as tax collection improvements and changes in land tenure arrangements; and making progress toward respect for the rule of law, freedom of expression and of the press, and recognizing the importance of individual freedom, initiative, and private enterprise.

and

g. Responding to the vital economic, political, and social concerns of its people, and demonstrating a clear determination to take effective self-help measures.

Nepal is making efforts to make its tax structure more equitable -- e.g., increasing the burden on urban dwellers who have proportionately received greater gains than the rural population. Tax revenue has increased by approximately 15% per annum since FY 68, with the largest absolute gain in customs duty on luxury imports such as automobiles. With regard to land reform, the Government is still registering lands and imposing "ceilings" on large landlords. In the national budget, approximately 17% of total expenditures are for social services -- education, health, and panchayat. In the education sector, the Government has recently

instituted a New Education System Plan which calls for a doubling of current primary school attendance by 1976 and for the increased vocationalization of the curriculum. The Government has encouraged self-help projects (such as road construction) through local panchayats and through a Food-for-Work program, especially in the food deficit hill areas. Political and social reforms (such as the panchayat system) are based upon basic Nepalese traditions, but still evolving towards greater democratization and improved living conditions for the people.

B. Relations with the United States

1. FAA §620(c)

Is the government indebted to any U.S. citizen for goods or services furnished or ordered where: (a) such citizen has exhausted available legal remedies, including arbitration, or (b) the debt is not denied or contested by the government, or (c) the indebtedness arises under such government's or a predecessor's undonditional guarantee?

We are not aware of any such cases.

2. FAA §620(d)

If the loan is intended for construction or operation of any productive enterprise that will compete with U.S. enterprise, has the country agreed that it will establish appropriate procedures to prevent export to the U.S. of more than 20% of its enterprise's annual production during the life of the loan?

No question arises regarding competition with U.S. enterprise

3. FAA §620(e)(1)

Has the country's government, or any agency or subdivision thereof, (a) nationalized or expropriated property owned by U.S. citizens or by any business entity not less than 50% beneficially owned by U.S. citizens, (b) taken steps to repudiate or nullify existing contracts or agreements with such citizens or entity, or (c) imposes or enforced discriminatory taxes or other exactions, or restrictive maintenance or operation conditions? If so, and more than

six months have elapsed since such occurrence, identify the document indicating that the government, or appropriate agency or subdivision thereof, has taken appropriate steps to discharge its obligations under international law toward such citizen or entity? If less than six months have elapsed, what steps if any has it taken to discharge its obligations?

No.

4. FAA §620(j)

Has the country permitted, or failed to take adequate measures to prevent the damage or destruction by mob action of U.S. property, and failed to take appropriate measures to prevent a recurrence and to provide adequate compensation for such damage or destruction?

The cooperating Government has taken adequate measures to prevent damage or destruction of U.S. property.

5. FAA §620(l)

Has the government instituted an investment guaranty program under FAA §221(b)(1) for the specific risks of inconvertibility and expropriation or confiscation?

Yes

6. FAA §620(o)

Fisherman's Protective Act of 1954, as amended, Section 5. Has the country seized, or imposed any penalty or sanction against, any U.S. fishing vessel on account of its fishing activities in international waters? If, as a result of a seizure, the U.S.G. has made reimbursement under the provisions of the Fisherman's Protective Act and such amount has not been paid in full by the seizing country, identify the documentation which describes how the withholding of assistance under the FAA has been or will be accomplished.

No.

7. FAA §620(q)

Has the country been in default, during a period in excess of six months, in payment to the U.S. on any FAA loan?

No.

8. FAA §620(t)

Have diplomatic relations between the country and U.S. been severed? If so, have they been renewed?

No.

C. Relations with Other Nations and the U.N.

1. FAA §620(i)

Has the country been officially represented at any international conference when that representation included planning activities involving insurrection or subversion directed against the U.S. or countries receiving U.S. assistance?

No.

2. FAA §§620(a), 620(n)

Has the country sold, furnished, or permitted ships or aircraft under its registry to carry to Cuba or North Viet-Nam items of economic, military, or other assistance?

No.

3. FAA §620(u); *App. 108.

What is the status of the country's U.N. dues, assessments, or other obligations? Does the loan agreement bar any use of funds to pay U.N. assessments, dues, or arrearages?

Nepal is not delinquent in any U.N. dues, assessments, or other obligations. The loan agreement will not permit loan funds to be used for payment of U.N. obligations.

D. Military Situation

1. FAA §620(i)

Has the country engaged in or prepared for aggressive military efforts directed against the U.S. or countries receiving U.S. assistance?

No.

Abbreviations: *App - Foreign Activities and Related Agencies Appropriations Act, 1972

2. FAA §620(s)

What is (a) the percentage of the country's budget devoted to military purposes, and (b) the amount of the country's foreign exchange resources used to acquire military equipment, and (c) has the country spent money for sophisticated weapons systems purchased since the statutory limitations became effective? Is the country diverting U.S. development assistance or P.L. 480 sales to military expenditures? Is the country diverting its own resources to unnecessary military expenditures? (Findings on these questions are to be made for each country at least once each fiscal year and, in addition, as often as may be required by a material change in relevant circumstances.)

The defense portion of the Budget in FY 73 was 6%. Nepal has made no expenditures of its own foreign exchange for military equipment nor has the country directed any U.S. development assistance for this purpose. Nepal has not spent any money for sophisticated weapons systems. The Government is placing first priority on economic development and is not diverting a disproportionate amount of its resources into military expenditures.

II. CONDITION OF THE LOAN

A. General Soundness

-- Interest and Repayment

1. FAA §§201(d), 201(b)(2)

Is the rate of interest excessive or unreasonable for the borrower? Are there reasonable prospects for repayment? What is the grace period interest rate; the following period interest rate? Is the rate of interest higher than the country's applicable legal rate of interest?

The rate of interest is not considered excessive or unreasonable and there are reasonable prospects the loan will be re-paid. Interest during the 10-year grace period will be 2% per annum and 3% thereafter. The rate of interest is not higher than the country's applicable legal rate of interest.

-- Financing

1. FAA §201(b)(1).

To what extent can financing on reasonable terms be obtained from other free-world sources, including private sources within the U.S.?

Because the road is a continuation of a previously U S. Government-financed project, no other donor or private source is interested in financing its completion.

-- Economic and Technical Soundness

1. FAA §§201(b)(2), 201(e)

The activity's economic and technical soundness to undertake loan; does the loan application, together with information and assurances, indicate that funds will be used in an economically and technically sound manner?

Financial and other plans necessary for the effective utilization of this loan and a reasonably firm estimate of the cost of assistance to the U.S. have been completed.

2. FAA §611(a)(1)

Have engineering, financial, and other plans necessary to carry out assistance, and a reasonably firm estimate of the cost of assistance to the U.S., been completed?

Financial and other plans necessary for the effective utilization of this loan and a reasonably firm estimate of the cost of assistance to the U.S. have been completed.

3. FAA §611(b); App. §101.

If the loan or grant is for a water or related land-resources construction project or program, do plans include a cost-benefit computation? Does the project or program meet the relevant U.S. construction standards and criteria used in determining feasibility?

Not applicable. This is not a water or related land-resources construction project or program.

4. FAA §611(e)

If this is a Capital Assistance Project with U.S. financing in excess of $1 million, has the principal A.I.D. officer in the country certified as to the country's capability effectively to maintain and utilize the project?

Yes. See Annex 11.

B. Relation to Achievement of Country and Regional Goals

-- Country Goals

1. FAA §§207, 281(a)

Describe this loan's relation to:

a. Institutions needed for a democratic society and to assure maximum participation on the part of the people in the task of economic development.

Training and institutional development are major objectives of this loan. As a result of previous work on this project (financed through a rupee grant), the HMG Roads Department has increased its capabilities in design, planning, and construction. The continued improvement of these capabilities will have an important development effect in Nepal which must acquire its own capacity to build roads if a major impediment todevelopment is to be removed. In addition, road transport will enable larger numbers of hill people to participate in the task of economic development.

b. Enabling the country to meet its food needs, both from its own resources and through development, with U.S. help, of infrastructure to support increased agricultural productivity.

The road will serve as a major artery for food distribution in Western Nepal. One of the basic reasons for constructing north/south roads in Nepal is to enable foodgrains to be transported economically from the food surplus Terai to the food deficit hills. The road will also provide for a greater utilization of improved agricultural inputs in the food deficit area, thereby increasing food production.

c. Meeting increasing need for trained manpower.

The road project will serve as a training vehicle for a great variety of civil works and road building skills. Steps will also be taken to ensure that the newly acquired skills are used to upgrade the quality of the Roads Department so that the advantages of training will not disappear when the road is completed.

d. Developing programs to meet public health needs.

No direct relation exists

e. Assisting other important economic, political, and social development activities, including industrial development; growth of free labor unions; cooperatives and voluntary agencies; improvement of transportation and communication systems; capabilities for planning and public administration; urban development; and modernization of existing laws.

The road will promote the social and economic integration of isolated regions of Nepal by improving the transportation and communications in the area thereby stimulating social and ;economic development activities. The major role to be played by the Roads Department and the training which will be acquired during the construction period will substantially strengthen the infrastructure of that organization and enhance its overall capabilities to plan and implement projects of this nature in the future.

2. FAA §201(b)(4)

Describe the activity's consistency with and relationship to other development activities, and its contribution to realizable long-range objectives.

and

3. FAA §201(b)(9)

How will the activity to be financed contribute to the achievement of self-sustaining growth?

Adequate transport network is consistent with and complimentary to all other development activities. Roads are an essential factor in integrating the economy of Nepal which is a necessary prerequisite to realizing longer-range development objectives and achieving self-sustaining growth.

4. FAA §201(f)

If this is a project loan, describe how such project will promote the country's economic development, taking into account the country's human and material resource requirements and the relationship between ultimate objectives of the project and overall economic development.

The project will utilize a substantial amount of local material and human resources in an economically stagnated area. The road is a part of an integrated network which will provide the basis for a unified economy and have a positive effect on the overall economic development of Nepal.

9. FAA §201(b)(3)

In what ways does the activity give reasonable promise of contributing to development of economic resources, or to increase of productive capacities?

Transport at reasonable costs will promote the development of economic resources in the area, particularly in the agriculture sector. It should stimulate capital investment in a number of productive enterprises along the road corridor.

6. FAA §281(b)

How does the program under which assistance is provided recognize the particular needs, desires, and capacities of the country's people; utilize the country's intellectual resources to encourage institutional development; and support civic education and training in skills required for effective participation in political processes.

By utilizing indigeneous qualified personnel to the maximum extent and investing major responsibility for implementation of the project with a government organization, a portion of the country's intellectual resources will be usefully employed and the capabilities of an important public institution strengthened. Through the road, an isolated area of the country will be politically, socially, and economically integrated with the rest of the nation, thus providing the basis for greater participation on the part of the populous in the national political process.

7. FAA §601(a)

How will this loan encourage the country's efforts to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives; credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture, and commerce; and (f) strengthen free labor unions?

By providing an economical means to transport goods, the road will enhance the existing trade with India, foster private initiative and competition in the agriculture and industrial sectors. With

the added stimulus to agricultural production which the road is expected to have, utilization of credit unions and cooperatives will be maximized.

8. FAA §202(a)

Indicate the amount of money under the loan which is: going directly to private enterprise; going to intermediate credit institutions or other borrowers for use by private enterprise; being used to finance imports from private sources; or otherwise being used to finance procurements from private sources.

The total loan amount will be used to finance materials, equipment, and services from private sources in Nepal, the U.S., and 941 sources.

9. FAA §611(a)(2)

What legislative action is required within the recipient country? What is the basis for a reasonable anticipation that such action will be completed in time to permit orderly accomplishment of purposes of loan?

No special legislation required.

Regional Goals

1. FAA §619

If this loan is assisting a newly independent country, to what extent do the circumstances permit such assistance to be furnished through multilateral organizations or plans?

Nepal is not a newly independent country.

2. FAA §209

If this loan is directed at a problem or an opportunity that is regional in nature, how does assistance under this loan encourage a regional development program? What multi-lateral assistance is presently being furnished to the country?

This loan is not directed at a regional problem.

C. Relation to U.S. Economy

-- Employment, Balance of Payments, Private Enterprise

1. FAA §§201(b)(6); 102, Fifth.

What are the possible effects of this loan on U.S. economy, with special reference to areas of substantial labor surplus? Describe the extent to which assistance is constituted of U.S. commodities and services, furnished in a manner consistent with improving the U.S. balance of payments position.

The goods and services financed by this loan will be obtained from U.S., local, and 941 sources, with only a small portion being procured in the U.S.

2. FAA §§612(b), 636(h)

What steps have been taken to assure that, to the maximum extent possible, foreign currencies owned by the U.S. and local currencies contributed by the country are utilized to meet the cost of contractual and other services, and that U.S. foreign-owned currencies are utilized in lieu of dollars?

Because no U.S.-owned local currencies are available and the Government has only limited resources with which to finance this project, a large portion of the total loan amount will be used for local currency support.

3. FAA §601(d); App.§109

If this loan is for a capital project, to what extent has the Agency encouraged utilization of engineering and professional services of U.S. firms and their affiliates? If the loan is to be used to finance direct costs for construction, will any of the contractors be persons other than qualified nationals of the country or qualified citizens of the U.S.? If so, has the required waiver been obtained?

Engineering or other professional expertise required over and above that provided by the cooperating country or A.I.D. will be from private U.S. firms.

4. FAA §608(a)

Provide information on measures to be taken to utilize U.S. Government excess personal property in lieu of the procurement of new items.

The loan agreement will require utilization of U.S. Government excess property in lieu of procurement of new items, where practicable.

5. FAA §602

What efforts have been made to assist U.S. small business to participate equitably in the furnishing of commodities and services financed by this loan?

Advertising procedures specified in A.I.D. Capital Projects Guidelines will be used to encourage participation by U.S. small business.

6. FAA §621

If the loan provides technical assistance, how is private enterprise on a contract basis utilized? If the facilities of other Federal agencies will be utilized, in what ways are they particularly suitable; are they competitive with private enterprise (if so, explain); and how can they be made available without undue interference with domestic programs?

The technical assistance requirements over and above that provided by A.I.D. will be provided by private enterprise.

7. FAA §611(c)

If this loan involves a contract for construction that obligates in excess of $100,000, will it be on a competitive basis? If not, are there factors which make it impracticable?

Not applicable

8. FAA §601(b)

Describe the totality of effort by the President in the host country to encourage and facilitate participation of private enterprise in achieving the purposes of the Act.

Private enterprise is being utilized to maximum extent possible under this loan.

Procurement

1. FAA §602(a)

Will commodity procurement be restricted to U.S. except as otherwise determined by the President?

Procurement will be limited to Nepal and A.I.D. Geographic Code 941 Sources.

2. FAA §604(b)

Will any part of this loan be used for bulk commodity procurement at adjusted prices higher than the market price prevailing in the U.S. at time of purchase?

No.

3. FAA §604(e)

Will any part of this loan be used for procurement of any agricultural commodity or product thereof outside the U.S. when the domestic price of such commodity is less than parity?

No.

4. FAA §604(f)

Will the Agency receive the necessary pre-payment certification from suppliers under a commodity import program?

This loan will not be used to finance a commodity import program.

). Other Requirements

1. FAA §201(b)

Is the country among the 20 cou... ... ...ch development loan funds may be used to make loans in this fiscal year?

Yes

2. App. §106

Does the loan agreement provide, with respect to capital projects, for U.S. approval of contract terms and firms?

Yes.

3. FAA §620(k)

If the loan is for construction of a productive enterprise, with respect to which the aggregate value of assistance to be furnished will exceed $100 million, what preparation has been made to obtain the express approval of the Congress?

Not applicable

4. FAA §§620(b), 620(f); App. §109(b).

Has the President determined that the country is not dominated or controlled by the international Communist movement? If the country is a Communist Country (including, but not limited to, the countries listed in FAA §620(f) and the loan is intended for economic assistance, have the findings required by FAA §620(f) and App. §109(b) been made and reported to the Congress?

Yes; Nepal is not a communist country.

5. FAA §620(h)

What steps have been taken to insure that the loan will not be used in a manner which, contrary to the best interest of the United States, promotes or assists the foreign aid projects of the Communist-bloc countries?

The loan agreement will contain a provision covering thi provision.

6. App. §118

Will any funds be used to finance procurement of iron and steel products for use in Vietnam other than as contemplated by §118?

No.

7. FAA §636(i)

Will any part of this loan be used in financing non-U.S.-manufactured automobiles? If so, has the required waiver been obtained?

No.

8. FAA §§620(a)(1) and (2), 620(p); App. §117

Will any assistance be furnished or funds made available to the government of Cuba or the United Arab Republic?

No.

9. FAA §620(a)

Will any part of this loan be used to compensate owners for expropriated or nationalized property? If any assistance has been used for such purpose in the past, has appropriate reimbursement been made to the U,S. for sums diverted?

No.

10. FAA §201(f)

If this is a project loan, what provisions have been made for appropriate participation by the recipient country's private enterprise?

A substantial portion of the materials and services required for the project will be provided by the private sector in Nepal.

11. App. §104

Does the loan agreement bar any use of funds to pay pensions, etc., for persons who are serving or who have served in the recipient country's armed forces?

Yes.

12. App. §102

Have obligations for engineering and architectural fees and services over $25,000 on any one project been reported to Congress bi-annually?

Any reporting requirements will be complied with.

13. FAA §481

Has the President determined that the recipient country has failed to take adequate steps to prevent narcotic drugs produced or procured in, or transported through, such country from being sold illegally within the jurisdiction of such country to U.S. Government personnel or their dependents or from entering the United States unlawfully?

No.

14. App. §111

Is the loan being used to transfer funds to world lending institutions under FAA §§309(d) and 251(h)?

No.

15. App. §501

Are any of these funds being used for publicity or propaganda within the United States?

No.

16. FAA §612(d)

Does the United States own excess foreign currency and, if so, what arrangements have been made for its release?

Nepal is not an excess currency country.

17. FAA §604(d)

Will provision be made for placing marine insurance in the U.S. if the recipient country discriminates against any marine insurance company authorized to do business in the U.S.

Yes. An appropriate provision will be included in the loan agreement.

ANNEX IX
AID-DLC/P-2001

CAPITAL ASSISTANCE LOAN AUTHORIZATION

Provided from: Development Loan Funds
Nepal - Western Hills Road

Pursuant to the authority vested in the Assistant Administrator, Bureau for Asia of the Agency for International Development (hereinafter called "A.I.D.") by the Foreign Assistance Act of 1961, as amended, and the Delegations of Authority issued thereunder, I hereby authorize the establishment of a loan ("The Loan") pursuant to Part I, Chapter 2, Title 1, the Development Loan Fund, to His Majesty's Government of Nepal of not to exceed Seven Million Dollars, ($7,000,000 such funds to be made available to His Majesty's Government of Nepal to assist in financing of the foreign exchange and local currency costs for the construction of 143 kilometers all-weather road, related ancillary structures, training, and technical services.

The Loan is subject to the following conditions:

1. Interest rate and terms of payment

The Loan shall be repaid by His Majesty's Government of Nepal within forty (40) years after the date of the first disbursement. The interest on the disbursed balance of the Loan and on any due and unpaid interest shall be at the rate of two percent (2%) per annum during the ten (10) years grace period and at the rate of three percent (3%) per annum thereafter.

2. Currency of Repayment

Repayment of the Loan and payment of interest shall be in United States Dollars.

3. Other Terms and Conditions

3.1 Borrower to assure A.I.D. that adequate other currencies for the project have been and/or will be made available.

3.2 Procurement of goods and services to be from Nepal, the United States and A.I.D. Geographic Code 941 countries.

3.3 The Loan shall be subject to such other terms and conditions as A.I.D. may deem advisable.

Date: _____

_____
Assistant Administrator
Bureau for Asia

ANNEX X

AID-DLC/P-200

Loan Application:

According to a cable dated June 3, 1973, the following loan request was received by the A.I.D. Mission in Nepal on May 30, 1973:

Mr. William Carter Ide, Director
Agency for International Development
Rabi Bhavan
Kathmandu

Dear Mr. Ide:

His Majesty's Government of Nepal requests from the Government of the United States a loan of eight million dollars ($8.0 million) to finance the costs of equipment, materials, and services necessary to complete the construction of an all-weather 140 kilometer road from the Indian border to Dandelhura (Western Hills), a three kilometer access road to Dhangarhi, and the necessary ancillary structures.

His Majesty's Government places high priority to the completion of the Western Hills Road because of its importance to the economic growth of the area in which it is being constructed and because of the considerable investment made to date by both the U.S. Government and His Majesty's Government of Nepal.

We hope this request will be considered favorably by your Government.

Yours Sincerely,

Devendra Raj Ronday
Joint Secretary
Ministry of Finance

Section 611(e) Determination

According to a cable dated June 4, 1973, the A.I.D. Mission Director signed the following statement on June 1, 1973.

I, William Carter Ide, the principal officer of the Agency for International Development in Nepal, having taken into account, among other things, the maintenance and utilization of projects in Nepal previously financed or assisted by the United States, certify that in my judgement Nepal has the financial and human resources necessary to effectively utilize and maintain the Western Hills Road.

I base this judgement primarily on the facts as presented in the Capital Assistance Paper which adequately and accurately describes the project, the basis for undertaking the project, and the manner in which the project is to be implemented. The Capital Assistance Paper concludes the project is worthy of consideration for DL financing and that Nepal has the necessary resources to implement and effectively utilize and maintain the project. I concur with those conclusions.

GDP BY INDUSTRIAL ORIGIN

(in millions of Nepalese rupees)

	1964/65		1969/70	
	Value	Percent	Value	Percent [1]
A. At current prices				
Agriculture and Forestry	3,915	66.4	6,563	69.2
Mining	1	--	1	--
Manufacturing	83	1.4	278	2.9
Cottage Industries	392	6.7	656	6.9
Construction	123	2.1	192	2.0
Transport & Communications	91	1.5	192	2.0
Financial Institutions	69	1.2	128	1.3
Ownership of dwellings	654	11.1	729	7.7
Public Administration and Defense	82	1.4	199	2.1
Public Utilities	4	0.1	15	2.1
Wholesale and Retail Trade	309	5.2	274	2.9
Services	170	2.9	256	2.7
TOTAL	5,893	100.0	9,483	100.0
B. At Constant 1964/65 prices				
Agriculture	3,915	66.4	4,336	66.3
Nonagriculture	1,978	33.6	2,203 [2]	33.7
	5,893	100.0	6,539 [2]	100.0

Source: IMF Report, December 1972

[1] Because of rounding, the figures do not necessarily total.
[2] Provisional

COUNTRY: NEPAL
PROJECT: WESTERN HILLS ROAD
COST: Approx. $8 Million

12p.

Project:

The project as used in this IRR shall mean the completion of 140 km of all-weather motorable road (Western Hills) with ancillary structures now about 30 percent complete in the far western hills of Nepal. The estimated cost for the completion of the project is about $8 million.

Project Objective:

This project is the first part of a U.S. effort to assist Nepal in its economic and social development, by improvement of its transportation facilities in selected areas. The effort of which this project is a part will provide development loans for the construction of two roads and the improvement of two related airports. Because one of the roads (Western Hills), already begun with other financing, will require new funding on July 1, 1973 we are separating that portion of this effort for separate funding in this fiscal year.

Background:

The kingdom of Nepal is a land-locked country bordering on Tibet in the north, and India in the east, south and west. Nepal is roughly 800 km long and 170 km wide and is divided into three distinct physical

divisions: (i) the flat plains of the south called the Terai; (ii) the Himalayas in the north. The central and northern regions are dissected by deep valleys running generally from the north to south. The population of Nepal is estimated at about 12,000,000 of which about two-thirds live in the Terai, approximately 5 percent in the Kathmandu Valley, and the remainder in the central hills.

Nepal emerged from almost total isolation in 1951 and is still in its first stages of economic development. Although Nepal is not large, its development has been hindered by geographic characteristics. Due to primitive transportation facilities it does not have an integrated economy but, in many parts of the country, is composed of many loosely linked minor valley economies. Most of the population dispersed among the hills and mountains are linked only by trails which permit transportation only by foot.

An A.I.D. report prepared in 1968 by a team headed by Mr. Joseph C. Wheeler caught the essence of one of Nepal's critical needs: "It is apparent to any visitor in Nepal that additional roads are essential for further development. The existing network of roads is so limited that without air transport the country would lack the essential minimum level of communications to permit it to function as a nation. In the Team's view the question is not that of whether roads should be built

but where and how fast."

His Majesty's Government (HMG) has placed great emphasis on the construction of roads as an essential means of expediting development of the country, but has had little in the way of skills or resources to do it themselves. The East-West Highway which is currently under construction by a number of donors will provide one of the bases for an integrated road network for the country. It will traverse the entire length of Nepal in the Terai joining the eastern and western regions.

More important, presently, is the construction of north-south feeder roads which connect the isolated valley economies with each other and with the richer productive and trading areas in the plains (terai) of Southern Nepal. The longer east-west highway will be a useful connecting link for the country, but the more important and fundamental current development role for road transport is to connect the now separated hill and plain economies and provide a conduit for the modernizing effects of good transport.

In keeping with HMG's plans to open isolated areas and to begin work in remote areas, in 1969 the U.S. Government and HMG jointly agreed to finance the construction of a 140 km all-weather motorable road in the far western region of Nepal. The agreement was renewable each year and the U.S. financing was dependent upon the availability of U.S.

contracts [illegible] 420 Indian rupees. The road begins at the Indian border [illegible] extending south within three kilometers of the Nepalese town of Dhanghari and will terminate at a point near the hill town of Dandeldhura. The East-West Highway will intersect this road at a point approximately 15 km north of Dhanghari. The first 23 km of road traverses the Terai and is complete except for surfacing. The remaining 117 km is in the hills and is in various stages of construction. The first 85 km of road is now motorable in the dry season but less than 50 km is motorable in the wet season.

Of total construction costs to date, the U. S. has contributed approximately 75 percent using U. S. controlled PL 480 Indian rupees and the Nepalese have contributed the 25 percent balance in Nepalese rupees. Because of the current limitations on the availability of PL 480 Indian rupees, the U. S. financing of this project will terminate at the end of FY '73 unless dollar funding is provided. Because of the considerable investment and commitment made to date and the inability of HMG to finance completion of the project with their own resources, HMG has indicated a willingness to borrow dollars from the U. S. to accomplish completion.

HMG recently estimated the total costs for constructing the road at 146,670,584 Nepalese rupees ($14,295,378). Approximately 63,540,000 Nepalese rupees ($6,192,982) were expended from 1969 through FY '72 and approximately 12,244,780 Nepalese rupees ($1,193,448) is expected to be expended in FY '73. The residual costs for completing the road

according to the HMG estimate should be approximately 70,885,304 Nepalese rupees ($6,993,947). However, the HMG estimate does not include estimated costs for equipment and technical services which will be required to complete the project. The costs for equipment and services should not exceed $500,000. Equipment costs are expected to be minimized since labor intensive construction methodology, which has been insisted on by both AID and HMG, will be used to the maximum extent possible. A U.S. consultant engineering team will be visiting Nepal during the course of the intensive review to prepare new cost estimates as well as to review existing designs and specifications and construction methodology to be used for the completion of the road. With that report we will be able to quantify the U.S. and Nepalese contributions more accurately and to consider further the nature of the Nepalese input.

Project Justification:

This project has three separate, but related, justifications for consideration for AID financing. First, is what may be called a sense of "obligation" in having participated in the partial construction of a road with considerable exposure within the government and the citizenry through publicity. To abandon a partially completed project could be considered an act of bad faith. Second, is the rather substantial developmental accomplishments in a large and successful

[illegible] which has been a part of past construction and will be [illegible] the contribution of sorely needed social and political integration of an isolated area with more productive and modern sections. The latter two will be considered in more detail.

A major objective of this project is to promote the social, political, and economic integration of a part of Western Nepal, as a direct contribution to the acceleration of the developmental process. Because of the isolation of the hill sections the surplus foods of the terai move into India rather than into the food deficit hill communities. For similar reasons agricultural inputs such as fertilizer, are not utilized in the hills and food production is stalemated. As a result cash exists in very small quantities and there is little opportunity for increases in trade with resulting improvements in living standards. The road should alleviate this situation. Further, it is expected that with the availability of transportation and access, the government will provide increased developmental and public services.

Each year a large segment of the population of the area migrates to India seeking employment. Because the road will be constructed using labor intensive methods, hundreds of skilled and unskilled laborers will find employment locally. The wages earned by these laborers will be expended locally, further stimulating the economy of the area while the long range economic benefits of the road itself are developing.

Attempts have been made to evaluate the economic benefits on a [illegible]. A Department of Transportation economist has calculated a b/c ratio of 1.3. However, we appreciate the difficulties in making flat claims for the accuracy and dependability of [illegible] a study because statistics are often unavailable or unreliable and assumptions which must be made about future actions and reactions are necessarily speculative. Yet it has allowed us to make favorable predictions about economic benefits. In part those predictions are based on existing, though minor, measurable growth along the road under construction, which in turn gives increased credibility to assumptions about the future. And, added to this equation is the fact the road itself will be relatively low standard with gravel surface and a 5 meter width (except in the terai where traffic will be substantially greater), which, in turn results in lowest possible cost. We would also like to take this opportunity to gather data on the elusive subject of just what does happen in the process of "penetration" road construction. We intend to institute such a study as a part of this effort.

A second major consideration in the evaluation of this project as a loan prospect is its unique role as a training vehicle for a great variety of civil works and road building skills. Since its beginning in 1969, all substantive work on design, planning, construction, and maintenance has been done by Nepalese with consultation and periodic supervision by an American engineer. In recent years, when all road construction

In Nepal has been done by foreign donors only [illegible] Nepalese responsible for actually [illegible] stone masonry, culverts, etc. As a result, several hundred engineers, mechanics, equipment operators, carpenters, steel erectors, and similar skills have been trained on this project. It is our understanding, confirmed by the Nepalese Secretary of Transportation and Public Works, that there is no other source of such training in Nepal, since other donors (Chinese, Russian, Indian, and British) bring into Nepal their own construction organizations who provide these skills. The developmental effect is obvious, in a country which must acquire its own capacity to build roads if a major impediment to development is to be removed. This project will continue those training efforts and will insist on the Nepalese Roads Department taking those steps necessary to utilize the newly acquired skills in a way to upgrade the quality of the Department itself so that the advantages of training will not disappear when the road is completed.

Additional Analytical, Feasibility, or Institutional Work Required:

(a) The long range effect of the road will be dependent in large part upon the attention given the area by HMG in its development plans. HMG has demonstrated an interest in promoting development of the area by the time, money, and effort expended thus far on the road. During the

area will be reviewed and evaluated to determine if adequate long-term planning has been done in order to assure the growth potential of the area is realized.

(b) A comprehensive technical review of the project will be carried out by an independent engineering team which will evaluate construction completed to date, review designs and specifications to be used for the construction of the remaining part of the road, and estimate equipment, material and services required to complete the road. Estimated costs to completion will be carefully calculated.

Issue:

As mentioned earlier, since 1969 the U.S. has been assisting HMG with the financing of the road being constructed in the Western Hills Region. The contribution was made on a year-to-year basis and dependent upon the availability of PL 480 Indian rupees. The U.S. agreed to finance up to 75 percent of the annual cost. Even though the source of funds will change, the 75-25 ratio of U.S. funds to HMG funds will continue or the U.S. share could increase to 80 percent. Because the project will be implemented using labor-intensive methods only a small portion of the loan funds will be used to finance equipment and services. The majority of the loan funds will be used for local currency costs. However, because Nepal produces almost

no begin construction [illegible] There will be imports of cement, rebar, P.O.L., etc. from code 941 countries such as India, Korea, Philippines and Thailand. Therefore, the amount of dollars from the loan which will be utilized for procurement in the U.S. will be relatively small and probably will not exceed $500,000 for equipment and services. If this loan is authorized, we must be prepared to accept the fact that up to 80 percent of the loan funds will be used for local currency support and up to 15 percent spent in 941 countries.

We further recommend that those dollars that are made available for the payment of local costs not be tied to U.S. procurement. First, Nepal's trade patterns are almost exclusively regional, with negligible U.S. trade. And, as a practical matter, Nepal clearly does not have the administrative capacity to implement and manage a program loan kind of procurement procedure which would result from tying to U.S. sources.

Procedure:

If the intensive review request is approved, a substantial portion of the Capital Assistance Paper will be prepared in AID/W by the project committee. The engineering team will provide a major portion of the data for the CAP related to t[illegible]echnical aspects of the project. It is anticipated that two members from ASIA/CD will visit Nepal in early May to overlap with the engineering team to discuss their findings. In conjunction with the Mission Economist and Engineering Staff, a draft CAP will be prepared in the Mission and handcarried to AID/W

for [illegible] We expect to have the CAP ready for [illegible] CAPV Advisory Group by the first week in June.

Recommendation

That you approve the request to conduct an intensive review for a proposed development loan to finance the completion of the 140 km all-weather Western Hills road in the far western hills of Nepal by signature on the attached page.

[illegible] CAPITAL ASSISTANCE

[illegible] OF CAPITAL COMMITTEE

(1) COUNTRY : Nepal

(2) AMOUNT : $8 Million

(3) BORROWER/GRANTEE : His Majesty's Government of Nepal

(4) PURPOSE : Road Construction

(5) CAPITAL ASSISTANCE OFFICER: B. Donald Reese

(6) COUNSEL : Stephen W. Stein

(7) ENGINEER : B. Watkins/J. Nelson

(8) DESK OFFICER : Howard F. Thomas

(9) OTHER : None

Regional Assistant Administrator or Designee

June 6, 1973
Date

Clearances:
ASIA/SA:HThomas
ASIA/DP:AShakow
PPC/DPR:AHandly