

IMPACT OF FOREIGN AID IN ECONOMIC DEVELOPMENT OF NEPAL

A Thesis

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in
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Submitted By

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LETTER OF RECOMMENDATION

This thesis entitled "**Impact of Foreign Aid in Economic Development of Nepal**" has been prepared by Mr. Krishna Prasad Baral under my supervision. I hereby recommend this thesis for approval by the thesis committee as a partial fulfillment of the requirements for the Degree of MASTER of ARTS in ECONOMICS.

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APPROVAL SHEET

We certify that the thesis entitled “Impact of Foreign Aid in Economic Development Of Nepal” submitted by Mr. Krishna Prasad Baral to department of Economics, Prithvi Narayan Campus, Pokhara, Faculty of Humanities and Social Sciences, Tribhuvan University, in partial fulfilment of the requirements for the degree of **MASTER OF ARTS in ECONOMICS** has been found satisfactory in the scope and quality. Therefore, we accept this thesis as a part of the said degree.

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ACKNOWLEDGEMENT

This work entitled "Impact of Foreign Aid in Economic Development of Nepal" has been prepared for the partial fulfillment of requirements for degree of M.A. in Economics. Due to the time limit, the study may not have been comprehensive but the attempts have been made to give an overall picture of role of foreign aid in economic development of Nepal. The use of secondary data, with sample statistical tools, has limited the analytical aspect of the study. However, it is expected that this study may provide some idea to the concerned people.

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I assume the full responsibility for any mistake and short comings in this thesis work.

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ABSTRACT

Nepal is one of the least developed countries of the world with very poor economic and social infrastructure for development. It suffers from a serious resource gap with low saving and low investment. In this situation, foreign aid is only way to fulfill this types of gap and to boost up the economy or to accelerate the development. The short answer of foreign aid is that it consists of explicit transfer of real resources to less developed countries on concessional terms.

Underdeveloped infrastructures, lack of good governance, adverse geographical structure, political instability, lack of proper education, and traditional farming low saving etc. are the major hurdles in the economic development of Nepal. The most serious of these constraints is the political constraint, i.e. lack of grassroots level of political institutions, lack of responsible government, and over-centralization of political and economic powers, heavy bureaucratization and lack of political priority to development works. This country is receiving foreign aid especially for the development of agriculture, industry, education, infrastructure etc. But the problem is that the foreign aid has not been fully and optimally utilized in these sectors which may be due to the inefficiency of administration, non availability of suitable contractors, resulting delays in the implementation of projects etc. Hence the major issues can be shown as; what is the role of foreign aid in Nepalese economy? Has the foreign aid been used in the desired sectors? What is the trend and pattern of foreign aid to Nepal? What is the impact of foreign aid on GDP, PCI, HDI and agricultural and non-agricultural sector?

Descriptive, analytical and explanatory research design is used to gain insight about the foreign aid situation in Nepal. It is based on facts and interpretations of formation gathered in relation to the problems under consideration. Secondly data are handled to reach on the conclusions. Time-series data are taken to analyze the trends of assistance as well as to compare some important statistical indicators. Data are taken from officially published materials like books, journals, reports, papers etc. Such materials include the publications of Ministry of finance, Central Bureau of Statistics,

World Bank, Nepal Rastra Bank, Nepal Planning Commissions and different websites....etc. To meet the objectives of effectiveness of foreign aid Nepal, the study covers thirty five years time span from FY1975/76 to FY 2009/2010. During the analysis of foreign aid and its contribution on Nepalese economy is shown through regression analysis has been

used. The study also focuses on foreign aid and its impact on GDP. Charts, diagrams and tables are drawn as per the requirements of the study. Data are presented in percentage when required. For Regression analysis, SPSS computer software program and MS Excel are used. The programs are also used for the calculation of different statistical tests as well.

In the beginning transportation, power and communication sector has the biggest recipient of foreign aid. This sector has received greater amount of loans than grants. Share of aid to agriculture, irrigation and forestry sector was quite high until 1980s after which it began to fall. Social service sector has also remained an important sector from the perspective of aid receipt. The increasing trend of aid into this sector is a reflection of donor priority. This sector is provided with the grant assistance only. IN FY2009/2010, out of the total disbursed aid of Rs.49769.4million, 6.2 % was distributed to agriculture, irrigation and forestry, 23.7 % to transport communication and power, 0.77 percent to industry and commerce, 66.35 % to social services and 3 % to others.

The empirical analysis shows that, the coefficient of foreign aid is positive (I.e. 12.626), which means, there is a positive relationship between GDP and foreign aid inflows. The model predicts that with 1 percent increment in foreign aid, GDP is increased by 12.626 percent. This indicates the important contribution of foreign aid in the Nepalese economy. The value of R^2 (adjusted coefficient) is 0.683, which implies that about 68.3 percent of variation in dependent variable (i.e. GDP) is explained by the independent variable (i.e. foreign aid). The value of R^2 ranges from 0 to 1. As the value of R^2 is 0.683 or 68.3% approaches to 1, the regression line thus estimated is good fit.

Similarly, the coefficient of foreign aid is positive to PCI, HDI and others dependent variables. The coefficient of foreign aid to PCI is very less (i.e. 0.006). This result shows that only increment on GDP doesn't increase the PCI significantly. To accelerate the PCI, foreign aid should be utilized very properly and effectively. In this study PCI is taken from World Bank reports which are less than our government data, this results the less coefficient of foreign aid. But the impact of foreign aid on HDI is accountable. The coefficient of foreign aid is positive (I.e. 4.16), which means, there is positive relationship between HDI and foreign aid inflow. The model predicts that one percent increment in foreign aid, HDI is increased by 4.16 percent. This indicates the important contribution of foreign aid in the Nepalese economy. The value of adjusted R^2 is 0.743, which implies that about 74.3 percent of variation in dependent variable (i.e. HDI) is explained by the independent variable (i.e. foreign aid). as the value of R^2 is 0.743 or 74.3 percent approaches to 1, the regression line thus estimated is good fit.

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ABBREVIATIONS

ADB	:	Asian Development Bank
BoP	:	Balance of Payments
CBS	:	Central Bureau of Statistics
CEDA	:	Centre for Economic Development and Administration
CEDECON	:	Central Department of Economics
CPN	:	Communist Party of Nepal
DAC	:	Development Assistance Committee
DFID	:	Department for International Development
FA	:	Foreign Aid
FAO	:	Food and Agriculture Organization
FDI	:	Foreign Direct Investment
FY	:	Fiscal Year
GDP	:	Gross Domestic Production
GDPAG	:	Gross Domestic Product of Agricultural Sector
GDPNAG	:	Gross Domestic Product of Non-agricultural Sector
GoN	:	Government of Nepal
HDI	:	Human Development Index
HMG	:	His Majesty's Government
IBRD	:	International Bank for Reconstruction and Development
IDA	:	International Development Association
ILO	:	International Labor Organization
IMF	:	International Monetary Fund
JICA	:	Japan International cooperation Agency
MoF	:	Ministry of Finance
NDF	:	Neighborhood Development Foundation
NPC	:	National Planning Commission
NRB	:	Nepal Rastra Bank
OECD	:	Organizations for Economic cooperation and Development
OPEC	:	Organization of the Petroleum Exporting Countries
PCI	:	Per Capita Income
SAARC	:	South Asian Association for Regional Co-operation

T. U.	:	Tribhuvan University
UK		United Kingdom
UNDP	:	United Nations Development Program
UNESCO	:	United Nations Educational, Scientific and Cultural Organization
UNICEF	:	United Nations Children's Fund
USA	:	United States of America
USAID	:	United States Agency for International Development
USSR	:	United Soviet Russia
WB	:	World Bank
WHO	:	World Health Organization
WTO	:	World Trade Organization
WWW	:	World Wide Web