

# **CHAPTER-I**

## **INTRODUCTION**

### **1.1 Background of the Study**

Situated in South Asia, Nepal is bordered by the Tibetan region of China in the North and by India in the East, West and South. Nepal is an independent landlocked country. Modern Nepal was consolidated in the last quarter of the 18<sup>th</sup> century by King Prithivi Narayan Shah, the great of Gorkha who conquered and unified a number of small principalities that flouted existence at that time. Nepal is one of the least developed countries in the world. In the process of development; the higher availability of resource is one of the major conditions. But the availability of resource in Nepal is very low as compared to other developed countries. The per-capita income of Nepalese people is very low which is around 716 US dollars (Economic survey, 2011/12) and the economic growth is not satisfactory. The economy is based on agriculture. With such a low per-capita income, a higher domestic savings cannot be expected. The low rate of income is due to low rate of productivity which creates low rate of capital formation.

For developing countries like Nepal, only the internal finance cannot meet the required investment for the targeted economic growth. Thus, the only way to meet the required target of the economic growth as well as to pull the economy out of the vicious circle of poverty is to resort to foreign aid. Not only in UDCs but also the developed countries had received external assistance in one form or the other for speeding up the pace of economic development.

In Nepal, the systematic development started with the first plan in 1955/56. Since then, foreign aid has been playing a crucial role in the process of development in Nepal. Foreign aid occupies significantly a large volume in the development expenditure of Nepal. More than often, two thirds of development expenditure is financed by foreign aid. The contribution of foreign aid in Tenth Plan is around 58 percent of development expenditure.

Foreign aid can be regarded as the aid given by comparatively advanced countries to the less developed countries. This term is used to refer to the transfer of capital and technologies from developed and advanced World to underdeveloped countries (Third World) either in the form of loan or in grant.

Foreign aid, which is also alternatively called “Economic aid” or “External economic assistance” or “Development assistance” is an ambiguous term. Some of its definitions, including that of the UN, view it narrowly to mean only “Outright grants” (in which case there is no direct economic compensation derived by the donor) and “Net long-term loans” for economic purpose; while some others take it in a much wider sense to embrace everything from grants and loans through short-term export credits to straight trading relations. To begin with, it is therefore important to clarify what is meant by “Foreign aid”.

The essence of foreign aid is that it consists of explicit transfer of resources financial and or technical from the donor to the recipient countries on concessionary terms. At this stage one should make a distinction between foreign aid and foreign resource. Foreign resources also include foreign private investment which may not be included in aid because the flow of private investment is normally based on commercial considerations of profit expectations, and there is no emphasis on ‘aid’ as such. On the other hand, foreign aid is a “Co-operation with a foreign state or autonomous political unit in furthering its economic growth and social progress. Foreign aid may, therefore, be defined as transfer of capital and know-how from one country to another, which is made on concessionary term such as in terms more favorable than those obtaining concurrently in the World capital markets. The transfer of resources which does not involve a certain degree of favorable terms than those available commercially does not ‘grant element’ and as such, a transfer like this can hardly be called aid. While loans contain only some elements of aid, grants of freely convertible currency constitute aid in the full sense of term. The aid component of a loan depends upon the span to the grace and amortization periods and the rate of interest. It varies directly with the length of the grace and the amortization period and inversely with the rate of interest.

Under the narrower definition, loans given by some international agencies may not be considered as aid because the repayment schedule is less than ten years and the rate of interest over 6 percent or so, as in the case of some World Bank loans. But loans from the WB are also taken as aid because individual recipients benefiting

from these loans may not be in a position to rise on their own similar sums on comparable terms from the World capital markets.

Foreign aid is normally associated with national governments and international organization. Although there are certain private institutions or organization which extends supports to needy countries, they do not assume a much significant share in the total flow of aid. This is truer in the case of Nepal. Foreign aid is, therefore, viewed as a concept which refers to flow of capital and technical resources either directly from the government of a donor country or through international channels to the government of a recipient country. It includes bilateral and multilateral grants, concession loans, and technical assistance.

Some experts have defined foreign aid as explicit transfer of real resources to the less developed countries on concessionaire terms in order to uplift the developing economy and the living standards of the poor. "Foreign aid is the international transfer of public funds in the form of loan or grant either directly by one government to another (Bilateral assistance) or indirectly through the vehicle of a multilateral like "IBRD" (Todaro, 1988).

Foreign aid consists of grants, loans, technical assistance, etc. and can be provided multilaterally as well as bilaterally. Bilateral aid is offered directly on the government-to-government basis. Aid through international agencies such as IBRD, IDA and OPEC etc. is called multilateral aid. Likewise, aid extended by non-government philanthropic organization or individuals is called private aid.

The objective of foreign aid is to promote long term growth and short term political and strategic interest of donor. The subject matter of the foreign aid is concerned with economic and social progress of the country. The purpose of aid to developing countries is to accelerate their economic development up to a point where a satisfactory rate of growth can be achieved on a self-sustaining base. The function of aid for a development program is not directly to raise standard of living in the recipient countries but to permit them to make a transition from economic stagnation to self sustaining economic growth.

After more than five decades of effort, the country is still entangled in its vicious circle of poverty and is unable to find the best way out. In the one side, more than 30 percent population lives in miserable state of poverty and their income is one of the lowest in the World. On the other side, Nepal faces severe problems of deficiency in resources mobilization due to low saving and high consumption ratio.

Above all there is serious resource gap problem in Nepal. Therefore, fiscal deficit is growing every year. So in this context huge amount of foreign aid in the form of capital as well as financial and technical assistance is needed to solve these problems.

There is correlation between foreign aid and economic development. Indeed, income, saving and investment of the developing countries are very low. No country can achieve steady growth without increasing the rate of these crucial factors. Many academics, policy makers and intelligent sections feel that there is no escape from foreign aid for an underdeveloped country which suffers from a chronic shortage of sources, if it wants to achieve a significant level of development. Thus the straight forward justification is granting aid for the promotion of economic development in the recipient countries.

Many economists think that foreign aid can play a vital role in breaking the vicious circle of poverty that operates in underdeveloped countries. There is great urge among the people of underdeveloped countries to break this vicious circle and to accelerate the role of economic growth, however, this requires high rate of investment. But being poor their own savings are too low to permit them to undertake sufficiently high rate of investment required to get the economy out of low-level equilibrium. Thus, there exists a saving gap, which shows inability of an underdeveloped country to raise its saving rate to the level of required investment so that target rate of economic growth is reached and low-level of equilibrium is overcome. The foreign assistance can play a crucial role by supplementing the domestic savings and thereby ensure the desired rate of investment. Without foreign aid the rate of investment and domestic saving, it will be lower and therefore, it may not be possible for underdeveloped economy to get rid of low-level equilibrium. Thus without foreign aid the growth rate will be lower and the economy may remain caught up in the vicious circle of poverty. It therefore, follows that for achieving high growth rate and stability in prices, foreign aid can play a useful role in raising the rate of investment by filling the saving gap.

So the requirement of foreign aid seems to be even more acute in our economy. That is the reason; foreign aid plays a significant role for economic development of Nepal. But, foreign aid should be used properly. Nepal needs foreign aid for the utilization and mobilization of economic resources because Nepal is rich in natural resources whereas poor in capital to utilize them. Nepal has to be benefited from aid in various sectors such as education, health, agriculture, rural development,

transport, public administration and financing, technical support for industrial development.

## **1.2 Statement of the Problem**

Most of the developing countries in the world have been getting aid either from developed countries or from international organizations in the initial stage of development. In these countries, including Nepal is moving around the ‘vicious circle of poverty.’ To break this type of circles, domestic source of capital is not enough. Therefore, this country needs to raise the income level, require infrastructure development, and increase the employment level. All this require huge amount of capital as well as technical investment. At this stage of development, foreign aid is the one of the major way for every country to fulfill the essential requirement of each and sector.

Most of the specialists say that foreign aid has been playing crucial role for the economic progress of Nepal. In the study about foreign aid inflow in Nepal, there seems to be a controversy that on one hand, the disbursement of the foreign aid has been increasing steadily resulting and increasing in expenditure, but on the other hand, Nepal has been facing a problem of under spending. There in also the problem of huge gap between foreign aid commitment and disbursement. The amount of foreign aid has increased in each and every year, but it has not brought the satisfactory change in the Nepalese economic growth. This may be due to inefficiency of administration, non-availability of suitable contractors, and resulting delays in the implementation of donor countries. In this context foreign aid in Nepal is used in the different sectors of the economy for infrastructure development and construction of various projects. But sometimes the donors are using aid in their own interest rather than representing the interest of Nepal and Nepalese people. Similarly, donors often lobby to appoint incompetent experts to work in developing countries as experts.

Being a least developed country, Nepal is getting aid from different countries and organizations in the form of bilateral as well as multilateral assistance. The composition of foreign aid has been heavily in favor of grant but later on since 1961/62 foreign loans started to enter the national economy. There is fluctuating trend in the proportion of loans to the total aid, but it is on an increasing trend. The data shows that Nepal has the highest degree of foreign aid as a percentage of government

expenditure. Every year more than 40 percent of total government expenditure is financed by foreign aid in Nepal. Main problem of the study is to understand the role played by foreign aid in economic development of Nepal. In this context specific issues can be raised in following questions:

- What is the trend and pattern of foreign aid?
- What is the difference between foreign aid commitment and disbursement?
- What is the sectoral allocation of foreign aid?
- What is the impact of foreign aid on GDP?

### **1.3 Objective of the Study**

The specific objectives are as follows:

- (i) To analyze the trend and structure of the foreign aid inflow in Nepal.
- (ii) To present the differences between foreign aid commitment and disbursement.
- (iii) to express the sectoral allocation of foreign aid.
- (iv) To find out the role of foreign aid on GDP.

### **1.4 Importance of the Study**

Foreign aid has significant role in the development of different sectors of the economy. Nepal has been receiving aid in terms of grant, loan, technical aid, training service, scholar etc. For financial resource deficient country the rapid economic growth and achievement of required growth rate is difficult without foreign assistance. Foreign aid plays a vital role in economic development, but it has not been fully utilized.

The study of foreign aid provides the idea about aid, being provided by foreign countries for various development works and infrastructure building. This study may help for the researcher, planners and others to decide whether to bring in more aid or reduce dependences of it. The study is also focused on impact of foreign aid in GDP. Similarly the study of foreign aid provides a clear cut vision about aid pattern and utilization of received aids by least developed country like Nepal, which further may provide guidelines to correct weaknesses made previously in this respect. Such studies provide knowledge of other required information to people or authorities who are interested in the study foreign aid situation and its impact on economic development

of Nepal. Similarly this study will help to understand the sectoral impact of foreign aid.

## **1.5 Limitations of the study**

- 1 The analysis is made on the basis of availability of the data
- 2 The data only covers the 1975/76 to 2009/10 in the study.
- 3 This study does not cover the political as well as military aid.
- 4 The study is conducted within limited time frame and financial limitation.
- 5 The study uses secondary data only.
- 6 The assistance from foreign private investors is excluded.

## **1.6 Organization of the Study**

This study has been organized and divided into five chapters. The first chapter is related to introduction. This introduction chapter has been included the background of the study, statement of the problem, objectives of the study, needs and significance of the study, limitation of the study and organization of the study. Second chapter is related to the review of literature. This chapter has covered the theoretical framework and related studies. Related study has further divided into two parts international context and Nepalese context. Chapter three deals with research methodology. It includes the methodology, nature and sources of data, data presentation, data analysis, statistical tools for analysis and statistical test of significance. The fourth chapter concern with presentation and analysis of the data. It includes trend and structure of foreign aid, sources of foreign aid, sectoral allocation of foreign aid, share of foreign aid in GDP and government expenditure and empirical analysis of impact of foreign aid. The last chapter covers the summary conclusion and recommendation.

## **CHAPTER -II**

### **REVIEW OF LITERATURE**

The concept of foreign aid is not a recent phenomenon. In general, the declared objectives have evolved over the years and include support for economic growth, poverty alleviation, and human development, to underwriting economic reform programs and strengthening democracy, good governance, and human rights.

Foreign aid originated from the disruption of the world economy that followed World War Second. Before the system of international trade and capital movements could be restored, the economics of the industrial countries had to be rebuilt and their ties with former colonies replaced by multilateral arrangements. Until these structural changes could be brought about, much of the World depended on the United States for essential imports. Many writers wrote different kinds of book, booklets, journals and article about foreign aid. They also tried to show the role of foreign aid.

Rosienstein-Rodan (1957) argued “The purpose of an international program of aid to underdeveloped countries is to accelerate their economic development up to a point where a satisfactory rate of growth can be achieved on self sustaining basis.” He also includes technical assistance as part of aid, although it is not a normal capital inflow, because it is a form of transfer of skills, which can result in economic growth.

United Nations in 1960, when it launched first development Decade, defined foreign assistance as “All transactions (for a country or an international organization), which result in permanent net addition to total resources available for economic development of another country.” According to the United Nations, aid consists only of outright grants and net long term lending for non-military purposes by government and international organization. In international affairs, in principle and practice, aid has been accepted as part of the responsibility of the international community.

As more and more prosperous countries got involved in offering aid to developing and less developed countries, they realized the need for:

- (a) Estimating the required aid flows,
- (b) the sharing of the burden or cost, and
- (c) Evaluating the impact of aid on the recipient’s development.



Organization for Economic Development (OECD) defined aid as “Net financial flows to the less developed countries and multilateral organizations.” The net financial flow was also categorized as official and private flows. The transactions included in the financial resources flows were: bilateral grants, bilateral loans repayable in the recipients’ currencies, transfer of resources through sales for recipients’ currencies, bilateral loan with a maturity of more than one year, grants and capital subscription payments to international organizations and agencies for development purposes, and official net purchases of the obligations (with maturity of more than one year) or international institutions.

Once again plunging into the general definition an extract from B.C. Upreti (1988) in “Dynamics of foreign aid” stating Milton Friedman expressed that foreign aid consists of grants or loans from one government to another government for economic development. Then after, he added himself that foreign aid consists of with or without concession rates of interest.

## **2.1 Impact of Foreign Aid**

Rosenstein Rodan (1957), in his book “Notes on the theory of big push” speaks about the external supply of capital. According to him, in view of saving gap, foreign aid assumes much importance as means to break the vicious circle of poverty and to accelerate the pace of growth.

In the words of Rosenstein Rodan (1961), “The purpose of an international program of aid to underdeveloped countries is to accelerate their economic development up to a point where a satisfactory rate of the growth can be achieved on a self-sustaining basis.” For this purpose, he defined aid as, “Those parts of capital inflow which normal market incentives do not provide.” His list of resources transfers that can be defined as foreign aid consists of “Long-term loans repayable in foreign currency.....grants and soft loans, including loans repayable in local currency.....sale of surplus product for local currency payments and technical assistance as a part of aid, although it is not a normal capital inflow, because he considers it to be form of transfer of skills, which helps in economic growth.”

Lord Bauer, one of the main advocates of the negative impact of aid, argued that the consequences of aid in suppressing the fundamental laws of the market efficiency through state intervention in the economy because “It often served to underwrite and prolonged extremely damaging policies commonly pursued in the

name of comprehensive planning.” He further argued, “Foreign aid is plainly neither a general necessity nor a sufficient condition for emergence from poverty.” According to him, what is necessary for development is the presence of conditions for development other than capital and if these are present capital becomes automatically available. He also believed that foreign aid permits concentration of power in a recipient country by promoting state power, corruption and inequality.

Another early explication of foreign aid is provided by Hollis Chenery, who defines foreign aid as an instrument of bridging various gaps and relieving various bottlenecks existing in and underdeveloped economy. For a country to develop on its own it would require “skills, domestic saving and export earnings as well as an allocation of those rising levels of income” which would be almost impossible for a developing country to achieve; the role of foreign aid would be to provide capital and other resources to fill these shortcomings.

Chenery, with co-authors Burno (1962), MacEwan (1966), and Strout (1966) has formalized the “Two-gap” model. Here, two of the gaps that foreign aid expected to fill the saving-investment gap and the foreign exchange gap. Centralized planning and a fixed exchange rate regime seen to be the implicit assumptions behind this concept, for this model, as devised by the authors, presumes on omnipotent inter-temporal decision-maker, and assumes away any complications that fluctuations in export and import prices (Which might affect saving and, thus investment, in a country) could bring about as a result of floating exchange rate for the domestic currency.

The “Two-gap” model is familiar equation derived from national income identity.

$$Y = C + I + G + X - M$$

Here,

Y = National output/Gross Domestic Product (GDP)

C = Consumption within the Economy

I = Investment

G = Government expenditure (Which is exogenous to the consumption decision made by citizen.

X = Exports

M = Imports.

Saving in this economy is the excess of production over consumption, both by private citizens and the government, algebraically this would be:

$$S = Y - (C + G)$$

Plugging this equation the national accounts identity gives:

$$S = I + X - M$$

Rearranging this equation gives the required results:

$$I - S = M - X$$

This equation states that the excess of imports over exports should balance the excess of investment over savings.

The left hand side of the equation is saving-investment gap; it is the gap that exists between the investment that is thought to be required for the development of country and the development of country and the saving that has been generated within the country, when saving falls short of the amount needed for investment, the planned growth target cannot be achieved, this short fall is the gap that foreign aid intends to fill.

Giffen and Enos (1970) argue that aid is motivated more by political considerations rather than the development of the recipient country and hence its utility in improving the economic conditions of a poor country is rather lower. They explain that the inflow of foreign capital may reduce domestic saving in various ways. First, the government may rely on it as a substitute for domestic saving and relax its efforts to raise taxes or force certain institutional changes for rising domestic saving. Secondly, the government may expand its consumption expenditure by raising the salary of its employees, or increasing the size of army, or the number of civil servants, or constructing bungalows and purchasing automobiles for high ranking officials, and so on. Thirdly, foreign aid may lower private domestic savings by being accessible on easy terms through development banks and other institutions.

## **2.2 Foreign Aid According to Nepalese Writers**

S.R. Poudyal (1982) states that, foreign aid appears to have played a laudable role in as much as it has inspired successive government in Nepal to demonstrate their commitment to development. Even if the desire to the people in Nepal for better living standard was a product of endogenous stimuli, everything else forms the objectives of development to be influenced by foreign aid. Channeling to funds was

not significant until the beginning of Nepal's first five-year plan in 1956. Since, then foreign aid from various sources has been meeting a large proportion of the cost of Nepal's development program.

S.R. Poudyal, "Foreign Aid" (1988) also points out; the increasing role of foreign aid in Nepal is revalued ever more clearly by the consistent rise in per capita aid and the ratio of aid to GDP. It is not only that the aid-GDP ratio has been increasing in Nepal, but also it has been quite high compared to other countries of the south-Asian region.

Bama Dev Sigdel (1985) in his dissertation "A Study on Foreign Aid in Nepal" points out that under capitalization due the low income of the people is the main hindrance for financing the development activities in less developed economy. They have fiscal resource gap problem. The gap between expenditure and revenue collected, always remain in the public finance. Resource gap can be defined simply or the difference between expenditure and revenue of the government finance or excess expenditure over revenue reflects generally the resource gap.

Expenditure is more than revenue collected due to the poor revenue source on one hand and increasing inflation and population growth on the other even to maintain the same speed of economic growth, in such countries. The less developed countries are suffering from the availability of capital, technical know-how, institutions conducive to growth necessary infrastructure and incentive to capital investment.

Actually economic growth is a direct function of the rate of capital formation. But capital formation itself depends upon the domestic saving. The developing country like Nepal has little portion contribution of domestic saving to capital formation for the development process. Insufficient domestic saving has created the resource gap problem in our country.

He further points out that as we mentioned earlier, foreign aid may be the form of technical co-operation, commodity assistance, local currency payment, long term soft loans at a low rate of interest. That is why it is sometimes remarked that foreign aid might be the golden bridge for a poverty-ridden country like ours rejoining the vital gap between expenditure and revenue, more strictly despair and hope.

Govind Ram Agrawal (2039) in his book "Current Issues in Nepalese Development," has written that somewhat different approach to the discussion of foreign aid than the patterns seen in the other sessions. All of us are found of throwing number growth rates, percentages, changes ratios etc. He would like to examine why

we have developed such a dependency on foreign aid and look at the tangible and intangible effects of foreign aid. He said that there was no any sector free from the foreign aid influences.

In his sub-heading “development preference” point out that poverty exists because of the prevalent socio-economic structure of the society. Some-how the other there has been a tendency to maintain the present structure and the sustenance of the present social structure has resulted in nothing expect feeding the poverty and in enriching the well to do.

He has also explained the importance of foreign aid. According to him there has been big concern with donor and recipient both countries about the effectiveness of foreign aid. It has been realized that the foreign aid has been very ineffective in delivering the expected outputs. As a whole this study is descriptive in nature and no any mathematical tools are used.

Rabindra K. Shakaya (2059) in his study “Foreign Aid Management in Nepal,” states that the external assistance has played a significant role in the development of various institutions have continued to live up to their expectations. It is relatively easier to create and institution but extremely difficult to keep it effective, efficient and responsive to the needs of the country. Still more difficult is to inculcate an appropriate institutional culture in people among its staff and clientele. The creation of newer institutions, councils, committees etc. alone without effective arrangement for co-ordination with other like agencies in policy and programs formulation and implementation without sufficient resources allocated to then does little to assure effective utilization of external assistance.

He also says that Nepal’s intention has been to achieve self-reliance with regard to the financing of its investment needs for development while Nepal’s dependence on foreign assistance will continue to meet her requirements for the transfer of technology, for institution building, for financing trade and fiscal imbalances her ability to improve aid utilization will depend on her ability to address to structural, administrative and institutional, constraints inhabiting such utilization. Hence, it is evident, that for the increased level of aid utilization in years to come there will be a need for a great deal of domestic efforts duly supported by those of donor communities. More aid is necessary for effective aid, and effective aid is necessary for economic growth, poverty reduction and sustainable development.

Nepal hence has to seriously consider making the effective use of foreign resources in order to attract on increasing amount of external resources.

He claims that aid works in good policy and that aid cannot buy good policy. Consequently, if there is no internal environment with the country to set and own the right policy environment, aid cannot remain effective. Nepal needs budget support to face resources crunch not only to maintain ongoing priority programs but also to make resources available for building developments and for providing other essential facilities required for people.

In order to deriving maximum advantage from the foreign aid policy, it is necessary that the policy be implemented effectively, that aid is made a more effective tool for poverty reduction in the context of the overarching objectives of the tenth plan, that wasteful and ineffective implementation of development programs is eliminated or reduced; that trust and co-operation between donors, government and society is built; and that national ownership of development strategies, priorities and programs is ensured.

Narayan Khadka (1991) has written that the inflow of foreign aid in Nepal coincided with three major development paths within and outside the country. First, the emergence of development theory as a distinct branch of economics in the late forties and its emphasis on capital-oriented growth models which means the then less developed countries desirous of developing their economy should invest in capital-intensive projects. The second factor is political, i.e. the political change in the two neighboring countries, India and China, which adopted two diametrically opposite systems and orientations in their external relations. The strategic geographical location, which also puts Nepal in a sandwiched position between these countries, made it a ground for their aid competition. The third factor is the political change within Nepal in the early fifties; the overthrow of the family oligarchies role in Nepal and its awakening for modernization and development accompanied by the unfolding of all these new forces.

G.P. Subedi (1982) in his dissertation, "Role of America aid in the Developing Process of Nepal," has tried to explain the role of foreign assistance in different plan project in one hand. On the other hand, he has shown the decreasing trend of US aid in different plan period. In the first plan, its rate is 58.88 percent out of total foreign aid, in the second 45.57 percent, in the third 22.55 percent, in the fourth 14.3 percent

and the fifth plan is down to 10.94 percent. Then it gradually decreases and flow minimum amount of Nepal, through US aid from the out of foreign aid.

He again express that, US is the first country to co-operate in Nepal in the beginning of the plan period. In conclusion, he says that foreign aid provides assistance to promote the economic development of Nepal. But it has not effected in desirable level of the economic development.

K.K. Guruharana in his paper “Development Cooperation” remarks that external assistance for over 40 years has not appreciably succeeded in alleviating poverty, improving human development situation and fostering overall growth. He states that there is insufficient amount of aid relative to the requirements. The ad-hoc nature and changing priorities of aid on the one hand, and the weak institutional and managerial capacity, inappropriate macroeconomic and sectoral policies, and lack of proper planning and commitment in government in government side on the other hand, made the amount of foreign assistance insufficient. Nepal has not yet received the quantum of aid comparable to those of Korea or Taiwan or Europe under the Marshall plan. It is like giving a medicine far below the prescribed dose. The effect not only prolongs the disease, but also eventually increases its severity.

Y.P Pant in his book, Problems of Smaller Countries; “A Study in Problems and Prospects of Development Process” says that the external assistance available to the least developed and smaller countries can be discussed under the headings of foreign aid in the form of grants, loans and technical assistance. According to him, shortage will be supported by foreign aid at least in the initial stage of development plans. He further says that rapid formation of capital for accelerating the growth of LDCs cannot possible without foreign aid, even if domestic resources are mobilized to the optimum level.

Harka Gurung (1984), in his paper “Economic Implication of Foreign Aid” says that foreign assistance to developing countries is related less with economic consideration but more with strategic political implication. Economic development continues to be externally oriented and most of foreign agencies have had rely on its own infrastructure before planning into aid programs. The poor domestic saving rate and resources to finance the development expenditure required the external assistance. Thus there is excess reliance in meeting government expenditure.

Meena Acharya (1992) has pointed out that, basically, aid has been used to substitute domestic savings. Instead of complementing domestic savings it has

probably replaced domestic savings altogether. This is a very alarming sign given at the current investment requirements of the country. At the same time, if we look at the external debt ratio, the figure itself, in an absolute way, is not very alarming. In that respect, Nepal is probably weakest amongst all the different South Asian countries. The capacity to repay is governed by the exporting capacity. It is the more serious problem.

Rambhakta P.B. Thakur (1994) describes that receiving foreign aid is not difficult for Nepal either because of its political relations or geo-political situation or higher economic potentiality in selected sectors like hydroelectric, cement etc. But efficiency of management and proper utilization of foreign aid are much more important problems for Nepal. The rooted concept of “Free Lunch Aid” has to be wiped out. Honest execution of politics and projects as equally significant in this direction. He points out that the problem of foreign aid in Nepal in two fields:

- i) How to mobilize required the quantum of assistance from those multiple sources which are most favorable to the interests of the nation, and
- ii) How to use the resources obtained through different channels of supply in the process of economic development so as to achieve a higher rate of growth. Though such problems are almost common to a developing economy, the position of Nepal needs a separate treatment. It is pleasing to note that the political administration and the economic system of Nepal have appreciated the necessity of development as a measure of improved living conditions to the people. But effectiveness of utilization of resources and economy of financial administration do need a different form of discipline in country. This form of discipline can only be a joint effort of the government and the people.

### **2.3 Research Gap**

There has been conducted several studies on foreign aid in Nepal. Most of these studies are analyzing particular country's aid to Nepal and its impact on national economy. They are analyzing the impact of foreign aid and GDP only. This study will try to explore the impact of foreign aid on Per Capita Income (PCI) and Human Development Index (HDI) of Nepal. Similarly, this study analyzes the total aid's pattern to Nepal.



## **CHAPTER – III**

### **Research Methodology**

#### **3.1 Data Collection**

The study is based on the secondary data and information. The data are collected from different sources, such as Central Bureau of Statistics (CBS); Nepal Rastra Bank (NRB); National Planning Commission (NPC); Ministry of Finance (MOF) etc. Besides these, information has been also collected from various Articles, Journals, Magazines and Newspapers.

#### **3.2 Research Design**

This research is designed to assess the increasing volume of foreign aid inflow and GDP growth in Nepal. It has tried to focus on trend, needs, impact and role of foreign aid in Nepal. Most of the data has been taken from already produced data in various publications. The descriptive research design is used for the study.

#### **3.3 Data Processing and Analysis**

After collecting the data from different sources, these are arranged in systematic way and tabulated according to the need of research content. The tables, graphs etc. are used according to situation and requirement of the study. In the analysis period, the available data which are reported in foreign currency have been converted into Nepalese currency. Data are presented in percentage when required. The collected data have been analyzed by different descriptive statistical and mathematical methods. For regression analysis, 'SPSS' computer software program has been used. The program is also used for the calculation of different statistical tests as well.

#### **3.4 Statistical Tools for Analysis**

In order to make an empirical analysis simple regression models in log-linear forms have been used.

##### **a) Regression Analysis**

Regression analysis is used to establish the nature of relationship between dependent variable and one or more independent variable. Regressions are the estimation of unknown values or prediction one variable from known values of other variables. The regression of Y on X is used to estimate the value of the dependent variable Y for any given value of independent variable and vice versa.

$$\text{GDP} = a + b\text{FA} \quad (\text{i})$$

$$\text{PCI} = a + b\text{FA} \quad (\text{ii})$$

$$\text{HDI} = a + b\text{FA} \quad (\text{iii})$$

Where,

GDP = Computed value of Gross Domestic Product, i.e. GDP (dependent variable)

FA = Computed value of Foreign Aid, (independent)

PCI = Computed value of Per Capita Income (dependent variable) HDI = Computed value of Human Development Index (dependent variable)

a = autonomous increase in dependent variables

b = Slope of independent variable i.e. Foreign Aid

**b) Log Linear Model**

Log linear model depicts the relationship between dependent and independent variable in the logarithmic form.

Log linear form of equation (i) is

$$\text{Log GDP} = a_0 + b_0 \log \text{FA}$$

Log linear form of equation (ii) is

$$\text{Log PCI} = a_0 + b_0 \log \text{FA}$$

Log linear form of equation (iii) is

$$\text{Log HDI} = a_0 + b_0 \log \text{FA}$$

Where,

Log = Natural logarithm

$a_0$  &  $b_0$  = Regression parameters

## CHAPTER -IV

### PRESENTATION AND ANALYSIS OF THE DATA

Nepal and the United States completed the establishment of formal diplomatic relations for the first time on October 29, 1952. Meantime, Chester Bowels, American Ambassador to both India and Nepal, made his official visit to Nepal in February 1953 for exploratory talks concerning United States aid to Nepal. Nepal received a grant of \$ 320,000 from the Technical Aid Administration from July 1, 1952 to 30<sup>th</sup> June, 1953. This fund was used to implement the first five year plan. Nepal's relationship with United States has been largely in terms of economic aid. The US aid for the fiscal 1954 was \$ 1,097,000. In fiscal year 1955 aid amounted to \$ 2, 447,000 out of which \$ 920,000 was used to organize 1,050 primary schools and to open a training institution for teachers. Others areas of aid expenditure have been in village improvement, agricultural development, and mineral exploration.

India for the first time offered her aid in the construction of small Gaucharan Airport (now Tribhuvan International Airport). This program was taken up in 1951 in Kathmandu to make air link between Kathmandu and Patna of India. Since then, India has been providing aid i, e. grant and technical assistance for the economic development of Nepal. There is no loan element in the composition of Indian aid so far. Road, airport, irrigation, power, drinking water supply, agriculture and horticulture education and health, industrialization and communication are the areas benefited by the Indian aid.

After the first five years of aid story, the plot changed and Nepal, slowly, started to become pawn of the power aid. In October 1956, it was reported that Nepal would receive economic assistance worth 60 million rupees from communist country china; one third of the aid would be a direct money grant and the rest consisted of capital goods. It was alleged by Indian sources that Nepal's premier Tanka Prasad Acharya was playing India against china to gain advantage from both the countries. King Mahendra, while visiting Moscow in June 1958 agreed on an aid plan from the U.S.S.R. In May 1958, Nepal and the United States was signed an agreement covering ten major projects intended to raise Nepal's standard of living whereby the united

states agreed to contribute \$ 7,880,400 plus \$ 364,000 worth of material. The areas concerned on agriculture public works, construction of industrial development, creation of suspension bridges, village development centers, an anti-illiteracy campaign, a teacher training program, public health services and measures for the control of insect-borne diseases. The American Ambassador to India and Nepal, Ellsworth Bunker, announced that the US would give Nepal \$ 4,125,000 in aid during the fiscal year 1958.

It was noteworthy that political friction did not halt the flow of aid and experts into Nepal. About 83% (1962) of Nepal's development funds still come from abroad. The United States was, as usual, the largest contributor; India was second, followed by china, the Soviet Union and Great Britain.

Japan, one of the main contributors of Nepal, paid attention to Nepal's development only after the late 1970s. The story of Japanese aid begins when king Birendra paid a state visit to Japan in May 1978. Japan granted Nepal \$ 10.3 million in aid to be used for food production and the purchase of industrial and medical equipment.

The signing of Mahakali treaty in January was a major landmark in Indo-Nepal relations, providing for the joint exploitation of the water resources of the Mahakali River, including the Janakpur dam, and the construction of a giant hydroelectric power plant. Some measures were also taken to improve economic cooperation between the two countries. Foreign aid donors to Nepal pledged substantial new commitments and in April, the Nepal aid group promised development assistance totaling \$ 993 million for the period of 1996 – 1997.

There were only two donor countries (US and India) during the late 1950s, and early 1960s. Nepal got many opportunities to get aid from U. S. S. R., UK, China, France, Germany, Canada, etc. Nepal amalgamated the Colombo plan in 1952 and gradually attracted the interest of other countries in her economic development efforts. Besides the Colombo plan, Peoples Republic of China has been utilized mainly to build up infrastructure. Soviet Union joined the growing numbers of donors in 1959 as well. In addition to these major donors there are more than twenty other countries providing considerable amount of aid to Nepal also. There are many international agencies or institutions as World Bank, IMF, UNICEF, UNDP, etc. are providing aid through various sources in Nepal.

#### 4.1. Trend and Magnitude of Foreign Aid in Nepal

Nepal began receiving foreign aid since 1951, and the volume of inflow has increased steadily after 1960. The important factors responsible for the remarkable increase in the aid receipts of Nepal seem to be mainly three causes, which are, firstly, Nepal's expanding international relations increased and diversified the source of aid, secondly, the introduction of development plan helped it to rationalized the demand for aids, thirdly, the bonus effect of the cold war and feeling of the competition among some donors pushed up the level of aid. The following table shows the increasing trend of foreign aid in Nepal.

**Table no. 4.1**

Aid Inflow in Nepal (1960 – 2010)

(Rs .in million)

Year	Total Aid Inflow	Percent Increment
1961-1970	1640.8	-
1971-1980	5549.8	238.2374
1981-1990	34263.6	517.3844
1991-2000	125323.5	265.7628
2001-2010	252960.7	101.8462
<b>Total</b>	<b>422404.4</b>	

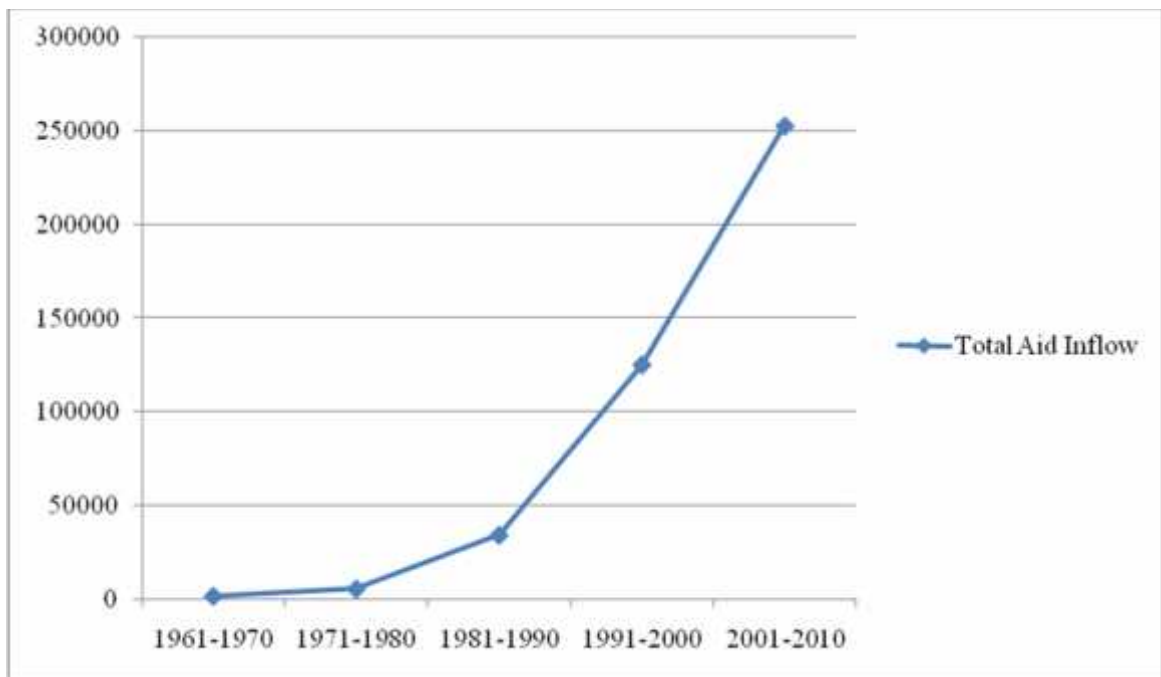
Source: Economic Surveys of Nepal (Various Issues)

The above table and below graph clearly displays the increasing trend of foreign aid in Nepal. The amount of foreign aid that the country received during a 1960s decade from year 1961 A D to year 1970 A D was only Rs. 1640.8 million. According to table in the 1970s decade foreign aid has received by Nepal Rs. 8215.8 million. In the period 2000 to 2010, the foreign aid to Nepal is Rs. 252960.7 million. Every decade, aid inflow of Nepal is increase rapidly may be the globalization and liberalization, increasing of the Nepal's expanding international relations, the introduction of development plan which help to rationalize the demand of aid.

**Fig. 4.1**

Aid Inflow in Nepal (1960-2010)

Rs. In Million



#### 4.2. Components of Foreign Aid (Grants Vs. Loan)

With an increase in magnitude, the structure and composition of foreign aid had also changed over time. Present trend in sources (bilateral versus multilateral), components (grants versus loans) and sectoral disbursement of aid coming to Nepal are presented below.

Aid element consists both the loan and grant component. 100% aid was in the form of grant during the initial periods. Loan element crept in only from the year 1963/64 which considered 9.7 percent of the total aid.

**Table No. 4.2**  
**Aid Inflow in Nepal: Grants vs. Loans (1960-2010)**

(Rs. In million)

<b>Year</b>	<b>Grants</b>	<b>Loans</b>	<b>% of Grants</b>	<b>% of Loans</b>	<b>Total Aid</b>
1961-1970	1595.3	45.5	97.2	2.8	1640.8
1971-1980	3622.1	1927.7	65.3	34.7	5549.8
1981-1990	12211.4	22598	35.6	66.0	34263.6
1991-2000	39035.3	86293.6	31.1	68.9	125323.5
2001-2010	165341.8	89624.1	65.4	35.4	252960.7
<b>Total</b>	<b>221805.9</b>	<b>200488.9</b>	<b>52.5</b>	<b>47.5</b>	<b>422404.4</b>

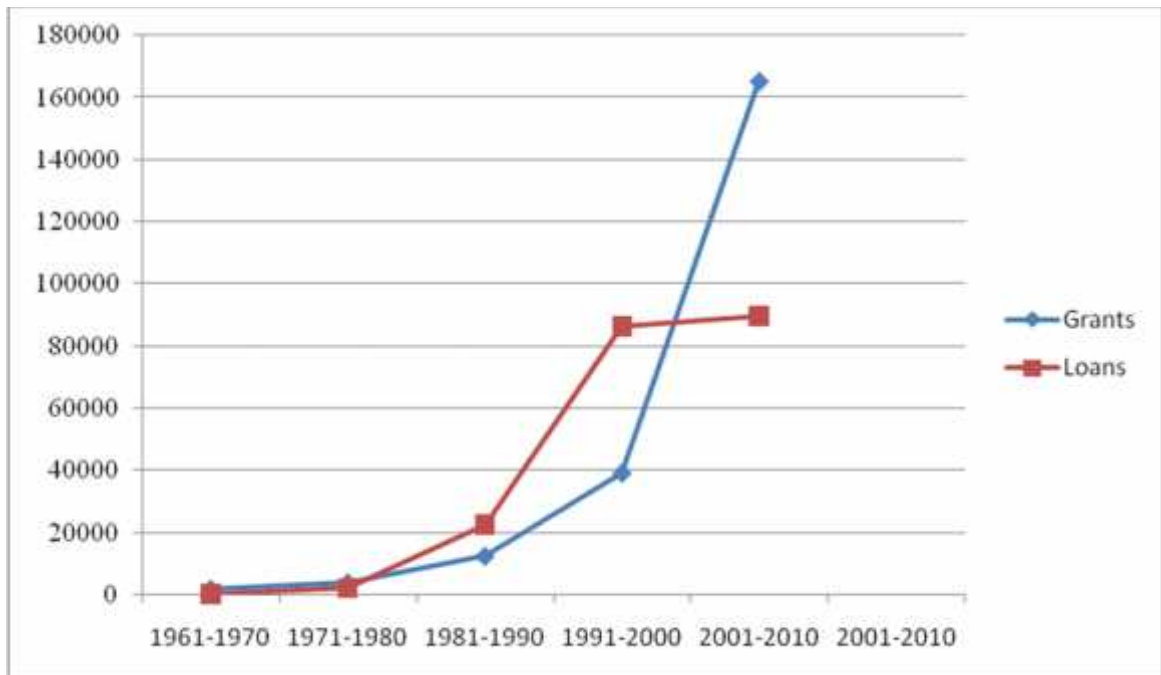
Source: Economic Surveys (Various Issues)

In this table the share of grant aid is declining while the loan aid is increasing. During the period 1960s, grant and loan occupied 97.2% and 2.8% of total foreign aid to Nepal respectively. This share comes to be 65.3% and 34.7% during 1970s. Similarly, foreign grant and loan occupied 31.1% and 68.9% respectively of the total foreign aid in the year 1990s. The main cause of decreasing grant and increasing loans will be the causes of political instability, process of re-saturation of democracy. But the situation changed after 1980s. Due to emergence of new and bigger international lenders (especially IDA and ADB), providing bigger and bigger loan package, the share of grants began to fall. After the 1990s the share of loan in total aid was rapidly increasing.

**Fig.: 4.2**

Aid Inflow in Nepal: Grants versus Loans (1960- 2010)

Rs in million



This is because of the Comprehensive Peace Agreement bilaterally was signed by Communist Party of Nepal (Maoist) and Nepal government in this period. This trend clearly depicts that the government is unable to utilize the committed amount of grant the basis of disbursement; Nepal received Rs. 424749.8 million of the total foreign aid since 1960/61 to 1009/10 which constitutes 52.8% (Rs. 222147) of grant and 47.2% (Rs. 200451) of loan.

### 4.3. Sources of Foreign Aid

According to critics, bilateral aid depends on the mutual cooperation between two countries. Nepal had received the first bilateral aid from the USA under the Point Four Programs. Recent trend depicts that bilateral aid has been declining from 45.86% of the total aid in the period 1980/81-19985/85 to 37.64% in the period 1985/86-1989/90. After the 1980s, the number of regional multilateral donors increased. Japan was the largest bilateral donor country providing of the total bilateral assistance in the FY 1999/2000. Multilateral assistance began with the establishment of International Labour Organization and then IMF and IBRD.



**Table No. 4.3**  
**Bilateral and Multilateral Aid (1980-2010)**

(Rs. in million)

Year	Bilateral	Bilateral as a % of total	Multilateral	Multilateral as a % of total	Total
	4854.3	45.86	5730.9	54.14	10585.2
1986-1990	9063	37.64	15014.8	62.36	24077.8
1991-1995	16791.5	36.64	29041.1	63.36	45832.6
1996-2000	24940.4	31.38	54550.5	68.62	79490.9
2001-2005	35734.9	39.00	55902.8	61.00	91637.7
2006-2010	66507.1	40.72	96810.7	59.28	163317.8
Total	157891.2	38.05	257050.8	61.95	414942

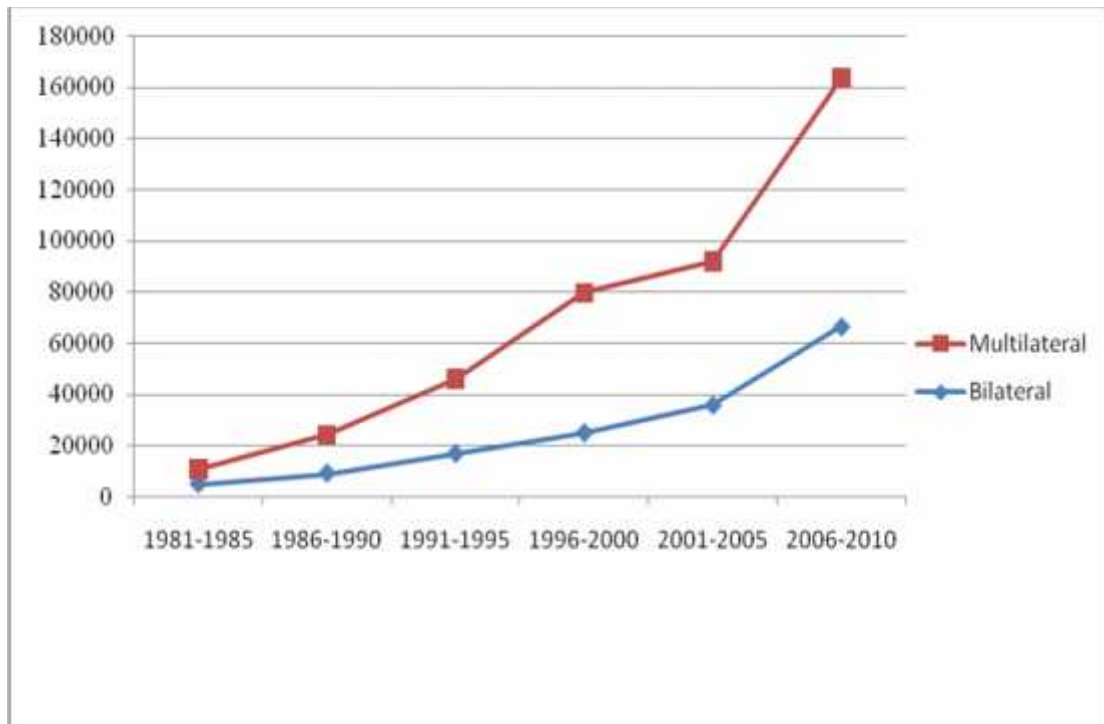
Source: Economic Survey of Nepal Various Issues

The above table shows that multilateral aid has been increasing from of total aid in 1980/81 to 2000/01 i.e. 45.5% to 85.3%. So, in the period, 1980 to 2000 multilateral aid is increased and bilateral aid is decreased. Multilateral aid is more significant as it is less politically motivated. Nepal has received 39.00% bilateral and 61.00% multilateral aid in total foreign and in the period 2000-2005 the reason of multilateral aid decrease is Maoist conflict in the country which effect on multilateral aid disbarment. In the fiscal year 2006-2010 the bilateral aid is increase 40.72% as a total disbursement aid. This is may be the causes of the Comprehensive Peace Agreement bilaterally signed by Communist Party of Nepal (Maoist) and Nepal government in this fiscal year. The aid disbursement of multilateral and bilateral aid is based on the government dealing power with the donor country and donor agency. The main reason of fluctuating sources of aid in Nepal will be the change in government in every year.

**Fig. No.: 4.3**

**Bilateral and Multilateral Aid (1980-2010)**

Rs. in million



#### **4.4 Foreign Aid Commitments and Disbursements**

Aid commitment refers to the expression of the donors to provide financial support of specified amount under agreed terms and conditions for the specific purpose to the recipient country where as disbursement is the time lag because aid for many projects are committed in one year and the committed aid is disbursed in subsequent years. Besides, failure in receiving the committed amount may be the political instability and lack of commitment on the part of the recipient government. Similarly, bureaucratic hurdles inefficiency, absence of institutionalization in development administration, corruption and poor management of development projects and absorptive capacity, the capacity of utilize committed amount of aid continues to remain will be the crucial problems for the Nepalese government. The following table (Table no. 4.4) shows the status of foreign aid commitment and disbursement.

Foreign assistance data for the period FY 1980/81 to FY 2009/2010 shows that on an average about 59.44% of the committed foreign aid was actually disbursed. Surprisingly in the period 1980-1990, actual disbursement has exceeded commitment

which was 55.86. But, it is decreased 47.10% in the period 1985-1990. Again it is increased 55.00%. This is the cause of new elected government after panchayat rulers. However, in the year 2000-2005 it is decreased to 88.2% in 1998/99 and 85.7% in 1999/2000. But it again decreases to 54.03. It may be decreases of autocratic rule of King Gyaneandra. In the FY 2005/06, again the amount of committed aid was greater than disbursed aid i.e. Rs: 2210.9 million was disbursed including bilateral as well as multilateral grants and loan, although the committed aid was Rs: 20924.2 million. This is because of the Comprehensive Peace Agreement bilaterally signed by Communist Party of Nepal (Maoist) and Nepal government in this fiscal year.

**Table No: 4.4**  
**Foreign Aid Commitments and Disbursement (1980-2010)**

(Rs: In millions)

Year	Commitment	Disbursement	Disbursement as a % of Commitment
1981-1985	18948.9	10585.2	55.86
1986-1990	50914.3	23978.4	47.10
1991-1995	83325.4	45832.2	55.00
1996-2000	124003	79490.9	64.10
2001-2005	169608	91637.4	54.03
2006-2010	251257	163378.37	65.02
<b>Total</b>	<b>698056</b>	<b>414902.5</b>	<b>59.44</b>

Source: Economic Surveys of Nepal Various Issues.

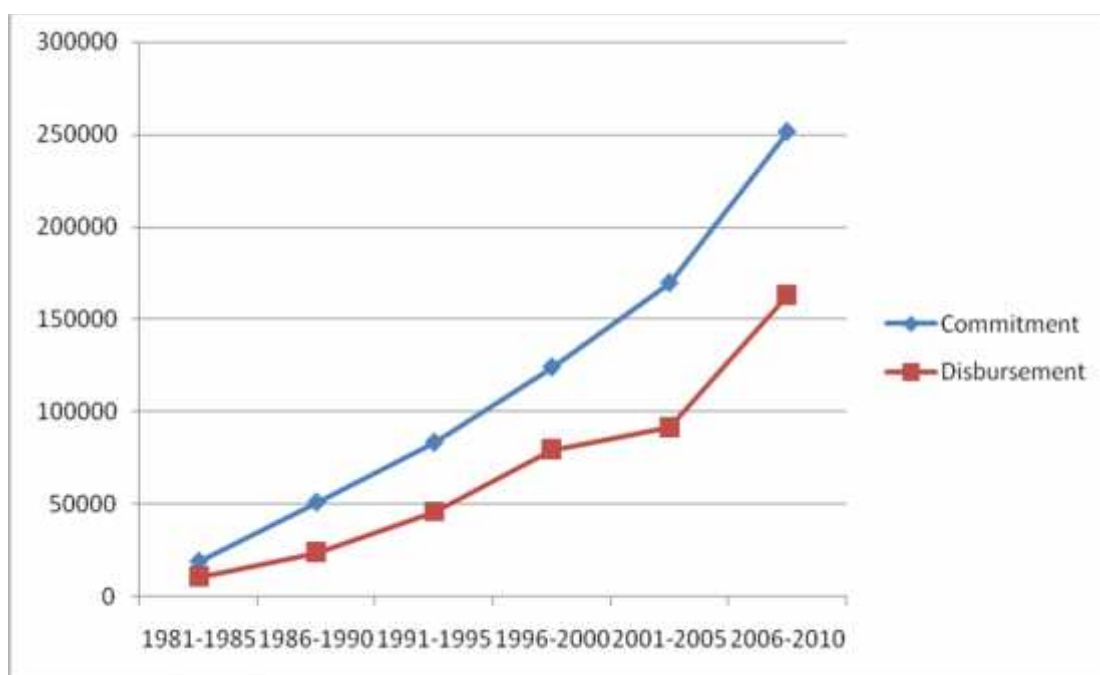
The poor absorptive capacity will be the main cause of raising the difference between foreign aid commitment and disbursement. The major constraints of absorptive capacity in Nepal will be lack of skilled manpower, technology, innovative entrepreneurs and efficient institutional set up. The lack of adequate local cost in meeting the administrative and institutional costs of the aid financed projects/ programs may also another constraint in absorptive capacity. Donors seek to provide the assistance in their own priority on installment basis and they also observe the performance in implementing the projects in different sectors. If they do not find good performance of foreign and utilization, they will not disburse the whole committed aid. The lack of efficient administration, centralization of power, and delay in the

implementation of the foreign aided projects as well as political instability will be the main constraint in effective utilization of foreign aid.

**Fig No: 4.4**

**Foreign Aid Commitments and Disbursements (1980-2010)**

(Rs: In million)



But again in the FY 2003/04, disbursement was nearly 80% of the committed aid. In fiscal year 2008/09 disbursement was 75.76% of the commitment aid. In fiscal year 2009/10 disbursement was 51.55% of the commitment aid.

**4.5 Foreign Aid Disbursement by the sectors**

Various sectors of the Nepalese economy have been provided with the foreign aid. Nepal has been receiving the foreign assistance in the different sectors ever since it adopted the planned economic development. The sectoral distribution of foreign aid is not smooth and has very fluctuating nature. Due to the strategic interest on some major donors, foreign aid has not been provided to match the plan targets. Good example of vested interest being imposed to the recipient by the donor countries can be seen in the projects assisted by India and China. Some donor countries which don't have strategic interest towards Nepal provided aid for agricultural development and institutional buildings.

In 1956, when Nepal began to leap forward in the path of planned economic development, Nepal was in dire need of infrastructure such as transport, communication and hydro-electricity in the country. Realizing the importance of transportation facilities, road construction emerged as the priority at the initial periods. Sectoral allocation of foreign aid in different sectors in the review period is shown in the table below.

**Table 4. 5**  
**Sectoral Allocation of Foreign Aid (1980-2010)**

(Rs. in million)

Year	Transport, Power and Communication	Agriculture, Irrigation and Forestry	Social Service Sector	Industry and Commerce	Total
1981-1985	4252.1 (40.45)	3186.8 (30.32)	1962.4 (18.67)	1109.5 (10.56)	10510.8
1986-1990	11378.7 (47.92)	6519.2 (27.45)	4094.9 (17.25)	1752.6 (7.38)	23745.4
1991-1995	17744.6 (38.10)	14107.5 (30.29)	9583.7 (20.58)	5132.1 (11.02)	46567.9
1996-2000	32140.5 (46.10)	15672.9 (22.48)	20959.3 (30.1)	940.6 (1.34)	69713.3
2001-2005	14263.8 (22.00)	14263.8 (22.00)	35243.2 (54.36)	1060.5 (1.64)	64831.3
2006-2010	10985.9 (4.1)	68260 (25.22)	174079.2 (64.31)	17382 (6.42)	270707.1
Total	189638.7 (32.42)	122010.2 (20.86)	245922.7 (42.04)	27377.3 (4.68)	584948.9

Source: Economic Surveys of Nepal Various Issues

\*Figures in brackets ( ) show the percent of total

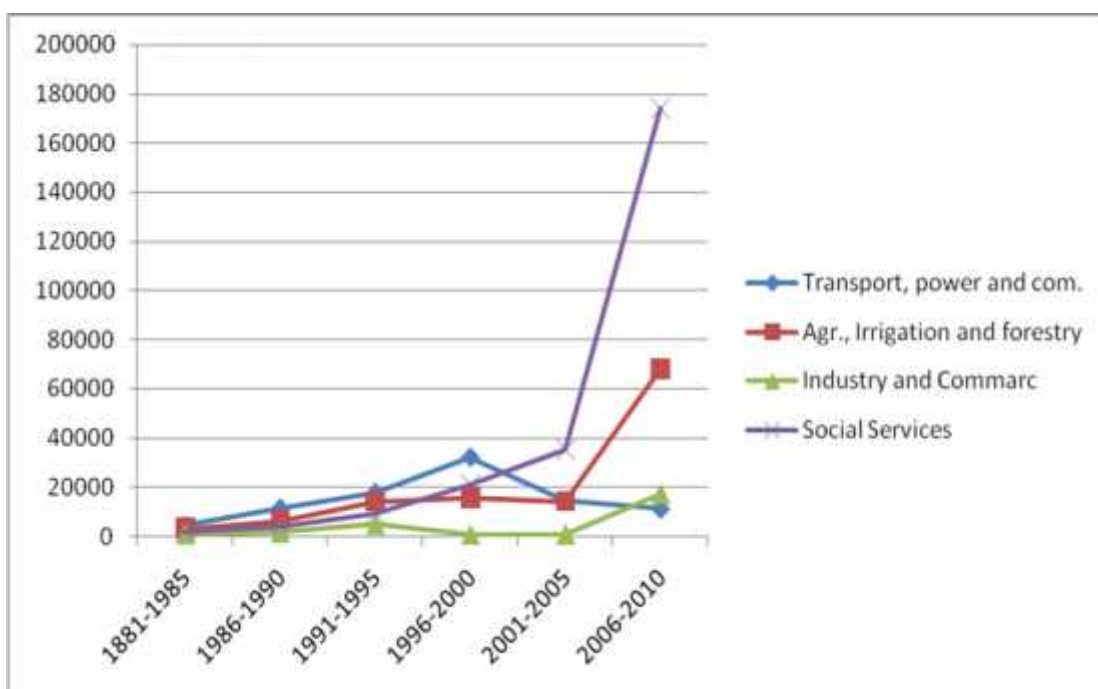
It is clear from the above table that since the very beginning transportation, power and communication sector has been the biggest recipient of foreign aid. This sector has received greater amount of loans than grants. In the period 1980/81 to

1984/85, this sector received the largest portion of aid which was 40.45% of the total aid. Share of aid received by industry and commerce sector was relatively smaller than other sectors. The source wise annual aid disbursement indicated that the percentage share of agriculture in 1980s was smaller in comparison to transport and communication sectors. 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. In the period 1980/81 to 2009/10, out of the total disbursed aid of Rs. 584948.9 millions, 42.04% was distributed to social services, 20.86% agriculture, irrigation and forestry, 32.45% transport communication and power, , and 4.68% to industry and commerce.

**Fig.:4.5**

Sectoral Allocation of Foreign Aid

Rs. In Million



#### 4.6 Resource Gap and Need for Aid

The resource gap is defined as the total budgetary expenditure less the resource mobilized internally. Resource gap creeps in when a country spends more on investment and expenditure than its internal resource. If this resource gap is not

bridged timely then it may invite serious problems like unfavorable balance of payment and foreign exchange gap. Nepal has been experiencing a serious and widening resource gap in her regular as well as development finance. The following table reflects the serious position and growing financial resources crisis in Nepal.

**Table No: 4.6**  
**Resource gap Situation in Nepal (1980-2010)**

Rs: In million

Year	Total Govt. expenditure	Total Revenue	Resource Gap
1981-1985	32265.2	15266.2	17000
1986-1990	73389.4	26034.9	40354.5
1991-1995	153524.1	83547	72126.1
1996-2000	279235.7	171349.0	107886.6
2001-2005	435916.3	288022.6	137893.8
2006-2010	885194.7	655963.8	228834.9
<b>Total</b>	1380174.4	851834.8	513489.9

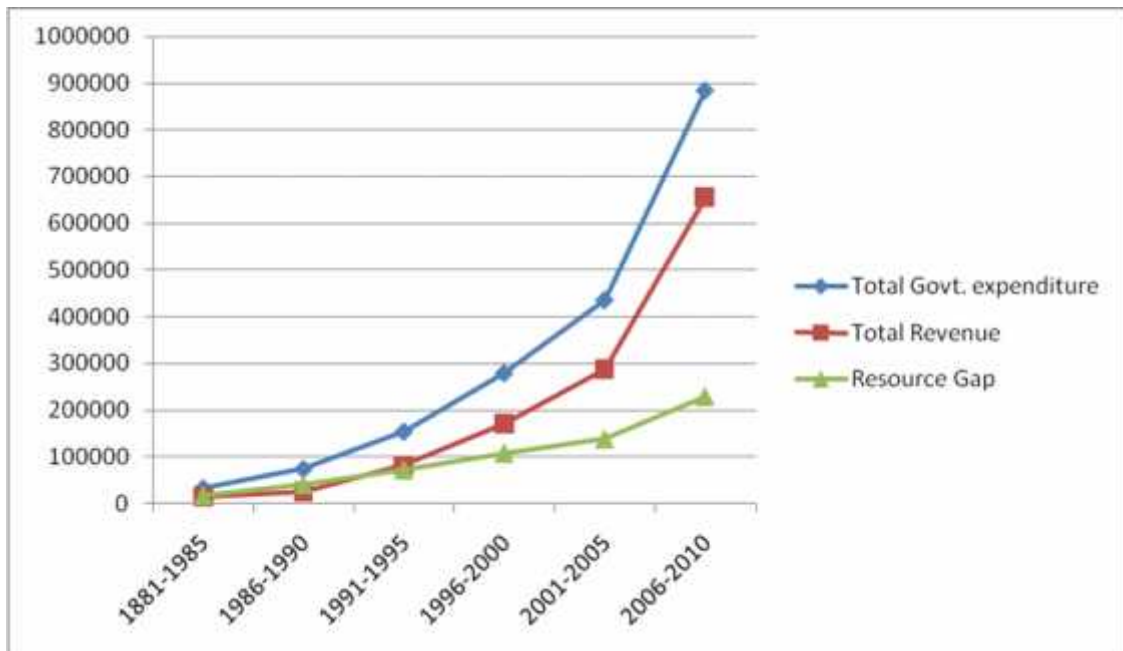
Source: Economic Surveys of Nepal Various Issues.

It is clear from the above table that the resource gap has been growing every year. In year 1980/81-1984/85, initial resource gap was Rs: 17000 million. It increased to Rs: 40354.5 million in year 1985/86-1989/90, which is more than two times the gap in 1980/81-1984/85. It further increased to Rs: 72126.1 million in year 1990/91-1994/95. The trend of increasing resource gap depicts the alarming financial situation in Nepal. Therefore, the role of foreign aid will be of paramount importance in the process of bridging this resource gap. The resource gap in Nepal is Rs: 513489.9 million.

**Fig. no: 4.6**

Resource gap situation in Nepal (1980-2010)

Rs: In million



#### 4.7 Share of Foreign Aid on GDP and Government Expenditure

Foreign aid plays an important role in the economic development of Nepal. In the overall welfare of the country, the increasing level of foreign aid can be argued to be necessary for further growth of economy. The increasing role of foreign aid is revealed even more clearly by the consistent rise in the ratio of aid to GDP. The following table shows the share of foreign aid in GDP of Nepal from FY 1979/80 to FY 2009/10.

From the following table, it was found that in FY 1990/91, total foreign aid was increased by 36.17%. In the FY 1990/91, 1994/95, 1998/99, 2001/02 and 2005/06, total foreign aid was found negatively decline as comparative to respective previous fiscal year. In the FY 1987/88, the total foreign aid was found drastically increasing during the period 1979/80 to 2009/10, which was 53.23%.

In the FY 1990-1995, the foreign aid/GDP ratio was 5.54%. Aid/GDP ratio was lowest in the period 2000-2005, which was 4.07%. It may be Maoist conflict which is effect on aid disbursement. During the period, year 2005/06 to FY 2009/10, the share of foreign aid in GDP, was 7012%. The following table shows the share of foreign aid in the GDP of Nepal from FY 1990/91 to FY 2009/10.



Initially, the share of foreign aid in the government expenditure was 29.85%. After the period 1990 to 2010, the share of foreign aid in the government budget was continuously decreasing. During the FY 1994/95 to FY 1999/2000, the share of foreign aid in the government budget expenditure was around 28.47%. During the FY 2000/01 to FY 2005/06, the average share of foreign aid in the government budget expenditure was 21.02%. In the year 1990/91-2009/10 the share of foreign aid in the government expenditure was only 21.68%.

**Table No: 4.7**

**Share of Foreign Aid on GDP and Government Expenditure (1990-2010)**

Rs: In million

Year	Foreign Aid	GDP	Govt. Budget Expenditure	Share of Foreign aid (in %)		
				Aid/GDP ratio	% change in total aid	Govt. Budget Exp.
1991-1995	45832.6	827264	153523.1	5.54	-	29.85
1996-2000	79490.9	1495025	279236	5.32	42.34	28.47
2001-2005	91637.4	2253078	435916.4	4.07	13.25	21.02
2006-2010	163317.8	2301558	885194.7	7.10	43.89	18.45
<b>Total</b>	<b>380278.7</b>	<b>6876925</b>	<b>1753870.2</b>	<b>5.53</b>	<b>57.05</b>	<b>21.68</b>

Source: Economic Surveyes of Nepal Various Issues

#### **4.8 Foreign Aid on GDP: An Empirical Analysis**

For the positive impact of foreign aid on the economic growth and the overall welfare of the country, there must be positive relationship between Gross Domestic Product (GDP) and foreign aid. In other words, there must be direct relationship between GDP and foreign aid for the economic development of the country. Moreover, other things remaining same, as foreign aid increases there is also increase in GDP and vice versa, for the positive impact of foreign aid on the economy. To prove the above relation, the basic starting point is the examination of a relationship between GDP and foreign aid. To calculate the regression equation, R-square, standard error of Appendix A, there is using the SPSS program. By using this program, the following results have been obtained:

$$\begin{aligned} \text{GDP}_t &= 54366.632 + 12.626\text{FA}_t \\ \text{S. E.} &= 24569.117 \quad 1.499 \\ \text{R}^2 &= 0.683 \\ \text{F} &= (70.954)^* \\ \text{T} &= (8.423)^* \\ \text{D-W} &= 0.427^* \quad (* \text{ Five percent level of significance}) \end{aligned}$$

In the above equation, since the coefficient of foreign aid is positive (i. e. 12.626), it means, there is a positive relationship between GDP and foreign aid inflows. The null hypothesis set for this analysis holds that there is no significant relationship between foreign aid to Nepal and GDP growth in Nepal. But the above result indicates that there is positive impact between foreign aid and GDP growth in Nepal.

The model predicts that with 1 percent increment in foreign aid, GDP is increased by 12.62 percent. This indicates the important contribution of foreign aid in the Nepalese economy. The value of  $R^2$  (unadjusted coefficient) is 0.683, which implies that above 68 % 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.

The above value of standard error of regression line is a good measure of precision in the prediction of dependent variable (i.e. GDP) based on the regression equation, given the value of independent variable (i.e. foreign aid). The coefficient of foreign aid is very significant, it is indicated by its 't' value, which is greater than the tabulated value of 't' at 0 percent level of significance and a given degree of freedom. The value of 'F' is also significant, as the calculated value of 'F' is larger than the tabulated value of 'F'.

From the D-W table, we find that for  $n=35$ , and number of explanatory variable  $k=1$  at 5 level of significance,  $d_L= 1.402$  and  $d_U= 1.519$ . Since the value of D-W or  $d$  is less than  $d_L$ (i.e.,  $d= 0.427 < d_L= 1.402$ ), in other words,  $0 < d < d_L$ , there is positive auto correlation of the first order.

In logarithmic form the results are as follows:

$$\ln\text{GDP}_t = 3.767 \quad + \quad 0.902\text{LnFA}_t$$

R <sup>2</sup>	=0.942	
F	= (533.543)* <sup>1</sup>	
t	= (23.099)*	
D-W	=0.488*	* Five percent level of significance

The result shows that an increase in foreign aid has a positive effect on GDP. The above equation shows 1 % increase in foreign aid inflow, GDP is increased by more than 0.90 percent. The ‘t’ value and ‘F’ value is significant at 5 percent level of significance. The equation is good fit, with 94.2 percent of total variation in GDP is explained by foreign aid. The value of D-W is less than d<sub>L</sub>, which shows that there is positive auto correlation.

#### 4.9 Foreign Aid on PCI: An Empirical Analysis

Another most favorable and effective indicator of economic growth and development is Per Capita Income (PCI). As we know higher the PCI, Higher the economic growth, and vice versa. So for the positive impact of foreign aid on the economic growth, development and overall welfare of the country, there must be positive relationship between PCI and foreign aid, in other words, there must be direct relationship between PCI and foreign aid for the economic growth and development of the country. Moreover, other things remaining same, as foreign aid increases there is also increase in PCI and vice versa, for the positive impact of foreign aid on the economy. To prove the above relation, the basic starting point is the examination of a relationship between PCI and foreign aid. To calculate the regression equation, R-square, standard etc of Appendix B, there is using the SPSS program. By using this program, the following results have been obtained:

PCI <sub>t</sub>	=	130.966 + 0.006FA
S. E.	=	5.167            0.00
R <sup>2</sup>	=	0.928
F	=	(422.798)*
T	=	(20.502)*
D-W	=	0.572*            *Five percent level of significance

In above equation, since the coefficient of foreign aid is positive (i.e. 0.006), it means, there is a positive relationship between PCI and foreign aid inflows. But the impact of foreign aid on per-capita income of Nepalese people is very less or significant.

The model predicts that with 1 % increment in foreign aid, PCI is increased by 0.006%. This indicates that there is very less impact of foreign aid on per capita income of Nepalese because the data PCI here used is taken from World Banks reports which are based on WB standard. The value of  $R^2$  (unadjusted coefficient) is 0.683, which implies that above 68 % of variation in dependent variable (i.e. PCI) 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 0.928 or 92.8% approaches to 1, the regression plane thus estimated is good fit.

The above value of standard error of regression line is a good measure of precision in the prediction of dependent variable (i.e. PCI) based on the regression equation, given the value of independent variable (i.e. foreign aid). The coefficient of foreign aid is very significant, it is indicated by its 't' value, which is greater than the tabulated value of 't' at 0 percent level of significance and a given degree of freedom. The value of 'F' is also significant, as the calculated value of 'F' is larger than the tabulated value of 'F'.

From the D-W table, we find that for  $n=35$ , and number of explanatory variable  $k=1$  at 5 level of significance,  $d_L= 1.402$  and  $d_U= 1.519$ . Since the value of D-W or  $d$  is less than  $d_L$ (i.e.,  $d= 0.572 < d_L= 1.402$ ), in other words,  $0 < d < d_L$ , there is positive auto correlation of the first order.

In logarithmic form the results are as follows:

$$\begin{aligned} \text{Ln PCI}_t &= 3.079 + 0.250\text{Fat} \\ \text{S.E} &= 0.017 \\ \text{R}^2 &= 0.871 \\ \text{F} &= (222.837)* \\ \text{T} &= (14.928)* \\ \text{D-W} &= 0.307* * \text{Five percent level of significance} \end{aligned}$$

The result shows that an increase in foreign aid has a positive effect on PCI. The above equation shows 1 % increase in foreign aid inflow, PCI is increased by more than 0. 25percent. The 't' value and 'F' value is significant at 1 percent level of significance. The equation is good fit, with 87.1 percent of total variation in PCI is

explained by foreign aid. The value of D-W is less than  $d_L$ , which shows that there is positive auto correlation.

#### 4.10 Foreign Aid on HDI: An Empirical Analysis

Another vital and most important indicator of economic development is Human Development Index (HDI). When a country moves forward on the way of development HDI seems higher and vice versa. So for the positive impact of foreign aid on the economic growth, development and overall welfare of the country, there must be positive relationship between HDI and foreign aid, in other words, there must be direct relationship between HDI and foreign aid for the economic growth and development of the country. Moreover, other things remaining same, as foreign aid increases there is also increase in HDI and vice versa, for the positive impact of foreign aid on the economy. To prove the above relation, the basic starting point is the examination of a relationship between HDI and foreign aid. To calculate the regression equation, R-square, standard error of Appendix C, there is using the SPSS program. By using this program, the following results have been obtained:

HDI <sub>t</sub>	=	0.296 + 4.16FA <sub>t</sub>
S. E.	=	0.28            0.00
R <sup>2</sup>	=	0.743
F	=	(17.334)*
T	=	(4.165)*
D-W	=	1.134* * <i>Five percent level of significance</i>

In the above equation, since the coefficient of foreign aid is positive (i. e. 4.16), it means, there is a positive relationship between HDI and foreign aid inflows. The model predicts that with 1 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 R<sup>2</sup> (unadjusted coefficient) is 0.743, which implies that above 74 % of variation in dependent variable (i.e. HDI) is explained by the independent variable (i. e. foreign aid). The value of R<sup>2</sup> ranges from 0 to 1. As the value of R<sup>2</sup> is 0.743 or 74.3% approaches to 1, the regression line thus estimated is good fit.

The above value of standard error of regression line is a good measure of precision in the prediction of dependent variable (i.e. HDI) based on the regression equation, given the value of independent variable (i.e. foreign aid).

From the D-W table, we find that for  $n=8$ , and number of explanatory variable  $k=1$  at 5 level of significance,  $d_L= 0.763$  and  $d_U= 1.332$ . Since the value of D-W or  $d$  is less than  $d_L$  (i.e.,  $d= 1.134 < d_L= 1.402$ ), in other words,  $0 < d < d_L$ , there is no positive auto correlation.

In logarithmic form the above regression results are as follows:

$\ln HDI_t$	=	-2.834 +	0.194 $\ln FA_t$
S.E.	=	0.150	0.015
R <sup>2</sup>	=	0.964	
F	=	(159.009)*	
T	=	(12.610)*	
D-W	=	2.389*	<i>* five percent level of significance</i>

The result shows that an increase in foreign aid has a positive effect on HDI. The above equation shows 1 percent increase in foreign aid inflow, HDI is increased by 0.194 percent. The 't' value and 'F' value is significant at 1 percent level of significance. The equation is good fit, with 96.4 percent of total variation in HDI is explained by foreign aid.

## CHAPTER – V

### SUMMARY, CONCLUSION AND RECOMONDATION

#### 5.1 Major Findings of the Study

Nepal is receiving foreign aid since long time. It receives aid from various sources for various purposes. It this study tries to find out the trend and pattern of foreign aid inflow in Nepal, sector wise allocation of foreign aid, impact of aid on GDP and differences in-between foreign aid commitment and disbursement. The major findings of this study are as follows:

- ) Inflow of foreign aid is not smooth. In beginning the volume of aid is increasing rapidly, later on the growth rate of aid inflow declines gradually. In the period of 1971-1980 inflow of aid increased by more than 238 percent, similarly in 1981-1990, it increased by more than 517 percent. But in next decade (1991-2000) aid inflow increased by only more than 265 percent and later in 2001-2010 AD it increased by only around 100 percent. It shows that the trend of aid is fluctuated.
- ) Foreign aid is playing vital role in economic development of Nepalese economy. The empirical analysis shoes that the foreign aid and GDP are positively related means foreign aid has positive impact on GDP growth. The coefficient of foreign aid on GDP is 12. 626, which means if one percent increment on foreign aid inflow it results the more than twelve percent increment on GDP.
- ) Similarly, foreign aid has positive impact on PCI and HDI. Regression analysis results that the coefficient of foreign aid on Per Capita Income and Human Development Index. Coefficient of foreign aid on PCI is 0.006 which means if foreign aid inflow increases by one percent PCI will increase by 0.006 percent. It shows that there is positive relationship between foreign aid inflow and per capita income in Nepal. Coefficient of foreign aid on HDI is 4.16, which means if foreign aid inflow increased by one percent HDI will increase by more than four percent. It shows that foreign aid inflow and human development index are positively related.
- ) Nepal is receiving large volume of aid. Each and every year various bilateral and multilateral agencies committed for large volume of aid for Nepal for various

purposes but due to various circumstances large portion of committed aid has not been disbursed. Committed aid is increasing gradually and in similar way the differences between commitment and disbursement also increased. In period 1980-1985AD about 55 percent of committed aid was disbursed, in next period 1986-1990 AD it was only about 47 percent. Similarly, in 2005-2010 AD about 65 percent of committed aid was disbursed. In average about 40 percent of committed aid did not disburse because of various reasons.

J Nepal receives aid from various sources for different sectors. Donor agencies are mainly interested on infrastructures of development like transport, communication power, agriculture, irrigation and forestry, industry, commerce and various social service sectors like education, health etc. This study finds that since the very beginning transportation, power and communication sector has been the biggest recipient of foreign aid. This sector has received greater amount of loans than grants. In the period 1980/81 to 1984/85, this sector received the largest portion of aid which was 40.45% of the total aid. Share of aid received by industry and commerce sector was relatively smaller than other sectors. The source wise annual aid disbursement indicated that the percentage share of agriculture in 1980s was smaller in comparison to transport and communication sectors. 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. In the period 1980/81 to 2009/10, out of the total disbursed aid of Rs. 584948.9 millions, 42.04% was distributed to social services, 20.86% agriculture, irrigation and forestry, 32.45% transport communication and power, and 4.68% to industry and commerce.

## **5.2 Summary**

The concept of foreign aid was started after the Second World War. United States of America started to finance for European Recovery Program generally known as the 'Marshall Plan'. This arrangement was the forerunner of aid program for developing countries. Nepal started to receive foreign aid only after the revolution of 1950s. Formally USA is the first country to donate Nepal. At present more than two dozen countries and international agencies are donating Nepal.



Nepal has been receiving foreign aid since 1951. The American Government's assistance of Rs. 22000.00 provided under Point Four Program on January 23, 1951 was the first formal foreign aid to Nepal. India, China and USSR joined in assisting Nepal's economic development in 1951, 1956 and 1958 respectively. With increasing the number of donors, the amount of aid received by Nepal has been increasing continuously. But there has been change in the trend and compositions of aid, no sector of the economy have been remained untouched by foreign assistance. Nepal's development efforts were almost financed by foreign assistance during last 57 years. The growth rate of foreign aid is very high but the economic growth rate of Nepal is very low. Every year dependency on aid is increasing. That is why very burden of debt in Nepal is also increasing. At the same time, the growth rate GDP of Nepal is very low. In this way Nepalese economy is highly dependent on foreign resources.

Foreign aid is concerned with economic and social development of the country. The objective of foreign aid is to promote their economic development up to a point, where a self-sustaining rate of economic growth can be achieved. The function of aid for a development programme is not directly to raise standard of living in the recipient countries but permit them to make the transition from economic stay nation to self sustaining economic growth.

Foreign aid helps bridge the gap between the short falls of the national saving to the national investment. It has supported to fulfill the gap between the excess of imports of goods and services over their exports. There are hardly any economic activities in Nepal particularly relating to the government of Nepal that does not have the element of foreign aid. Many of Nepal's economic, social and political policy makings are done with the support of foreign assistance. Foreign aid is crucial in contributing to the poverty reduction, and economic promotion. Foreign aid has been supporting Nepal's development plan and strategies since early fifties. The increasing role of foreign aid is revealed even more clearly by the consistent rise in per capita aid and ratio of aid to GDP.

The aims of this study are to explore the contribution of foreign aid to the economic development of Nepal, to review the trend and structure of foreign aid in Nepal, to assess the various sources of foreign aid to Nepal.

Foreign aid has been supporting Nepalese economy. The total inflow of foreign aid between the FY 1975/76 to FY 2006/07 was Rs 303661.4 million and the

share of foreign grant and loan were 44.07 percent and 55.93 percent respectively. Until the FY 1960/61, foreign aid was only in the form of grant. Inflow of foreign aid was only in the form of grant. Inflow of foreign loan started only from FY 1961/62, but it was lower than foreign grants up to the FY 1982/83. But from the FY 1983/84 to FY 2001/02, the foreign loan has been higher than that of foreign grant. In recent a year that is after the FY 2002/03 to FY 2006/07, the share of grant has been greater than the loan in total foreign assistance. During the FY 2002/03 to 2006/07, the average share of grant and loan was 63.14 percent and 36.86 percent respectively.

The main sources of foreign aid are bilateral donors and multilateral donors. From the FY 1975/76 to FY 1981/82, the share of bilateral aid was greater than the share of multilateral loan. Besides the FY 2003/04 and the FY 2006/07, the share of bilateral aid was less than the share of multilateral aid, during the FY 1982/83 to FY 2006/07. In the FY 1975/76, the amount of foreign aid Rs.505.6 million. By the time passes it increases continuously and reached to Rs.25854.3 million in the FY 2006/07. There are many problems related to foreign aid. The main problem related to foreign aid is commitment disbursement gap. Besides, the FY 1990/91 and the FY 2005/06, the commitment is always higher than disbursement. Since the volume of committed aid has increased, gap between commitment and disbursement of aid has also been expanded. In average about 40 percent of committed aid has not been disbursed.

In the beginning foreign aid was highly attracted to physical development like power, transport and communication, than agricultural sector and social services have given more priority. Very less priority was given to trade and industry. In period 1981-85 about 40 percent of total aid was received by transport, power and communication, around 30 percent aid was allocated to agricultural and forestry and 18.67 and 10.56 percent aid was disbursed to social service and trade and industrial sectors respectively. Later social service sector became the main interested sector for donors. In period 2005-10 this sector got more than 42 percent of total aid inflow, but industry and trade still received very less portion of aid.

Similarly, there are many other problems like conflict in objectives and priorities, lack of coordination, lack of foreign aid policy etc. These types of problems hamper the development process of the economy. But still there is positive relationship between foreign aid and GDP. The empirical study shows that there is positive relationship between inflow of foreign aid and GDP of Nepal. The beta coefficient is 12.626 implies that 1 percent change in foreign aid results into the

12.626 percent change in GDP of Nepal. The adjusted  $R^2$  value is 0.683 implying that 68.3 percent change in GDP is explained by the change in foreign aid. T-test and F-test also shows the best theoretical fit of the parameters.

Similarly there is positive relationship between foreign aid inflow in Nepal and PCI of Nepal. The impact of FA on GDP is very crucial but impact on PCI is no more notable. The empirical analysis show that the parameter of FA on PCI is 0.006 implies that 1 percent change in foreign aid inflow in Nepal results the 0.006 percent change on PCI of Nepal. Moreover, there is positive and significant relationship between FA inflow in Nepal and HDI of Nepal. The empirical analysis show that the value of parameter is 4.16 implies that one percent change in FA inflow results the 4.16 percent change in HDI. The adjusted  $R^2$  value is 0.743 shows that 74.3 percent change on HDI is explained by FA. Statistical tools like T-test and F-test also shows the best theoretical fit of the parameters.

Though Nepalese economy is foreign aid based, utilization of foreign aid indicates that there is extreme necessary to improve the method of utilization of foreign aid. The absence of effective and transparent policy on the mobilization of foreign aid will be the main problem of the Nepalese economy. In extreme necessity cases we must accept foreign loan and properly utilize it, in order to get more benefit through own development works.

### **5.3 Conclusions**

Based on the analysis of this study the following conclusions are drawn:

Both expenditure and revenue of the Nepalese government has been increasing every year, but the government expenditure has been increasing rapidly. It is because, even after the induction of market economy, the state is still a prime actor to facilitate public goods and public utilities to the people. The government is bounded to spend in the field of education, health and public utilities like water supply, telecommunication, transportation and electricity. These activities require huge amount of development expenditure. Therefore, government expenditure is increasing rapidly with respect to time but the government of Nepal has not been able to increase its revenue accordingly.

The inflow of foreign aid has been increasing with respect to time. The share of foreign aid in the government expenditure is also increasing but the positive impact of foreign aid has not been that significant in the Nepalese economy. The growth rate

of the GDP and per capita income are very low; whereas dependency on foreign aid, burden of debt and price level are increasing rapidly. One of the main causes of these problems seems to be an unproductive and ineffective use of foreign aid. If we see the share of foreign aid in the government expenditure since FY 1975/76 to FY 2009/10, 24.65 percent of total expenditure and 39.94 percent of the development expenditure has been financed by foreign aid. It shows that foreign aid had played an important role in the government expenditure of Nepal. From this it is apparent that without foreign aid the country will degrade to far worse condition than that it is right now. It is because; in the absence of foreign aid Nepal has to reduce more than fifty percent of its development activities.

The government of Nepal has failed to demonstrate a reasonable degree of absorption capacity. Because of the low degree of absorption capacity, Nepal has been unable to disburse all the committed aid. Grant disbursement was far lower than grant commitment but disbursement of loan was more than it was committed. It looks like the government of Nepal accepts the strict pre-conditions that it cannot fulfill while the committed amount of grant aid. Loan aid, as we know, should be paid back with stipulated amount of interest. Hence, it is easy to take foreign loan. Probably because of this reason loan disbursement was more than loan commitment.

Regression analysis shows that there is positive relationship between GDP and foreign aid, during the FY 1975/76 to FY 2009/10. The coefficient of foreign aid on GDP as a dependent variable is 12.626 which mean if the foreign aid increased by Rs.1 million, GDP will be increased by Rs. 12.62 million. This result indicates that foreign aid is one of the most important variables to increase the GDP. On the other hand, the 't' value, 'f' value etc. are also significant at 5 percent level of significance and the given degree of freedom. The value of D-W test indicates that there is positive auto-correlation between foreign aid and GDP. The value of  $R^2$  (i.e. 0.683) shows that the regression line estimated is good fit. Thus, we can be concluded that foreign aid has positive impact on the Nepalese economy.

The positive relationship between foreign aid and GDP, saving, revenue, investment, etc. indicate that foreign aid helps to increase these variables. However, the impact of foreign aid on above-mentioned variables except price level has not been that high. Hence the impact of foreign aid to above mentioned variables except price level is positive and significant but not satisfactory. The main reason of low impact of foreign aid in the economy may be lack of commitment of the government

of Nepal, donor's own strategic interest rather than economic development, misutilization of foreign aid, corruption, unnecessary political interference in the bureaucracy, weak administration, ineffective monitoring system, unproductive utilization of foreign aid, tied aid, political instability, etc. The existence of the above mentioned factors make foreign aid ineffective.

Every year, price level in the economy has been increasing. Nepalese people are facing the problems of inflation. The positive correlation between foreign aid and the price level indicates that the foreign aid is one of the main causes of inflation. Because of the low growth rate of output and income and a high growth rate of price level, the living standard of the people has not increased significantly. The unproductive use of foreign aid is one of the reasons of inflation. On the one hand, demand for goods and services has been increasing due to inflow of foreign aid, on the other hand, due to an unproductive use of foreign aid the growth rate of output is less than that of its demand. Hence, demand pulls inflation is taking place in Nepalese economy.

## **5.4 Suggestions**

Based on the study undertaken for this thesis the following suggestions or recommendations are offered. The following measures may help to solve some of the problems of foreign aid and increase the productivity of foreign aid.

### **5.4.1 Suggestion to the Government**

1. According to the need of the country, the priority list should be made for the proper utilization of foreign aid.
2. A system of government should be operating that suited to its own geographic situation and at the sometime competent enough to handle the modern process of structural transformation and economic development.
3. Foreign aid should be used in a transparent manner with proper accounting system of recording the movement of foreign aid.
4. Transparency and accountability should be maintained for that clear-cut policies and guideline should be formulated.
5. Nepal should adopt a critical attitude towards foreign aid. Nepal should use foreign aid only for these sectors and projects, which are vital for the

economic and social development and benefits and which are shared by majority of its population particularly the poor section of the society. Nepal should seek united foreign aid to the extent possible. This will enable it to use the resources according to its own priorities. Efforts should be made to obtain grants as much as possible. But in the process seeking the foreign aid Nepal should not sacrifice its right to choose the development strategy in favour of the strategy suggested by the donor.

6. The government should set clear criteria when donors select area and project (by district, zone, region, etc. and based on locally identified needs). The relevant parties should be bear responsibilities in the case of failure of projects. Government staff should be technically and economically efficient in both project implementation and monitoring.
7. Project management efficiency should be improved and enhanced.
8. Selected projects should be implemented with full commitment regarding their objectives so that it can generate sufficient resources to payback the aid.
9. Entire freedom in the selection of the projects should not be provided to donors.
10. The parliament must have a significant influence on the performance of foreign aid. There must be an independent body to govern the assistance. The committee must be accountable to the government, the public and the donors like the house of commons committee of public accounts in the united kingdom. The body should examine the scope and balance of their evaluation in order to ensure that it covers a significantly comprehensive area of population and provide all necessary information and suggest methods of aid and implementation to make aid more effective. The committee must review periodically the benefit of aid through an impractical and independent research agency and draw conclusions and suggest appropriate actions.
11. The aid must be audited by the government auditors and the donor auditors.
12. Universities, Teaching and Training Institutions must help to demonstrate information to future managers on the usage of aid. They can also suggest methodologies on the application of latest ideas on the foreign aided project implementation.
13. There must be technical and operational involvement of private sector in aid management.

14. Adopt debt management strategy which place emphasis on debt relief based on tight financial and economic reforms supported mainly by World Bank and IMF Funding.
15. Increase export and future repayment capacity that satisfies the World Bank and IMF definition of debt sustainability.
16. Government must set time-bounded targets for reducing overall poverty and for the eradication of absolute poverty.
17. Aid policy of both recipient country as well as the donors must be transparent.
18. The priority should be given grants rather than loan.
19. The focus should be given in the bilateral donors as they provide large amount of grants than loans.
20. Improving the administrative and institutional structure for development through decentralization.

#### **5.4.2 Suggestion to the Donors.**

1. Aid to be directed to the most basic needs: Donors should see that the aid is directed on basic needs. This approach of the donors will work to reduce poverty, illiteracy, malnutrition etc. More than 60 percent of the must be directed on social needs. This includes health, education and the development of organizations of people living in poverty.
2. Ensure full transparency of dealing: Donors must be explicit about the usage of aid in specific areas and have to be transparent in aid dealings.
3. Prioritize aid for Growth and Development: All donors must accept the need and their responsibility to restore aid to a growth path.
4. Provide relief towards debt burden: Multilateral institutions must put in place measures to relieve the multilateral debt burden.
5. Donors should work as a facilitator and watchdog of projects implemented through their money.
6. Donors should provide assistance based on Nepalese real needs and requirements, instead of sticking to their own priority and interest.
7. Donors should attempt to strengthen people's capabilities to identify their needs, design and implement projects themselves.
8. Donors should allow Nepal the freedom of machine, equipments to import from cheaper source.

9. The donors should help the recipient country to manage resources to achieve the desired development objectives within the prescribed time frame. The donors must track the flow of project inputs activities and outputs for accounting and planning purposes. The donors should have serve as an early warning system to signal serious deviations from expected project implementation and thus to prompt selective interventions.

#### **5.4.3 Suggestion to the Public**

1. The general public must be aware about the aid in respect to the quality and implementation of aid.
2. Measures must be made to involve local public in the implementation of aid because it the local people that should be benefited by the aid.
3. Public must be genuinely concern on the role of aid.
4. Public must see to it that the aid must be used in the priority areas. It must be the local organizations that should suggest the government in prioritizing the area for aid.
5. Beneficiaries must organize themselves to question the government on the rational of aid spending.



**Appendix: A**  
Foreign Aid Inflow and GDP

<b>Fiscal Year</b>	<b>Foreign Aid</b>	<b>GDP</b>
1974/75	386.77	
1975/76	505.65	17394
1976/77	556.98	17280
1977/78	848.4	19732
1978/79	989.4	22215
1979/80	1340.5	13351
1980/81	1562.2	27307
1981/82	1723.2	30988
1982/83	2075.5	33761
1983/84	2547.5	39390
1984/85	2676.4	44441
1985/86	3491.5	53215
1986/87	3314.4	61140
1987/88	5078.5	73170
1988/89	5666.9	85830
1989/90	6427.1	99702
1990/91	5990	116128
1991/92	7800.4	144931
1992/93	9235.6	164634
1993/94	11557.2	191596
1994/95	11249.4	209974
1995/96	14289	239388
1996/97	15031.9	269570
1997/98	16457.1	289798
1998/99	16189	330018
1999/2000	17523.9	366251
2000/01	18797.4	393566
2001/02	14384.8	422244
2002/03	15885.5	453698

2003/04	18912.4	474919
2004/05	23657.3	508651
2005/06	22041.8	556879
2006/07	532038.2	25864.3
2007/08	564516.5	29300.6
2008/09	591933.4	36351.1
2009/10	616250	49769.4

Source: Economic Survey of Nepal Various Issues

## Appendix - B

### Trend of Per-capita Income of Nepal

Fiscal Year	PCI (\$)
1974/75	100
1975/76	110
1976/77	120
1977/78	120
1978/79	120
1979/80	130
1980/81	140
1981/82	150
1982/83	150
1983/84	140
1984/85	160
1985/86	160
1986/87	170
1987/88	180
1988/89	200
1989/90	200
1990/91	210
1991/92	210
1992/93	200
1993/94	190
1994/95	200
1995/96	200
1996/97	210
1997/98	220
1998/99	210
1999/2000	210
2000/01	220
2001/02	230
2002/03	230

2003/04	240
2004/05	270
2005/06	290
2006/07	320
2007/08	350
2008/09	400
2009/10	440
2010/11	490

Source: World Bank's Report 2013

## Appendix C

### HDI Trend of Nepal

Year	HDI
1980	0.234
1990	0.341
2000	0.385
2005	0.424
2006	0.432
2007	0.442
2008	0.448
2009	0.455
2010	0.461
2011	0.464
2012	0.466

Source: UNDP Human development Report 2013.

## Appendix D

### Share of Agricultural and Non-agricultural Sector on GDP of Nepal

Rs. In Million

Fiscal Year	GDPAG	GDPNAG
1974/75	11550	5021
1975/76	11611	5783
1976/77	10506	6774
1977/78	11752	7980
1978/79	13522	8693
1979/80	13683	9668
1980/81	15679	11628
1981/82	17903	13085
1982/83	19282	14479
1983/84	22771	16619
1984/85	22761	21680
1985/86	27136	26079
1986/87	30623	30517
1987/88	36755	36415
1988/89	42572	43259
1989/90	50470	49232
1990/91	55368	60759
1991/92	65156	79777
1992/93	70090	95260
1993/94	80589	111007
1994/95	85569	124407
1995/96	96896	142492
1996/97	108785	160785
1997/98	112498	177303
1998/99	132373	197645
1999/2000	145131	221120
2000/01	157442	268013
2001/02	168239	275813
2002/03	175113	298433
2003/04	188632	329362
2004/05	202116	364463
2005/06	214838	415492
2006/07	230240	467124
2007/08	251566	527881
2008/09	311798	627727
2009/10	378342	731963
2010/11		

Source: Economic Survey of Nepal Various Issues

## Appendix: F

### Total Aid Inflow in Nepal (Grants And Loan)

Rs. in Million

Fiscal Year	Grant	Loan	Total Foreign Aid	% of Grant	% of Loan
1950/51	1.01	-	1.01	100	-
1951/52	1.01	-	1.01	100	-
1952/53		-	0	-	-
1953/54		-	0	100	-
1954/55					-
1955/56	0.01	-	0.01	100	-
1956/57	1	-	1	100	-
1957/58	1	-	1	100	-
1958/59	86.42	-	86.42	100	-
1959/60	111.69	-	111.69	100	
1960/61	227.5	-	227.5	100	-
1961/62	128.84	-	128.84	100	-
1962/63	128.36	-	128.36	100	-
1963/64	125	13.44	138.44	90.29	9.70
1964/65	141.05	5.86	146.91	96.01	3.98
1965/66	175.3	3.3	178.6	98.15	1.85
1966/67	142.23	3.7	145.93	97.46	2.54
1967/68	162.23	3.7	165.93	97.77	2.23
1968/69	185.9	-	185.9	100	0
1969/70	243.74	7.55	251.29	96.99	3.00
1970/71	270.69	32.46	303.15	89.29	10.71
1971/72	242.04	38.89	280.93	86.16	13.84
1972/73	180.26	47.38	227.64	79.19	20.81
1973/74	222.62	87.87	310.49	71.69	28.30
1974/75	282.79	103.97	386.76	73.12	26.88
1975/76	359.72	145.94	505.66	71.14	28.86
1976/77	392.66	146.32	538.98	72.85	27.15
1977/78	466.6	381.8	848.4	54.99	45.00
1978/89	599.3	390.1	989.4	60.6	39.4

1979/80	805.6	534.9	1340.5	60.01	39.00
1980/81	868.9	693.3	1562.2	55.62	44.38
1981/82	993.3	729.9	1723.2	57.64	42.36
1982/83	1090.1	985.8	2075.9	52.51	47.49
1983/84	876.6	1670.9	2547.5	34.41	65.59
1984/85	923.4	1753	2676.4	34.50	65.49
1985/86	1120.6	2370.9	3491.5	32.09	67.90
1986/87	1078.3	2236.1	3314.4	32.53	67.47
1987/88	1984.2	3094.3	5078.5	39.07	60.93
1988/89	1478.2	4188.7	5666.9	26.08	73.92
1989/90	1798.8	4628.3	6427.1	27.98	72.01
1990/91	1630	4360	5990	27.21	72.79
1991/92	1531	6269.4	7800.4	19.63	80.37
1992/93	3273.9	5961.7	9235.6	35.45	64.55
1993/94	2393.6	9163.6	11557.2	20.71	79.29
1994/95	3937.1	7312.3	11249.4	34.99	65.00
1995/96	4825.1	9463.9	14289	33.77	66.23
1996/97	5988.3	9043.6	15031.9	39.84	60.16
1997/98	5402.6	11054.5	16457.1	32.83	67.17
1998/99	4336.6	11852.4	16189	26.79	73.21
1999/2000	5711.7	11812.2	17523.9	32.59	67.41
2000/01	6753.4	12044	18797.4	35.93	64.07
2001/02	6686.2	7698.6	14384.8	46.48	53.52
2002/03	11339.1	4546.4	15885.5	71.38	28.62
2003/04	11283.4	7629	18912.4	59.66	40.34
2004/05	14391.9	9266.1	23658	60.82	39.18
2005/06	13827.5	8214.3	22041.8	62.73	37.27
2006/07	15810.8	10053.5	25864.3	61.12	38.88
2007/08	20320.7	8979.9	29300.6	69.35	30.65
2008/09	26382.8	9968.9	36351.1	72.58	27.42
2009/10	38546	11223.4	49769.4	77.44	22.56

Source: Economic Survey of Nepal Various Issues.



## Appendix: G

### Foreign Aid Commitments and Disbursements

Rs. in Million

Year	Commitment	Disbursement	Disbursement as a % Commitment
1980/81	4012.6	1562.2	38.92
1981/82	2886.1	1723.2	59.71
1982/83	2959.2	2075.9	70.15
1983/84	3099.6	2574.5	82.2
1984/85	5991.4	2676.4	44.67
1985/86	99504.2	3491.5	36.74
1986/87	8727.5	3314.4	38.0
1987/88	6449.6	5078.5	78.74
1988/89	10403	5666.9	54.47
1989/90	15830	6427.1	40.6
1990/91	5665.4	5990	105.73
1991/92	31084	7800.4	25.1
1992/93	20527	9235.6	45.0
1993/94	13172	11557.2	87.74
1994/95	12877	11249	87.36
1995/96	16537	14289	86.41
1996/97	36643	15031.9	41.02
1997/98	32022	16457.1	51.39
1998/99	18353	16189	88.21
1999/2000	20448	17523.9	85.7
2000/01	31287	18797.4	60.08
2001/02	33228	14384.8	43.29
2002/03	43203	15885.5	36.77
2003/04	23738	18912.4	79.67
2004/05	38152	23657.3	62.0
2005/06	20924	22101.9	105.6
2006/07	36563	25854.37	70.7
2007/08	49186	29301	59.57
2008/09	47975	36351.7	75.76
2009/10	96609	49769.4	51.55
2010/11			
<b>Total</b>	698056	414902.5	59.54

Source: Economic Survey of Nepal Various Issues

## Appendix: H

### Sectoral Allocation of Foreign Aid

Rs. in Million

Fiscal Year	Transport, Power and Communication	Agriculture and Forestry	Industry and Commerce	Social Service
1980/81	1000	322.6	67.7	146.4
1981/82	775.6	454.3	143.9	335.9
1982/83	648.3	599.2	211.2	612.4
1983/84	859.1	757.6	494.9	432.4
1984/85	969.1	1053.1	191.8	435.3
1985/86	1321.2	1298.8	275.7	586.4
1986/87	1473.7	1037.6	183.4	585.4
1987/88	2784.6	1226.3	445.7	522.3
1988/89	3120.1	1466.8	191.2	845
1989/90	2679.1	1489.7	656.6	1555.8
1990/91	2575.6	1253.2	1391	1575.8
1991/92	2485.1	1945.4	2174	1191.6
1992/93	3939.6	1927.4	696.9	2667.6
1993/94	4169.4	5519.1	389.9	1468.6
1994/95	4574.9	3462.4	480.3	2680.1
1995/96	8052.7	3399.6	15.9	2636.2
1996/97	8504.5	2827.5	23.4	3665
1997/98	8989.6	2852.1	198.1	4417.3
1998/99	3383.9	3383.9	404.7	4446.4
1999/2000	3209.8	3209.8	298.5	5794.4
2000/01	3774.8	3774.8	19.9	5759.5
2001/02	3285.8	3285.8	368.7	4685.8
2002/03	2177.9	2177.9	401.2	5321
2003/04	2429.6	2429.6	146.8	8730.1
2004/05	2595.7	2595.7	123.9	10746.8
2005/06	2396.3	2396.3	105.3	11162.2
2006/07	2882.4	2882.4	6662	15159.4
2007/08	6709.5	3859.3	78.7	18193.1
2008/09	6297.7	2291.2	160.7	24695.7
2009/10	11793.2	3080.9	380	33025.3

Source: Economic Survey of Nepal Various Issues

## Appendix: I

### Resource Gap Situation in Nepal

Rs. in Million

<b>Fiscal Year</b>	<b>Total Govt. Expenditure</b>	<b>Total Revenue</b>	<b>Resource Gap</b>
1975/76	1913.40	1116.1	-797.3
1976/77	2330.4	1322.9	-1007.5
1977/78	2674.9	1582.2	-1092.7
1978/79	3020.5	1811.9	-1208.6
1979/80	3470.7	1880.8	-1589.9
1980/81	4092.3	2419.2	1674.1
1981/82	5361.3	2679.5	2681.8
1982/83	6979.3	2842.6	4137.7
1983/84	7437.4	3409.3	4028.1
1984/85	8394.9	3916.6	4478.3
1985/86	10097.1	4644.5	5452.6
1986/87	11513.1	5975.1	5538
1987/88	14104.9	5350.9	8754
1988/89	18005	776.9	10228.1
1989/90	19669.3	9287.5	10381.8
1990/91	23549.8	10729.9	12819.9
1991/92	26419.2	13512.7	12905.5
1992/93	30897.7	15148.4	15749.3
1993/94	33597.4	19580.8	16166.6
1994/95	39060	24575.2	14484.8
1995/96	46542.4	27893.1	18649.3
1996/97	50723.7	30373.5	20350.2
1997/98	56118.3	32937.9	23180.4
1998/99	59578.8	37251	22328
1999/2000	66272.5	42893.8	23378.7
2000/01	79835.1	48893.6	30941.5
2001/02	80072.2	50445.5	29626.7
2002/03	84006	56229.8	17776.3
2003/04	89442.6	62331	27111.6
2004/05	102560.4	70122.7	32437.7
2005/06	110889.2	72282.1	38607.1
2006/07	133604.5	87712.2	45892.3
2007/08	161350	107620.5	53729.5
2008/09	219661.9	169857.3	49408.6
2009/10	259689.1	218491.7	41197.4

Source: Economic Survey of Nepal Various Issues

## Appendix: J

### Share of Foreign Aid in GDP and Government Expenditure

Rs. in Million

Fiscal Year	Foreign Aid	GDP	Govt. Budget Expenditure	Share of Foreign aid (in%)		
				Aid/GDP ratio	%change in total aid	Govt. Budget Exp.
1975/76	505.6	17394	1,913.40	2.91	-	26.42
1976/77	556.9	17280	2,330.40	3.22	10.15	23.90
1977/78	848.8	19732	2,674.90	4.30	52.34	31.72
1978/79	989.4	22215	3,020.50	4.43	16.03	32.59
1979/80	1340.5	23351	3,470.70	5.74	36.17	38.62
1980/81	1562.2	27307	4,092.30	5.72	16.54	38.17
1981/82	1723.2	30988	5,361.30	5.56	10.31	32.14
1982/83	2075.5	33761	6,797.20	6.15	20.44	30.53
1983/84	2547.5	39390	7,437.30	6.47	22.74	34.25
1984/85	2676.4	44441	8,394.80	6.02	4.99	31.86
1985/86	3491.5	53215	9,797.10	6.56	30.54	35.64
1986/87	3314.4	61140	11,513.20	5.42	-5.07	28.79
1987/88	5078.5	73170	14,105.00	6.94	53.23	36.00
1988/89	5666.9	85830	18,005.00	6.60	11.59	31.47
1989/90	6427.1	99702	19,669.30	6.45	13.41	32.68
1990/91	5590	116128	23549.80	5.16	-6.80	24.44
1991/92	7800.4	144932	26418.20	5.38	30.22	29.53
1992/93	9235.6	164634	30897.70	5.61	18.40	29.89
1993/94	11557.2	191596	33597.4	6.03	25.14	34.40
1994/95	11249.4	209974	39060.00	5.36	-2.66	28.80
1995/96	14289	239388	46542.40	5.97	27.02	30.70
1996/97	15031.9	269570	50723.80	5.58	5.20	29.63
1997/98	16457.1	289798	56118.30	5.68	9.48	29.33
1998/99	16189	330018	59579.00	4.91	-1.63	27.17
1999/2000	17523.9	366251	66272.50	4.78	8.25	26.44
2000/01	18797.4	393566	79835.00	4.78	7.27	23.55
2001/02	14384.8	422244	80072.20	3.41	-23.47	17.96
2002/03	15885.5	453698	84006.10	3.50	10.43	18.91
2003/04	18912.4	474919	89442.60	3.98	19.05	21.14
2004/05	23657.3	508651	102560.50	4.65	25.09	23.07
2005/06	22041.8	646471	110889.20	3.41	-6.83	19.88
2006/07	25854.3	719477	133604.50	3.59	17.30	19.35

Source: Economic Survey of Nepal Various Issues

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