

CHAPTER I INTRODUCTION

1. 1 Background of the Study

Nepal is one of the landlocked and developing country in the world with per capita GDP only \$717. About growth rate of population 1.35 percent literacy rate 65.9%, GDP growth rate is about 3.5 % all most economy is dependent remittance lag of resources, trade deficit, inflation, high consumption etc. are the features of Nepalese economy. Less growth and undeveloped economy, GDP growth rate is very low due to the external and internal factors like strike, high demand of labors wage, lack of utilization of natural resources etc. In such a condition, foreign aid can play a very significant and vital role in the proper utilization of natural and human resources. (MoF 2013, CBS 2011)

If country is sufficient in every sector foreign aid is not necessary to develop the country but it is not in practical world. So, foreign aid is necessary to develop the every sector of the economy of the developing and less developed countries. The term 'Foreign Aid' can be defined as "the transfer of capital, technical resources from the developed countries through either directly from the government of donor country to recipient country or through international channels to the government of recipient country for the purpose of encouraging economic uplift of the developing country or under-developed countries." The foreign aid includes bilateral and multilateral grants, loans and technical assistance.

The development assistance of the Organization of Economic Co-operation and Development (OECD) of UN records, the term 'Foreign Aid' is defined as "the flow of long term financial resources to developed countries from multilateral agencies including official flow and private lending and export credit as constituting foreign aid." This definition includes the economic flows whether they are official or private.

Whatever way Foreign Aid is defined, it does not make any difference because its main theme is economic aid or external assistance or economic assistance. It is

generally provided either for humanitarian relief for the country or for the accelerating economic development mainly in the developing the LDCs, where the development process is not moving smoothly. In other words it refers to the assistance that is given to by richer countries to poorer countries. This sort of assistance consists of grants, loans, technical assistance etc. It can be provided multilaterally as well as bilaterally.

There are two components of foreign aid: Grants and Loans. Grants component of aid are free resources for which no repayment is required. A loan with at least 25 per cent of grant component is considered as Foreign Aid. Grants components are measured in terms of interest rate, maturity and grace period (interval to first repayment of capital) of a loan. It measures the concessionality of a loan in the form of the present value of an interest rate below the market rate over the life of a loan.

Developed countries are likely to provide aids to the poor countries with the wide range of objectives to accelerate their trade and commercial activities as well as to assure human rights, political freedom, peace and socio-economic stability. Foreign aid is concerned with the economic and social betterment of the recipient country. The main goal of aids is to enhance the economic growth of the country. Developing countries like Nepal are characterized as 'capital poor' or 'low investing' economy. The appearance of inflationary pressure is inevitable in a developing country because of the existence of disequilibrium between demands and supply of domestic products. Foreign Aid is advantageous to minimize such inflationary pressure.

In an initial stage of development, Foreign aid is indispensable. It is an economic necessity. Even the highly developed countries of to-day took Foreign Aid in the initial stage of their development. They are the countries like USSR, Japan and European countries.

Nepal is one of the least developed countries of the world. It is characterized by low saving ratio, lack of advanced technology, lack of skilled manpower etc. There

are many constraints to the growth of the Nepalese economy. Nepal faces severe problem of deficiency in resource mobilization. Fiscal deficit is growing every year. The only alternative to meet the deficit in domestic budget is external assistance. External assistance will be required to carry out most of the development activities until the country becomes self sufficient in financing itself. Nepal started building relationship with foreign countries with the dawn of the democracy in 1950. The government of USA in 1951, under four point program started the formal aid to Nepal.

Nepal has been getting Foreign Aid from different countries in different ways. Nepal has been getting Foreign Aid for the donor in two ways i) Bilateral and ii) Multilateral. Countries such as USA, UK, Japan, India, China, France, Germany, Netherland, Canada and Russia lie under the bilateral and the aid received from the organizations established by more than two countries such as WB, IDA,ADB,UNDP,UNICEF,WHO,OPEC lie under the multilateral aid.(MoF,2012)

It is found that Foreign Aid has been playing a vital role in the development of a developing country like Nepal. After the rise of democracy in 2007 B.S. democratic practice along with development and construction also started in Nepal. Due to the lack of internal resources the developmental activities could not be carried out as defined.

Still and before in all development plans the Foreign Aid is playing a vital role in the development of fields such as road, irrigation, communication, hydroelectricity, education, drinking water, agriculture and health. Foreign Aid is also helped to increase the productivity and production to expand the developmental works and to find out suitable technologies.

India has been playing foremost role in the development of Nepal in the field of transportation, industry, education, agriculture, health, technological development etc. Indian aid programs are found to cover almost sectors of the economy. The magnitude, pattern, trend and motives of foreign aid provided in the Indian Assistance or Cooperation do not only have economic and developmental

influences in Nepal but also they have political and strategic motives as well.

The 'Foreign Aid' in Nepal started from Rana regime when the aid had been used for Pherping and Sundarijal hydroelectricity project (British Support). However, aid officially started from January 23, 1951, after the Second World War, with an agreement on 'Point Four Program' with the US. The remarkable increase in foreign aid had been noticed from the time when Nepal entered Colombo Plan in 1952 and with India 1953. The agreement of foreign aid for the construction of Tribhuvan highway from Raxaul to Kathmandu. Then the flow of it started to come from the other countries like China, UK, Japan, Finland, Denmark, Norway, Australia etc. The year 1969 was termed as a good year for Nepal since it started to get loan from the World Bank and ADB at the subsidized rate, because of which it was also known as the golden year in the context of foreign aids. (IECCD Report-2012)

There were many donor countries, among which one of the prominent donors of Nepal is our neighboring country, India, whose economic power is rising rapidly in the world. Since it has surrounded Nepal from east, west and south, it has many similar socio- cultural, religious, geographic and demographic features. So, it has direct impact on Nepalese economy. However, the Nepalese economy in comparison with that of India is underdeveloped. This is because of unavailability of more natural resources like oceans, petroleum products, mining as well as unfavorable international relationship.

The economic assistance of India to Nepal began to flow from October 1951 when two Nepalese officials took six month training in statistics in India. The main goal behind the Indian aid is to act as supplement of the efforts of the government of Nepal to increase the standard of living as well as to develop the national economy. Indian aid is mainly based on the humanitarian grounds and sometimes on political and educational motives as well. India has offered help to Nepal in almost all economic sectors like agriculture, industry, infrastructure development, education health etc. One of the main grounds of Indian assistance is that, poverty

anywhere is a threat to prosperity everywhere. It provides aid in the form of technical, manpower, financial and commodity terms. Indian aid has been taken for the completion of many projects for development purpose. The aid also helps to enhance mutual relationship and seek solution for the common problems of both nations.

Nepal needs huge amount of foreign aid in the form of capital as well as financial and technical assistance. Those countries which have been developed are also still receiving foreign assistance. Without foreign aid, the condition of people which is under the poverty line cannot improve well. Hence, the foreign aid (Indian assistance) is the corner stone to uplift the economic condition of developing countries like Nepal.

1.2 Statement of the Problem

Most of the developing countries like Nepal are in vicious circle of poverty. In Nepal, about 75 % of the total population has been engaged in agriculture sector and 82.93 % people live in of rudimentary type so that the production is very low. Every year, there is high resource-gap in the budget of Nepal i.e. the budget is deficit budget. Except this year, in many years before, Nepal could not bring the budget in time, Current expenditure is high then Capital expenditure. Also Capital expenditure is not fully used in time so some amount of budget goes in freeze. The expenditure is higher than the revenue collection in the budget. In this situation, foreign aid can only play the crucial role to fulfill this gap. Domestic source of capital is not enough to meet this gap between developed and under developed countries. So, only the foreign aid plays an important role to raise the nation from its backwardness by the technical revolution to mobilize resources for economic growth. Foreign aid is the medium of transferring the resources from developed to underdeveloped countries.(Census Report-2011, Economic Survey-2012)

Nepal has been received foreign aid since 1951 for the economic development of the nation but there are several impediments to reach this to the targeted population and areas. The purpose of utilization of foreign aid is to improve the

economic condition of the poor people. Foreign aids would be used properly, transparently and co-coordinately with the full of co-operation of people of targeted groups. Unfortunately, sometimes it is out of track. Even the donor countries and donor agencies have used their aids for the fulfillment of their vested interest through various conditions.

Rapid increment in foreign aid is observed every year but it has not been fully utilized. It may happen due to inefficient administration, low absorptive capacity, corruption, delays in the implementation of projects from recipients side and vested interest, directed aid programs, their strategic motives etc. from donor's side.

In this context, this study seeks to answer the following questions. The main research questions in the study are:

- a) What is the trend and pattern of total Foreign Aid in Nepal?
- b) What is the trend and pattern of Indian Aid to Nepal?
- c) What is the contribution of Indian aid on GDP of Nepal?

1.3 Hypothesis Testing

Here in order to analyze the contribution of Foreign Aid and Indian Aid to Nepal, the null hypothesis will be taken as 'there is no effect of aid on the GDP of Nepal'. Then it will be tested using regression technique by adopting t-test, F-test and so on in order to test statistical significance of the hypothesis.

1.4 Objectives of the Study

The general objective of this study is to analyze role of Foreign Aid with special reference to Indian Aid to Nepal. The specific objectives of the study are as of:

- a) To illustrate trend and pattern of foreign aid to Nepal.
- b) To analyze the trend, pattern & sectoral allocation of Indian aid to Nepal.
- c) To assess the impact of Indian Aid on Nepalese Economy.

1.5 Significance of the Study

As it is known that economic development depends upon many factors such as availability of resources and the ability of the people to exploit the available natural resources. Among those, one of the most important factors contributing to economic development is foreign aid. Thus this study focuses on availability and impact of foreign aid in the economic development of Nepal with special reference to Indian aid.

Nepal has a high degree of foreign aid as a percentage of government expenditure. Except few years, trend of aid is inclining. Aid and GDP ratio is approximately 10 percent and in development finance, aid ratio is still more than 60 percent.

Nepal has been continuously receiving foreign aid during the past five decades and India is one of the most influential and traditional donor of Nepal. India has assisted in every field of Nepalese economy and massive economic aid of India has helped to promote infrastructural development in Nepal.

In this regard this study analyzes the total Foreign Aid and Indian Aid to Nepal in past and present. This study will help to other scholars to study about the composition, direction, contribution and motives of Economic Assistance and particularly of Indian aid to Nepal.

As most of the research studies are done under the aggregate foreign aid concerning to Nepal and very few studies have been made about Indian Aid to Nepal.

This research study has a greater significance to provide an overview of Foreign Aid and Indian aid to Nepal. Updated information regarding trend, pattern and motives of Indian aid provides the basis to review the economic diplomacy with this country.

1.6 Limitation of the Study

Foreign aid no doubt influences almost all sectors of the Nepalese economy because there is hardly any sector in which such assistance has not been taken.

Moreover, Nepal has received so many assistances from bilateral and multilateral agencies. Therefore, this study mainly focuses on contribution of the Indian aid and the main limitations are:

-) It covers foreign assistance to Nepal mainly from 1990/91 to 2011/12.
-) The focuses on Indian Aid to Nepal.
-) Foreign private investments are not included in the analysis.
-) Military assistance is also excluded from the study.
-) Most of the data and information are derived from the AMP of Ministry of Finance which still lacks many information.

1.7 Organization of the Study

This thesis consists of six chapters in total. There are several difficult conceptual problems in terms of aid: defining foreign assistance, distinguishing it from other kinds of international transfer and so on. And there are parallel difficulties of data availability, measurement and statistical testing.

Despite these this thesis is organized as follow. First chapter summarizes the background information about the Foreign Aid. It also covers statement of problem, objective of the study, justification of the study, limitations and finally organization of the study. The second chapter illustrates the thorough review of literatures related to Foreign Aid by distinguishing theoretical and empirical aspect. As well as in this chapter several literatures are reviewed written by national and international authors.

The third chapter covers the research methodology. Fourth chapter includes the general overview of 'Foreign Aid to Nepal. Several statistics related to aid are presented in this chapter. The fifth chapter focuses on the Indian aid and it's related issues. And, sixth chapter summarizes the major findings of the study, concluding remarks and policy recommendations for the concerned authority for the effectiveness of Foreign Aid.

CHAPTER II

LITERATURE REVIEW

Actually in the field of foreign aid, there are several publications in form of books, booklets, journals and many useful articles. In the same manner there are several books, Booklets, Journals and articles written by Nepalese writer as well as foreign writers in the context of foreign aid in Nepal. This part of the study has tried to review the theoretical aspect as well as empirical aspect of foreign aid in the international and national context. The literature reviewed here are significant in that respect which has described theoretically the relationship between foreign aid and economic development need of foreign aid for development, allocation of aid etc.

The explicit transfer of real resources from developed countries to less developed or developing countries on concessional terms called foreign aid. All types of resource transfer cannot be considered as foreign aid because foreign aid has certain qualities.

Foreign aid, it should be undertaken by the official agencies (i.e. from government to government). It has to be taken with the aim of economic development, for the welfare of the recipient country and not for profit motive. It should have a 'grant element' concession and very low rate of interest which can be paid in long time back. Thus, any types of resource transfer from developed to less developed countries having above mentioned qualities is called foreign aid.

Foreign aid means transfer of financial and other resources in the form of grant, loans. From economically better nations which are not able to meet desirable growth in the era of post second world-war the term foreign aid is the transfer of resources from developed to less developed nations. The main purpose of donor country is to influence the receiving country through the moral principle of solidarity.

2.1 Theoretical Aspect

The concept of Foreign Aid is not certainly a recent phenomenon. It has been

coming from early period of classical economists. But it is generally agreed that Foreign Aid is originated from the disruption of the world economy then followed by World War II.

There are several publications in the field of Foreign Aid. Here, respective literatures of foreign aid specially related with Indian Aid are reviewed thoroughly. These literatures focus on the definition of aid, its need for and against for the developments of developing countries like Nepal and its composition. For instance, different national, international, published and web-based literatures (Books, Journals and Articles) have been reviewed related to this study in term of international and national context.

2.1.1 International context

Rodman(1961) in his book argued that 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 at a self sustaining basis. He further writes outlining the objectives of Foreign Aid, the general aim of aid is to provide in each underdeveloped country a positive incentive for maximum national effort to increase its rate of growth. The increase in income, saving and investment which aid indirectly or directly makes possible will shorten the time it takes to achieve self sustaining growth.

There is debate for and against of Foreign Aid. The economists like Rostow, Millikan, Rosenstein-Rodan and P. Hoffman accorded a top priority to Foreign Aid in economic development.

Rodan(1968) in his book assumed that the international aid would have two basic impacts: Mobilization of domestic savings and increasing the rate of investment. According to him "Aid should be allocated where it will have a maximum catalytic effect of mobilizing additional effort or preventing a fall in national effort".

Higgins(1969) in his book has emphasized the importance of Foreign Aid by saying that the availability or absence of Foreign Aid of the right kind and in the

right amount might take the difference between success or failure of a country's own effort to launch a process of sustained economic growth. The most obvious thing is that Foreign Aid can fill gap between capital requirements for take-off into sustained growth and domestic capital for saving and required investment. He has explained the usefulness of Foreign Aid for the construction of roads, dams, electric projects etc. So the capital requirements of LDC's are not as high as that of developed and fast growing economy. Because the development works in LDCs is equated with public utilities and often with basic necessities.

Griffin and Enos(1970) in their book gave a slightly different argument on Foreign Aid and economic development of developing countries, opined that “aid recipients appear to reduce domestic savings that they do not add to investment”. They argued that the inflow of foreign capital might reduce domestic saving in various ways. First the government may rely on it as a substitution for domestic savings and relax their efforts to raise tax. Second, foreign aid induces to raise salary and consumption expenditure.

Meir(1984) in his book mainly concerned how to improve the process of transferring resources from rich to poor countries-whether this transfer is in the form of public financial aid, loans from private foreign banks, private foreign investment or no monetary transfer of managerial and technical knowledge. This is not only a matter of greater amount of resources; there is now also a concern over the ‘appropriateness’ of the transfers from the developed Countries to Least Developed Countries.

Meir said about the public financial aid-that is, concessional finance or the ‘grant equivalent’ in the capital inflow has a twofold function. It supplements the LDC's low domestic savings and hence helps to fill the resources gap or “saving gap” and also provides additional foreign exchange and thereby-helps to fill the “foreign exchange gap”.

Bijoy(2010) in an article writes that, India's ODA has been focused primarily on its immediate neighborhood, namely Bhutan, Nepal and Afghanistan. The aid to

Bhutan and Nepal has been mainly in infrastructure, education, and health, with infrastructure such as hydroelectric projects holding the top position. Economic and political concerns, rather than direct humanitarian assistance, have been the prime motive, with the assistance categorized as economic cooperation rather than aid.

Murthy(2010) a research paper for Institute of Peace and Conflict Studies, writes Indian policy towards Nepal in this transitional period should be based on the twin pillars of building consensus among the political parties there and adopting measures which will fulfill the goals of Jana Andoaln II.

Vaughn(2011) in an article for the CRS Report for Congress writes that though Nepal's status as a small, landlocked state situated between India and China also makes it important to foreign policymakers. Nepal's reliance on these two giant neighbors leads it to seek amicable relations with both, though ties with India have historically been closer. Some believe India is concerned a Maoist regime in Nepal could lend support to Maoist rebels in India. China, meanwhile, has taken several steps to pressure Nepal to repatriate, or at least constrain the activities of, refugees crossing the border from Tibet.

2.1.2 National Context

Various Authors of Nepal have made several studies about Foreign Aid to Nepal and as well as in the context of Indian Aid to Nepal.

Phulara(1974) in his thesis shows that India has provided substantial assistance for the development of Nepalese economy at the best of here capacity. Since, 1951, India extended support to many areas of economic development. He further states that the economic assistance from India in different sectors of Nepalese economy has taken 38 percent of the total assistance to Nepal 1951 to 1972. However, he was unable to mention the assistance after flowing 1972 in different sectors.

Poudyal(1980) in his thesis has concluded that India has been a pioneer and continues to be the foremost in the field of assistance to Nepal in initiating and

accelerating the process of her economic development. His study has included the Indian aid to Nepal since 1979/80. After 1979/80, many economic activities have been held under India-Nepal co-operation.

Bhandary(1986) in his dissertation recommended that the effectiveness and appropriateness of external assistance in light of development and transfer of suitable agriculture technology. He further suggests that the external assistance should be made responsive to Nepal's need and benefit of Nepalese people. The assistance should result a permanent increase on production and income level and at the same time contributing strengthening of institutional base so that development projects are sustained after the withdrawal of external assistance.

Upreti(1998) in his book shows six kinds of aid in different perspectives which are as follows:

Capital aid: Capital aid includes in grants and loans. The purpose of it is to enhance the quality of life by achieving the proper healthcare, education, infrastructure development etc.

Technical aid: Technical aid includes the services of technical expertise, scholarships and fellowships. It generally bears four objectives, (a) To provide trained personnel to the recipient country (b) To help the recipient country in building up their manpower (c) Employment of donor's own technical personnel in other countries and (d) To test their supplicated technologies in the other countries.

Multilateral aid: The aid inflows through IMF, WB, IBRD etc.

Bilateral aid: Bilateral aid is the flow from the government of another. The terms and conditions of aid vary from country to country. Upreti (1998) says bilateral aid is politically motivated and certain sector of its economic of the recipient countries are focused which they want to develop with the help of foreign aid and many others may remain neglected.

Karna(2007) in his article argued a much debated and controversial phenomenon. He introduces the Nepalese economy as facing recession and is passing through a critical phase of low level equilibrium trap circumscribed by mass poverty and

stagnation. Similarly, there is a manifesting of an acute disguised unemployment and subsistence farming with limited prospects for mechanization. Nepalese society is moving towards three headed crisis that are constituting existence of poverty on a large scale, threat to national environments resources base and high population growth. There is an existence of conflict, corruption, policy failure, instability and other shortcoming which affect the rate of capital formulation resulting huge gap between supply and demand resources.

Finally, he suggested that to make foreign aid more effective and efficient, there must be the following aspects which need to be considered priority list for proper utilization of foreign aid, selection of projects with full commitment regarding their objectives substantial improvement in the absorptive capacity of foreign aid, control of corruption, formulation of proper co-ordination, evaluation and monitoring mechanisms.

Tamang(2009) in his article mentioned that, As a result of recent concerns over global security, donors and aid agencies have redirected aid funding to strategic and political interests. They shifted their priorities from humanitarians and sustainable development to freedom and international security. Such shifts undermine interventions to ease widening socio-economic disparities as a result poor countries like Nepal have experienced a significant decline in international development aid.

By examining the geopolitical interest of donor countries and the effects of this interest on the provision of aid, this paper gave a new insight into the complex relations between international development aid and geopolitics. He argued that development aid is politically motivated and often used as a tool to promote donor countries as a tool to promote donor countries' interests, and it thus contradicts the humanitarian aspect of aid itself.

Raut(2008) reviewing a book writes that Foreign Aid has not been successful in contributing to the growth of Nepal. The major problem hindering growth as regards to Foreign Aid is the poor competitive edge of Nepal's development

projects especially the low productivity of key inputs. He says that the book further perceives that the efficacy of Foreign Aid should be judged on the basis of its contribution towards increasing productivity and economic opportunities to poor, developing human resources, providing safety nets, enhancing institutional capability and promoting good governance.

Pyakurel, Adhikari and Dhakal (2008) in their book had explained the availability of economic resources which are fundamental for overall development indicative of a nation. For this, it requires to increase the productive capacity of the economy, which again depends on the increasing share of investment in total GDP. To increase investment, it requires really total consumption and increasing domestic saving. However, the consumption shows that it is growing continuously. For the period of 1994-2004, the total consumption rate grew up from 85 percent to 87 percent of total GDP. This leads to be dependent on foreign assistance for investment.

Foreign Aid Policy(2009) of Nepal outlines key problems contributing to ineffective foreign aid management and poor development results seen both from the donor and country perspective. From donor's perspective lack of ownership, internalization and institutionalization, lack of leadership and direction, poorly functioning institutions, weak governance, fragile political environment, lack of political consensus on economic agenda and absence of policy coherence and consistency were pointed out. Looking through the national perspective, it can be argued that aid has achieved success in a number of areas such as building physical and social infrastructures like roads, health, drinking water and education, in sectors such as agriculture, forestry and irrigation and also in erecting and empowering institutions needed for advancing economic reforms. However, despite the volume and magnitude of aid mismatch of priorities between the recipient and donors. Absence of prioritization based on national needs, ignorance of sustainability, operation and maintenance aspects of the projects and slow disbursement as compared to commitment are the problems.

Malone(2010) a former diplomat in Himalayan Times suggests that Nepal should reduce dependency on aid. The president of Canada's International Development Research Centre (IDRC) and the former Ambassador of Canada to Nepal and India Malone said that the content and context of the discussions on aid policy is changing globally so Nepal should lower its dependency on the development aid assistance to ensure the better future.

He further said that Nepal is dependent on the remittances and the foreign aids and both are taken as the bad indicators of economic sustainability. "The emerging economies of the world succeeded due to internal promotion of the economy so foreign aid is not a good driver for development and Nepal should start the ground works for lowering its dependency on foreign aids and remittances." Malone further said that the development aid providing communities are like fashions so their priorities changes with the time and the global agendas.

Humagain(2011) in Kathmandu Post writes that the increased aid to Nepal-both grants and loans-coincides with China's economic might and it's global leverage. He further says in his article that China now figures in the list of top five development partners.

2.2 Empirical Aspect

2.1.2 International Context

Campbell(2012) in a case study mentioned the interest of Chinese engagement in Nepal as: China does not have a development agenda per se that is comparable to that of Western donors, but its engagement in Nepal and other developing countries is based on a number of core principles. A central principle that guides much of China's foreign policy is that of respecting the sovereignty of all states. China's position is that it will not intervene or seek to influence the domestic affairs of any country since these are the exclusive concern of the national government. This is generally referred to as China's policy of 'non-interference'. Thus, when the current Chinese Ambassador in Kathmandu took up his post, he reassured Nepal that "China will never deviate from its policy of non-interference

in the internal matters of Nepal”.

In addition to the sovereignty and non-interference, another key principle of China’s engagement in developing countries is that of mutual benefit. China through global engagement, especially in new developing country such as Nepal likes to expand its market.

Fuchs & Vadlamannati(2012) in a study outlined that, it is puzzling to note that India, which has a large domestic constituency of impoverished population that suffers from underdevelopment, chronic poverty and mal-governance, has jumped onto the bandwagon of the development aid business. Given this backdrop, it is ironical that India provides development aid to other developing countries.

With the intension to learn why poor countries such as India provide foreign aid, their paper made an attempt to analyze econometrically India’s aid allocation decisions. Their found some interesting points. Indian aid is largely driven by commercial and political interests, while recipient need is no key determinant of India’s allocation of technical assistance. They concluded that the “needy donor” mainly cares about its own needs rather than the needs of others.

2.2.2 National Context

Poudyal(1988) in a research paper using data from 1964 to 1982 performed regression analyses between foreign aid and economic growth, and aid and domestic savings. He found that aid had a significant positive effect on the level of GDP. Poudyal estimated the model using five years lag of aid. For the one and two years lag, the coefficients were found smaller and negative. But for the four and five years lag, the coefficients were positive and larger. Thus, he claimed that the long running aid funded projects did not contribute to the economy in the short-run. The negative short-run relationship between aid and growth was attributed to the use of domestic resources (as a part of recipient contribution) to support these long running foreign financed projects. However, the study did not find statistically consistent results between aid and domestic savings. Poudyal strongly believed that foreign aid contributed positively to the development of Nepal. It was

only possible through aid to build major projects and physical infrastructure, which would not have been built due mainly to resources constraints.

Sigdel(2004) in his study found that there is a significant relationship between resource gap and Foreign Aid during the period 1981/82-2001/02. The study found that the role of Foreign Aid to bridge the resource gap in Nepal has been crucial which is estimated to be more than 60 percent of total resource gap. In addition, that study concluded that Foreign Aid has become a foundation to North-South (China-India) relation.

Bhattarai(2005) in his PhD Thesis employed time-series econometric techniques such as co-integration and the error correction mechanism, using data for the period 1970-2002. The empirical analysis is divided into three parts. In the first part, the relationship between aid and per capita real GDP is examined within a framework of the neoclassical production function. In the second part, the relationship between aid and investment is examined within the framework of the two-gap model. In the third part, the relationship between aid and government's expenditure and revenue is investigated within the framework of the fiscal response model. The results show that aid has a positive and significant relationship with per capita real GDP, savings and investment. The fiscal response to aid suggests that aid induces more non-development expenditure than development expenditure; however, aid does not have any negative impact on revenue raising efforts.

Aryal(2008) in his thesis has done an overall assessment of the role of Foreign Aid in economic development of Nepal. The objective of the study was to analyze the relationship between Foreign Aid, GDP and Human Development Index (HDI). In order see the relationship OLS method has been to estimate the model and F-test, T-test, R^2 test were used in order to check the statistical significance of results.

Aryal has found an increase in Foreign Aid has the effect on the GDP with 1% increase in real Foreign Aid causes the 2.92% increase in GDP value in Nepal. The result of his study also shows that there is the association between real Foreign Aid

and HDI, with 1 million rupees increase in Foreign Aid increase HDI ranking of Nepal by 0.000003. His study provided an empirical foundation that the role of Foreign Aid in Nepal is playing positive increase in GDP as well as HDI.

Thapa(2009) in his thesis found that the percentage of Indian Aid to the GDP of Nepal ranges from 0.03(FY 1995/96) to 0.66(FY 2003/04) and the average share of Indian Aid to the GDP is 0.25 during that period. He further found that Indian Assistance is spread in all sectors. Specifically 33% of it's total assistance is disbursed in Transportation development of Nepal.

Paudel(2013) in his thesis found the close interlink of GDP with the foreign assistance. To compare the Chinese Aid and Indian Aid to Nepal, He used regression analysis in order to find the contribution of Indian Aid and Chinese Aid to the GDP of Nepal. From the regression analysis he found the beta-coefficients 0.501& 0.716 respectively. The implication of this finding is that Chinese Aid has higher positive effect on Nepal's GDP as compared to Indian Aid at current prices.

By reviewing the national and international literatures related with Foreign Aid to Nepal and particularly of Indian Aid to Nepal, It can be said that the contribution of Foreign Aid in Nepal is pervasive and influential. Since the India is neighboring country as well as there is cultural, social, economic, historical as well as political commonalities and relation. Indian influence in Nepal has further consolidated after signing Comprehensive Peace Accord (CPA) in 2006. Indian then and after continually assisting Nepal with increased volume in every sphere. This thesis presents the updated present scenario of Indian assistance in Nepal.

CHAPTER III

RESEARCH METHODOLOGY

3.1 Data collection and Sources of Data

This study attempts to get various empirical results using only secondary data. The required data are collected from various sources like Ministry of Finance, Embassy of India, National Planning Commission, and Central Bureau of Statistics. Likewise different Budget Speeches, Economic Surveys of different years and Plan Documents have been used for the completion of this study. In addition to these the required data and information are collected from various Books Articles, Journals, Magazines and web-based sources. The collected data are arranged systematically in tabular form according to the need of the study. The methodology used in this study is of descriptive as well as analytical in nature. This research is mainly based on secondary data. The data for our study is mostly collected from national sources, especially from Foreign Aid Division of Ministry of Finance.

3.2 Sampling

To analyze the impact of Foreign Aid and Indian Aid to Nepal, the data has been selected as the sample size according to purposive sampling method. To analyze Indian Aid and its contribution to Nepalese economy through regression analysis, sampling size of fiscal year ranges from FY 1990/91 to FY2011/12. However, the study also tries to explore and analyze the sector wise impact of Indian aid to Nepalese economy since its formal initiation.

3.3 Data Processing and Data Analysis

The data collected from various sources are classified and tabulated as per the requirements of the study. The simple calculation like percentage, ratio, average value etc. be made and tables, graphs, pie charts are used to explain and compare the data series. To illustrate the contribution of Indian aid to Nepal regression analysis has been used. Furthermore Marginal Productivity of Aid and Elasticity of Aid have been estimated. Computer software like Excel, Stata and SPSS are employed as per need to analyze the study.

3.4 Model specification for the impact assessment

The regression model specified to find out the impact of Indian aid to the GDP of Nepal is given below.

$$Y = a_1 + b_1 F_{T \text{ Aid}} \dots \dots \dots (1)$$

$$Y = a_2 + b_2 F_{I \text{ Aid}} \dots \dots \dots (2)$$

Where Y : GDP

$F_{T \text{ Aid}}$: Total Aid

$F_{I \text{ Aid}}$: Indian Aid

a_1, a_2, b_1, b_2 are coefficients.

3.5 Test of the Goodness of Fit (R^2)

After estimating the regression parameter R^2 judges the explanatory power. The formula to derive R^2 is mentioned below

$$R^2 = \frac{\sum_{i=1}^k b_i x_i y - \Gamma b_k x_k y}{\sum_{i=1}^k b_i x_i y - \Gamma b_k x_k y}$$

Where, $\bar{y} = \frac{\sum XY}{\sum X}$
 $\bar{x} = \frac{\sum ZY}{\sum ZX}$

3.6 t-Test

T-test is carried out in order to identify the statistical significance of an observed sample regression coefficient and the formula for calculating value is

$$t = \frac{\hat{a}_i}{SE(\hat{a}_i)}$$

Where \hat{a}_i = estimated value of a_i

$SE(\hat{a}_i)$ = standard error of a_i

$$SE(\hat{a}_i) = \sqrt{Var a_i}$$

3.7 F-test

F test is used to examine the overall significance of the model. The formula for calculation is

$$F = \frac{R^2 / K}{(1 - R^2) / (N - K)}$$

R^2 = Coefficient of determinant

K = Number of explanatory variable

N = Number of observation in the sample

CHAPTER IV FOREIGN AID TO NEPAL

4.1 Background

Foreign Aid continues to play an important role in Nepal's socio-economic development, representing about 26 percent of national budget. Nepal receives official development assistance from over 40 donors (IECCD Report, 2013).

Nepal is a landlocked South Asian country, lying between the two giants – India and China. To the south, west and east is India; the north borders with China. Nepal's per capita income is of US\$ 742 make it the 12th poorest country in the world and the poorest in South Asia. In purchasing power parity terms Nepal is the 30th poorest country in the world. According to the National Population and Housing Census of 2011, Nepal's total population has reached 26,494,504 million, and the annual population growth rate is 1.35 per cent. Agriculture is the main source of income: it provides a livelihood for over 76.3 percent of the population and accounts for 36.9 per cent of GDP.(MoF-GON 2012, Census Report-2011)

In capital-starved countries like Nepal, Foreign Aid has been considered as the important source of financing, implementing and completing different socio-economic programs. However, the accessible external aid has not always been utilized in formulation and effective implementation of effective programs. While a judicious use of external assistance has been instrumental in achieving accelerated development of many LDCs of the world, many nations have failed to use it aptly and optimally. As a result such countries have accumulated significant amounts of debt with not many benefits in terms of economic growth and living standard of the poor.

Many aid recipient countries that are least developed too failed to use the Foreign Aid effectively due to the inadequate absorptive capacity, donor driven aid, lack of transparency and corruption etc.

4.1.1 Historical Background of Foreign Aid in Nepal

The history of Foreign Aid in Nepal is not very old. Until 1951, Nepal was under the feudalistic and exploitative regime (Rana Regime), which kept country isolated from the rest of the world. The history of foreign assistance in Nepal begins with the signing of an agreement with the United States of America under its 'Point Four Programme' in 1951.

In 1952, Nepal joined the Colombo plan and gradually attracted the interest of the friendly countries in her development efforts. The volume of aid inflow into the country played a meaningful role in the progress of various sectors of Nepal. Nepal remained underdeveloped because it was poor with lack of resources and technical know-how; Foreign Aid transmits not only money but also ideas, values and technologies. After joining the Colombo Plan, Nepal got considerable amount of aid for various projects from the USSR, China, UK, Germany, Canada etc.

In 1976, Nepal Aid Group was formed in order to channelize Foreign Assistance in a coordinated and internationally agreeable manner under the guidance of World Bank. The bulk of Foreign Aid came after 1976 came from this group. The Nepal Aid Group has enlarged the number of its members to about 2-dozens including multilateral donors, namely IDA, WB, IMF, UNCTAD etc.

In mid to late 1980's recorded aid disbursements averaged more than US\$200 million annually about 7 percent of GDP. More than 70 percent of the aid was in the form of grants, the remainder was in the form of concessional loans. By 1991, Nepal was receiving external assistance in the form project aid, commodity aid, technical assistance, and program aid.

After the restoration of multiparty democracy, many international donors as well as multilateral agencies have taken keen interest of providing aid in different sectors of the Nepalese Economy.

4.2 Magnitude and Trend of Foreign Aid in Nepal

Since 1951(A.D), the history shows that Nepalese economy is overwhelmingly dependent on foreign aid (through grants and loans). Foreign aid has become an integral part of the development process in Nepal. For the first five years, from 1951-1956, Nepal received NPR 95 million in aid, all in the form of grants.

The latest budget for fiscal year 2013/14, puts the estimated receipt of foreign aid at NPR 113.24 billion. In which 69.54 billion is grants component and 43.7 billion is loan.

The tables 4.1 in the following page, with data culled from many different sources, attempt to give a clearer picture of the evolution of foreign aid in Nepal. For our purpose, we have analyzed the foreign aid in Nepal from fiscal year 1990/91 to FY 2011/12.

Table 4.1
Total Aid Inflow to Nepal

(NRS in Million)

FY	Total Aid	Grant	% of Grant	Loan	% of Loan
1990/91	5990.00	1630.00	27.21	4360.00	72.79
1991/92	7798.40	1531.00	19.63	6267.40	80.37
1992/93	9235.60	3273.90	35.45	5961.70	64.55
1993/94	11557.20	2393.60	20.71	9163.60	79.29
1994/95	11249.40	3937.10	35.00	7312.30	65.00
1995/96	14289.00	4825.10	33.76	9463.90	66.24
1996/97	15031.90	5988.30	39.84	9043.60	60.16
1997/98	16457.20	5402.60	32.83	11054.60	67.17
1998/99	16198.00	4336.60	26.65	11852.40	73.35
1999/2000	17523.90	5711.70	32.59	11812.20	67.41
2000/01	18797.40	6753.40	35.93	12044.00	64.07
2001/02	14384.80	6686.20	46.48	7698.60	53.52
2002/03	15885.50	11339.10	71.38	4546.40	28.62
2003/04	18912.40	11283.40	59.66	7629.00	40.34
2004/05	23657.30	14391.20	60.83	9266.10	39.17
2005/06	22041.70	13827.40	62.73	8214.30	37.27
2006/07	25854.30	15800.80	61.11	10053.50	38.89
2007/08	2930.70	20320.70	69.35	8979.90	30.65
2008/09	3635.20	26382.80	72.58	9968.90	27.42
2009/10	4976.90	38546.00	77.45	1122.34	22.55
2010/11	8640.00	4924.80	57.00	3715.20	43.00
2011/12	8320.00	4992.00	60.00	3328.00	40.00
Total/Average	293366.80	214277.70	47.19	172857.90	52.81

Source: Various Issues of Economic Survey, AMP MoF Nepal

Table 4.1 shows the historical trend and pattern of Foreign Aid volume received by Nepal in different fiscal years. In the table, percentage share of Grants and Loans in Total Aid have been presented as well.

The table shows, for each year, aid receipts have been broken down into loan and grant components. One obvious distinction is that aid given as loan has to be repaid (though most of credit offered Nepal have been at low rates with generous payment plans), while grants do not. One of the most noticeable features of this table is the increasing share of grants in the composition of foreign aid. Initially, all of the aid received was in the form of grants.

By observing the above table total aid received by Nepal since FY 1990/91 to FY 2011/12 is around 2934 billion Nepali Rupees. On which average percentage of Grants component is 47.19 percent and the average percentage of Loan is 52.81. Which shows that the changing pattern of Foreign Aid to Nepal comparison to initial year.

By studying the overall history of Foreign Aid to Nepal, the formal economic assistance is found to be provided after political revolution of 1950s. The “Point Four Program” agreement signed between Nepal and USA on January 23,1951,under this agreement US government provided Rs.22000\$. It was then followed by China (1956) and USSR (1958). However, the trend of Foreign Aid inflow began to increase continuously after 1956. Until 1963/1964; most of the Foreign Aid was provided in the forms of grants. Afterwards, the trend of Foreign Aid changed with the inclusion of loan. The loan amount exceeded the grants gradually up to now. The major reason behind the decline of loan and increment of grants is due to the conflict resolution and peace process. Many donors have shown interest for the post conflict infrastructural development and rehabilitation of the economy.

4.3. Foreign aid commitment and disbursement

In developing countries like Nepal foreign aid is considered as one of the most important factors for development. Foreign aid also differs from its commitment and disbursement. Commitment are the firm obligations to lend a specific amount on specific term and conditions and disbursements imply the utilization of foreign fund received under agreements signed. It is an inflow of to aid recipient country.

In the following table commitment and disbursement figures of Foreign aid to Nepal are presented from the fiscal year 1990/91 to 2011/12.

Table 4.2
Pattern of Foreign Aid Commitment and Disbursement

(NRS in Million)

FY	Aid Commitment	Aid Disbursement	Disbursement as Percentage of Commitment
1990/91	5990.00	5665.40	94.58
1991/92	21084.10	7800.40	36.99
1992/93	20526.70	9235.60	44.99
1993/94	13172.20	11557.20	87.75
1994/95	12876.80	11249.40	87.36
1995/96	16537.50	14289.00	86.40
1996/97	39643.00	15031.90	37.91
1997/98	32022.00	16457.10	51.39
1998/99	18352.50	16189.00	88.21
1999/2000	20448.00	17523.90	85.69
2000/01	31287.00	18797.40	60.08
2001/02	33227.70	14384.80	43.29
2002/03	43202.70	15885.50	36.76
2003/04	23738.00	18912.40	79.67
2004/05	38152.30	23657.30	62.00
2005/06	22041.80	20924.20	94.92
2006/07	37022.90	25854.30	69.83
2007/08	49186.20	29300.60	59.57
2008/09	479775.30	36351.70	7.75
2009/10	96609.00	49769.40	51.51
2010/11	106100.07	57997.80	54.66
2011/12	76733.40	48521.23	66.23
Average	56260.41	22061.61	62.92

Source: Different issues of Economic Survey, MoF-GON

Table 4.2 shows that the historical pattern of commitment and disbursement of Foreign aid to Nepal in different fiscal year. By observing the table it is clear that

there is greater gap between commitment and disbursement figure. The table shows the disbursement as a percentage of commitment. In an average only 62.92 percent of committed aid is disbursed in Nepal. The main reason behind this is the lack of aid absorptive power and inability to meet the different provisions made by the donors from the side of Nepal.

4.4 Foreign Aid in Nepalese Periodic Plan

External financing, along with internal resources, has been playing an important role in development activities. In late 1930s the Nepalese government prepared 20 year economic development plans but it was not implemented because of Second world-War. Then, in 1984, the National Planning Board (NPB) was established to prepare the 15 year plan, but it could not carry out because of the political change of 1950/51. In order to improve the living standard of Nepalese people, it required undertaking new strategies. The government started making five year plans for the economic development. Foreign Aid has played a significant role in financing Nepalese development plans. The contribution of Foreign Aid in public sector expenditure in different periodic plans is shown in the table below.

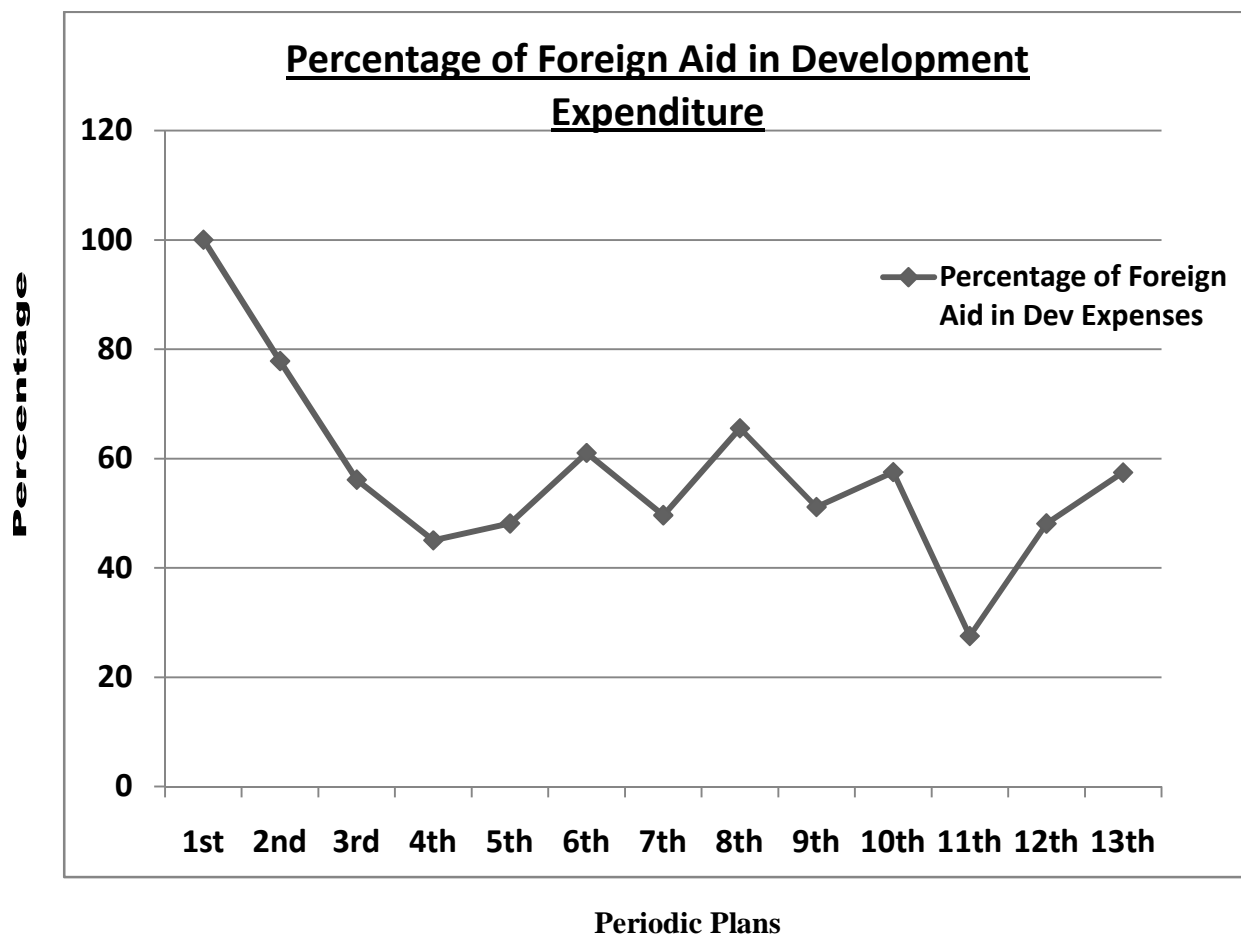
Table 4.3
Foreign Aid and Nepalese Plan Period

(NRS in Million)

Plan	Plan Period	Development Expenditure	Total Foreign Aid	Percentage of Foreign Aid in Dev Expenses
1 st	1956-61	382.90	382.90	100.00
2 nd	1962-65	614.70	478.30	77.80
3 rd	1965-70	1639.10	919.81	56.10
4 th	1970-75	3356.90	1509.10	45.00
5 th	1975-80	8870.60	4264.10	48.10
6 th	1980-85	21750.00	13260.00	61.00
7 th	1985-90	48345.40	23978.50	49.60
8 th	1992-97	111919.80	74355.00	65.50
9 th	1997-2002	215154.40	111546.00	51.10
10 th	2002-2007	234030.00	134620.00	57.50
11 th	Interim Plan 2007-2010	140660.00	38695.60	27.51
12 th	2010-2013	364340.00	175180.00	48.08
13 th	2013-2016 (Concept Paper)	329976.00	189455.00	57.41
Total/ Average		1481039.80	768644.31	57.28

Source: National Planning Commission 2009,2013

Figure 4.1
Foreign Aid and Nepalese Plan



Source: Based on the Table 4.3

From the table 4.3 and trend line plotted in Figure 4.1, it can be seen that the contribution of Foreign Aid in first periodic plan of period 1956-1961 to finance the development expenditure was 100 percent. Up to now 11 periodic plans has been exercised in the country and now 12th plan is under progress. By analyzing the Trend Line and Table above it can be see that in second plan period the share of Foreign Aid decreased to 77.8 percent. Such decrease in continued up to 45 percent in 4th plan. In 5th plan, Foreign Aid increase to 48.1 percent and in 6th plan its share reached 61 percent. From 7th plan percentage share of Foreign Aid was again declined into 49.6. In 8th plan percentage of Foreign Aid in development expenditure increase again to 65.5 percent. In the 10th plan, it remained 57.5 percent. In Interim Plan (2007-2009) Foreign Aid contributed to finance the 27.51 percent of targeted development expenditure.

4.5 Aid Management in Nepal

Foreign aid plays an important role in Nepal's socioeconomic development, representing 26 percent of the national budget. The main sectors receiving external support are education, local development, health, roads followed by drinking water, energy, agriculture, and peace and rehabilitation. Various economic and financial reform programs also receive significant external support. Nepal receives official development assistance from over 40 donors, including 35 resident agencies. The Ministry of Finance is mandated for the overall coordination of foreign aid in Nepal, including its allocation in line with national priorities. The Foreign Aid Coordination Division (FACD) of the Ministry of Finance is empowered, among others, to oversee the Government's activities in the area of aid coordination, harmonization and alignment.

4.5.1 Aid Management Platform

For the purpose of aid transparency and aid predictability, the Aid Management Platform (AMP), an online web-based information system has been set up in the Ministry of Finance. All development partners have been given access to this and requested to report regularly. In addition, all the ministries including the National Planning Commission, Ministry of Education, Ministry of Health and Population and Ministry of Local Development have been given access to this system. Ministry of Finance is planning to make key aid information available to the public through its website in 2013 with the help of AMP, and to conduct a number of outreach activities with all concerned stakeholders, including Parliament, civil society and Government officials.

The AMP has currently been a very effective tool for the collection and dissemination of information related to foreign aid inflows. It has been custom-made for Nepal to meet its particular development planning and information needs. It has filled significant gaps in government knowledge about trends in aid allocation, the amount of aid that is off budget, particularly technical assistance (TA), in addition to the extent of aid fragmentation and the predictability of aid. The first development Cooperation Report based on AMP data was published in

March 2012 and it gave a broad overview of foreign aid in Nepal along with some analyses of aid fragmentation, the use of technical assistance, and the alignment of programs with national policy.

4.6 Structure of Foreign Aid in Nepal for the Fiscal Year 2011-12

The total volume of foreign aid disbursement including Technical Assistance (TA) for FY 2011-12 was US\$ 104 Billion. On which 60% of aid was Grants 63090 Million, Loan 25% (25470 Million) and Technical Assistance(TA) 15% (15950 Million). The multilateral assistance was of 63020 Million and Bilateral 41500 Million for that fiscal year. The following table presents the sector wise disbursement of Foreign Aid in fiscal year (2011-12).

Table 4.4
Sector wise Disbursement of Foreign Aid in FY 2011-12

(NRS In Million)

S.No	Sector	Aid Volume (Million)
1.	Education	22900.00
2.	Local Development	11670.00
3.	Road Transportation	11670.00
4.	Electricity	10680.00
5.	Health	8500.00

Source: MoF, IECC Divison Nepal

Table 4.4 shows the top five sectors on which Foreign Aid is concentrated for the FY 2011-12. In Education 22900 Million has been disbursed, for the local development 11670 , Road Transportation 11670, Electricity 10680 and Health 8500 Million disbursed respectively.

CHAPTER V

INDIAN AID TO NEPAL

5.1 Introduction

The South Asian Countries, India and Nepal have similar religious, cultural, environmental physical and natural heritages. After independence movement in India, the relationship between these countries has been closed and receiving help for the betterment of political and economic condition. In 1947, Nepalese citizen played active role to free India from British Colony. After the end of British Colony in India, they helped to overthrow Rana Family Regime from Nepal.

The relationship between India and Nepal is very much interlinked. Such relationship further intensified after the signing the 12-point agreement in New Delhi. After the Sino-India conflict, India increased her assistance to Nepal considerably both in quantity and quality to expedite economic development.

The program of India-Nepal economic cooperation was launched in 1952 with the construction of an Air-Strip at Gaucher. Gradually, the volume of assistance began to increase and it became necessary to establish a full-fledged Indian Aid Mission in Kathmandu in 1956. The Indian Aid Mission was later renamed as India Cooperation Mission. Presently the India Cooperation Mission is transformed as a part of the Embassy of India as it's Economic Cooperation (EC) Wing.

The objective of this program was to supplement the efforts of the Government of Nepal in the national development of the country. India's assistance program in Nepal is guided by the vision that alongside progress in political process in Nepal, it is equally important to ensure that economic deliverables, particularly in the areas of education, health and infrastructure, must reach the people without any pre-conditions in a smooth, quick and unencumbered manner. Towards this end, Government of India is providing technical and financial assistance for multi-sectoral development of Nepal.

India has been assisting Nepal continuously in many ways it's independence from

British colony in 1947. India has mainly helped Nepal in the field of Transportation, Industry, Education, Agriculture, Health, Technological development etc. Indian aid plays important role in the field of economic development as well as humanitarian base.

5.2 Nepal-India Relations

A. Political

Nepal and India established diplomatic relations in 13 June 1947. To concretize it's vision of development cooperation, Government of India set up the Indian Aid Mission in Kathmandu in 1954, which was later renamed as the Indian Cooperation Mission (ICM) in 1966 and remained functional till the 1980s. Later, the ICM was recast as the Economic Cooperation Wing of the Embassy of India.

Nepal and India are bound together by age-fold ties of history, culture, tradition and religion. The relations between these are deep and extensive pervading many aspects of life. There are time-honored traditions and socio-cultural ethos common to both peoples. A firm commitment to the principle of peaceful coexistence and sovereign equality of the states has characterized our relations. Both countries share commonality of approach in many outstanding international issues. With the establishment of SAARC, some more areas have been added for self reliance within the region. The main thrust now is to strengthen and broaden neighborly relations based on mutual understanding of each other's aspirations and interests.

Nepal and India have been living as close neighbors of South Asia since the existence of the two countries. The relationship between the two countries is bound by history, geography, economic cooperation, socio-cultural ties and people-to-people relations. The bilateral relationship, which is marked by mutual trust, good will and cooperation, has been moving forward with the increased interactions and close cooperation between the two countries with the passage of time.

A number of mechanisms exist between Nepal and India for bilateral cooperation covering various aspects of bilateral relations ranging from trade and economic cooperation to security and water resources. Post the visits from Nepal to India at the level of Prime Minister after Nepal got transformed into a democratic republican country in 2008 A.D, both the countries agreed to reactivate the bilateral mechanisms. Consequently, interactions have taken place on cooperation related to security, water resources, trade and commerce, customs, etc. at different levels. There has been a renewed interest in both the sides to make the bilateral relationship more interactive and fruitful.

India is Nepal's important trade partner. Trade relations between the two countries are growing year after year, though it is in India's favour. India is also a major source country of Nepal's foreign direct investment. A good number of joint venture projects with Indian investment are in operation in Nepal. Due to geographical proximity, socio-cultural linkages and increased interactions between the two peoples, trade, commerce and economic cooperation have been expanding along with the growth in other aspects of bilateral relationship.

On the economic side, India has cooperated with Nepal in the construction of various projects, especially in the sectors of infrastructure, health, education and other technical fields. There are other projects that benefit both the countries. Some projects, including relating to cross-border connectivity, are in the pipeline. Development of infrastructure, communication and technological capabilities of Nepal facilitates mutual gains through commercial, economic and technical cooperation between the two countries.

India's sustained economic growth and development can be an energizing factor for the economy of other neighboring countries like Nepal. Having been closely interconnected economic ties, the growing Indian economy can

provide space for stimulus to Nepal's drive towards faster economic growth. It would also open up broad areas of cooperation for the two countries.

B. Economic Relation

Nepal and India enjoy excellent bilateral relations in political, economic, trade and cultural fields, apart from intimately closer people-to-people ties. India is extending economic and technical support to Nepal, especially after 1951. The signing of the India-Nepal Treaty of Peace and Friendship in 1950 established the framework for the unique ties between the two countries. Since the early fifties, India has contributed significantly to the socio-economic development of Nepal. Areas of economic relations mainly cover basic infrastructure such as airports, irrigation, agriculture, roads, bridges, power projects, industrial estates, communication, surveys, forestry, building construction, along with some vital social sector areas like health, education, human resource development etc.

A number of projects including improving physical facilities and infrastructure at important border customs stations and check-posts, pilot projects in rural and community development, small/medium hydro-power projects, milk and dairy development, establishment of Information Technology Institute etc. are under process. The Raxaul-Birgunj Broad Gauge Rail Link Project has eased the trade of both countries. Setting up of an Emergency and Trauma Centre at the Bir Hospital and the Mahendranagar-Tanakpur Link Road Project are some other commitments made by India.

Similarly, a project presently on anvil for cross-border rail links at five locations at the Indo-Nepal border (Jalpaiguri-Kakarbhitta, Jogbani-Biratnagar, Jaynagar-Bardibas, Nautanwa-Bhairahwa, Nepalgunj Road-Nepalgunj) will significantly boost cross-border linkage and will be of immense value in promoting trade and commerce between the two countries.

C. Trade and Commerce

Nepal and India have a history of age-old relations in trade and commerce. India is Nepal's largest trade partner and source of foreign investment. In the fiscal Year 2011/12 total bilateral trade between Nepal and India was NPR 155228.40 Million and percentage share of trade with India was 65.12%. During that year, Nepal's Imports from India amounted 299389.60 Million and Exports to India remained about NPR 49616.30 Million.

The following table shows the historical direction of Nepal's annual trade with India.

Table 5.1
Direction of Foreign Trade with India

(NRS in Million)

	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
Export	27956.20	26430.00	30777.10	38916.90	40714.70	41728.80
Import	56622.10	70924.20	78739.50	88675.50	107143.10	115872.30
Share in Total Trade (%)	54.80	55.86	57.58	61.29	63.18	62.03
	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13*
Export	38555.70	41005.90	39993.70	43360.40	28473.80	33254.20
Import	142376.50	162437.60	217114.30	261925.20	299389.60	237643.90
Share in Total Trade (%)	64.34	57.77	59.08	66.29	65.12	65.82

Source: Economic Survey 2013, MoF Nepal

By observing the above table we see that in each year the share of India in total Foreign Trade of Nepal seems quite great. And in each successive fiscal year it is increasing. When we observe the Exports of Nepal to India it is low compare to Imports. Further, the Volume of Export in each successive fiscal year is declining whereas the Import volume seems increasing.

Major commodities exported by Nepal to India are Jute Goods, Plastic Utensils, Textiles, Pashmina, Polyesters, and Juice etc. Other traditional export items to overseas countries are hides and skin, lentils, metal and wooden handicrafts, agro- and forest-based primary and secondary goods, leather, raw jute, large cardamom, ginger, tea and medicinal herbs. Coffee, honey, terry towels, micro transformers, blankets and buttons are emerging as new export items.

Visualizing the scope of technology enhancement and production potentials, the upcoming export items would be Mushroom, Saffron and Floriculture products. Vegetable seeds, Orthodox and CTC tea, Niger seeds, essential oils from medicinal and aromatic plants, Leather goods, Woolen goods, Silver Jewellery and Silverware, Gold Jewellery, etc also offer good export prospects beside the existing exportable items.

Over the years, Nepalese imports to India have increased substantially and undergone major structural changes. The major import items include Petroleum products, Machinery and Spare parts, Transport equipment, Pharmaceuticals, Chemicals, Electrical goods, Vehicles and Spare parts, Medicines and Medicinal equipment, Raw silk, Threads, Fertilizers, Telecommunication equipment, etc.

D. Socio Cultural

The countries in South Asia, while enjoying their own peculiarities, share common culture and ways of life. The norms and values, mainly of Hinduism, Islam, Buddhism and Sikhism, are deeply rooted in South Asian

societies. Though the numbers of followers of these religious and cultural mainstays vary from country to country, their presence and influence in local arts, cultures and traditions are distinctly visible in every country and society in the region. Nepal, too, has its unique geography, history and cultural heritage, and still is an integral part of the broader cultural history and tradition of Indian sub-continent. As the saying goes, culture sees no borders.

While being parts of broader South Asian culture, Nepal and India share special closeness and similarity in cultural tradition. They are so closely and strongly interlinked by social life and cultural tradition that nobody can imagine to separate them. Both have made great contributions to enriching religious and cultural heritage in this region, and beyond. Lord Buddha, born in Nepal, has left his footprints not only in South Asia but all over the world. Sita, the daughter of Nepal, who was married to Ram, the crown prince of Ayodhya in India, has made special place in the hearts of Hindus living anywhere in the world. The contributions made by Indian philosophers and saints need no further elaboration. It is these great personalities of this region that have helped evolve, develop and spread the cultural heritage that is proudly known today as the South Asian culture.

The cultural links between Nepal and India have many facets. Religion is perhaps the most important factor, and plays a predominant role in shaping the cultural relations between these two countries. This is manifested in the large number of peoples from both countries visiting each other's countries for pilgrimage. Thousands of Nepalese nationals visit pilgrimage sites in India every year. The Char Dham Yatra (visit of four dhams in India, viz. Badrinath/Kedarnath in Uttarakhand, Jagannath (Puri) in Orissa, Rameshwaram in Tamilnadu, and Dwarka in Gujrat) is a life-time aspiration of almost all Hindus. There are many other places in India which are considered sacred sites by Nepalese people. They include Haridwar, Rishikesh, Varanasi, Gaya, Vaishnodevi, and many more. Similarly, there

are a number of religious sites in Nepal which are considered very sacred and important, and are attractions as 'must visit' religious destinations for Indian nationals. Such sites include Pashupatinath in Kathmandu, Lumbini (the birth place of Buddha) in Rupandehi district, Ram-Janaki temple in Janakpur (the birth place of Janak and Sita), and many more. As the peoples of both countries share common religious faiths and philosophies, and revere and worship same gods and incarnations, their cultural ties are really very strong and inseparable.

Another component of Nepal-India cultural relations is cinemas and music. Indian movies are popular in Nepal; and so is Indian music. Similarly, Nepali cinemas and music are popular in India, especially in places with concentration of the people of Nepalese origin, mainly in Northern and North-eastern India.

Language is yet another component of Nepal-India cultural affinity. Peoples in both countries share many languages. Such common languages include, inter alia, Nepali, Maithili, Bhojpuri, Hindi, Avadhi, etc. Sanskrit is the root of many of these languages, which is regarded as the language of the gods and saints. Nepal and India both use Devnagari script in writing Nepali, Hindi and many other common languages. Many a religious texts, including the Vedas, Upanishads, Puranas, Tripitak, are written in this script.

Between Nepal and India, there have been frequent exchanges of ideas, personalities and groups of people representing the areas of the art, culture, music, literature and sports. These kinds of events are not limited to government entities alone, but are taking place even more at the peoples' level. Nepal's diverse cultural heritage of dance and music- both classical and folk-, theatre, fine arts, and sports have been interacting with their counterparts in India, and have been contributing to foster friendly ties and generate a better understanding and appreciation of each other's traditions. Every facet of art and culture has become a way of life, and is expressed in

carvings, paintings, architecture, sculptures and performing arts like music, cinema and dance. Every form of the arts in these countries is heavily influenced by the respective religious traditions and mythologies, and has helped shape religious norms and values in Nepal and India.

The close cultural relationship between the peoples of Nepal and India is a great asset for both countries. This closeness has not only helped maintain traditional friendly relations between the two countries but has also greatly contributed to promoting mutual understanding, appreciating each other's aspirations, and cementing the existing ties of warm and cooperative neighborhood. This has remained, and will continue to remain, the strongest and unshakable link between these two countries.

5.3 Objectives of Indian Aid

Donors provide assistances for the various objectives. Generally aid comes with political, strategic, humanitarian and economic objectives. The ultimate objectives of aid do vary from donors and from time to time. More often, the motives of aid are cocktailed or mixed. They are normally strategic broadly political, basically humanitarian and certainly economic. From the Indian view, aid to Nepal is just for humanitarian, friendship and economic motives which is being very much blamed for political motive by commentators.

Indian assistance to Nepal can be divided under two broad headings i.e. supporting assistance which have both strategic relevance and economic value. Another type of assistance is developmental which has economic value and related to the strategic and political consideration. Basically it belongs to the development of social infrastructure (Dharmadasani, 1988)

The major objective of Indian Aid to Nepal can be discussed under the topic of Indian aid policy. Indian's aid policy and interest in Nepal are governed by following objectives. The major objectives of Indian aid towards Nepal are:

a) Political Ideological Objectives

Being a neighboring country, India geared her aid to encourage political stability in the kingdom. India's interest in Nepal has been to build up a strong economic system so that political system may be maintained. For successful political system it is essential to build up a sound economic base which could fulfill the rising aspiration of the people and thus bring political stability in the economy.

b) Strategic Objectives

Strategic objective is another important aspect of Indian aid to Nepal. Nepal has strategic value for India's security system. Moreover India aimed at minimizing the influence of other powers so that it could permit her predominant position in Nepal.

c) Economic Objectives

Economic objective is also an aspect of Indian Aid to Nepal. The main objective of Indian Aid is to expand and consolidate economic, scientific and technological assistance with its neighboring countries. The long-term objective appear to be that India wants to establish an stable and mutually advantageous basis for furthering cause of Nepal's economic development, independence and the growth of the scientific and technical capabilities. On the other hand the vested objective of economic cooperation are based on the utilization of water resources i.e. a long part of India's eastern river system originates in Nepal and without Nepal's cooperation the large river system would remained underdeveloped and unharnessed. This interest has prompted India to seek the cooperation of Nepal in the economic field. Another reason could be the promotion of trade as Nepal provides an easy market for Indian goods. Most of Nepal's trade is with India where the share of Indian trade in Nepal's total trade is 59.08% in Fiscal year 2066/067. The data reveals that most of the trade is becoming more concentrated towards India either in the form of exports or in the form of imports. As India's interest to further promote this trade volume, for this India require to increase economic activities in the Nepal.

5.4 India-Nepal Economic Cooperation

The core philosophy of India's development assistance programme in Nepal is the welfare of the people of both countries. Guided by this philosophy, soon after independence in 1947, India strongly supported Nepal's desire for transformation into a modern and welfare state.

India, itself a developing country and with its limited resources. It started contributing significantly towards the development of infrastructure and human resources in Nepal with the programme of cooperation in 1951. For the first two Five Year Plans of Nepal, India was the only foreign country involved in Nepal's development.

The programme of India-Nepal economic cooperation was launched in 1951. The objective of this programme was and remains to supplement the efforts of the Government of Nepal in the national development of the country. India's assistance programme in Nepal is guided by the vision that alongside progress in political process in Nepal, it is equally important to ensure that economic deliverables, particularly in the areas of education, health and infrastructure, must reach the people without any pre-conditions in a smooth, quick and unencumbered manner. Towards this end, Government of India is providing technical and financial assistance for multi-sectoral development of Nepal.

The scope and breath of India's economic assistance programme has been expanding over the years. A snapshot of the number of projects in recent years is as follows:

Table 5.2
Projects of Indian Aid

No. of Projects on FY	Small	Large & intermediate	Total
2004	16	10	26
2005	56	22	78
2006	100	24	124
2007	174	26	200
2008	247	28	275
2009	294	30	324
2010	340	30	370
2011	366	35	401
2012	396	35	431
2013	425	35	460
Total	2414	275	2319

Source: Indian Embassy of Nepal

Table 5.2 shows different projects small, large and intermediate completed in Nepal from the Indian assistance. From fiscal year 2004 to 2013 the total number of completed small projects are 2414. For the same period 2319 number of Intermediate and Large projects have been completed from Indian assistance.

5.5 Total Magnitude of Indian Aid

Indian aid has been continuously increasing in various sectors of the Nepalese economy. There is an increasing tendency of assistance in Nepal. Such trend has been further increased after the signing of Comprehensive Peace Accord (CPA) in New Delhi with the India's initiative. India has mainly helped in the field of Transportation, Industry, Education, Agriculture, Health, Technological Development etc. Indian aid plays prominent role in the field of Socio-economic development as well as humanitarian relief. The following table shows the Indian assistance to Nepal from FY 1990 to FY 2011/2012. The data are collected from different sources as well as reserved in Aid Management Platform (AMP) Software of Foreign Aid Coordination Division of MOF.

Table 5.3
Annual Flow of Indian Aid to Nepal

(NRS in Million)

Fiscal Year	Indian Aid	Percentage of Indian Aid to Total Foreign Aid
1990-91	361.81	6.04
1991-92	523.01	6.70
1992-93	1056.59	11.44
1993-94	1163.68	10.06
1994-95	1450.00	12.88
1995-96	80.17	0.56
1996-97	1207.35	8.03
1997-98	807.68	4.90
1998-99	725.50	4.41
1999-2000	1224.17	6.98
2000-01	437.87	2.32
2001-02	447.11	3.10
2002-03	1623.02	10.21
2003-04	629.09	3.32
2004-05	851.84	3.60
2005-06	364.11	1.65
2006-07	5490.00	21.23
2007-08	8000.00	36.00
2008-09	7891.72	16.32
2009-10	9563.20	25.04
2010-11	6826.94	20.09
2011-12	1570.07	18.37
Average	2317.04	10.60

Source: Economic Cooperation Wing- Indian Embassy of Nepal, AMP MoF Nepal

The magnitude of Indian assistance has been mostly increasing during the passage of time. Here the data series is started from FY 1990/1991, in this year India has provided the Nrs. 361.81Million. Such a tendency of increment in assistance

continued upto FY 1994/95. But in FY the assistance decreased to only 80.17 according to the official database of Ministry of Finance. Again the Volume of The assistance in the successive fiscal years seems very fluctuating and the official records of assistance for some fiscal years were not recorded sufficiently. Another reason behind the unavailability of data is that though India is one of the prominent donors of Nepal, it is reluctant to say himself a donor and does not provide data and information even it assist Nepal each year. Though MOF installed an AMP Software for the systematic record keeping of aid and transparency, this software also couldn't provide sufficient information as per the need of our study.

The third column of table shows that the percentage share of Indian Aid to total Foreign Aid in different fiscal year. By analysing the share of Indian Aid to total aid it can be said that on an average the average share of Indian Aid is 10.60 percent.

It is true that, Indian aid figures occupy the prominent place among the aid giving countries to Nepal. The latest figure of FY 2011/12 shows India stood as the second largest bilateral development partner of Nepal.

5.6 Sector wise allocation of Indian Aid (From FY 2000/01-2011/12)

Indian aid has covered almost all sectors of the Nepalese Economy, and certain sectors have received more attention. The development of Road Transportation have received highest amount of aid during these fiscal years. Second priority has been accorded to Local Development. India has diversified it's cooperation in Nepal from mega projects to grass root projects. But over the period of six decades the Indian Aid covers all the major sectors of Nepalese economy ranges from building Infrastructure to Human Resource Development. In the past, India invested in large scale infrastructure development projects. But in recent years, it has shifted it's priority to implement bigger as well as small-scale projects that directly benefit the people.

The following table shows the Indian assistance in various economic sector of Nepal.

Table 5.4
Sector-wise Allocation of Indian Aid (From FY 2000/01-2011/12)

(NPR. In Million)

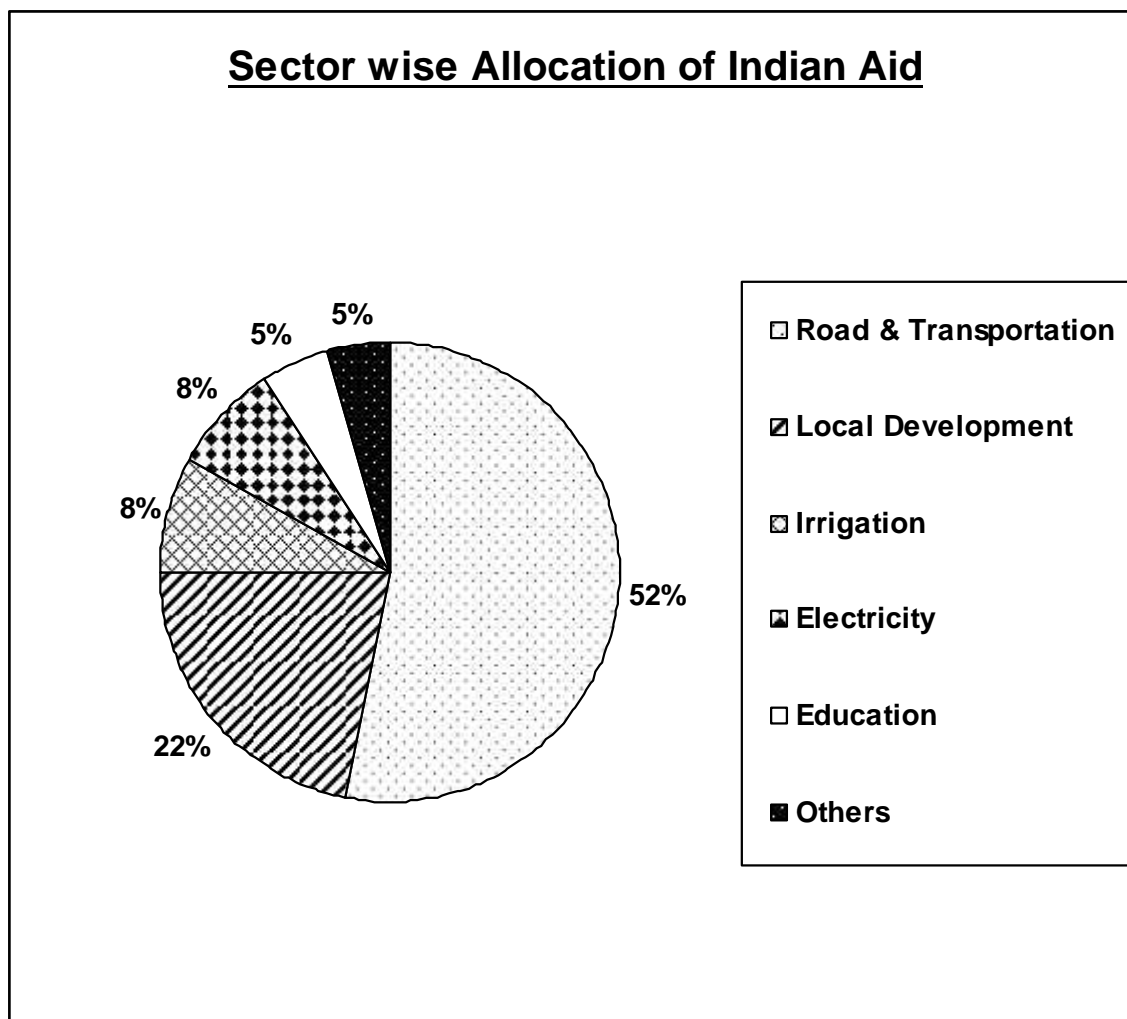
Sector	Indian Aid	Percentage	Rank
Road & Transportation	3591834.97	52.09	I
Local Development	1486541.00	21.97	II
Irrigation	547677.00	8.09	III
Electricity	523192.02	8.03	IV
Education	308548.65	4.96	V
Others	308548.65	4.86	VI
Total	6766342.29	100	

Source: AMP-MoF Nepal

The table 5.4 and the figure 5.1 show the Road & Transportation sector has been given top most priority during the FY 2000/01-2011/12 to the Indian Aid by providing more than half of it's assistance namely 52.09 percent. Second priority sector seems Local Development which occupies almost 21.97 percent of total Indian assistance. In the same way Irrigation accorded third priority by occupying 8.09 percent of Indian Assistance. In Electricity and Education Indian assistance is allocated 8.03 and 4.96 percent respectively. And all other sectors occupy the 4.86 percent of Indian Assistance during those fiscal years.

The sector wise allocation of Indian Aid to Nepal from FY 2000/01-2011/12 is presented in the following pie diagram too.

Figure 5.1
Sector wise Allocation of Indian Aid (FY 2000/01-2011/12)



Source: Based on the Table 5.5

5.7 Empirical analysis of Indian Aid to Nepal

Foreign Aid is said to have effects on economic growth and overall welfare of the economy. Larger amount of Foreign Aid is necessary for the further growth of the economy. But there is also a question like whether foreign assistance has proved beneficial for Nepal. Has foreign assistance shown positive effects on the economic growth and overall welfare of the country? If the answer to these queries is found positive then to some extent it can be argued that foreign aid has played positive role in the Nepalese Economy and is necessary for the further growth of economy.

This segment intends to analyze the impact of Indian Aid to the gross domestic product (GDP) of Nepal. All the data in the analysis are taken from various economic surveys, data reserved in AMP (Aid Management Platform) software in Foreign Aid Coordination Division, of Nepal. All regression lines in this chapter are constructed by using MS-Excel and SPSS software.

Empirical Findings:

The basic starting point is the examination of direct relationship between the GDP and the amount of Indian Aid. For this purpose, it is borrowed a model included in the ‘Research Methodology’ for the purpose of regression analysis.

The models specified are as follow:

$$Y = a_1 + b_1 F_{T \text{ Aid}} \dots\dots\dots(1)$$

$$Y = a_2 + b_2 F_{I \text{ Aid}} \dots\dots\dots(2)$$

Where Y : GDP

$F_{T \text{ Aid}}$: Total Aid

$F_{I \text{ Aid}}$: Indian Aid

a_1, a_2, b_1, b_2 are coefficients.

The fitted equation of the regression models at current price are:

Relation between GDP and Total Foreign Aid

$$Y_t = 464015.3 + 0.410 F_{T \text{ Aid}} \dots\dots\dots(4)$$

(4.247) (1.83)

Adj $R^2 = 0.304$ $F = 5.38$ $N = 16$ $D-W = 0.723$

Where,

Y_t = Gross Domestic Product in time period t, (Dependent variable)

$F_{T \text{ Aid}}$ = Total Aid in time period t, (Independent Variable)

Interpretation of the Result:

It has been set a null hypothesis as “there is no significant relationship between Total Foreign Aid and GDP of Nepal. But the above result showed that there is a positive relationship between nominal GDP and Total Foreign Aid to Nepal.

The coefficient of total foreign aid is not significant, as indicated by it’s low t-value (1.83). The equation itself is not a good fit, with 30.4 percent of the variations in dependent variables being explained by independent variable. Standardized coefficients, i.e Beta is equal to 0.410. It implies that one Million Rupees increase in Total Foreign Aid leads to 4 Lakh and 10 thousand increase in GDP. The theoretical value of F at the 5% level of significance with v1=1 and v2=N-K=15 degree of freedom is found from the F-table is F_{0.05}=5.12. Hence F_{cal}=5.38>F_{0.05}=5.12, we reject the null hypothesis. i.e. We accept that there is a significant relationship between GDP of Nepal and Total Foreign Aid obtained from the data 1995/96 to 2011/2012.

Relation between GDP and Indian Aid:

$$Y_t = 413610.8 + 0.151F_{IAid} \dots\dots\dots(5)$$

(3.161) (2.258)

Adj R²=0.712 F= 34.64 N=16

Where,

- Y_t = Gross Domestic Product in time period t,(Dependent variable)
- F_{IAid} = Indian Aid in time period t,(Independent Variable)

Interpretation of the Result:

Equation (5) shows that there is a positive relationship between GDP and Indian Aid inflows to Nepal. The coefficient of Indian Aid is not significant as indicated by low t-value (2.258). The equation itself is a good fit with 71.2% of variation in dependent variable being explained by independent variable.

A standardized coefficient, i.e. Beta is equal to 0.151. It implies that One Million Rupees increase in Indian Aid leads to almost 1 Lakh and 51 thousand increase in GDP. The theoretical value of F at 5% level of significance with $v_1=1$ and $v_2=N-K=15$ degree of freedom is found from F-table $F_{0.05}=5.12$. Since $F_{cal}=28.64 > F_{tab}$. So we reject the null hypothesis and accept there is significant impact of Indian Aid to the GDP of Nepal.

From above analysis, it can be said through regression analysis that Foreign Aid is playing positive effect on Nepal's GDP and Indian Aid is also affecting GDP of Nepal as per its aid quantum. The Beta coefficient of total Foreign Aid is definitely higher than that of Indian Aid. The coefficient of Total Aid is 0.410 while that of Indian Aid is 0.151. Since both coefficients are positive, the impact of both aids in Nepal has positive impact upon the GDP.

CHAPTER VI

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

It is now time to look over the contents covered by this study, to highlight its basic findings and to reflect the implication of Nepal's experience on Foreign Aid especially in terms of Indian aid.

The Foreign aid has been and remains an important source of financing the needs of developing countries in their quest for economic progress. This is no different for Nepal. About half of Nepal's development expenditure remains financed by foreign aid. Yet Nepal remains one of the poorest countries of the world with nearly 25 percent of its population living in absolute poverty. This However, there has been no comprehensive macroeconomic study of foreign aid effectiveness in Nepal. This thesis aims to fill this gap.

6.1 Summary

In true sense Foreign Aid means transfer of financial resources and technical know-how from the developed countries to developing countries to augment economic development of recipient country. In this study, in general Foreign aid to Nepal is analyzed and specifically study has been concentrated to analyze Indian Aid from different perspective.

The impact of foreign aid on economic growth remains a subject of considerable debate. Its performance varies across countries due to geography, policy environments and socio-economic conditions.

A substantial portion of aid may be used to finance projects with low rates of return, and in some cases, aid promotes consumption rather than investment. In particular, aid can contribute to the increase in a government's recurrent expenditure and reduced revenue effort. In other words, aid can make a government lazy. Critics have also pointed out that aid facilitates corruption.

The history of Foreign Aid is not very old for Nepal. Before Second World War or even before pre-democracy period, Nepal was not familiar with the concept of aid.

Whatever she got before this period was much more connected with war or military assistance. It was not for any clear-cut purpose of economic development.

India is one of the most influential donors and development partners of Nepal. It has been continually assisting Nepal after its independence from British Regime. For Nepal, India is giant neighboring nation who has supported in various sectors like: Local Development, Education, Industry, Irrigation, Transportation, Communication etc. From 2006, it seemed that India was trying to maintain dominant role in Nepal by applying all instruments of national power, in its desire for Nepal to respect and act according to India's interests. The close relationship formerly maintained by Nepal's dethroned monarch with China, pushed India to maintain close ties with major political parties within Nepal, and furthermore, India's role was found to be instrumental in bringing the armed conflict to an end.

The construction of the two most important highways of Nepal: East-West Highway (Mahendra Highway) and Tribhuvan Rajpath are the most valuable work of India. Besides that other roads have been constructed in Nepal by Indian co-operation. By the contribution of Indian assistance have open up the country for the outsider, more easily from one part to another and have great facilities to flow of Trade and Commerce.

Indian aid as percentage of GDP was 0.03 in FY 1995/1996 and in FY 2011/12 it increased to 2.55 percent of GDP of that Year. As the Indian Aid in each fiscal year fluctuates the percentage of Indian Aid to the GDP of Nepal also seems fluctuating over years. But it is true that the share of Indian Aid to the GDP of Nepal is increasing over years.

India's has concentrated its aid in the development of Road & Transportation during these years. Next focus is in Local Development . To develop agriculture status of Country India contributed to assist in Irrigation. India has completed more than two dozen of irrigation projects in the different part of Country under the Indian Aid Mission. Multi purpose mega project such as Koshi, Gandaki and Mahakali have been providing irrigation and hydropower to both countries (Nepal

and India) which are established and conducted by Indian Government in collaboration with the government of Nepal.

Indian assistance in Nepal's education is an investment for the human resource development. In this context, India has helped to construct several School/College/Library buildings. Manmohan Memorial Polytechnic, Polytechnic at Hetauda, Establishment of a Science Learning Centre at Kathmandu are the notable investment in Education of Nepal by India.

A healthy society forms a healthy nation. Government of India had been providing support in this sector in line with the priorities of the Government of Nepal and has helped in the creation of physical infrastructure and training of medical personnel. Bir Hospital, Bharat-Nepal Maitri Emergency & Trauma Centre in Kathmandu, B.P. Koirala Institute of Health Sciences (BPKIHS) at Dharan, Police Hospital Several health posts, nursing campuses maternity centres, eye hospitals, naturopathy hospitals have been undertaken under our Small Development Project scheme by Indian assistance. Gifting of Ambulances/Buses, Assistance to Nepal Netra Jyoti Sangh (NNJS) for Cataract and Trachoma surgeries programme etc are other remarkable contribution made by the Indian aid in the health sector of Nepal.

India also helped in the sector Telecommunications in Nepal. The Government of India provided assistance to Nepal for the laying of 904 Kilometres Optical Fibre cable along the East-West Highway and setting up of 80 stations of SDH equipment. The fibre optic cable has formed the backbone of telecommunication network in Nepal and has transformed the lifestyle of Nepali citizens and made connectivity faster and reliable.

Based on our empirical findings too, it can be concluded that the overall contribution of foreign aid in Nepal is positive. In the same way the contribution of Indian Aid to the GDP of Nepal is also positive. Foreign aid fully financed the development expenditure of the First Five-Year Plan and still contributes over 50 per cent of the development expenditure.

Soon after the downfall of the Rana Regime in 1951, foreign assistance came into the country mainly for the development of infrastructure. Since then Nepal has achieved notable progress. For example, motorable roads increased from less than 280 kilometers in 1951 to over 24417 kilometers including Gravel and Black-topped in 2012. Likewise, irrigated land increased from about 6,000 hectares in 1951 to over 47678 hectares (excluding the farmer-managed irrigation system) in 2012. During the same period, production of electricity increased from less than 1.5 megawatts to over 706 megawatts. Moreover one can now find many schools, universities and hospitals across the country. Telephone lines, healthcare facilities and the availability of safe drinking water also substantially increased. These have contributed to a remarkable progress in Nepal's social development. For example, the overall literacy rate (for population aged 5 years and above) has increased from 54.1 per cent in 2001 to 69.5 percent in 2012. Life expectancy at birth increased from 42 years in 1970 to 68 years in 2012, and the under-five mortality rate (per 1000 live births) decreased from 234 in 1970 to 50 in 2012. These achievements have been possible through foreign assistance; Nepal's own revenue was too low to meet the development effort it required. In other words, resource gaps (namely, the savings–investment and foreign exchange gaps) were huge in Nepal. To enable the country to meet its development objectives, these gaps have been financed by foreign aid.

Therefore, one can conclude that despite the low rate of economic growth,, foreign aid has been an important contributory factor in Nepal's socio-economic development. As the India is neighboring and most prominent donor and development partner of Nepal, it's continuous assistance in Nepal is remarkable.

6.2 Conclusion

Geographically Nepal is in between two big Asian giant nations in south India and in the north China. Nepal has good relation with both its neighbors. Due to culturally, linguistically, and open border Nepal is close to its southern neighbor compare to its north neighbor China. Its geographical structure is in such situation if Nepal makes appropriate bilateral political policy and economic policy with

these two Asian giant it will get lots of benefit.

Nepal's politics is deeply influenced by its southern neighbor India. The above mentioned things and most of the Nepal's political leaders get their education from India and also they took part in India's independence. Beside that Nepal was only the Hindu country in the world and most of the Indian people believe in Hinduism. In that way Nepal has of religious importance. Every year the report says position of the Indian tourist in Nepal is third after the US and other country. Now a day's Chinese tourist also choose Nepal as their tourist destination.

Being a small and landlocked country Nepal's economy is mostly depends on India. Nepal is highly dependent upon the foreign aid. Every year Nepal gets a huge amount of foreign aid for its development. The major donor country is India, China, US, England, Germany, and Scandinavian countries. Nepal is dependent on India due to unequal treaty made in 1950 by both countries. Due to this unequal treaty between Nepal and India, Nepal's politics and economy is dominated by India. This is the reason Nepal is facing political instability. Lots of government has been formed and but none of the government is able to be stable government of Nepal.

Our economic scenario has become failure due to vicious circle of poverty, low rate of capital formation, administrative bottlenecks, backward social and development infrastructure, political instability, low per capita income etc. To solve these above foreseen and unforeseen contingencies foreign aid is widely accepted.

Historical as well as geographical factors have brought India and Nepal together. History, religion, culture and art have knitted the neighbors closer. However Indian aid is neither free from debate nor politically and economically sound. It is said that India was involved in Road projects only for strategic reasons i.e. to maintain influence within Nepal and Nepalese government in foreign affairs.

In transportation sector almost all roads network within the country has been built by foreign assistance. Airport and Railway link were also extended by foreign assistance. Number of hospitals, health posts, hydroelectricity plants have been constructed by the foreign financing as well as technical assistance.

Nepal, solely from its internal resources can not promote the economy in the absence of foreign aid. Indian cooperation to Nepal is essential not only to sustain development activities but also for reduce inequality and deprivation. As foreign assisted projects bring advanced technology and knowledge to recipient country but in other hand it neglects domestic people's interest and their skills.

In the context of Indian aid to Nepal, India is a continuous donor of Nepal in its developmental practices six decades. Its contribution can be found in all sectors of Nepalese economy. Among the total assistance India has been disbursed 53.09 percent of aid for the development of Road and Transportation. From this it is proved that India gives emphasis on infrastructural development of Nepal.

Finally, Nepal achieved some how satisfactory benefits of as a whole foreign aid as well as Indian aid and much remains to be done. India has been a pioneer donor and continually supporting every sphere of Nepalese economy.

In order to harvest the fruits of aid Nepal should have a stable government then needs excessive exercise to make appropriate policy. That policy has to be in the favor of the country's national interest and security. Then needs to analyze on the unequal 1950s treaty's all the aspects. After that both the government needs to discuss on the matter in friendly environment and act accordingly without any delay. If the leaders are able to make this happen it will show the way to Nepal in future how to walk between dragon and elephant rather focusing just on their party's ideology. All the political leaders have to focus on one ideology that is national interest. In this way Nepal will be able to make a balanced and sound relation with both the south and north Asian giants.

Furthermore, Nepal's technological and institutional capabilities were too weak to utilize aid effectively. There was no skilled manpower, and there were always a

shortage of policy makers in the early days of the country's development. Some of these weaknesses still persist, causing a low absorptive capacity. The problem is compounded by a lack of coordination among various government departments. There is also no proper coordination among donors, leading to high aid volatility, overlapping aid-funded projects and lopsided allocation of aid.

6.3 Policy Recommendations

The rationale for foreign aid is that it assists a developing country to achieve rapid economic growth and poverty reduction. In the case of Nepal, foreign aid can help achieve targeted economic growth by improving aid effectiveness of aid through the design and implementation of appropriate and consistent foreign aid policies compatible with national interests. More precisely, aid should be channeled to those areas/sectors where aid can have relatively high economic and social returns. For example, more aid should be directed to pro-poor sectors such as agriculture, primary health and education.

Nepal's main source of income and employment is the agricultural sector. Yet most of Nepal's poor live in rural areas. Thus, in the context of Nepal, poverty reduction that is enhanced by rapid economic growth can be achieved through productivity growth in Nepal's agricultural sector. Despite some efforts in the past, the agricultural sector is still far behind in lifting the living standard of the majority of the Nepalese. With more than three-quarters of the total population still engaged in agriculture, the sector needs to be given a high priority.

However, Nepal's sectoral distribution of aid indicates that more amount of aid has been directed to the building of capital infrastructure across the country rather than to the development of the agricultural sector. Nepal therefore needs to channel more foreign aid to the agricultural sector, and it needs to do so effectively. Aid has a direct impact on the productivity growth of the agricultural sector. Aid brings new technology, which plays a key role in modernizing the sector. Aid can finance improvements as well as the building of new irrigation facilities across the country.

Since Nepal has a shortage of skilled labor, increased emphasis also needs to be given to the development of its human resources. Labor productivity can be improved through appropriate education and training. Nepal's adult literacy rate is still below 70 per cent, and the female literacy rate is lower than the male rate. Since a skilled labor force is directly linked to economic growth (being a factor of production), providing education and training (specifically vocational) to illiterate people is certain to improve living standards, by giving people an opportunity to earn higher income. Therefore, investment in primary education and vocational training should be increased.

To strengthen the aid absorptive capacity that is required for Nepal to achieve rapid economic growth and poverty reduction. One can in fact justify a higher allocation of aid and investment in education on other grounds. For example, educating an illiterate person will indirectly help improve health and sanitation at the personal and family levels. In other words, education has a positive multiplier effect in changing a backward society into a more modern, (economically) productive society.

Since aid effectiveness also depends on the extent of corruption in the recipient country, Nepal should also combat corruption. An efficient foreign aid management team (specific government department) with strong financial discipline is required to maximize the benefits of aid. As donor agencies stress the importance of decentralization, strong corruption measures should be introduced at the local government levels (such as district council and Village Development Committee). In addition, regular evaluation of the effectiveness of projects and programs needs to be conducted, to ensure that targeted socio-economic returns are being met. By carefully scrutinizing and supervising capital-intensive infrastructure projects, Nepal can minimize corruption.

Aid to Nepal comes not only from donor governments but from International Non-governmental Organizations (INGOs) as well. Although a large number of INGOs are working in Nepal, the government does not always have a direct link with them in terms of their economic assistance. To maintain transparency and accountability, regular supervision and effective reporting provisions (in the national budget) about the operations and effectiveness of INGOs are required. It is also important to compile data on INGOs aid for future research.

Finally, while foreign aid is an important source of revenue, Nepal should be able to

improve and broaden its domestic sources of revenue. Aid can help in many ways. For example, technical assistance can help to improve and extend the tax base as well as create a more efficient tax administration. Aid contributes to higher economic growth, which eventually helps to expand domestic revenue. Most significantly, Nepal's aid dependency can be reduced through linking aid-financed projects to an improved domestic revenue mobilization capacity. This study tries to outline some policy recommendations to the concerned authorities and stakeholders for the effective utilization of aid.

- 1) It is necessary to establish the linkages between the policies, goals and priority of the government and acceptance of foreign assistance by developing mutually agreeable modalities
- 2) The proper attention should be placed for the effectiveness and utilization of aid in the economy
- 3) There is need to demarcate the projects to be financed under loan or grant assistance
- 4) Aid should be used to finance to projects that promote the base to further production rather than in immediate consumption goods and services
- 5) Transparency in the flow of aid is very essential. Proper monitoring system has to be set up to regulate the flow of aid
- 6) A proper action should be taken to create a uniform and accessible database of foreign aid. Further improvement should be done in the AMP software
- 7) The aid policy formulated by Nepal should be compatible with the donor countries' aid policy
- 8) The data and information regarding the volume of Indian assistance are not accessible to researchers because India is reluctant to say donor himself. Special arrangement should be made for the transparency aid inflow to Nepal regarding India and other countries.
- 9) The Indian assistance is increasing over time. Such assistance should be come under budgetary framework of Nepal and meeting the priority sector.
- 10) Nepal should be aware to protect it's national sovereignty and social setting in the name of assistance that come from other nations.

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