



Report

# Incubating policy for economic transformation

Lessons from Nepal

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Cover photo: A young Nepali man cutting a marble slate in Pokhara, Nepal © Igor Ovsyannykov 2017.

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# Acronyms

<b>AiiN</b>	Accelerating Investment and Infrastructure in Nepal
<b>APPIIC</b>	Accelerating Private and Public Investment in Infrastructure
<b>CIG</b>	Centre for Inclusive Growth
<b>CITCW</b>	Committee on Industry, Trade and Consumer Welfare
<b>CPN–MC</b>	Communist Party of Nepal – Maoist Centre
<b>CPN–UML</b>	Communist Party of Nepal – Unified Marxist-Leninist
<b>DRC</b>	Democratic Republic of Congo
<b>DFID</b>	UK Department for International Development
<b>EPI</b>	Economic Policy Incubator
<b>IBN</b>	Investment Board of Nepal
<b>IEA</b>	Industrial Enterprises Act
<b>IFC</b>	International Finance Corporation
<b>M&amp;E</b>	Monitoring and evaluation
<b>MoI</b>	Ministry of Industry
<b>MoU</b>	Memorandum of understanding
<b>MP</b>	Member of parliament
<b>ODI</b>	Overseas Development Institute
<b>PDIA</b>	Problem-driven iterative adaptation
<b>PPP</b>	Public–private partnership
<b>SAWTEE</b>	South Asia Watch on Trade, Economics and Environment
<b>SEZ</b>	Special economic zone
<b>SEZB</b>	Special economic zone at Bhairahawa
<b>TAF</b>	The Asia Foundation
<b>ToC</b>	Theory of change
<b>UK</b>	United Kingdom
<b>USA</b>	United States of America
<b>USAID</b>	United States Agency for International Development

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# Executive summary

A substantial body of theory now exists on economically sound and politically smart ways of jump-starting progress in poor developing countries. At several levels, however, the practice is lagging behind the theory, meaning there is much to learn from any new experiences suggesting precisely how to advance this agenda. This paper reports some early successes from a UK Department for International Development (DFID)-funded programme in Nepal, the Economic Policy Incubator (EPI). Although this programme is at a relatively early stage, it has some highly transferable features and has already generated valuable lessons.

The paper begins by expanding on the proposition that practice is not yet matching theory. This is true, it is argued, at three levels: (1) economic policy priorities in a world of global value chains; (2) smart ways of navigating the political obstacles and reaping the political rewards of wise policy choices; and (3) approaches to development assistance that support the ambitious pragmatism that is at the root of successful economic transformation. At the third level, the needed shift is from solution-driven to problem-driven aid, and from ‘blueprint’ to adaptive programme designs. While the reasons why this is a difficult transition are well known, how to overcome the main hurdles is much less clear.

EPI is an innovative response to chronic deficiencies in Nepal’s economic policy processes that threaten to hinder the recovery from political instability and economic stagnation that the country now needs. It is distinguished by being led by a well-known and widely respected team of senior Nepali economists, and by a smart working method. The method rests on targeting policy problems that are both important and tractable, in the sense that powerful stakeholders or a potential coalition wish to see them resolved; making ‘small bets’ on a range of such problems; and revisiting strategies and assumptions at regular intervals to revise, scale up or abandon approaches on the basis of anticipated effectiveness. The team applies a toolkit including brokering, convening and technical assistance. Research evidence is brought to bear in response to problem definition and demand, rather than generated in advance in expectation of policy uptake.

Within a few months of completing its inception phase, EPI contributed to a significant breakthrough in fast-tracking and improving the legislation on special economic zones (SEZs). It went on to facilitate important amendments to other Acts that are critical to the investment climate in Nepal. These results were the product of a learning process that led the team first to

abandon an initial ‘bet’ on improving the bureaucratic procedures for the entry of new businesses and then to discover ways of addressing the political concerns that were holding up the passage of key laws in parliament.

This early success has been followed by further convening activity and technical assistance designed to enable Nepal’s first SEZ to become operational. Problem identification and otherwise absent coordination efforts have been undertaken with mayors and administrators in the newly established municipal tiers of government in the economic corridor where the first SEZ is located. A range of other economic policy weaknesses and gaps combining the qualities of importance and tractability are being tackled in a similar way.

EPI has been able to apply the principles of problem-driven adaptive working or ‘development entrepreneurship’ in a relatively uncompromising way, which has not often been possible in programmes funded on a substantial scale by bilateral donors such as DFID. The paper attributes this to a layered set of enabling factors, including some distinctive features of DFID Nepal; the country track record and intellectual contributions of the design and support team provided by the lead contractor, Palladium; and an exemplary approach to reconciling adaptive working with rigorous and transparent reporting to the funder.

Looking forward over the remaining two to three years of EPI’s expected lifetime, the key challenge that will be faced is avoiding any dilution of the following principles:

- focusing on problems that stakeholders are motivated to solve;
- maintaining a range of tactical options with respect to entry points and coalitions;
- combining high-grade technical advice with formal and informal brokering, convening and persuasion.

The paper suggests that the upcoming dangers include pressure to provide increasing amounts of conventional technical assistance, especially in the new sub-national tiers of government, and failing to adapt the approach to the somewhat different contexts of provincial and municipal economic governance. It recommends a substantial increase in the team’s capacity for brokering and facilitation work with firms and businesses.

When EPI reaches its scheduled end in 2020, what should be the next step? The paper makes a plea for realism about the timescale on which the dysfunctions of Nepal’s policy system might be tackled by some form of institutionalisation of EPI’s practice. The effectiveness of

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EPI depends crucially on the team's *not* being part of the civil service and subject to its rules and informal norms. The need for the kind of 'policy incubation' it practises is going to continue for some time. Any suggestion that this is an insufficiently 'transformative' agenda should be rejected. World-wide historical experience suggests that selective removal of critical blockages to economic progress almost always precedes widespread institutional modernisation.

Palladium and EPI should disseminate actively the lessons learnt from their experience to date. Particularly important and widely relevant lessons can be drawn about:

- the benefits and the feasibility of implementing a strong form of the 'local leadership' principle in problem-driven programming by appointing a distinguished national of the country to the programme leader position;
- the gains from, and practicality of, an approach to programme monitoring and reporting that sets out quantitative indicators of performance against a 'menu' of desirable outcomes and against outputs that constitute the typical steps in an agreed form of problem-driven adaptive practice.

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# 1 Introduction

After 50 years of unprecedented progress in building economies and raising living standards across the globe, a great deal is now known about how to make development happen. This knowledge includes a solid understanding of three topics:

1. what it takes to set in motion cumulative processes of economic transformation in initially poor countries by implementing well-chosen policies, especially in the field of globally oriented manufacturing;
2. how, in a great variety of country contexts and periods, leaders have found ways around apparently overwhelming political and institutional barriers to put policies to work and set in motion cumulative change; and
3. how foreign aid can be reformed to make it more effective in supporting change in complex political-economic systems, by following and promoting a problem-driven and adaptive approach.

In each of these three areas, however, the theory is running well ahead of the practice.

## 1.1 The practice deficit

To begin with, while jump-starting economic development with well-designed industrial policies presents a massive opportunity for nearly all less developed countries, only a minority are currently grasping this opportunity firmly. Evidence on how to do so is therefore more historical than current. Second, leaders in many countries find it difficult to perceive how to navigate the immediate political obstacles in order to harvest the potential political pay-offs from mass job creation in manufacturing. There are few formulas for doing this that seem replicable across countries and political regime types. Finally, debates about the effectiveness of foreign aid have generated broad consensus on the value of problem-driven adaptive approaches, not least when seeking to support economic development. However, aid-funded programmes that are fully committed to this type of approach are fewer than the rhetoric might suggest. Those successfully applying the principles are probably fewer still. Implementation of adaptive working is challenging for several reasons, and there is a severe shortage of successful models.

It follows that early dissemination of good or promising experience in any one of these fields of lagging practice is an important task. Leaders of countries' development efforts, international agencies, development think-tanks and implementing organisations alike have reasons to share and reflect on the latest experience of relevance to what they are collectively seeking to achieve.

This paper aims to contribute to such a shared learning process by reporting on the experience to date of Nepal's Economic Policy Incubator (EPI). This is a five-year programme led by senior Nepali economists and funded by the UK Department for International Development (DFID) through the commercial service provider Palladium. It is only two years into implementation but is already showing promise, first as an enabler of the manufacturing revival that Nepal needs; second, as a pioneer of politically smart problem-driven policy reform; and third, as a case of adaptive programme management succeeding under the constraints large-scale bilateral donor funding imposes.

## 1.2 Why EPI

The view of this paper is that EPI is at the leading edge of current practice in the field of problem-driven adaptive support to economic development. It exemplifies a successful application of the principles of 'development entrepreneurship' set out by Jaime Faustino, based on his experience with The Asia Foundation (TAF) in the Philippines. Development entrepreneurs are politically smart indigenous reform leaders who, by making 'small bets' and 'failing quickly to learn fast', replicate the adaptive approach that has proven successful in business start-ups and other fields (Faustino, 2012; Faustino and Booth, 2014).<sup>1</sup> The results achieved with this approach in the Philippines have been described previously in a series of books and papers (TAF, 2011; Booth, 2014; Fabella et al., 2014). They include the liberalisation of air and maritime transport, substantial improvements in urban land tenure and the creation of new revenue streams that have financed widened access to primary health care. Each reform had a measurable impact, and the cumulative effects on the process of national economic development have been very significant.

The results attributable to development entrepreneurship in the Philippines are not yet matched

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1 For more on the background, see Harford (2011) and Sims (2011).



by what has been achieved by EPI in Nepal. On the other hand, the Philippines experience is not in all respects a good model for replication. The reform initiatives that were most successful received modest funding from the United States Agency for International Development (USAID) through TAF, a reputable and well-established non-profit intermediary organisation. An accountable grant modality with relatively light reporting requirements was adopted. Supervision of performance on behalf of USAID was undertaken by an experienced agency staffer who understood and had confidence in the approach and the programme leader. This helped create an exceptionally favourable operating environment for adaptive programme management. In short, the Philippines experience showed that it is possible to do development entrepreneurship with the help of donor funding. It did not establish so clearly that it can be done at scale with the reporting requirements and scrutiny of performance that is now typical for official bilateral agencies such as DFID. In this respect, EPI may turn out to be a more widely relevant model.

### 1.3 Scope and aims

This paper identifies and discusses the particular features of the EPI approach and set-up that seem distinctive and worthy of emulation. It is based on a two-week visit to Kathmandu and Pokhara under the agreement between Palladium, the lead contractor, and the Overseas Development Institute (ODI), which is a consortium member. It draws heavily on a comprehensive review of programme documentation and on group and one-to-one interviews with members of the EPI team and senior advisers in DFID Nepal. The author conducted semi-structured interviews with senior officials from EPI's six most important public sector counterpart organisations: the parliamentary Committee on Industry, Commerce and Consumer Welfare; the Ministries of Finance, Industry and Commerce; and the Special Economic



The EPI logo. © EPI

Zones Authority. He also attended and engaged in further conversations hosted by the municipality of Pokhara and supported by EPI on the theme of public-private partnerships (PPPs).

The paper describes the results recorded so far, how they have been achieved and what has enabled this to happen, in terms of management approach and the relationship between DFID and Palladium. There follows a brief consideration of the challenges and options that the programme and DFID will be facing in the coming years, ending with a plea to remain focused on developing and extracting maximum development results from EPI's distinctive method of work. The paper concludes by underlining the two most clearly generalisable lessons of the EPI experience to date.

Section 2 elaborates the proposition that the theory on technically sound and politically smart support to economic development is running ahead of the practice. Section 3 describes the EPI approach and some early results, while Section 4 discusses enabling conditions. Section 5 addresses the way forward for EPI and DFID, including possible pitfalls and misconceptions. Section 6 singles out the most important transferable lessons from the way EPI has been set up and managed.

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# 2 Smart economic transformation: from theory to practice

The body of theory relevant to the incubation of policies for economic transformation in Nepal has three principal strands, each of which has been significantly strengthened by papers and books published during the past decade. These are well-chosen economic policies; ways of navigating the political obstacles and seizing the political opportunities associated with those policies; and ways of harnessing foreign aid to this purpose by focusing it on adaptive problem-solving. In each of these areas, this section contends, theory is ahead of practice, implying a need for rapid catch-up.

## 2.1 Jump-starting economic development

Any country in the world today can develop its economy and pull its people out of poverty quickly, so long as it respects a couple of simple policy rules. This is the startling but compelling judgement of Justin Yifu Lin and Célestin Monga in their *Beating the odds: jump-starting developing countries* (2017). The simple rules are:

1. Start building an industrial base by copying the most dynamic production processes in countries that have approximately twice your per capita income and therefore roughly similar endowments of capital and labour. Put your most abundant resources to work and raise their productivity with borrowed technology, specialising according to your latent comparative advantages.
2. Target your scarce financial, human and institutional resources towards making this work. Create a small cluster of manufacturers that can be internationally competitive and profitable, providing a platform for further diversification and the acquisition of new capabilities in the next phase in the growth of the global economy. This is what China but also all successful developers did, from England in the 18th century onwards.

Although Lin and Monga are ideally placed to make these arguments, their book may properly be regarded as one of the best recent statements of a view on industrial policy for developing countries about which there is now considerable technical consensus (Cimoli et al., 2009; Newman et al., 2016; Whitfield et al., 2015). As well as presenting a set of practical steps for policy-makers, *Beating the odds* provides a convincing account of why there are so many failures in development, despite basically favourable global conditions (massively expanding markets, latecomer advantages, etc.). They are nearly all traceable to *either* emulating economies that are much too far ahead, with radically different factor endowments (defying comparative advantage); *or* not targeting scarce resources to the priority task but spreading them thinly across a wide range of sectors and activities.

Lin and Monga also link up with a wider consensus on the redundancy of ‘obstacle’ thinking about development. They provide a step-by-step critique of all the intellectual currents in economics and institutional theory that say that countries cannot break through into globally competitive manufacturing (or agriculture) unless they satisfy in a comprehensive way a long list of preconditions – in education, infrastructure, financial deepening and anti-corruption. This usefully puts a cap on a long tradition of critical literature on preconditions going back to Hirschman’s ‘Quasi-vanishing act’ article (1965) and including several compelling dismissals of bad governance and weak institutions as major barriers to development progress (Noman et al., 2012; Sundaram and Chowdhury, 2012).

If removing all the obstacles identified in this broad interdisciplinary literature were a genuine precondition for development, no countries would ever have made the grade. All such obstacles become important in due course, especially as manufacturing productivity rises and more complex challenges are encountered, but at the beginning they can be tackled by rigorous targeting, for example around industrial clusters. Concretely, this means special economic zones (SEZs) clustering together firms,

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including small ones, which are doing the potentially competitive emulation-based production.<sup>2</sup> It means finding the right segments of global value chains and exploiting the opportunities for efficient specialisation, access to constantly expanding markets and acquisition of productive and commercial capabilities that these represent, especially as wage levels go up in China and elsewhere.

Ethiopia's growing role in leather footwear and apparel is a widely cited current illustration of this advice being followed (Oqubay, 2015; Staritz and Whitfield, 2017). However, the number of other current examples is not large. Nepal in the current period is an important test case, and potentially a good source of additional experience, with which to validate the perspective Lin and Monga offer.

## 2.2 Getting politically smarter

Policy disappointments in developing countries reflect failure not of politics but of economic thinking and policy-making, Lin and Monga argue at one point (2017: 160). The specific reference is to the failure of the grandiose and 'comparative advantage defying' industrialisation plans of Ghana's first president Kwame Nkrumah – a particularly extreme case in point. However, the book also makes the broader and more contemporary point that the political payoffs from the job creation and export revenues that can flow from supporting industries inserted in global value chains are potentially enormous. They may also be realised relatively quickly. Unlike previous types of development planning, initiatives of this sort can be effective without immediately tackling the cronyism and corruption that remain dominant in the rest of the economy. They are also capable of delivering noticeable results within a single electoral term. In this sense, the short-term orientation and focus on tangible symbols of success that typify developing country politics do not represent a fundamental obstacle. At any rate, this is less of a problem than it used to be, and less of a problem than discredited ideas – laundry lists of preconditions, a persistent desire to emulate the industries and institutions of rich countries and a range of donor ideas that continue to encourage over-comprehensive reform and spreading efforts too thinly.

All of these points should be conceded, partly because they are backed by a growing list of case studies of the process of policy learning in China and other development pioneers in Asia (Ang, 2016; Coase and Wang, 2012; Studwell, 2013). However, the argument would be more compelling if there were more instances, particularly recent ones, of this 'ambitious pragmatism' being applied and done well, with the political payoffs

plain for all to see. With more such cases to set alongside the numerous instances of governments failing to follow the best advice on industrial policy, it will become easier to disentangle the respective roles of discredited ideas and political short-sightedness. Nepal is one of the places where this may be expected to happen. However, it seems clear that, in the best of cases, some nudging may be required. It is also possible that externally funded programmes have a part to play in this, so long as the funders and implementers can get their act together.

## 2.3 Doing development aid differently

Can aid donors become effective allies of Lin and Monga's ambitious pragmatism, rather than obstacles to it? The Western aid business has long been criticised for insisting on comprehensive reforms and 'best practice' solutions, rather than addressing specific problems identified as such by country stakeholders. It has been condemned for insisting on pre-planned interventions in complex systems where there is a great deal of uncertainty (Andrews, 2013; Hummelbrunner and Jones, 2013; Levy, 2014; Ramalingam et al., 2014; Andrews et al., 2017). Against this background, there is growing support for problem-driven iterative adaptation (PDIA) and its variants as the formula around which domestic reformers and external funders should converge. Terms of reference increasingly call for programme designs to be 'flexible and adaptive'. A growing number of current programmes advertise themselves using one or other of the associated expressions, 'thinking and working politically', 'politically smart and locally led' or just 'doing development differently' (Wild et al., 2017).

As suggested, however, the discourse on these themes is well in advance of the practice. For example, it has proven relatively simple to create flexible programmes – that is, programmes that have the ability to respond to volatility in the operational environment, for example by scaling planned expenditure up or down, or moving resources from one budget line to another. It has been much harder to deliver truly adaptive designs, where the desired outcomes are clearly specified but the means of achieving them are left open and made subject to a rigorous form of trial and error. Focusing on locally salient problems and breaking cleanly with solution-driven, 'best practice' thinking has also been a bottleneck (Jones, 2017; Wild et al., 2017).

The reasons why a transition to problem-driven adaptive working is difficult are reasonably well understood. They include the reluctance of funding agencies, under pressure to assure taxpayers of the effectiveness of their spending, to let go of the illusion

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2 The reason there are so many SEZ failure stories, Lin and Monga argue, is that, gross mismanagement aside, too often zones have been occupied in a random way, by firms that are not following latent comparative advantage and by firms producing different things and therefore not generating the learning spill-overs that are the main point of industrial clusters.



that detailed preplanning is a way of securing certainty about impact. This reluctance can and does coexist with a commitment in principle to politically informed and learning-oriented programming. It is commonly manifested in resistance to monitoring of programme performance on the basis of ‘mere process’ measures and the perception that the only way to ensure that implementing partners, especially commercial service providers, are sufficiently ‘stretched’ is to hold them accountable for concrete deliverables set out according a fixed timetable. The whole purpose of adaptive programming is, of course, to shift the focus of performance assessment onto outcomes and means of achieving them, but in practice this has not been sufficiently persuasive.

Other well-understood barriers are more on the side of implementers. They include an unwillingness to assume the perceived commercial risks of an open-ended and learning-oriented delivery schedule, especially when linked to outcome- or output-based payment triggers. Where multi-level implementation partnerships are involved, there are other, much-commented, obstacles. One is the difficulty of finding organisational partners and team leaders that are trained and psychologically prepared for working on the basis of trial and error. Decades of donor programming on the basis of blueprint-style logframes and highly specialised delivery functions have left their mark.

Last but not least, the formula ‘politically smart and locally led’, which the literature associates strongly with a problem-driven approach (Booth and Unsworth, 2014), has been hard for donor-funded programmes to translate into reality. For many funding agencies, entrusting programmes fully even to highly capable nationals of the country seems like a step too far in letting go of the levers of accountability. This is a problem. The tasks of identifying problems that powerful players really want to solve, and then navigating the political rocks and shoals towards good enough solutions, are only likely to be tackled effectively by senior professionals of the country.

The tensions between the demands of problem-driven adaptive programming and these various barriers do not seem irreconcilable in principle. However, there continues to be a severe shortage of good, practical examples of exactly how to achieve a reasonably happy marriage of the two. The experience with EPI in Nepal, even though it is not yet mature and faces a number of potential challenges, represents an unusually rich source of learning on more than one of the most prominent issues identified here. The following sections describe the principles on which the programme is currently operating, some initial results, the conditions that seem to have enabled this success, the challenges and prospects going forward and the most important lessons to draw.



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# 3 Nepal's Economic Policy Incubator

Nepal is facing a potential turning-point in its development. Following an extended civil war and a further period of heightened political instability, recent elections under a new federal constitution are raising political expectations. If the country can achieve greater continuity and orderliness in the conduct of government, new prospects will open up for tackling the major backlog of national development challenges that has built up over the past decades. Among the priorities is reversing the precipitous decline that has taken place in the climate for foreign and domestic private investment and in the performance of the manufacturing sector in particular. This is an important but not a simple challenge, given deep-seated and likely enduring features of the country's political economy. The set-up and approach of the EPI programme must be understood in this context.

## 3.1 Chronic problems, complex changes

In purely economic terms, the challenge is daunting. The contribution of manufacturing to Nepal's gross domestic product fell from 9% in 2001 to 5.5% in 2016, the lowest share among the major economies of South Asia and contrasting sharply with the 18% for Bangladesh. A youthful population is entering the labour market at an impressive pace. If living standards have been maintained thus far, this is largely due to the scale of remittances arising from insecure labour migration to Gulf states (Jones and Basnett, 2013; EPI, 2017b; Lemma and te Velde, 2017).

UK aid to Nepal has several components designed to assist the country to rise to the economic challenges of the period. Different programmes are contributing to the infrastructure, energy, skills and financial management dimensions of the challenge. EPI is specifically dedicated to improving the economic policy regime, using a politically smart approach. The programme's scope is purposely wide and open-ended. During its inception phase, the programme generated a list of nine

cross-cutting constraints to inclusive and transformative growth, together with a matching list of nine areas of economic opportunity.<sup>3</sup> These form an agreed 'menu' of policy improvement areas on which EPI is permitted to work. The assumption is that there is no shortage of diagnostic analysis pointing to policy changes that, if implemented, would make a large difference to Nepal's economic development prospects. In much shorter supply is informed opinion on which important issues are likely to prove tractable in the short or medium term. The 'menu' is therefore subject to a continuous process of selection and refinement that takes into account what can be learnt about the feasibility of making headway on each issue.

A widely accepted institutional diagnosis pinpoints four features of the situation in Nepal as significant barriers to making headway on any of the listed issues:

1. a marked lack of high-level leadership in economic policy caused by frequent government turnover and a related lack of continuity in senior ranks of the civil service;
2. coordination problems across government intensified by a style of patronage politics that rewards loyalty over competence and encourages risk-avoidance, not ambition;
3. an enduring pattern of social, ethno-regional and political fragmentation that discourages coherent policy-making for development;
4. consequent limited uptake of available evidence and analysis into policy and ineffectual implementation of existing policies, including those enshrined in elaborate strategic planning documents.

The task of 'incubating' more effective economic policies centres on efforts to navigate around and mitigate the worst effects of these chronic sources of weakness. This means being selective about which desired outcomes to pursue. It also means recognising that these are complex problems. That is, they consist of bundles of interrelated

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3 The constraints are (1) the high cost of transportation, (2) poor access to reliable electricity, (3) business procedures and regulations, (4) challenges in contract enforcement, (5) rigid labour laws, (6) non-tariff barriers (to trade), (7) political instability (its effects on economic management), (8) coordination failures and (9) anti-competitive practices. The areas of opportunity are (1) commercialisation of agriculture, (2) trade with India, (3) manufacturing, (4) renewable energy, (5) youth (demographic dividend), (6) information and communication technology and innovation, (7) tourism, (8) labour migration (regulation and harnessing remittances) and (9) the informal economy (raising its productivity).



issues, influenced by many players acting according to often ill-defined formal and informal rules, and mutually adjusting their attitudes and behaviours. Consequently, they are not likely to be susceptible to ready-made solutions. At the outset, what is likely to ‘work’ to unblock a particular process, and how in due course this will interact with concurrent changes in the wider context, will usually be quite unclear. It may become apparent only as implementation proceeds. The most realistic approach is therefore one that seeks to address problems selectively, and to learn by trial and error how to make headway on them. This is the basic thinking that EPI’s set-up reflects.

## 3.2 EPI’s set-up and approach

EPI is fully funded by DFID. It has 12 full-time staff, including senior economists and governance advisers, research staff and administrative support, and manages a large un-earmarked budget for flexible technical assistance. The current funding commitment from DFID is for £6 million over four and a quarter years (2016–20). The management consortium is led by Palladium, with a national think-tank, South Asia Watch on Trade, Economics and Environment (SAWTEE), and ODI as consortium partners. The work undertaken by the team and the consultants they hire consists of a mixture of advisory services; convening and facilitation of both formal and informal deliberations; commissioning tailored research; and mentoring of partner organisations at different levels of public policy-making, including parliamentary committees and municipal councils.

The scope of EPI’s work has already been considerably refined, including in ways that are consistent with the ideas of Lin and Monga on jump-starting manufacturing growth. Further refinements are to be expected in the future. However, a basic method of work has been developed and applied quite consistently. This has two distinguishing features:

1. The identification of policy problems for attention begins with conversations with leaders and officials to identify which, from among the panorama of possible blockages or gaps, are the ones they see as priorities and are motivated to address. The accent here is on informal discussion, building on previous interactions and relationships, not on the kind of formal ‘policy dialogue’ favoured by international agencies. Once an issue of interest has been identified, evidence and technical advice are brought to bear on it, reversing the more usual pattern in which technical advisers seek ‘uptake’ of findings from research.
2. Given the uncertainty about whether and how solutions can be arrived at, on account of the complexity and changeability of the conditions influencing success, several problems identified in this way are selected for simultaneous attention. The

tactics initially selected in the search for solutions are also subject to frequent review and readjustment. Borrowing the language used in the business start-ups field and previously applied by TAF in the Philippines, several ‘small bets’ are pursued to avoid the risks and likely waste associated with pursuing one large bet. The small bets are subject to cancellation or adjustment in the light of robust indications of their potential to deliver specified outcomes.

The set-up of the programme has two central features that are crucial for delivering this method of work:

1. The programme leader is a well-known Nepali economist with a reputation for political impartiality and a record of high-grade public service, including an extended vice-chairmanship of the National Planning Commission (2002–06) and five years as Nepal’s ambassador to the USA (2009–14). He is supported by a deputy and two senior technical advisers who combine experience in Nepal’s civil service or the private sector (banking) and advisory positions at the World Bank and DFID. The senior team therefore is not only highly qualified in the technical fields of relevance to the task but also enjoys the reputation and trust needed for the issue-identifying conversations described above. It also has the necessary inside knowledge of government systems and personnel to be able to make judgements about political viability and the likelihood of success with alternative tactics of change. Two able junior research coordinators play a valuable role, leading detailed enquiries that might otherwise distract the senior team from their priority tasks.
2. With a compact core team and a flexible budget for hiring technical (e.g. legal, business or economic) advice and research services, the programme has relatively few prior commitments of the type that could limit its ability to change course in the pursuit of its objectives. By design, it therefore has considerable freedom to shift its attention from one set of government or civil society counterparts to another set, to employ tactics that prove politically smarter and, if necessary, to cancel whole streams of work that have proven unpromising.

To summarise, the distinctive features of EPI’s approach are:

- focusing on problems that stakeholders are motivated to solve;
- maintaining a range of tactical options, with respect to entry points (e.g. regulations versus laws) and coalitions (e.g. bureaucrats versus politicians);
- combining high grade technical advice with formal and informal brokering, convening and persuasion.

The approach reflects a two-part diagnosis: (1) government in Nepal is not, or not yet, a determined

and joined up actor that can address economic policy limitations across the board, but (2) there are particular organisations and individuals that are motivated to address particular issues, especially if they are brought together with like-minded others and stimulated to think in fresh ways about potential solutions.

The method consists of convening those actors in a sensitive way and prompting them to work together to identify and remove the key blockages. The element of technical assistance is essential for two reasons. It provides a convenient way of ‘opening doors’ and starting conversations. And it is important for arriving at modalities of collective problem-solving that are technically sound (that is, liable to make a significant difference to economic development performance) as well as politically feasible.

### 3.3 Early successes

EPI will eventually be judged by its cumulative contribution to easing the constraints and harnessing the opportunities affecting investment, production, job creation and exports in Nepal. In its first two years, it has already registered some striking successes in a couple of policy areas. At this stage, these contributions are not certain to have a major impact, given the complexity of the processes involved. However, feed-through to impact is considered likely on the basis of a robust assessment of the plausibility of different pathways of change. More important, these early successes exemplify a formula for ‘incubating’ economic policies that seems suited to producing a cumulative flow of such gains over the remainder of the programme period and perhaps beyond.

Within a few months of its inception, EPI had already made one notable contribution to Nepal’s economic policy environment. The centrepiece is the legal and regulatory regime for SEZs and its implementation in Nepal’s first SEZ, inaugurated in 2014 and located close to the Indian border at Bhairahawa (SEZB). Addressing the principal infrastructural and institutional constraints on manufacturing by the SEZ method (that is, through geographical concentration of effort) emerged as a focus soon after inception along with targeted interest in public and private investments in the Economic Corridor from Pokhara to Sunauli, in which SEZB is located. The main issue was that the governing legislation, in the form of an SEZ bill, had been stuck in parliament for eight years. Without its passage, SEZB could not be made operational.

Initially, work on the SEZ issue was accompanied by interest in improving Nepal’s poor performance against the World Bank’s Doing Business criteria, which focus on ease of entry for new investors. This would have rested on work with the Ministry of Industry (MoI) to simplify business registration and compliance procedures. Consultants supervised by EPI Senior Advisor Hiramani Ghimire prepared an Agenda for Simplifying Business Regulation in Nepal, and the MoI validated and accepted

this (EPI, 2017a). However, early consultations with the leadership of the MoI and other stakeholders detected little serious interest in pushing through the required changes in procedures. It was also confirmed that these could be expected to incur significant bureaucratic resistance. Meanwhile, discussions in parliament, especially with the Committee on Industry, Trade and Consumer Welfare (CITCW), suggested an unexpected level of interest among parliamentarians in unblocking the SEZ legislation. Expressions of appreciation by the CITCW for the technical advice offered by Dr Sharma and his team on the SEZ bill encouraged EPI to revise its initial focus on business entry procedures and redirect its efforts to legislation affecting broader aspects of the investment climate, including amendments to the Industrial Enterprises Act (IEA) and the Companies Act.

This shift involved EPI in revising its initial assumption that, given Nepal’s fractious party politics and shifting parliamentary coalitions, legislation would be a harder route to effective policy improvement than changing bureaucratic procedures. While first impressions and standard *ex ante* political economy analysis might have supported this assumption, engagement with CITCW members on the detail of the SEZ bill revealed a more complicated picture. Not only were the Minister of Industry and his secretary keen on getting the SEZ law passed, but also there were champions in the relevant parliamentary committee.

A principal reason for the blockage was found to be the inclusion in the bill of a clause limiting labour strikes in SEZs, which had been opposed by most political parties and their affiliated trade unions. In informal meetings with the parliamentarians, however, the EPI team found some support for its inclusion, even among left-leaning MPs. Some of them were concerned about the impact of factory closures caused by strikes in their constituencies. Others had been influenced by their knowledge of the background to notorious inefficiencies in government-owned firms. This provided fertile ground for acceptance by committee members of broader arguments about the impact of Nepal’s reputation for unruly labour relations on future foreign and domestic investment, especially in SEZs.

The EPI team worked at first quite informally, including through bilateral conversations with individual MPs. Later they brokered and facilitated more formalised evidence sessions with the whole committee and external stakeholders. Dr Sharma’s presentations on experience in other countries were backed up with study tours to southern China and Thailand. Influential members were persuaded to sponsor the bill in committee. Having been persuaded of the potential political gains from increased manufacturing employment, the politicians were apparently able to get sufficient assent from the party-linked trade union leaders.

A secondary blockage to the passage of the SEZ law was also addressed in the committee, thanks in part to politically smart technical guidance from the EPI team. The draft bill required investors benefiting from SEZ



conditions to export 100% of their output. The final text lowered the requirement to 75% to meet objections from private sector representatives that could have prevented its approval.

With the endorsement of the bill, including the controversial clauses, at the committee stage, the Act was passed by parliament on 30 August 2016 without further opposition. This breakthrough opened up a stream of work to operationalise the provisions of the Act, with particular reference to SEZB. The principal counterpart for this work is the new and relatively inexperienced SEZ Authority. The work takes the form of high-grade, politically attuned, technical assistance to the preparation of implementation guidelines that will ensure sound implementation of the principles set out in the law. This includes active problem-solving on such issues as the legal framework for electricity supply to the SEZB site, and leveraging additional public investments in the site's infrastructure.

### 3.4 Consolidating relationships

The SEZ work forged a partnership between EPI and the CITCW that seems likely to survive the current transition from a three-way governing coalition (Nepali Congress plus two leftist parties) to a two-party leftist one. A memorandum of understanding (MoU) between EPI and the committee commits EPI to providing ongoing advice and capacity-building, including the preparation of a procedural handbook for new members. Under the new constitution, parliament is smaller and there will be fewer parliamentary committees, but it is expected that the agreement will be picked up by the

successor committee whose remit includes trade and industry.

The relationships consolidated in this way permitted EPI to play an influential part in steering the IEA and Companies Act amendments through the committee stages. Improvements in the content of these laws are expected to make a significant difference to the climate for investment. In several respects, the changes are attributable to wise committee decisions based on arguments put forward by EPI. For example, the IEA as amended entitles firms to submit required documentation electronically and requires ministries to recognise firms' digital signatures. This is expected to relax at least some of the bureaucratic delays involved in processing paperwork in the traditional manner. Environmental and social impact assessments are now required after land for factories has been acquired and before company operations start, rather than, as previously, at the initial investment proposal stage. The IEA also restores previously abolished fiscal incentives and includes some limits on wildcat strikes. Some seven amendments of these types were made to the Companies Act, drawing on proposed improvements suggested years previously in a study by the International Finance Corporation (IFC, World Bank Group) but never acted upon.

EPI's early successes, most of which took place within 18 months of the programme start-up, have confirmed the team's belief in selective issue identification and agile coalition-building. The principle that powerful stakeholders must be interested in, and willing to assume ownership of, a reform has been powerfully endorsed. Experience has also shown that a senior team combining technical expertise and a reputation for political impartiality can use offers of technical assistance to open doors and influence people in ways that sidestep the notorious dysfunctions of the Nepali policy process.

### 3.5 Increasing scope

It is on this basis that the team has expanded its agenda of 'small bets'. On the investment climate, a Foreign Investments Bill improved with EPI help is due to go to the newly elected parliament in early 2018. Thanks to EPI, the MoI has a vision document giving a central place to reinvigorating manufacturing and creating employment opportunities over the decade 2017-27. The SEZ follow-up has included the approval of necessary bye-laws and regulations by cabinet, securing agreement on a roadmap for the operationalisation of SEZB with key stakeholders, removal of uncertainties around the SEZB electricity supply and an additional budgetary commitment to implementing the SEZ policy.

In addition, new projects have been started on (1) sub-national economic growth (support to investment policies and procedures at the new municipal level of elected government, focusing on the Pokhara–Sunauli corridor), and (2) facilitating investments in

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e-commerce. Thirdly, responding to a request from a Ministry of Finance official, who was the first chair of the programme's Steering Committee, EPI has been providing training in economic analysis for civil servants in a sub-programme called Economic Brain.

Of these recent and current initiatives, the most important is probably the move to sub-national work. The creation of two new tiers of elected government, at provincial and local (municipal) levels, is one of the most significant features of the constitution now being implemented. What happens at these levels will be a major determinant of the prospects for inclusive growth and economic transformation during the coming decades. Since the required technical, administrative and decision-making capabilities are going to need to be built almost from scratch, the demands for routine technical support and training are going to be large. For all these reasons, sub-national work represents a great opportunity but a dangerous one from the perspective of EPI's distinctive method and contribution.

The work has begun in a promising fashion. The team has had conversations with the mayors and secretaries of four of the new municipalities in the Pokhara–Sunaili corridor (Pokhara–Lekhnath, Butwal, Tilottama and Siddharthanagar) to identify investment projects and other initiatives of priority interest to them. EPI also supported wider consultations and evidence-based prioritisation processes in some municipalities. MoUs have been signed with the four mayors, under which EPI is committed to advisory and facilitation support. The investment priorities include bus stations, leisure parks, multi-storey car parks and other infrastructure projects that are attractive both politically, as symbols that the mayors are having an impact, and as a potential source of local tax revenue. Since the capital investment required is more than municipal budgets are likely to permit, there is interest in PPPs. Under the new constitution, both the provincial and the municipal councils have legislative powers, and these powers can be used to translate federal legislation into appropriate local versions. EPI, using specialist consultants, has been helping with this task as it applies to localising the federal law on PPPs. They are also working on longstanding problems in the business registration and tax systems at local level.

EPI's sub-national workstream is geographically targeted, partly with a view to creating demonstration effects that can be emulated within the corridor and elsewhere. However, it has set out to ensure that any learning on what works within the decentralised structures gets reflected in national policy. It helped the government establish an inter-ministerial task force on the implementation of decentralisation, and the MoUs

with the selected municipalities are anchored by regular reporting to the National Planning Commission.

Little of this effort would be necessary if Nepal's government system were well coordinated and steered consistently through time by a coherent vision for national development. However, as we have seen, the actual state of affairs is that these qualities are for the most part absent, and the challenges are compounded by the decision to undertake an ambitious decentralisation programme. Under these circumstances, the type of brokering of agreements, facilitation of change processes and expert steering that EPI is qualified to provide may make a very substantial, and ultimately measurable, difference to the outcomes that matter for Nepal.

### 3.6 Moving towards impact

There is a real sense in which EPI's real challenges still lie ahead. The progress that has been made in improving the general investment climate and the SEZ policy framework in particular through intelligent legislation will count for something important only when the Bhairahawa SEZ is operational and investments begin to flow. Various anticipated snags are being dealt with now and others may well emerge over the next couple of years. Nevertheless, there are already signs that the expected impacts will be realised.

For example, the IEA provisions on online registration of businesses and the timing of impact assessments are up and running, with the necessary software and hardware in place. On the basis of the legislative changes, Nepal has crept up a couple of places in the Doing Business rankings. As of March 2018, there has been a 14% increase in registration of industries at MoI. Confidence among businesses that SEZB will soon be operational is suggested by the fact that thirteen investors have applied for permission from SEZA to register their industries, foreseeing the creation of 2,963 direct jobs. The roadmap for the development of e-commerce, supported by EPI, has been agreed by the Minister of Commerce. Two commercial banks have installed payment gateways, and the central bank has authorised 28 banks and three other organisations for online banking. Despite being at an early stage, the partnership agreements on local economic growth signed with the four municipalities should begin to yield concrete results within the next year. If these trends continue – especially in the SEZ policy area – EPI will have made a very significant difference to Nepal's economic transformation prospects. It will have done so at relatively modest cost to the UK taxpayer.<sup>4</sup>

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<sup>4</sup> Although significant at £6 million over four and a quarter years, EPI's budget is small by many standards. It is a modest share of the £35 million awarded to the Accelerating Investment and Infrastructure in Nepal (AiIN) programme of which it is a part. Over the four years corresponding most closely to EPI's programme period, DFID Nepal's total project budget is projected to be £426 million (source: DFID Development Tracker).



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# 4 Enabling conditions

EPI is already influencing outcomes and showing real promise of continuing to do so. It is working on a broad front and with a significant budget, provided by a bilateral donor agency that is strongly committed to Nepal but also under political pressure to exercise tight control and stay focused on easily communicated results. Ordinarily, such pressures are discouraging, if not prohibitive, of the kind of problem-driven adaptive contributions that EPI is delivering. As noted in the Introduction, the best examples until now of effective development entrepreneurship have benefited from more modest donor funding, provided on much more relaxed terms than those currently governing UK aid.

What has made EPI possible is a layered set of enabling conditions. Some of these are specific to DFID's Nepal office and may not be fully replicable in other countries, although they include some sound general principles. Others have to do with the way the programme has been designed and managed, several features of which seem highly transferable – one of the reasons it seems worth reporting about them at this relatively early stage in the programme's operational life.

## 4.1 DFID Nepal

The Nepal office of DFID has some track record of supporting innovative programming, especially in the area of politically smart support to economic development. The Centre for Inclusive Growth (CIG), the predecessor of the umbrella programme Accelerating Investment and Infrastructure in Nepal (AiiN), under which EPI sits, was a pioneering example of an advisory facility staffed mainly by Nepalis and intended to provide targeted technical support to the then most dynamic unit of the national government, the Investment Board of Nepal (IBN). The CIG/IBN link-up had a large positive impact, especially on the agreements needed for Nepal to exploit its considerable potential in hydroelectric power generation (Thapa and Basnett, 2015; Laric and Waddell, 2016).

The CIG experience encouraged the growth team in DFID Nepal to include in the Business Case and Invitation to Tender for AiiN an 'anchor component' intended to address selected institutional problems in economic policy using a flexible and learning-oriented approach (DFID, 2015). The impact of CIG had been written up by DFID advisers alongside other cases of politically smart support to economic growth in a challenging policy context – in the Democratic Republic

of Congo (DRC) and Nigeria (Ramalingam et al., 2014; Booth, 2016). This kind of thinking by DFID may come most easily in countries whose economic performance is markedly below potential and where the reasons appear to lie in chronic but potentially tractable institutional dysfunctions. Arguably, there are few DFID partner countries that do not fit that description. However, the inadequacy of 'business as usual' is particularly stark for aid donors in places like DRC, Nigeria and Nepal. As a result, DFID Heads of Office in those countries have been unusually supportive of innovation in the country portfolio, which has facilitated the adoption of politically smart adaptive programme designs (Wild et al., 2017).

In the Nepal case, the DFID office backed up its commitment to the concept of a flexible 'incubator' by leaving the design of EPI relatively open, to be shaped by the successful bidder. It has also followed throughout a relatively 'light touch' management style, avoiding undue intrusion into the approach developed by the implementing partner, Palladium.

## 4.2 Programme design and management

While DFID signalled quite strongly its interest in flexible policy 'incubation', much of the detail of the EPI approach was worked out in Palladium's bid document. It was then refined in the programme's Inception Report, prepared during the three months following signature of the contract. This detail drew heavily on the country experience and networks of members of Palladium's bid team, of whom a number were well versed in the theory and practice of adaptive programming.

One of the things this experience suggested strongly was the importance of assigning programme leadership to a senior Nepali with government experience. Another was the importance of supporting that person with a weighty group of other team members with both the technical expertise to advise on economic policy and inside knowledge of key policy systems and personnel. CIG was reckoned to have been less effective than it might have been because, although mainly staffed by expatriate and locally hired Nepalis, it was led by a foreigner. It also relied on the special, semi-autonomous status of IBN, which insulated it from normal civil-service reporting lines and procedures. This status eventually proved unsustainable. It was also inconsistent with Palladium's preferred approach of working selectively with the main government bodies to facilitate incremental improvements. The Palladium team must





be credited for insisting quite strongly on the Nepali leadership point and overcoming the typical tendency in DFID to favour programme leaders that know and understand the aid business, and in this respect to offer a ‘safe pair of hands’.

Thanks to its solid networking, Palladium was also in a position to bring into the proposed EPI team one of the most distinguished and able of Nepali economists: Shankar Sharma has proven to be an exceptionally competent and inspiring team manager as well as an unmatched opener of doors to influence for EPI. His deputy programme leader and the two senior advisers also appear to have been well selected, bringing the necessary combination of expertise, independence, government experience and professional networks, including in a couple of instances DFID and/or World Bank postings. The interview evidence for this paper suggests that the levels of distinction and skill brought together by Dr Sharma and his colleagues constitute on their own one of the most salient enabling conditions of what EPI can do. A less highly reputed and capable team would not have received the hearing or elicited the responses from senior politicians and bureaucrats that are the key ingredients of the EPI recipe.

That having been said, the distinctive mode of working that EPI has developed owes much to an excellent working relationship between Palladium and the Nepali programme leadership, with DFID’s generally supportive posture in the background. This relationship has made EPI a powerhouse of bright ideas for smart working on economic policy. Particular ideas that have been useful in giving practical form to the basic approach include:

- focusing on demand-led opportunities to improve policy on specific issues, as opposed to trying to build policy-making capacities on a broad front;
- using evidence and analytical work to feed this demand, rather than seeking ‘uptake’ for research findings;
- working up an integrated package of EPI outputs appropriate to each issue area, rather than following a standard sequence in which dialogue is followed by technical assistance and then by institutional strengthening;
- engaging broadly with stakeholders across the policy system, including a number of different stakeholders in government and civil society, thereby avoiding ‘capture’ by any one of them and maximising the chances of a winning combination;
- maintaining conversations at different levels of government (Secretary, Joint Secretary, Section Head, etc.), to ensure both high-level authorisation and continuity when governing coalitions change and key contacts get transferred;
- casting the net wide to search out a number of high-impact yet tractable issues to work on, thereby managing the uncertainties and resulting attrition rates of interventions (due to the continuing volatility in the political environment and new scenarios arising from the constitutional changes as well as the perennial implications of institutional complexity).

These were recognised and endorsed in EPI’s first Annual Review by DFID (August 2017) as wise strategic choices. According to the review, they should continue to govern the programme over the next few years, with the exception of the final bullet point. From Year 2, EPI

would focus mainly on delivering against existing issues, while continuing to employ imaginative tactics and accommodate new learning in doing so.

### 4.3 Monitoring and reporting

One of the most innovative and broadly relevant dimensions of the EPI/Palladium approach is performance monitoring and reporting progress to the funder, DFID. As mentioned in Section 2, the apparent conflicts between genuinely problem-driven and adaptive programme management and the requirements and habits of traditional monitoring and evaluation (M&E) have been one of the principal stumbling blocks in this field. To the knowledge of this writer, no current development programme operating on a significant scale with official donor funding anywhere has achieved a really successful marriage of adaptive working and donor progress reporting – that is, where the reporting frame supports the learning process while also providing a high level of results-based accountability.

Until now, the most serious efforts to achieve such a marriage (e.g., Derbyshire and Donovan, 2016) have relied on frequent modifications of the outputs in the logframe or results framework to reflect learning or changes in circumstances. This is unsatisfactory because assessors (e.g. those leading DFID Annual Reviews or Mid-Term Reviews) are expected to score a programme's performance in delivering its outputs as well as its expected contribution to outcomes and impacts. This is not possible if outputs are frequently changing. In

practice, some reviewers of programmes that have been set up to be flexible and/or adaptive take the view that they should also score the quality of the learning or the wisdom of the adjustments. But this is also unsatisfactory if there are no proper criteria to guide these judgements. Compromises of this sort also leave implementers and M&E personnel under the sway of traditional 'blueprint planning' ideas, under which non-delivery of a pre-defined output feels like evidence of programme failure and managers have few incentives to recognise approaches that are not working.

It is clear in principle that adaptive programmes will not show their true potential unless and until their M&E systems are geared to recording and rewarding the kinds of learning and adaptation that are important for contributing to outcomes. At the same time, any such systems need to provide acceptable evidence that implementation is 'on track' and implementing teams are applying the agreed approach to a high standard of quality and at a reasonable pace. One of the features that appear indispensable in making such evidence acceptable to DFID is quantification. Clever use of appropriate quantification is one of the things that distinguish the EPI results framework, making it an exemplary effort to reconcile effectively the twin demands of problem-driven adaptive working and robust scoring of output performance.

A basic understanding of the approach can be taken from Table 1, which shows the indicators for outcomes and outputs in EPI's initial results framework. Performance against these indicators was the basis of the 2017 Annual Review. The columns of the results framework are in rows in Table 1, for ease of presentation. The milestones (targets)

**Table 1 EPI performance indicators (2016–17)**

Outcome indicators						
Number of top 9 cross-sectoral constraints to inclusive and transformational growth significantly eased (cumulative)		Number of sectoral and regional opportunities for inclusive and transformational growth harnessed (H), and number of these that are harnessed on a significant scale (S)		Number of key issues where resources are harnessed from government, donors, private sector and others, and average achievement of targets (%)	Number of significant steps taken towards more effective policy by EPI counterparts and partners	Number of issues around which institutional structures and capacities have been significantly improved
Output indicators						
Sub-output 1: Problem identification, project design and implementation			Sub-output 2: Project adaptation and learning		Sub-output 3: EPI engagement and learning	
Number of significant and tractable policy problems identified with stakeholders	Number of quality project plans developed with key actions agreed with partners	Average % achievement of planned deliverables	% of active EPI initiatives adapted based on implementation experience	Number of projects that are scaled up (S) or dropped (D) based on evidence and EPI learning processes	Number of ideas and lessons generated or learned to support improved policy and programming	Number of processes or mechanisms developed that embed strong relationships with core economic governance bodies to support policy incubation and implementation

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and means of verification corresponding to the indicators are left out for the same reason.

What is significant and distinctive about these sets of indicators is that they identify things that can be counted (making them useful internally as well as for external reporting, because they incentivise a rigorous pace of work) but they are also consistent with the open-endedness of the problem-driven approach and do not impose distortions on adaptive working. The things that get counted at the output level are the building-blocks of the way of working to improve policy that EPI has adopted. Therefore, the focus for performance scoring is on how well and how vigorously the approach is being applied.

This has been accepted by DFID as an appropriate monitoring scheme; each of the things counted is seen and approved by DFID, allowing standard objections to output indicators that ‘only’ measure processes to be overcome. As a result, EPI is being monitored as it should be, with a strong focus on desired outcomes and the steps and packages of activities that are necessary in the real world to make them materialise.

Two further things are probably essential to making all of this work. One is the contribution of a two-person EPI M&E team, who give constant attention to operationalising the basic indicators and ensuring there is evidence to support the claims made, including ensuring this happens *ex ante* – in other words, in advance of the required reports (EPI, 2018). The other is a relatively elaborate set of procedures and templates for documenting the rationale, aims, assumptions and plans of action covering each of the selected issue areas. These are based on brainstorming and planning sessions involving the whole team, usually chaired by the team leader. They also involve a substantial recording, drafting and communication effort on the part of the technical and M&E personnel provided by Palladium.

This combined effort helps in achieving two important things. On the one hand, it ensures the whole team is of one mind on what EPI is seeking to do and why. On the other hand, it provides a high level of transparency about the process, so that accountability to the funder does not rely exclusively on the necessarily crude machinery of the results framework. Sufficient resourcing of the indicator work and recording functions seems an essential condition for this to work well.

The standard items of EPI documentation are:

- **Issue Theories of Change (ToCs)**, for each selected problem area. Up to 20 pages long, these include a problem analysis, hypotheses about the economics of the issue, and about scale, sustainability and feasibility; an assessment of potential impact and intermediate outcomes; and a proposed strategy. The Older Issue ToCs have an annex listing any revised assumptions and changes to strategies.
- **Project Plans**, detailing the actions, deliverables and inputs for each of the interventions a given Issue is thought to require.
- **Case Studies**, for reporting to DFID in narrative form on significant EPI contributions to programme outcomes.

These materials provide a solid body of documentation that can be drawn on in completing the narrative part of DFID’s annual reporting. To the credit of DFID Nepal, the standard Annual Report format has been customised to reinforce the emphasis on what has been learnt and how the programme has changed over the year. It calls for answers, intervention by intervention, on the assumptions made, what has been learnt, how success is being measured and what will be done differently in future. This too seems exemplary and worthy of emulation.

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# 5 Looking forward

What are the main challenges facing EPI over the coming years? Answers to this question need to be offered with some humility, as they are based on an intensive but relatively brief exposure to the EPI documentation, its counterparts and some of its ‘live’ processes. If they have merit, compared with the insights of those who have a much better grasp of the detail, it is because they convey something of how EPI looks from the outside, from the perspective of the progress and prospects of problem-driven adaptive programming worldwide.

## 5.1 Keeping focused

If what we have seen in this paper so far is true, the key challenge going forward is to maintain a high level of consistency in applying the principles and methods that have already proven effective. The principal risk is that of allowing the approach to be diluted.

Several ways this could happen are associated with the technical assistance aspect. Currently, the responsive technical assistance being provided includes some training of a relatively generic sort (on basic econometrics and spreadsheets under the Economic Brain initiative, and on parliamentary committee procedures). This is being used to consolidate some of the relationships that have proven important to getting EPI recognised and positioned to improve policies. This technical assistance may be described as ‘demand-driven’ but it should be contrasted with the use of that phrase in connection with routine capacity-building of the traditional sort. There is almost always a strong demand for the traditional type of capacity-building, focused on individual capabilities. But international thinking has long given up the assumption that the limitations of developing country bureaucracies and parliaments are to be addressed by transferring individual knowledge and skills.

The practical difficulty for EPI is that the demands for technical assistance from its counterparts in government are potentially inexhaustible, and the costs of refusing to scale up this part of the work may be high. Maintaining collaborative relationships may be impossible without at least a constant level of training or advisory inputs. The danger of slipping progressively back into traditional modalities of technical assistance is particularly great at the sub-national level, since the new provinces and municipalities have weak or non-existent capacities for performing many basic governance functions. As more of EPI’s portfolio of issues and projects shifts to sub-national levels, therefore, the demand may be expected to grow.

DFID itself is under pressure to respond to the new decentralised configuration of government in Nepal by supplying conventional technical assistance at all levels across the country. On the basis of global experience, any response to this demand on the expected scale will not be problem-driven and may well involve the type of uncritical promotion of ‘international best practices’ in public sector and public financial management that has blunted the capabilities of bureaucracies in many countries (Andrews and Bategeka, 2013; Bridges and Woolcock, 2017). This is not the place to discuss that possibility. However, it is certainly pertinent to urge that, whatever is decided about this issue, it should not burden EPI with any part of the response.

## 5.2 The new demands of sub-national programming

Getting diverted into routine technical assistance is not the only challenge involved in the move to sub-national work. Some additional creativity and learning is going to be required to adjust the method that has been so successful in Kathmandu in a way that maintains its core principles. Two particular issues seem worthy of brief discussion.

First, the principle that evidence and technical arguments are brought in solely to help address problems that stakeholders in government wish to solve may be harder to apply in the selected municipalities than it has been at national level. The recently elected mayors and the centrally appointed administrators who are currently supporting them may not yet have clear priorities (and the politicians and administrators may have very different concerns). Policy concepts and practices that are well established in the federal context may be surrounded by an aura of prestige that makes them hard to resist at the local level, even if they do not correspond well to local priorities and implementation capacities. To the extent that this is the case, there will be pressures to revert to top-down, solution-driven remedies to the assumed concerns of municipal leaders.

A case in point is the approach to be taken in localising the national PPP guidelines. To date, EPI (and Accelerating Private and Public Investment in Infrastructure, or APPIIC, the other AiiN component that has an interest in this policy area) has turned to the PPP theme for sound reasons, seeing it as a logical implication of the municipal leaders’ expressed priority of undertaking public benefit investment projects that they cannot afford without co-funding. However, something



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to be watched is whether, in contexts such as the PPP workshop in Pokhara in February 2018, the real and possibly quite uncomplicated needs of the municipalities in mobilising a few quick wins remain the dominant factor. The potentially diversionary factor is the natural tendency of the legal and institutional specialists in this field, as in many others, to set the bar rather high, guided by general notions of sound practice.

### 5.3 Engaging with firms

A second challenge in applying the EPI method sub-nationally relates to the principle of maintaining a range of tactical options, including entry points and counterparts. EPI has been set up to relate to the principal actors in economic policy processes, including business associations and other elements of civil society but with quite a strong emphasis on the executive and legislative branches of government. This has provided an adequate range of options in rolling out the problem identification, brokering and coalition-building process that constitutes EPI's working method. Although the new municipal and provincial governments have executive, legislative and indeed judicial functions, the range of official players is expected to be smaller. Local civil societies, even including community organisations, may be expected to be less diverse, especially outside of major cities such as Pokhara. Individual companies and private businesses may be more significant than the local branches of private sector associations.

To keep alive the core of its variable tactics approach, therefore, EPI needs the ability to interact productively with firms and businesses as well as with politicians, officials and formal associations. This applies to the municipal investment projects and even more clearly to the work around SEZB and other activities in the Pokhara–Sunauli economic corridor, the success of which will hinge on the brokering of individual investment deals and agreements. EPI's current staffing reflects the interest in building a team that has both technical expertise and the ability to establish productive relationships with, and make wise judgements about, government stakeholders. An equivalent inside track and set of sensitivities, based on lengthy direct experience, is required for effective work with firms. With the move to sub-national work, EPI should be not only setting up and staffing local offices but also boosting its high-grade capabilities for facilitating multi-stakeholder agreements in ways that make good sense from business as well as public economics and public procurement perspectives.

If, as seems likely, there is scope to increase EPI's resource envelope significantly during the remaining years to 2020, this enhancement of its private sector

brokering capability should be a priority. In DFID, this should be accepted as a necessary implication of preserving and deepening what is special about EPI.

DFID should resist the normal tendency to put its support into distinct packages according to the nature of the country counterpart organisation. A widely observed practice in donor programming is to separate public sector and private sector interventions (as well as government-facing and civil society-facing ones), awarding the implementation contracts to different organisations, with the effect that they become separate silos of activity. There are welcome precedents for moving away from this practice when it comes to investment facilitation, including in DFID's overarching Economic Development Strategy (2017a) and in recent central initiatives, such as InvestAfrica (DFID, 2017b).

### 5.4 Following up EPI post-2020

As EPI reaches the middle of its scheduled term, the question naturally arises: what next? The question can be posed in several different ways, and it seems important to pose it in a way that makes realistic sense, given the agreed diagnosis of Nepal's development prospects and challenges. EPI is proving effective as a means of navigating the dysfunctions of the policy process in Nepal and achieving policy improvements, with potentially large impacts, despite those features. It is not designed to reform the way policy is made except in relation to specific, currently prioritised, outcomes.

This is realistic. The literature on improving public sector capabilities in countries at and even above Nepal's level of per capita income suggests these are very slow, cumulative processes (Fukuyama, 2014; Levy, 2014; Andrews et al., 2017). Seldom do they occur ahead of substantial improvements in the productive capabilities of leading economic sectors. The more common pattern, including in the history of the USA, is that public sector performance improvements lag several decades behind major economic breakthroughs. Studies of the political economy of Nepal do not give us any reasons for thinking that the country is going to be exceptional in this regard (see, notably, Roy and Khan, 2017).

The question, therefore, is not whether the follow-up to EPI should be seeking to 'institutionalise' problem-driven adaptive approaches to policy improvement. The effectiveness of the EPI method depends crucially on the fact that it brings to bear resources, and, in particular, capabilities for development entrepreneurship, that are *not* part of the government system or governed by its rules. The reasons why this contribution adds value arise directly from limitations of official processes that are not going to disappear any time soon.<sup>5</sup> Therefore, the

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<sup>5</sup> Just possibly, they may be mitigated by the demonstration effects of solving problems linked to potentially large, tangible outcomes, as suggested by Laric and Waddell (2016).



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pertinent question is not whether the country context after 2020 will be significantly different, so that a new and more ambitious approach can be contemplated, but whether there will continue to be plenty of economic policy gaps and blockages that are susceptible to EPI-style problem-solving. The answer to this is a clear yes, suggesting that DFID would be fully justified in investing UK resources in further efforts of the same type.

Any suggestion that this reasoning is insufficiently focused on ‘transformation’ should be rejected firmly. Nepal needs economic transformation – productivity-enhancing structural change and within-sector accumulation of productive capabilities. But, in the spirit of the discussion of Lin and Monga (2017) with which we began, this is most likely to be achieved *not* through

comprehensive policy or governance reform but through appropriate concentration of effort.

The most transformative results will be achieved by jump-starting employment-intensive manufacturing and successfully tackling the policy obstacles of most direct relevance to that aim, which is the EPI thinking. If a breakthrough into inclusive economic growth can be managed by triggering take-off in a few dynamic sectors, it will be possible to tackle the gradual transformation of other important areas of public life and human well-being on a much stronger basis in succeeding years. In Nepal, as in other parts of Asia (Studwell, 2013), economic and social change will bring new groups and classes into the political process, with new agendas and ambitions. The immediate task is to begin to make this happen.

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# 6 Transferable lessons

The right questions about what should come after EPI are most likely to be asked, and the wrong questions avoided, if EPI does a good job of explaining its methods and results to the international community of practice concerned with problem-driven adaptive methods. DFID has its own political drivers that frequently override technical preferences and compromise its ability to function as an effective learning organisation. However, decisions are not unaffected by trends in international thinking and discourse, and the current willingness to prepare Business Cases and Terms of Reference calling for flexible and adaptive working is a good example of this. So EPI should see as part of its role active promotion of what it thinks are the transferrable lessons from its experience.

What, then, are the principal lessons from EPI's initial experience to which interested observers in the wider development assistance business should pay attention? Two stand out as particularly important.

## 6.1 Going all the way on 'local leadership'

The first is that DFID programmes aiming to provide politically smart support to economic development should embrace the 'local leadership' principle wholeheartedly. Wherever possible, programmes should be led, both formally and substantively, by distinguished nationals with the right combinations of a reputation for impartiality, inside knowledge and technical competence.

The EPI experience shows how much more can be achieved under this type of leadership than by even highly skilled international appointees. It also shows that there is no necessary trade-off between a programme leader's aptitudes and capabilities for navigating the country political economy and his or her ability to respond well to DFID concerns. Palladium has shown how a well-staffed service provider can shoulder easily enough the documentation and monitoring tasks that might be underappreciated by a programme leader who, lacking background in the aid business, falls short of the traditional concept of a 'safe pair of hands'. No less important, perhaps, it has shown how it is possible to bring the service provider's clout and experience to bear on DFID when a less donor-savvy manager might give way to unreasonable demands.

This experience should encourage DFID advisers designing programmes and negotiating with service providers to make clear that they favour national programme leadership. It should encourage service providers to express this preference in their bids, and stand firm in any subsequent contract negotiations

against any reluctance to follow the local leadership principle in a full-blooded way.

## 6.2 A breakthrough on monitoring?

The second is the fundamental issue of performance monitoring and accountability. EPI has shown, probably for the very first time in a large programme, that it is possible to reconcile the demands of problem-driven adaptive working and those of results-oriented accountability.

The key ingredients here include thorough documentation in real time of the issue-selection processes, assumed ToCs and specific adjustments and adaptations that have been made in the pursuit of a range of outcomes. However, the most important breakthrough, given the international record to date on this matter, is in the design of the results framework.

As we have seen, the results framework is far from unconventional. It uses the logframe language of outcomes, outputs, activities, indicators and means of verification. It eschews a radically different format, such as the Search Frame advocated by the pioneers of PDIA at Harvard and the World Bank (Andrews et al., 2017). However, the requirements of a politically attuned problem-driven approach are accommodated by setting outcome-level performance indicators as numbers and percentages of contributions within a menu of issue areas. Learning and adaptation are accommodated and incentivised by recording numbers and percentages of outputs comprising the typical steps in applying the method to new and mature problem-solving projects. Reporting against these indicators, including work by M&E specialists to ensure they are measurable and able to be evidenced, meets the DFID preference for numerically based performance assessment. No less importantly, it allows the setting of targets or milestones that 'stretch' the implementers, prompting them not to rest on their laurels but to keep up a good pace of activity.

This basic approach seems widely applicable to large programmes funded by official bilateral donors. It does not need to be limited to economic development interventions. Palladium should be willing to share the details of the method as a public good, so it can be emulated in a well-informed and intelligent way by other providers in other countries and sectors. DFID Nepal should be congratulated for its part in showing how the long-standing tension between adaptive management and results-based accountability can be resolved. The importance of adequately resourcing this part of the service provider's role should not go unnoticed.

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