

# **Role of Foreign Aid in Nepal: Focus on Poverty Reduction**

A Dissertation

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Rashmi Sharma

August, 2019

## **LETTER OF RECOMMENDATION**

I certify that this dissertation entitled “Role of Foreign Aid in Nepal: Focus on Poverty Reduction” has been prepared by Rashmi Sharma under my supervision. I hereby recommend this dissertation for final examination by the research committee at the Department of International Relations and Diplomacy, Faculty of Humanities and Social Sciences, Tribhuvan University in the fulfillment of the requirements for MIRD 526 Thesis for the Master’s Degree in International Relations and Diplomacy.

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## **DECLARATION**

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## Approval Sheet

## ABSTRACT

Aid to developing countries by the developed and the richer countries is finally intended to help the recipient countries achieve sustainable development in various areas like economic growth, poverty reduction, infant and maternal mortality rate reduction, disaster resilience etc. Nepal as one of the Least Developed Country in the world has been receiving different forms of bilateral, multilateral and other aids since long ago. Observably it is found that foreign aid has been playing vital role in the field of developmental activities such as construction of road, irrigation, expansion of communication, hydroelectricity, education, drinking water, agriculture health etc. While talking about poverty reduction, foreign aid has somehow assisted but not in expected level. Hence, we conclude that it is obvious that foreign aid has positive influence on poverty reduction but the impact so established is not so noteworthy. Therefore, it is necessary that aid donors including the developed countries as well as the international donor organization should allocate aids for a specific necessities and practice wise steps to make sure that the aid provided are used for the targeted purpose with fact-based assessments and implementation reports rather than only focusing on its own vested interest. Similarly, the country receiving the aid should be need and priority oriented rather than being donor oriented.

*Keywords: Foreign aid, poverty reduction, least developed countries, donor countries, development partners*

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## LIST OF ABBREVIATIONS AND ACRONYMS

ADB	Asian Development Bank
AMP	Aid Management Platform
CBS	Central Bureau of Statistics
DANIDA	Danish International Development Assistance
DCP	Development Cooperation Policy
DFID	Department for International Development
DPs	Development Partners
EEC	European Economic Chamber
IBRD	International Bank for Reconstruction & Development
IDA	International Development Association
IECCD	International Economic Coordination Division
IFAD	International Fund for Agricultural Development
INGOs	International non-governmental Organizations
MPHBS	Multi-Purpose Household Budget Survey
NGO	Non- Governmental Organization
NLSS	Nepal Living Standard Survey
NPC	National Planning Commission
NPPR	Nepal Portfolio Performance Review
OPEC	Organization of Petroleum Exporting Countries
PAF	Poverty Alleviation Fund
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Program
USA	United States of America
USAID	U.S. Agency for International Development

# CHAPTER I

## INTRODUCTION

### 1.1 Background Context

Foreign aid can be defined as economic support from one country to another, the receiving countries usually being a least developed country (LDC) or poor country. Aid is usually provided to promote the economic development of a nation, support in the humanitarian relief in emergencies, or to finance military expenditure. Aid may take the form of outright gifts of money, which may be tied to purchases from the donor, or untied and available for expenditure anywhere. It may take the form of soft loans, on terms easier than those available to the borrower in world capital markets. Aid may also be given in kind, including food, plant and equipment, military supplies or technical assistance (Acharya, 1998).

Official Development Assistance (ODA) is defined as government aid which is aimed to promote the economic development and wellbeing of the least developed countries. Aid may be provided bilaterally, from donor to recipient, or channeled through a multilateral development agency such as the United Nations (UN) or the World Bank (WB). Aid includes grants, "soft" loans and the provision of technical assistance. Soft loans are those where the grant element is at least twenty five percent of the total (OECD, 2010).

The broader definition of foreign aid subsumes all money classified as official development assistance and further incorporates military assistance, political development programs, export promotion, debt forgiveness and non-concessional lending by all bilateral and multilateral organizations. Foreign aid itself can be distinguished into various categories based on its purpose and effects, intended upon

the recipient country (Basnet, 2010, p. 27). Financial assistance could be disbursed for various reasons including strategic, political, economic or cultural reasons, which in turn is used as a basis to differentiate various types of donors.

Foreign aid is a policy of giving financial and technical aid to other countries, such as policy may be undertaken for various reasons; emergency relief in time of war, famine, flood or other disaster, military aid for defense against a common enemy; enlightened self-interest, that is building up a poor country in order to improve one's own commerce or to help world trade in general. Aid may take a variety of forms; direct gift of money and equipment, short term or long-term loans with or without specific conditions of use and or terms of repayment, technical assistance and training programs, aid for particular projects or for broad development programs (Collier, 1997).

The main goal of foreign aid is to accelerate the development activities and free the country from being dependent. In the most of the countries, the expenditure of the country exceeds the internal resources and capacity of the country making those country reluctant on the developmental activities. In such circumstances, foreign aid acts as a support mechanism for those countries. Such scenario where the expenditure exceeds the internal resources makes the compulsory and obligatory need of foreign aid for development of the least developed countries.

Nepal is one of the developing countries with the population 28.8 million, growing at the rate of 1.60 percent yearly. The per capita income is calculated as \$ 730 (World Bank, 2014), this reflects equally unsatisfactory living standard. About 25.2 % of the population are forced to live below the poverty line (Central Intelligence Agency, 2011). The challenge of economic development has been further

complicated by its geographical structure, limited natural resources and the underutilization of the available resources, landlocked location and the social stigma. Its investment needs for infrastructure development, thus, are quite substantial. But at the same time public funds available for infrastructure investment are limited. The fiscal resources base of the country is small but unlikely to grow rapidly. This leaves government highly dependent on outside official development assistance for its economic development.

It is found that foreign aid has been playing foremost role in the development of a developing country like Nepal. Democratic practice along with development and construction started in Nepal after the rise of democracy in 1950. Still and before in all development plans, the foreign aid is playing a vital role in the field of development such as road, irrigation, communication, hydroelectricity, education, drinking water, agriculture and health. Foreign aid also helped to increase the productivity and production to expand the development works and to find out suitable technologies, donors and development partners have been quite supportive of its development plans and programs. In 1950 with the dawn of the democracy, Nepal started building relationship with foreign countries. After signing the point four programs with The United States of America (USA) in January 23, 1951, the government of Nepal started receiving foreign aid. Nepal has been receiving foreign aid mostly from 'Nepal aid group', which includes nations like Australia, Belgium, Canada, Denmark, Finland, Norway, Germany, Kuwait, Netherlands, Switzerland, Sweden, The United Kingdom, The United States of America, Japan and multilateral donors as IDA, IMF, EEC, UNCTAD, ADB, UNDP, WB, WHO, UNICEF, OPEC (Bhatta, 2017).

Poverty is a multidimensional phenomenon. It is the deprivation of one's ability to live as a free and dignified human being with the full potential to achieve one's desired goals in life. It also includes the concept of vulnerability, which is the likelihood that people will fall into poverty owing to shocks to the economic system or personal mishaps, and the concept of social exclusion, which focuses on the lack of participation of individuals or groups in society (Ferguson, 2011). The United Nations has defined poverty as a condition characterized by severe deprivation of basic human needs including food, safe drinking water, sanitation facilities, health, shelter, education and information. It depends not only on income but also access to services (UN 1995, p. 57).

Poverty reduction has become the primary objective of development interventions across much of the developing world. The role of foreign aid in alleviating poverty is increasing, and they are rapidly emerging as important actors and players in international politics and economic order (Sohel, et al., 2007). Nepal is among the world's poorest countries. Poverty in this small nation is not only persistent, but is widespread. According to the 2010 Nepal Living Standards Survey, conducted by the Central Bureau of Statistics and the National Planning Commission, 25.2% of the country's population lives below the poverty line (CBS, 2011). Today, more than 9 million people in the country are projected to be living on an income of less than \$1 a day (PAF Nepal, 2013). Foreign aid plays an important role in Nepal's development. Foreign aid is critical to meet the goals of poverty reduction as enunciated in the various recent governments three- and five-year plan.

## 1.2 Statement of the Problem

Poverty in Nepal largely depends on structural factors, especially on the modes of ownership, production and distribution of productive assets, which have their own dynamics and the effective use of foreign aid provided. But the dynamics is determined by the choice of application of development policy by the political class.

The World Development Report (2012) has highlighted the dimensions of poverty. The report postulates that poor people live with ill health, economic dislocation, and natural disasters. And they are often exposed to ill treatment by institutions of the state and society and are powerless to influence key decisions affecting their lives.

Government along with many development agencies with foreign aid providing agencies in Nepal are working for poverty alleviation. Programs like waging employment through food for work programs have provided only temporary relief on poverty. As a matter of fact, wage to a poor man is only a consolation. Removal or reduction of poverty is a continuous process of creation of assets so that the asset base of the poor becomes stronger at each economic cycle (WFP, 2000).

In the context of Nepal, the revenue surplus, domestic debt and foreign aid are the tools to finance the development of the country. Foreign aid is the receipt from savings of the foreign citizens. In particular, foreign aid is the transfer of free or heavily discounted economic resources by a donor government to a recipient government either directly or via an international organization, for the purpose of assisting the recipient in improving its economic and social welfare. Foreign aid is necessary to meet the domestic resource gap.

### **1.3 Research Questions**

The country is receiving a substantial amount of foreign aid from various bilateral and multilateral donors. The government is committed to creating an environment for productive use of foreign aid through various institutional mechanism and program of action. In this scenario, the research will try to answer the following questions,

1. What is the impact of foreign aid in Nepalese economy?
2. What are the implications of foreign aid in Nepal?
3. What are the ways to make foreign aid more effective in Nepal?

### **1.4 Research Objectives**

Primarily, the objectives of the research will be to answer the research questions put forth.

1. To examine the impact of foreign aid in Nepal.
2. To study the effectiveness of foreign aid in Nepal and its implication.
3. To identify the lapses in the foreign aid management and to explore the ways to make foreign aid more effective.

### **1.5 Significance of the study**

Foreign aid is one of the important topics in the arena of international relation. It is even more important topic for the developing country like Nepal where economy is almost sustained by the foreign aid and assistance from various bilateral and multilateral donors and remittance from the migrant workers. Previously, various research about issues of foreign aid has been made in context of Nepal. But much study wasn't made regarding the contribution of foreign aid in poverty reduction. So,



this research will somehow help in finding out the relationship between foreign aid and poverty reduction in context of poor and developing country like Nepal.

## **1.6 Chapter Organization**

**Chapter 1, “Introduction”**, is the introductory which starts with the background context of the study and includes the statement of problem, research questions, research objectives, significance of the study and organization of the chapters for the study.

**Chapter 2, “Review of Literature”**, as the title itself suggests, include the review of literature by various national and international scholars in the field of foreign aid and its roles on poverty reduction in developing country like Nepal. Similarly, cases of different countries and regions were reviewed in order to create a discussion on the relevant matters of the study. Also, various theoretical views on foreign aid were reviewed

**Chapter 3, “Research Methodology”**, explains the research methodology and designs used for the study. This part includes the research sites used for research, techniques of research designs, methods of data collection and analysis, limitations or delimitations of the study etc.

**Chapter 4, “Trend of foreign aid in Nepal”**, demonstrates the trend of foreign aid in Nepal. It includes data on trend of foreign aid in Nepal, state of poverty in Nepal as well as nature and incidence of poverty in Nepal

**Chapter 5, “Data Analysis and Presentation”**, presents various analyses of the secondary data of foreign aid provided to Nepal and the poverty situation at the time. It also includes discussion of various results being derived from data analysis.

**Chapter 6, “Foreign aid management for poverty reduction”**, dealt with the analysis of the data on foreign aid management processes, information systems and foreign aid transparency in Nepal.

**Chapter 7, “Conclusion”**, the final chapter of the dissertation gives summary of this dissertation and analyzes the findings thus drawing conclusion and finally offers some recommendations to the government of Nepal, bureaucrats, donor agency, civil society and other related stakeholders based on the findings of the research.

## **CHAPTER II**

### **REVIEW OF LITERATURE**

Foreign aid is normally associated with national government and international organizations. Although there are certain private institutions or organizations which extend supports to needy countries, but they do not assume a much significant share in the total flow of aid. Traditionally foreign aid was provided to overcome the saving investment gap, technological shortages etc. in the recipient countries, which would ultimately uplift the developing economy and living standards of people. Therefore, foreign aid is viewed as a concept which refers to the flow of capital and technical resources either directly from the government of donor country or through international channels.

The concept of foreign aid is not a recent phenomenon. It has been coming from early period of classical economists. But it is agreed that foreign aid is originated from the disruption of the world economy than followed by Second World War. Flow of aid becomes more rapid due to polarization, which creates the competing environment between United States of America (USA) and United Soviet Socialist Republic (USSR) to gain support from the other nations after the beginning of cold war; foreign aid became an integral part of foreign policy.

#### **2.1 Meaning and Definition**

The explicit transfer of resources from developed countries to less developed/developing countries in occasional term is called foreign aid. Foreign aid means transfer of financial and other resources in the form of grants, loan, technical assistance etc. from economically better off nations to least developed countries. The main purpose of resources from developed countries to developing countries is to

influence the recipient country through the moral principle of solidarity. Foreign aid also considered as a major means of building relationship with other countries. It is a means of fulfilling donor's and recipient's self-interest.

Foreign aid consists of grants or loans that one government or multilateral organization avails to a developing country to promote economic development and welfare. In other words, any money that benefits a developing country in grant concessional loans or non-concessional from a bilateral or multilateral organization is considered as foreign aid. To be foreign aid, it should be undertaken by the official agencies either bilateral or multilateral. It has to be taken with the main aim of economic development for the welfare of the recipient country and not for profit motive.

## **2.2 Theoretical Views on Foreign Aid**

In this part, international and national researches by various scholars regarding foreign aid, its linkage with various theories of international relations and its role in development of the recipient countries has been reviewed.

### **2.2.1 Foreign aid as a means of Neo-colonialism**

Neo-colonialism implies the new form of colonialism where the stronger nation indirectly exerts their power over the weaker or underdeveloped nation and their former colonies through various measures like economic and trade policies, technical and financial assistances, cultural and religious influences etc. through various Multi-National Corporations (MNCs), World Bank(WB) and International Monetary Fund (IMF) as it's not possible to directly rule and control the poor and developing countries as their colonies or subordinates like in past. Kwame Nkrumah

posits that neo-colonial states are nominally independent and sovereign. This is because they have all of the outwards trapping of international sovereignty. However, in reality, their economic systems and thus policies are directed from outside (Nkrumah, 1965, p.1). Internationally, various scholars have articulated foreign aid as a means of neo-colonial means used by the developed countries to influence the developing and poor countries.

M. Decker argues that among the special tactics employed by the new imperialism to perpetuate the effective enslavement of the former colonial countries, the use of what is called “economic aid” is of particular importance. Whereas in the classical period of colonialism, imperialist control over the resources of the colonies was naked and direct, the new imperialism has to adopt more indirect methods (Decker, 1961, p.15). He further states that in the “good old days” of imperialism the perpetual backwardness of colonies could be taken as granted, nowadays some sort of pretense has to be made of planning for the advancement of backward areas. Economic “aid” schemes organized by the imperialist countries admirably fulfilled both the purposes. On the one hand, they enable the imperialist country to tighten its control over its “sphere of influence” and block any attempts there at genuine development towards real political and economic independence. On the other hand, it enables imperialist propaganda to hide the harsh realities of exploitation behind a smokescreen of so-called aid to underdeveloped regions.

Similarly, Harvey (2003) argues that imperial powers are able to mobilize resources to satisfy certain political and economic ends. In this context, the World Bank and IMF have imposed historically informed political and economic values of the North on the South which satisfies the North’s ends. William Easterly argues that

despite of the developmental efforts made by the western imperialist during colonization in their the then colonies in various part of the world like Africa and various part of Asia, the growth and development seem to be very dismal and minimal as compared to the countries who were never ever completely colonized like China, Japan, Korea, Taiwan and Thailand. Similar is the case today. Even after long decades of decolonization and the continuous assistance and support from so called white in the form of neo-colonization to the former colonies and other developing countries in various part of the world, the change and development is very less. Easterly further states that western intervention in the government of the rest, whether during colonization or decolonization, has been on the far side of unhelpful. The west should learn from its colonial history when it indulges neo-imperialist fantasies. They didn't work before and they won't work now (Easterly, 2006, p.214). The current situation does indeed remind us of colonial times. Many of the third world countries had to fight for independence against colonial systems of exploitation, dependency, inequalities and concentration of capital. Unfortunately, many of the features of past are still existent in our modern economic system.

George Kieh has assessed the American way of neo-colonialism in African country, Liberia. He further states that American neo-colonialism played pivotal role in helping to generate the multidimensional crises of underdevelopment that culminated in civil conflict, and eventually the first Liberian Civil war in 1989. Using an assortment of neo-colonial instruments, the United States exploited Liberia economically, politically and strategically. The United States' stranglehold was made possible through the establishment of patron client relationship between the American government and various Liberian neo-colonial regimes. Using the power of the state, the various neo-colonial regimes created the conditions for Liberia to serve the

interests of the United States. In return, the various neo-colonial Liberian regimes received American political support and economic and military assistance (Kieh, 2012, p.180)

### **2.2.2 Foreign Aid and Liberalism**

Liberal ideology advocates the promotion of free trades and development of international markets. Furthermore, through the theory of comparative advantage, it was later demonstrated that even unequal states can benefit from free trades. Liberalism believes in the ability of the market to lead to prosperity (O'Brien & Williams, 2013, p. 14). After the Second World War, the Liberal ideology became increasingly perceived as a way to guarantee peace between nations as well as a mean to salvation for the under-developed world (O'Brien & Williams, 2013).

During cold war period, the world was bipolar and the foreign aid was based on security perspective. Soviet Union's aid used to be focused towards the countries contributing to flourish and expand communism whereas the American and other capitalist countries aid used to be focused towards the countries contributing to contain communism. And with the downfall of Soviet Union and end of cold war, liberal values and norms has been followed by the wealthier nations in their economic aid and assistance along with some hidden and vested interest for their own profit and benefits. Foreign aid to the developing and poor nations is based on the liberal values and norms i.e., promoting economy and flourishing democracy.

Stephen Brown has also given his opinion regarding the condition of aid before and after world war. He states that the 1990s saw the rapid growth of democracy promotion as bilateral and multilateral donors reformulated their priorities for assistance. With the disappearance of communism and soviet expansionism as credible

threats to the US and its allies, security considerations lost much of their relevance, especially in Africa. No longer in grave need of strategic alliances in the developing world, donors became more closely involved in the domestic matters of weaker states. New guidelines and policy statements from the Americans, British, Canadians, Dutch, French, Germans and others, all stipulated that funding allocation would take into account political liberalization, and the European Community, as it was then known, changed its rules to enable it to take into account a country's political system when determining aid levels (Brown, 2005, p.184). The US stresses democracy, while most western European countries and the European Union focus on less specific good governance. Nordic countries tend to pay more attention to human rights than other donors. Among multilateral agencies, the World Bank and the International Monetary Fund (IMF) increasingly emphasize good governance. Whereas, other agencies such as the United Nations Development Program (UNDP) do not apply policy conditionality.

### **2.2.3 North-South gap and foreign aid**

Global north refers the rich and highly developed countries like United States, United Kingdom, France, Germany etc. whereas global south refers the least developed and poor countries of Africa and Asia. Practically, global south possesses capital resources and technical skills and the south lacks it. This gap indicates the underdevelopment of the latter one. Therefore, the global north should promote international development through financial, economic and technical assistances to the global south.



## **2.3 Foreign Aid and Poverty Reduction**

### **2.3.1 Review of International Studies**

Here, scholarly articles by various scholars internationally regarding the relationship between foreign aid and poverty reduction have been reviewed.

Christian Schabbel has emphasized on the role of foreign aid in development, poverty reduction and regional conditions. Despite an improved analytical knowledge of poverty, a complex multilateral transfer system of official development assistance (ODA), and a list of clearly defined objectives (Millennium Development Goals), poverty reduction in low-income countries remains a great challenge for researchers and practitioners alike (Schabbel, 2007, p.146). Further, the writer mentions that after an era of pessimism, recent empirical studies indicate that foreign aid leads to economic growth under certain conditions, for example a sound policy environment. However, whether aid alleviates poverty or not is a highly debated issue in the international arena today.

In this background, E.F. Schumacher opined that empirical finding shows that aid sponsored development has failed to create jobs, to promote self-reliance and to reduce poverty level of most of the countries in the world. On the contrary, it has taken some imaginary agendas which are apparently taming the interests of local elites and maintaining status quo in society. There are clear indications that the current mode of funding does not harness the potential of foreign aid to its highest optimum, indeed it neither trickle down to the poorest who really needed nor does it advocate their problems with the concerned authorities. Paradoxically, it is largely promoting those who can help themselves rather than helping the helpless population.

Foreign aid thus does not change the established cycle of development planning which have been making the poor poorer and the rich richer.

Aid flows are meant to fill the gap between the investment needs and the domestic savings of the recipients states to help reduce poverty if not eradication. During the last centuries, developed nations have been offering aid to the countries normally bracketed in the category of the “third world”. Foreign aid has apparently played a crucial role in these countries in many aspects- from carrying out development activities to democracy building. However, not everything is well as far with the aid and the developmental works undertaken (Sharrock, 2013).

The article "*Effectiveness of Foreign Aid on Poverty Reduction in Kenya*" summarize that foreign assistance to developing countries including Kenya has risen in the recent past. However, poverty levels in these countries have not fallen commensurately. Using data from sixty nine districts in Kenya, the results generally show that ODA has significantly reduced poverty in Kenya. The results however, show that ODA disbursements have had stronger impacts on the poorest of the poor and less on those just below the poverty line (Oduor& Khainga, 2009, p.7).

This may be a pointer to the fact that donors may have, in the past, put too much emphasis on the poorest of the poor regions and ignored those who are just below the poverty line. This calls for a review of donor funding allocations among the poor regions in order for the impact of ODA to be felt more uniformly. In addition, the results show that the implementation of the 2005 Paris declaration has been felt only by the poorest of the poor and not those who are less poor again calling for emphasis of proper projects in all poor regions. The findings also show strong

spillover effects of ODA beyond the month of disbursement underscoring the long-term impacts of the projects (Ijaiya & Ijaiya, 2015, p.549).

Almeida in his research "*The effectiveness of foreign aid on poverty reduction: the role of the political regime* " summed up three main conclusions. In the first place, foreign aid is not effective in reducing poverty. Secondly, the political regime seems to have an important role in poverty alleviation, suggesting that a more democratic regime contributes to a decrease in poverty. Thirdly, in low-income countries, only the GDP per capita seems to be significant in poverty alleviation, capturing the effect of all the other channels, even the impact of inequality or political regime. These three conclusions have important political implications. Donor countries and institutions should be aware that helping poor countries is not only about financial support, but also to create and develop the institutional environment that promotes poverty alleviation and thus improves the living conditions of developing countries (Almeida, 2018, p.34). The results suggest that this environment involves a more democratic political regime, where citizens can participate in the selection of their government and that promotes political stability.

### **2.3.2 Review of Nepalese Studies**

Here, scholarly articles by various scholars nationally regarding the contribution of foreign aid in poverty reduction of Nepal have been reviewed.

Badri Prasad Bhattarai in his thesis "*The Effectiveness of Foreign Aid: A Case Study of Nepal*" examines the effectiveness of foreign aid in Nepal, and adds to the growing literature on the issue of aid effectiveness. Until the mid-1960s, almost all development projects in Nepal were financed by foreign aid. Since 1970, the average aid/GDP ratio remains at over six per cent, and in 2002, foreign aid financed over

fifty percent of Nepal's development expenditure. Despite the constant flow of foreign aid and decades of aid-financed development efforts in Nepal, it remains one of the poorest countries in the world, with per capita income of about US\$ 243 and almost 40 per cent of the total population living in absolute poverty (Bhattraï, 2005, p.18). A casual observer of these facts could easily conclude that foreign aid to Nepal has not been effective, though they would not be able to say what would have happened in the absence of aid.

Manoj Kumar Chaudhary in his research paper "*Economic planning and poverty alleviation strategies in Nepal*" emphasizes that Nepal being a developing country in the world has been facing a lot of problems for the rapid development in present context. The study identifies the major issues of poverty alleviation strategies of Nepal. In 2013 B.S, first five-year plan was formulated and implemented in Nepal. Poverty alleviation is the main objective of economic plans of Nepal since seventh plan. Most of the strategies were concerned with the formation of better and prosperous country with higher living standard of its citizen. Direct and indirect measures are taken from the side of government, international aid, private sector and co- operative, but the achievement is not so remarkable. Lack of domestic resources, low rate of capital formation, dependency on foreign sources, lack of political commitment, low level of awareness are the causes of failure of poverty alleviation strategies in Nepal (Chaudhary, 2018, p.47).

Damaru Ballabh Paudel in his article "Foreign Aid and Economic Development in Nepal: A Revisit" concludes that it has been more than six decades that Nepal is receiving foreign aid for financing development in Nepal. However, the economic growth rate of the last decade is less than four percent and still one fifth of

the population is under absolute poverty. If foreign aid had played a crucial role; it would have had higher growth rate and less poverty. Lack of evidence-based research shows that we need an empirical study to know the impact of foreign aid in the economic development of Nepal which would certainly help the planners and policy makers to make better policies regarding the foreign aid in Nepal (Paudel, 2016, p.41).

Comfort and Karkee on their article "*NGOs, Foreign Aid, and Development in Nepal*" concludes that there are numerous and various types of NGOs operating in diverse sectors, including health, agriculture, poverty alleviation, and good governance in Nepal. Although NGOs and foreign aid have brought service, knowledge, and resources in Nepal producing short-term outputs, Nepal still remains one of the poorest countries in South Asia. A change in working culture with performance-based evaluation in public institutions is necessary. International Non-Governmental Organizations (INGOs) should be more involved as advocates rather than direct service providers. INGOs program should be need based rather than the donor driven so that the aid will be invested in the priority sector of the country.

Chandra D Bhatta assesses the pivotal role of foreign aid in shaping Nepal's political economy. He indicates the trend of supplementing foreign loans and grants to the government by direct aid to non-state agencies, as reflected in the declining share of the aid in the GDP since the early 1990s. To him, this distribution has created turfs for imaginary agendas and facilitated diplomatic moves of the donor countries. His argument that the foreign aid is fostering "a renter state" is speculative though. Whether the efforts of non-state organizations in funneling the aid on social programs have produced a patronage culture, whether foreign countries conspire for

“ethnicization and regionalization of politics and development”, or whether privatization of the state’s welfare functions and the attrition of community institutions are symptoms of the NGOs’ model of development, all require explicit references and substantiation. Bhatta attributes the glaring gap in the aid commitment and disbursement (with only 17% of committed aid getting disbursed) to donors’ unwillingness to cooperate with concerned stakeholders. He also connects systemic issues such as bureaucratic ineptitude and lack of credibility of governmental agencies to perverse spillovers of the foreign aid. This clearly depicts the absence of clear policy in the acceptance and mobilization of the foreign aid.

Krishna Prasad Acharya in his article, “*Foreign Aid in Nepal*” concludes that though foreign aid is regarded as a key source to bridge the gap between government income and expenditure in Nepal, based on time series data, despite of increasing trend of all variables (foreign aid, foreign loan and grant), the rate of economic growth is far less than expected. There is a gap between foreign aid commitment and disbursement which is also a problem of Nepalese economy. In the context of foreign aid as a key source of deficit financing in Nepal, the size of government expenditure, gross domestic product, foreign aid is increasing. According to him, series data reveals that all the foreign aid related variables are increasing but increase in foreign aid is less than rapid/expected which a serious threat to our economy.

## **CHAPTER III**

### **RESEARCH METHODOLOGY**

In this chapter, sources, sites, method and techniques of data collection and analysis of the collected data, technique of research designs and the limitations/delimitations of the research have been discussed.

#### **3.1 Research Design**

An explanatory and descriptive research design has been used in this study. The analyses of data were presented descriptively. Study of coordination between different programs, socio-economic strength of the government's organization, and monitoring and evaluation of program were explored, analyzed and described. Both qualitative and quantitative techniques were used for the research.

#### **3.2 Research site**

The study being mainly based on the secondary data sources, research site were specifically public libraries, various internet sites, databases etc.

#### **3.3 Data collection Method**

The secondary data was collected from books, articles, reports and from non-governmental organization etc. Being a macro-level study, it has covered the role of government agencies, NGOs and social workers.

#### **3.4 Data Analysis Method**

The secondary data derived from books, booklets, reports, official records, articles and documents was analyzed by the use of descriptive statistics. The data was

presented into tabular forms which gave the comparative picture of the reality. Percentage and proportion have been used for simplifying data for comparison. The data was also represented in diagrams and maps by the proper use of cartographic techniques.

### **3.5 Delimitations**

Since this study is based only in a previous researches published on the internet and books, the research is based on the secondary data. Similarly, subject constraint was the main limitation of the study due to which detailed study has not been possible. Though scope was broad, the research was focused on few governmental organs and institutions. However, the researcher has tried to obtain as more information and data from different levels as possible.



## **CHAPTER IV**

### **FOREIGN AID IN NEPAL**

#### **4.1 Introduction**

Nepal relies heavily on foreign aid. Donors coordinate development aid policy through the Nepal Development Forum, whose members include donor countries, international financial institutions and inter-governmental organizations. Japan is Nepal's largest bilateral aid donor and the World Bank and Asian development bank are the largest multilateral donors. Donors have been reported as losing confidence in Nepal as a result of political interference and corruption in poverty relief efforts as well as the country's apparently poor capability to utilize aid.

Nepal has been a recipient of foreign assistance since 1952 when it joined the Colombo plan for cooperative, economic and social development in Asia and the Pacific. The plan was established, under a slightly different name by the Commonwealth of Nations in 1951. During the 1950's many Nepalese received scholarships through the Colombo plan to go abroad for study in technical and professional areas

#### **4.2 Need for Foreign Aid**

Natural resources are the most important factor for economic development of any country. Higher the natural resources, higher will be the rate of economic development. But in most of LDCs, domestic resources to finance the development program are not sufficient to increase the capital formation and to bring any reasonable growth in productive capacity, domestic saving should be supplemented by foreign aid.

In an initial stage of development, foreign aid is indispensable. It is an economic necessity of development process. Even the highly developed countries of today took foreign aid in the initial stage of their development. They are countries like Japan and European countries. In the forum of aid, a donor country gives training to the people of recipient country in various subjects or gives idea to solve the problems arising in the country and also handover capital in cash to the developing country for the construction of projects and much more things according to the need of the country. Besides these sometimes a foreign country aids other countries in the form of foreign investment. Foreign investment helps sufficiently to the recipient country in utilizing her sleeping human power physically as well as mentally and other natural resources, which are not utilized or under-utilized or miss-utilized in the economic development of the country.

### **4.3 History of foreign aid in Nepal**

Nepal as a developing country has a lot of problems for the rapid development in present context. Economic planning was started in 1930s' decade from former U.S.S.R so that their economy was not highly affected by the great depression of that decade. In Nepal, in 2013 B.S first five-year plan was formulated and implemented. Poverty alleviation is the main objective of economic plans of Nepal since seventh plan. Nepal received the first foreign aid from the US government under the Point Four Program in 23 January 1951. It was a technical assistance of 2000 American Dollars. Since then, Nepal has been a recipient of foreign assistance since when it joined the Colombo Plan for Cooperative, Economic, and Social Development in Asia and the Pacific in 1952. The plan was established in 1951 under Commonwealth of Nations. In 2002, Nepal formulated the first foreign aid policy. Due to the gradual development in the principles and the best practices widely adopted in global aid

architecture, the policy needed to be updated. Therefore, the Government of Nepal launched its new Development Cooperation Policy (DCP) in 26 June 2014 which internalized all the principles and practices of aid effectiveness such as global commitments reflected in the Paris Declaration and Busan Outcome Documents, South-South cooperation and so on. Foreign aid is an important instrument to bridge the fiscal gap in least developed countries in the world. It has two headings, foreign loan and grant. International finance among the public finance plays a key role in socio-economic development.

Foreign Direct Investment (FDI), remittance and Official Development assistance (ODA) falls under international finance. In the past, major source of development expenditure used to be foreign aid which currently occupies nearly twenty percent of the national budget. The share of foreign grants and debts is likely to grow in upcoming years due to necessity for post-earthquake reconstruction and rehabilitation works (Economic Survey, 2017).

#### **4.3.1 Before Maoist insurgency period**

In this globalized world, like other foreign countries, Nepal also highly depends on foreign assistance. Foreign aid to Nepal is not a recent fact: “The flow of foreign aid in Nepal began in the 1950s” (Devkota, 2011, p.41). Guided by that philosophy of extending its sphere of influence across the planet, the U.S became the first donor country to be interested in Nepal: “Nepal’s tryst with foreign aid began with the signing of an agreement with the government of the United States on 23 January 1951 for assistance under the point four programs” (Pandey, 2011, p.20). The presence of U.S in Nepal under its aid program was an opportunity for the U.S to monitor closely Nepal’s neighbors, China and India. “The aid agreement was signed at the time when Indo-U.S.-relations were tense and newly communist China posed a

new security risk to the countries of Asia, as made evident by China's invasion of Tibet in late October 1950" (Khadka, 1997, p.1046).

During 1950's most of the developed countries for instance, the people's republic of China, Soviet Union, Switzerland, Australia, Japan and New Zealand provided various financial assistance to Nepal and United Nations provided technical assistance. Until the mid-1960s, Nepal was mostly dependent on foreign grants for all its development projects, when the multilateral assistance programs began in the 1970s. During 1970s more than seventy percent of funding for development plan was supported by the donor countries. Further, by the end of the 1980s, the huge amount of foreign aid was in the form of multilateral assistance program and thus was directed through World Bank and the Asian Development Bank.

Nepal has been successful in tapping aid from various sources. While its neighboring countries, India and China are two traditional sources. Nepal has expanded its diplomatic relations with a large number of donors, resulting in increased aid flows to the country. By the late 1980s over thirty-five countries provided aid to Nepal (Khadka, 1997).

In addition, eleven UN agencies, seven multilateral lending agencies such as the World Bank, and eight private agencies (for example, the Ford Foundation) were involved in aid programs. Under the auspices of the World Bank, the Nepal Aid Group was established in 1976. By 1987, sixteen countries and six international agencies were involved in the group. After 1976, a large part of foreign aid came from this group. The level of commitment from the Nepal Aid Group increased from Rs. 1.5 billion in 1976-77 to Rs. 5.6 billion in 1987-88. The aid commitment further increased from Rs. 16.5 billion in 1995-96 to Rs. 18.8 billion in 2000-01 (Library of

Congress, 1991; Paudyal, 2003). The increased commitment by the group might be attributed to the Structural Adjustment Program that was initiated in the late 1980s.

In the 1980s, bilateral US economic assistance, provided through the Agency for International Development (USAID), averaged US\$ 15 million annually. The U.S. also contributed to various international institutions and private voluntary organizations that serviced Nepal. Its total contribution to multilateral aid agencies working in Nepal was in excess of US\$ 250 million in the 1980s. The members of the Organization of Petroleum Exporting Countries (OPEC) provided US\$ 30 million aid from 1979 to 1989. Communist countries provided US\$ 273 million in bilateral aid from 1970 to 1988. From 1981 until 1988, Japan was the premier source of bilateral official development assistance (ODA) for Nepal, accounting for more than one-third of all funds. The second largest donor during that period was the former west Germany. Historical data further make it lucid that foreign aid in the 1980s was Rs. 17.9 billion up from Rs. 1.7 billion in 1970s, a rise of 952.9%. This figure in 1990s and 2000s has reached Rs. 68.5 billion and Rs. 181.2 billion with the percentage change over each decade is 281.8% and 164.5% respectively (Dhungel, 2015).

#### **4.3.2 During Maoist insurgency period**

In Nepal, the Maoist insurgency started in 1996 and ended in 2006. In the beginning, three hill districts of Mid-western Development Region were affected by the insurgency which later on was wide spread all over the country. Since then, all the infrastructural development activities were devastated and ended up with the chaotic situation in the country. The resources had to be diverted from development to defense during the war and to restoring peace after the war which is slowly being achieved. During the war (1996-2006), Nepal received a total of Rs 167.8 billion as

foreign aid which surpassed the total amount received in three decades - the 70's, 80's and the 90's. (Dhungel, 2015).

#### **4.3.3 Post Maoist insurgence period**

The trend of post-conflict foreign aid has sprinted over to Rs. 131.1 billion during 2007-2011 periods. This amount, received during a five-year period, is nearly the amount received during the ten years conflict period. “In more recent times, the mistake with aid to post conflict situations has been that it has become too little and too soon. Yes, too soon. The peace settlements hit the media and politicians hit their check books. Aid floods-in in the first couple of years then rapidly dies up” (Collier, 2007 p.106). In contrary to this statement provided by Collier's, Nepal has been receiving aid continuously from both bilateral and multilateral sources at a cumulative rate after the restoration of peace for gaining the social, cultural, economic and international development.

#### **4.3.4 Present peace period**

ODA remains as an important source of development finance for Nepal because Nepal has been mobilizing foreign assistance for over six decades. Nepal has established itself as a federal democratic country which requires a huge number of resources (both capital resources and financial resources. Further, Nepal's aspirations to come out of LDCs and achieve the SDGs target also requires the assistance from the developed countries, international countries and the Multinational Corporations.

The share of foreign aid in the national budget was about 22% in FY 2017/18. The estimated foreign aid inflows for FY 2018/19 have increased to about 24% of the total budget. The share of foreign assistance in the Government's total budget, though uneven across fiscal years, has been declining aided by improvements in domestic

resource mobilization. This data shows the country's shift towards self-reliant economy from the dependent economy. Looking specifically at ODA mobilization, Nepal received a development cooperation amounting to US\$ 1,622.8 million in FY 2017/18.

The five largest Development Partners (DPs), disbursement-wise, (the World Bank, the Asian Development Bank, the United Kingdom, the United States Agency for International Development, and the European Union) contributed about 73% of support received by the Government in FY 2017/18.

The Government has embraced a unique socio-economic development model in accordance with its long-term objective of creating "Prosperous Nepal, Happy Nepalese". It believes that "overall development is only possible through high economic growth and its equitable distribution. The Report starting point of our journey towards socialism is fulfillment of basic social needs such as decent job, minimum food security, basic health and education services, clean drinking water and safe housing to all citizens" (Economic survey, 2018, p.2).

#### **4.4 Trend of foreign aid in Nepal**

##### **4.4.1 Foreign aid trend**

Nepal and U.S signed four-point program agreement on 23 January, 1951. This was Nepal's first experience of foreign aid assistance. The US government's provided Rs. 22,000 under four-point program. Nepal received foreign assistance mainly in the form of grants and loans. In 1960's and 70's Nepal received foreign aid mainly through grants. Grants made up almost 70% of total foreign aid. However, the composition of aid changed significantly when she asked to borrow. In 2000/01,

Nepal received 64.07% in the form of loan and 35.93% in the form of grants (Sigdel, 2004).

Again, the situation got changed in 2009/10, grants shares was 77.4%, while loans was 22.6%. The current situation shows that amount of loan is increasing and amount of grants is decreasing. In Nepalese context, loans are mainly from multilateral sources like IMF, WB and ADB etc., while grants are from bilateral sources. The table below shows the share of loan and grant in foreign aid in the process of economic development of Nepal. Table 4.4.1 illustrates the Trend of Foreign Aid in Nepal

Table 4.4.1

Trend of foreign aid in Nepal (Rs. in Million)

Fiscal years	Grant	Loan	Total
1980/81	993.3	729.9	1723.2
1990/91	1630	4360	5990.0
2000/01	6753.4	12044	18797.4
2005/06	19574.8	6162.70	2537.5
2007/08	20320.72	8979.87	29300.59
2008/09	26328.86	99688.61	36297.74
2009/10	38545.97	11223.38	49769.35
2010/11	45922.17	12075.60	57997.77
2011/12	40810.28	11083.07	51893.35
2012/13	35229.80	11969.44	47199.24
2013/14	42205.7	17998.82	60204.52
2014/15	38291.4	25615.6	63,907

Source: Various economic survey of MOF.



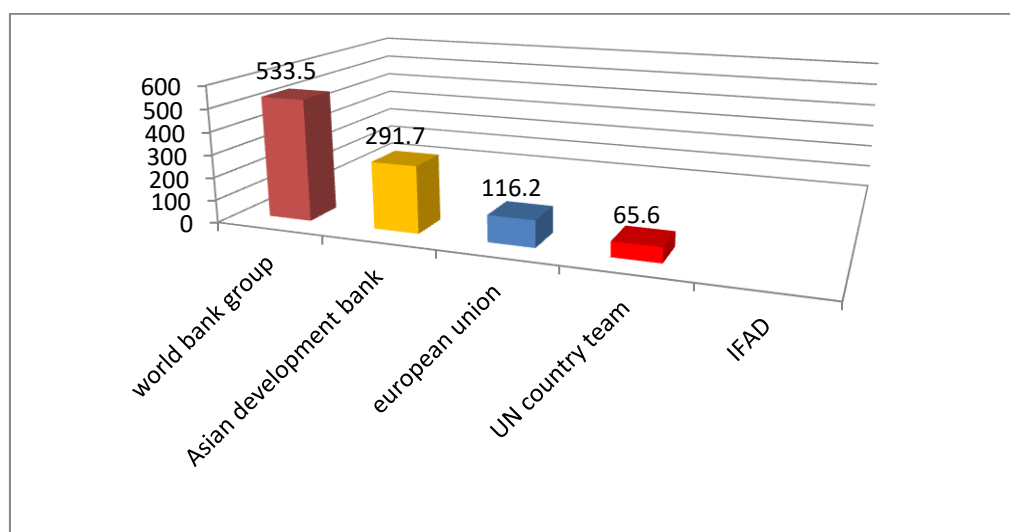
#### 4.4.2 Data and facts regarding the foreign aid in Nepal

Data and facts for the analysis of impact of foreign aid has been taken from fiscal year 2017/2018. The top five multilateral DPs in FY 2017/18, in terms of disbursement, were the World Bank Group which assisted 533.5 million followed by Asian Development Bank, 291.7 million and 116.2 million by European Union. Further, UN Country team assisted 65.6 million and IFAD 15.8 million. Together these multilateral DPs provided 63% of the total disbursement, which is an increase from the 59% contributed in FY 2016/17. There was no change in the DPs included in this group of five, but some changes were observed in terms of disbursement volume. The European Union has risen to the third position whereas the UN Country team moved to the fourth position. The World Bank's contribution represented nearly 33% of total disbursement in FY 2017/18. Table 4.2.2 illustrates the top five multilateral DPs in FY 2017/2018, in terms of disbursement.

Table 4.4.2

Top five Multilateral DPs in FY 2017/18, in terms of disbursement

(US \$ in millions)

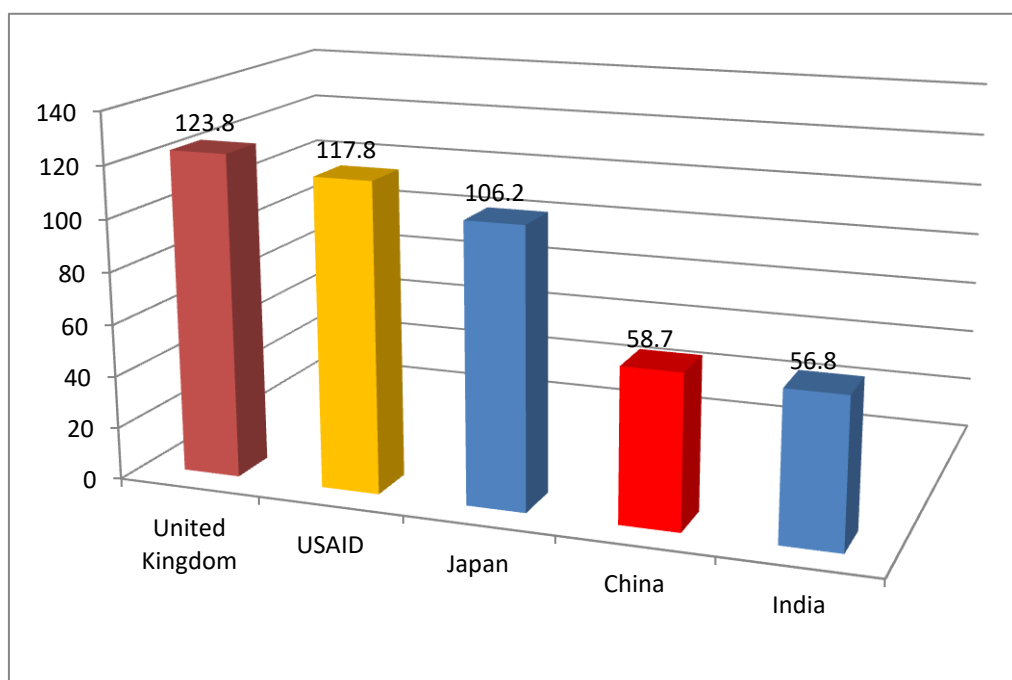


Source: Ministry of Foreign Affairs

Similarly, the five top-disbursing bilateral DPs for FY 2017/18 were the United Kingdom (US\$ 123.9 million). Second largest country was United States through USAID (US\$ 117.8 million) and third was Japan (US\$ 106.2 million). Further, China assisted US\$ 58.7 million and India US\$ 56.8 million. Together they contributed 29% of the total disbursement, slightly lower than the 32% they disbursed in 2016/17. Excluding Japan, which remains in the third position, there was a change in the order compared to FY 2016/17. The United Kingdom moved to the top position, followed by USAID, and China replaced India in the fourth place. Table 4.4.3 illustrates the top five bilateral DPs in FY 2017/2018, in terms of disbursement.

Table: 4.4.3

Top Five Bilateral DPS in Fiscal Year 2017-18, in terms of disbursement

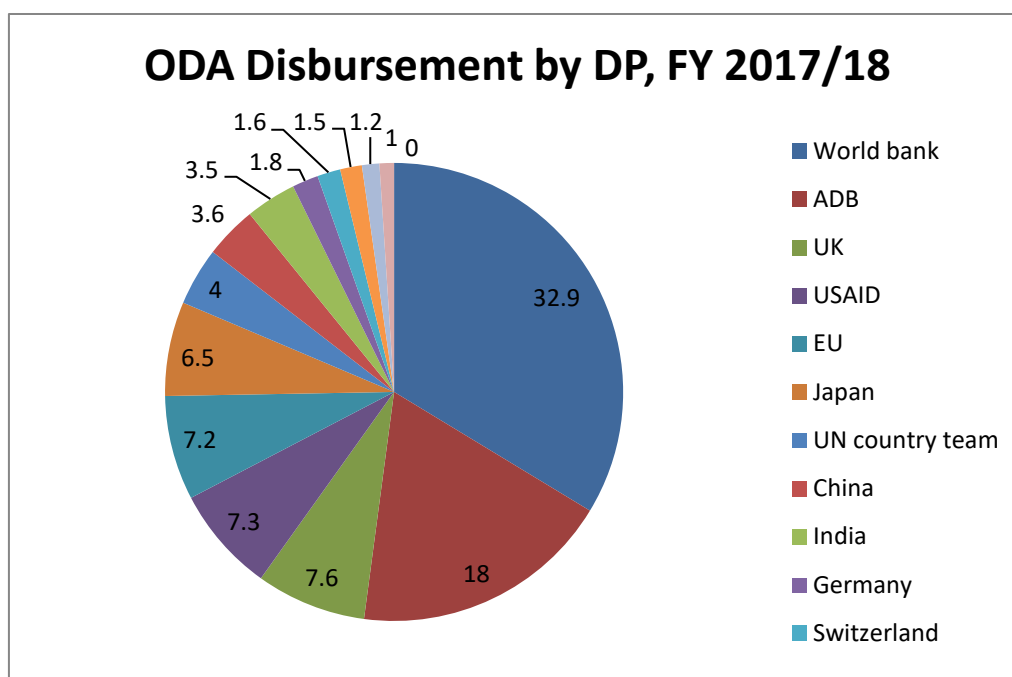


Source: Ministry of Foreign Affairs

As shown in Chart 4.4.4, the World Bank Group and the Asian Development Bank made the largest disbursements in FY 2017/18 i.e., 32.9% and 18%, respectively,

followed by the United Kingdom 7.6%, USAID 7.3%, the European Union 7.2%, Japan 6.5%, the UN Country Team 4%, China 3.6%, India 3.5% and Germany 1.8%. The disbursement by the World Bank Group increased significantly (about 16%) as compared to the previous fiscal year. Similarly, disbursement by the European Union and Japan increased by about 14% in FY 2017/18. There was a decline in the disbursement by the United Nations in FY 2017/18 as compared to that of FY 2016/17. The trends of ODA disbursements by the 10 highest-disbursing donors over the last eight years, shows fluctuations in disbursement from each passing year. Chart 4.4.4 shows that the disbursement in FY 2017/18 by most of the 10 DPs increased compared to FY 2016/17. There was a noticeable decline in disbursement by the UN Country Team, and a slight decline in that of the United Kingdom, USAID and India in FY 2017/18 compared to 2016/17.

Chart 4.4.4



Source: Ministry of Foreign Affairs

#### 4.5 Trend and relationship among government expenditure, foreign aid, gross domestic product (GDP)

The following table demonstrates that the relationship between foreign aid and government expenditure is constructive. Higher the foreign aid, higher will be expenditure from the side of government and vice-versa. When we observe the available data from 2000 to 2015 (16 Years), the trend is in increasing ratio but it is not linear so it is difficult to project for coming years.

Table 4.5

Government Expenditure, Foreign Aid, Nominal GDP, Loan & Grant of Nepal (in Million)

Year	grant	Loan	Foreign Aid	Government Expenditure.	Nominal GDP
2000	5711.7	11812.2	17523.9	66272.5	413430
2001	6753.4	12044	18797.4	79835.1	430400
2002	6686.2	7698.6	14384.8	80072.2	460250
2003	11339.1	4546.4	15885.5	84006.1	500700
2004	11283.4	7629	18912.4	89442.6	548490
2005	14391.2	9266.1	23657.3	102560.4	611120
2006	13827.5	8214.3	22041.8	110889.2	728000
2007	15800.8	10053.5	25854.3	133604.6	816000
2008	20320.7	8979.9	29300.6	161349.9	988000
2009	26382.8	26382.8	52765.6	219661.9	1193000
2010	38546	11223.4	49769.4	259146.06	1367000
2011	45922.2	12075.6	60008.8	339167	1527000
2012	40810.3	11083.1	51893.4	358638	1695000
2013	35229.8	11969.4	47199.2	435052	1965000
2014	42205.8	17998.8	60204.6	531558	21301500
2015	38291.4	25615.6	63907	601016	2,247,427

Sources: Ministry of Finance, 2017 (A study on foreign aid mobilization in Federal Nepal).

The table 4.5, shows that the amount of government expenditure, gross domestic product, foreign aid is significantly increasing. The increase is not linear in nature. This time series data reveals that all variables are increasing but increase in foreign aid is less rapid which a serious threat to our economy. GDP of our nation is not increasing accordingly. Earthquake of 2072 BS, flood and landslides of various years were some of the disturbances factors to increase GDP in projected manner. There is a gap between foreign aid commitment and disbursement which also is a problem of Nepalese economy.

#### **4.6 State of Poverty in Nepal**

Nepal is the one of the poorest countries in South Asia and ranks as the twenty-fifth poorest countries in the world. Poverty reduction has been the major strategy of government since seventh periodic plan. Government of Nepal in some extent has been able to make significant progress in reducing poverty but there is lot more to go. About four fifths of the working population live in rural areas and depend on subsistence farming for their livelihoods. In these areas the majority of households have little or no access to primary health care, education, clean drinking water and sanitation services. Life is a constant struggle for survival. Many poor families in Nepal are often obliged to send their children to work rather than to school. In this way the poverty cycle is reused in the next generation. It is estimated that about one quarter of children in Nepal between four and five years old are engaged in some kind of family or wage labor.

#### **4.7 Nature and Incidence of Poverty in Nepal**

Nepal is one of the least developed countries where poverty is deeply entrenched. Poverty in Nepal is widespread and persistent. The Economic Survey

conducted by the Ministry of Finance in 2017/18 shows that 21.06 per cent of the total population lives below the poverty line. The primary reasons behind poverty in Nepal are weak bureaucratic system, poor governance system, red tapism and corruption in administration, money laundering, underutilization of available of resources, political instability, social exclusion and exploitation etc.

Wide disparities exist in the poverty level based on urban and rural division, geography disparities, gender, ethnic communities and occupation castes. Poverty is highly rooted in the mid and far-western development regions. It is estimated that about ninety-five per cent of poor live in rural part of the country. Four fifth part of the rural poor are either self-employed or are engaged in agriculture. The average land holding of poor farmers is much less than that of non-poor. It is higher among women, dalits, tribes and female-headed households. The households that are headed by the female and the households run by the widow are particularly poorer. The number of widow-headed households has significantly increased during the period of Maoist movement particularly after armed conflict since 2001. During the period from 2001 to 2005, almost 17,866 people have been killed by both sides- the government and the Maoist rebels. (Ministry of Peace and Reconstruction, 2013)

#### **4.8 Education and Poverty**

Previously education in Nepal was not available to everyone; it was rather restricted to the ruling and elite families. Since 1951, things have changed radically and to this day the Nepalese government is continually committed to the improvement, development and expansion of education in Nepal. However, there are severe problems in how education is delivered in Nepal.

In 1990, there was change of government in Nepal. A fair and democratic system was supposed to take root. But people in power were paying attention to the interest of foreign countries who provided various aid, assistances and loan to Nepal and they were not interested to interest and expectation of the Nepalese Citizen. Foreign countries requested Nepal to privatize everything and Nepal did it. They introduced private education from kindergarten to university level. Suddenly, rich had good education but poor had education even worse than before. This created big social delinquent in Nepal and a decade long war was ensued starting at 1996. The main cause of this war is a feeling of injustice towards the poor and rural people. Children born in poor families in Nepal still do not have access to proper education and almost two-thirds of the adult population in Nepal cannot read or write.

#### **4.9 Nepal Human Development Index (HDI)**

Nepal's HDI value for 2017 is 0.574 which put the country in the medium human development category positioning it at 149 out of 189 countries and territories. Between 1990 and 2017, Nepal's HDI value increased from 0.378 to 0.574, an increase of 51.9 percent. Table 4.9 reviews Nepal's progress in each of the HDI indicators. Between 1990 and 2017, Nepal's life expectancy at birth increased by 16.3 years, mean years of schooling increased by 2.9 years and expected years of schooling increased by 4.7 years. Nepal's GNI per capita increased by about 111.6 percent between 1990 and 2017.

Table 4.9

## Nepal's HDI trends

<b>Year</b>	<b>Life expectancy at birth</b>	<b>Expected years of schooling</b>	<b>Mean years of Schooling</b>	<b>GNI per capita (2011 PPP\$)</b>	<b>HDI value</b>
1990	54.3	7.5	2.0	1168	0.378
1995	58.5	8.1	2.2	1322	0.410
2000	62.4	9.0	2.4	1526	0.446
2005	65.5	9.6	2.8	1689	0.475
2010	67.9	12.0	3.3	2001	0.529
2015	69.9	12.2	4.7	2353	0.566
2016	70.3	12.2	4.9	2334	0.569
2017	70.6	12.2	4.9	2471	0.574

Source: Human Development Indices and Indicator: 2018 Statistical Update (UNDP)



## CHAPTER V

### DATA ANALYSIS AND PRESENTATION

This section of the study presents various analyses of the secondary data of foreign aid provided to Nepal and the poverty situation at the time. Since the start of foreign aid in Nepal, there are considerable effects on the economic development. As economic development focus on various sector interconnected like health, infrastructure, education, social aspects and many other, it is a diverse topic to deal with. It also includes discussion of various results being derived from data analysis. This study is based on the secondary data collection through previously done research, published articles, census report and the books related to the topic.

#### **5.1. Implication of the foreign aid in Nepal**

The relation between foreign aid and poverty reduction has been a topic of concern for several scholars. Whether foreign aid is an effective mechanism in the poverty reduction or not has been a debatable issue in today's globalized world. Some of scholar's have concluded that aid promotes either directly or indirectly, by affecting indicators closely related to poverty. Foreign aid in Nepal has emerged as the subject of a great deal of development rhetoric. Despite the fact that its objectives have rarely been met, it continues to have a firm control in shaping Nepal's development priorities, modalities and outcomes. Though having limited resources to invest in socio-economic development infrastructure and cash-strapped status of the nation, aid continues to be a fundamental part of Nepal's economy. Some of the key questions pertaining to foreign aid in Nepal include: Why has there been very little development despite six decades of foreign aid? Is foreign aid part of the solution or part of the problem? (Pokhrel, 2019)

The composition of public expenditure, which can be easily manipulated by governments, together with corruption and red tapism, are strong determinants of aid ineffectiveness. Hence, with the new conditionality approach, donors can orient public expenditures to the pro-poor sectors, increasing the effectiveness of aid in terms of poverty alleviation.

International Economic Cooperation Coordination Division (IECCD), under the Ministry of Finance survey has identified fragmentation of aid, lack of project readiness and spending capacity from the government side and donors' engagement with various agencies, lack of transparency as the major obstacles for effective utilization of development assistance in Nepal. (Pokhrel, 2019).

### **5.1.1 Fragmentation of the aid**

Foreign aid agencies working in Nepal have been scattering financial resources in smaller projects. Such fragmentation of financial assistance reduces aid effectiveness and raises transaction costs of projects. Aid fragmentation, according to the Organization for Economic Cooperation and Development, is financial assistance that “comes in too many slices from too many donors, creating high transaction costs and making it difficult for partner countries to effectively manage their development”.

The European Union has recommended a maximum of three sectors for each donor, though it has called for some flexibility at the country level if the sectors are narrow in scope. The Finance Ministry, on the other hand, says engagement of every donor in a maximum of five sectors can be considered satisfactory. Yet many development partners here are operating far too many projects across a range of sectors. For instance, the United Nations Country Team was found to be implementing seventy-three projects in partnership with seventeen government

ministries or agencies in 2015-16, while the Asian Development Bank was overseeing forty-eight projects of fifteen ministries or agencies (Shrestha, 2015).

If resources are scattered in this manner, it will be difficult for the government to monitor implementation of every project. This will raise monitoring costs as teams have to be deployed to examine implementation of small and big projects. Many donor agencies, particularly bilateral donor agencies prefer to independently finance small projects as they want to see their country's tag on such schemes. These donors should not be driven by such desire because small projects do not make much developmental impact. Instead, these donors should pool resources and help fund bigger projects.

### **5.1.2 Political instability**

Nepal is highly dependent on foreign aid, especially for its development programs, but the political deadlock shakes the confidence of international donor agencies. Foreign aid makes up nearly sixty percent of the government budget, and in the fiscal year 2015-2016, US\$ 63907 million was received. The game of power being played in the political arena for years does not bode well for the country. The obsession of the political parties with grabbing power by using any means, fair or foul is highly objectionable. Such behavior on the part of the political parties has overshadowed the development agendas of the country. This is one of the reasons why the country has remained underdeveloped although it has been six decades since the concept of planned development got off the ground in 2013 B.S. Macro-policy environment and quality of governance have a direct bearing on poverty reduction; aid effectiveness is not critically contingent on them.

Foreign aid has its role to promote the transfer of technology or knowledge which accelerate production and productivity of the economy, which is one of the basic conditions for achieving the poverty alleviation objective and infrastructural development. Besides, foreign aid is useful instrument to meet foreign exchange gap, financial needs of crisis period and financial requirements for yearly budget and development plans. Since, Nepal has not been successful in attracting FDI as expected, because of internal factors such as prolonged political instability and lack of investment friendly environment. In this context, foreign aid helps to create environment for attracting foreign direct investment and promoting private sector investment.

## **5.2 Role of Foreign Aid in Economic Development**

Does foreign aid work for economic development of a developing country? This is a long-debated issue in the field of development economics. There are various arguments regarding the aid-development relationship. Some researchers argued that aid has stopped local initiation, increased the size of government, enlarged the number of elite increasing corruption and created bad governance in developing world (Moyo, 2010, Easterly, 2006). But their counterpart (Sachs, 2005) stated that foreign aid has positive relation with economic development and has success to reduce the poverty.

Regarding the positive view Jeffrey Sachs in his popular book “The End of Poverty” argues that if the rich world had committed \$ 195 billion in foreign aid per year between 2005 and 2025, poverty could have been entirely eliminated by the end of this period (Sachs, 2005). In contrary, regarding the negative view, Dambisa Moyo in her book “Dead Aid” and William Easterly in his book “The White Man’s Burden” argue that aid does more bad than good for economic development (Moyo, 2010,

Easterly, 2006). They further opined that aid prevents people of developing countries from searching for their own solutions, while undermining and corrupting local institutions. In addition, foreign aid also creates self-perpetuating lobby of aid agencies and more dependency in developing countries. Easterly clearly favors homegrown development rather than the development funded by foreign aid. The evaluation of aid effectiveness in Nepal has shown mixed results (Economic Survey, 2011). Due to the low absorption capacity, lack of fully aligned aid with the country system, lack of mutual accountability and dearth of result-based projects and donor driven syndrome are the major causes for the hindrance of aid effectiveness in Nepal. In summary, aid effectiveness is a controversial issue of debate. It appears that aid has been successful in some countries like in Rwanda but not many others and the hot issue for empirical research in identifying the relationship between aid and economic development of the developing countries.

The figure of outstanding foreign debt is gradually increasing in Nepal. Since, the total cumulative outstanding foreign debt is Rs. 346.8 billion in 2013/14 (Economic Survey, 2015). Even a newly born Nepali baby bears almost 20,000 rupees as outstanding debt among which 12,574 is the outstanding foreign debt per capita. Since the burden of foreign debt is increasing and the growth rate is sluggish, it is a quite debatable issue - Is foreign aid fruitful for development or just increasing the burden? Is foreign aid helping to reduce poverty? What is the role of foreign aid in economic growth? These questions are almost unanswered in Nepalese context. There is no any evidence-based study to find the answers to these questions. The developmental expenditure in each periodic plan was heavily financed by foreign aid. This show the role of foreign aid is supplement and enhances Nepal's meager domestic saving so as to mobilize increasing resources for poverty alleviation.

In Nepalese context, loans are mainly from multilateral sources like IMF, WB and ADB etc. while grants are from bilateral sources. Up to 1970, foreign aid flow to Nepal confined to diminutive size. During the period 1950-70, bilateral grant played a predominant role in the structure of foreign aid in Nepal. During 1980s and 90s assistance was rapidly increased which was provided by the multilateral financial institutions like ADB, IDA and other UN agencies. However, the composition of aid changed significantly when she asked to borrow. In 2000/01, Nepal received 64.07% in the form of loan and 35.93% in the form of grants. Again, the situation has been changed in 2009/10, grants shares was 77.4%, while loans was 22.6%. The current situation shows that amount of loan is increasing and amount of grants is decreasing.

Foreign aid is considered a key factor in enhancing competitiveness of development projects and expediting economic activities especially in least developed countries (LDCs) like Nepal. However, when it comes to utilization of foreign aid or its effectiveness, Nepal still seems to be far away in the picture. Over-dependency on foreign aid has made the people parasites. But when it comes to utilizing aid (both loans and grants) productively for self-reliance, Nepal is lagging behind. As foreign aid is composed of loans and grants, of the total commitments, Nepal has been able to use less than fifty per cent as of now. Do our institutions have capacity to use it properly and timely manner? This is the million-dollar question. The top multilateral agencies to provide aid to Nepal are mainly the World Bank, Asian Development Bank, European Union, UN Agencies etc. These agencies always feel privileged to give aid to Nepal but they also put strict conditions for effective utilization to enhance economic activities and support economic growth.

The economic survey for the fiscal year 2014-15 shows that outstanding debt of Nepal in the form of foreign debt and domestic debts stood at Rs. 545.31 billion by fiscal year 2012-13. This had increased by 1.5 per cent to Rs. 553.50 billion in fiscal year 2013-14. It also shows that outstanding debts seem to be on the rise. The share of foreign loan stands at over 61 per cent in the fiscal year 2012 to 13. It indicates that per capita outstanding debt stands at Rs. 20,068.00 in the fiscal year 2013-14, according to the Economic Survey for 2014-2015.

### **5.3 Role of Foreign aid in poverty reduction**

Foreign aid plays an important role in Nepal's development and poverty reduction. Foreign aid is crucial to meet the objectives of poverty reduction as articulated in the various recent government three-year plan. In the context of Nepalese economy, which is characterized by structural bottlenecks, large fiscal and external deficit and significant imbalance between saving and investment ratios, the role of foreign aid may significant. On the other hand, the role of foreign aid in the process of economic development of Nepal cannot be ignored due to resources constraints.

Since, saving gap increases when domestic savings rate is less than the investment required to achieve the targets. For example, if the growth target of national real income is 6% per annum and the capital output ratio is 4.5, then economy must save 27% of its national income to achieve the target of growth. But we can mobilize only about 8% of saving domestically the saving gap is 19% of national income. Thus, in our context, foreign aid may be crucial.

Foreign aid has its role to promote the transfer of technology or knowledge which accelerate production and productivity of the economy, which is one of the

basic conditions for achieving the poverty alleviation objective and infrastructural development. Besides, foreign aid is useful instrument to meet foreign exchange gap, financial needs of crisis period and financial requirements for yearly budget and development plans. Since, Nepal has not been successful in attracting FDI as expected, because of internal factors such as prolonged political instability and lack of investment friendly environment. In this context, foreign aid helps to create environment for attracting foreign direct investment and promoting private sector investment.

#### **5.4 Foreign aid and role of other stake holder**

Foreign aid and its proper use in the reduction of poverty and for the development project to conduct there are many stakeholders with their specific roles and importance. Role of different stakeholders with regard to financial information on aid, many stakeholders share common interests and needs. A cross-cutting concern for government, DPs and civil society is ensuring development effectiveness through better coordination and accountability. In this context, stakeholders share a motivation to understand how aid is allocated, spent and what results it contributes to. Core needs in this regard are for data on: on- and off-budget support from all DPs, including better data on humanitarian finance, I/NGO contributions and technical assistance; forward-looking data; and project-specific data on objectives, sectors, locations, timelines, duration, donors, implementers, and budgets (planned, committed and spent).

Key unmet needs are for more analytical information, in particular on needs, resources and results of development interventions in the federalized context, indicating an underlying need for disaggregated, geo-coded data, aid in relation to



national SDGs and other indicators, and aid in relation to domestic resources, highlighting the need for joined-up data across aid and fiscal management systems. Stakeholder priorities for improvement of current data and information are around comprehensiveness and completeness of off-budget data on technical assistance and INGO contributions, humanitarian assistance and increasing the availability of forward-looking data.

Overall, there is a strong sense that stakeholders require more analytical information than they feel is currently available to them. It is therefore important to recognize distinct needs for data that can be processed by machines and analyzed by experts, and for analytical information that is generated through interpretation and contextualization of data. Both better data and better information are critical but distinct. Quality, reliability, interoperability and openness of data are all essential to enabling analysis, but without use of data for analysis much of its value will not be realized.

## **5.5 Positive and Negative Impacts of Foreign Aid in Nepal**

Foreign aid has some effects on the economic development positively but there are numerous of other negative impacts as there are chances of corruption, transparency issues and other social issues. Some of the advantages and disadvantages of foreign aid in poverty reduction are dealt with below.

### **5.5.1 Positive Impacts of Foreign Aid in Nepal**

#### **5.5.1.1 Foreign aid in educational sector**

The United Kingdom, The United States of America and India are some of Nepal's bilateral donors that had established scholarship programs through which

those Nepalese students were able to go in those respective countries to acquire skills and knowledge that were lacking in Nepal (Niyibizi, 2015). Similarly, ADB has been contributing in primary and secondary education of Nepal. ADB became Nepal's major partner in the sector of education since the 1990s. In primary education, from 1991 to 2000, the bank funded a \$ 19.5 million Primary Education Development Project. In addition, ADB in partnership with the Danish International Development Agency financed a \$ 30 million Secondary School Support Project. The main objectives of those two projects were to improve the quality and efficiency of secondary education nationwide, and thereby produce middle-level human resources and qualified entrants into higher education. (ADB, 2015, pp. 40-41)

While Japan and India, put more emphasis on the teaching of science and technology. The newly built Tribhuvan University Teaching Hospital was a landmark in the evolution of medical education in Nepal (Pandey, 2006, p. 82). Pandey furthermore states that "The services provided also could be extended and a larger number of patients suffering from different diseases could be treated in Nepal. Previously, Nepalese patients had to travel outside to neighboring countries to seek medical treatment for relatively minor ailments because of lack of medical specialist in Nepal (p, 83). In today's context, scenario has been much changed than before. With the advancement of technology in medical sciences, treatment of almost every severe type of diseases is possible here in Nepal. Apart from Japan, Nepal's one of the immediate neighbor, India has been supporting in the development of science and technology by establishing schools, colleges, libraries, medical colleges and polytechnics. Scholarship in various field like agriculture, forestry, medicine, engineering etc. are provided to Nepali students through Indian embassy scholarship programme.

Thus, Education is one of the important sectors for the development of any country and a lot of foreign aid has been disbursed in this sector for developing and underdeveloped countries through various scholarship programme, educational platform, trainings, short-term and long-term courses as well as for the establishment of various educational institutes, schools, colleges, training centers, medical schools and polytechnics.

#### **5.5.1.2 Foreign Aid in Infrastructure Development**

Nepal, being a poor nation in terms of both resources and technical manpower need some assistance from donor for infrastructure development. Various bilateral and multilateral donors have been contributing in infrastructure development of Nepal since long ago. Countries like India, China, United Kingdom, United States, Germany, Japan etc. are the major contributors in infrastructure development on Nepal.

Indian Planning Commission visited Kathmandu to assess the requirements and absorption capacity in different sectors of Nepal. The experts suggested that it was not possible to prepare and implement a comprehensive programme at this stage. They, however, recommended the development to communication and transport links in Nepal (Singh, 1996, p. 93). The first venture undertaken by India was the construction of National Highway, which linked Kathmandu with the Indian border town Raxaul (Singh, 1996, p. 93). The highway construction began in 1953 and was completed in three years. Beside this Indian Aid has also contributed in construction of Siddhartha highway, various sub parts of Mahendra highway and bridges within the highway.

Aside from transport infrastructure, India has helped to build other infrastructures such as hydropower, drinking water and telecommunication. In the

hydropower infrastructure, hydroelectric plants in Koshi, Trishuli, Devighat, and Pokhara were completed as well as Gandak Hydel Scheme. As far as telecommunication infrastructure is concerned, some accomplishments have been made. By 1970, telephone lines connecting the majority of Nepal's districts were available. In 1972, Nepal acquired the international communication satellite allowing the country to connect with the rest of the world. Fiber optic cables covering nearly eighty cities and towns of Nepal was another achievement in that regard. In terms of drinking water, Indian aid, especially in the remote areas, has allowed people have access to safe drinking water. About one thousand safe drinking water projects worth Rs. 100 million have been implemented bringing people one of the basic essentials of life.

Beside India, role of Chinese aid is so immense in infrastructure development of Nepal. Chinese aid has contributed for the construction of highways like Araniko highway, Pokhara- Baglung highway, Prithvi highway, Narayangarh-mugling part etc. Along with highways, Chinese aid to Nepal has funded for the construction of hydropower projects like Sunkoshi hydropower, Seti hydropower and so on. Construction of Kathmandu ring road and its further enhancement and extension also belongs to Chinese aid.

Besides these, Germany is another Nepal's bilateral donor since 1961 and its assistance in the sector of infrastructure has been mainly used to generate more hydroelectric power. For example, two hydropower projects, Middle Marsyangdi Hydropower Plant Project and some contribution over Marsyangdi Hydropower Plant Project along with world bank was made through German's assistance. Like other bilateral donors, Japanese aid to Nepal contributed to the improvement of Nepal's

infrastructure. The infrastructure sector comprising communication development, bridges construction, and civil aviation accounted for more than one-third of the total grant assistance (Pandey, 2006, p. 7). In hydroelectric projects alone, Pandey shows the total amount of money in Japanese currency that Japan spent between the period of 1969 and 2004. Japanese assistance allocated to various hydropower projects generating as much as 237 MW amounted to 39.265 billion (Pandey, 2006, p. 9).

Similarly, Nepal's another development partner ADB has also been financing for development of infrastructure like Hetauda-Narayangarh highway. Beside this ADB has been contributing for the construction and enhancement of rural roads, bridges and rural water supply. Moreover, ADB made significant efforts in the increase of Nepal's hydropower. ADB assisted the Kali Gandaki- A, one of the largest hydropower projects of Nepal in collaboration with government of Nepal.

To sum up, Nepal has been provided with various aid and assistance for the infrastructure development. Donors have their own hidden vested interest for the economic, technical or infrastructural assistance to the recipient countries that might be either strategic interest, geo-political interest or anything like spreading their beliefs, values, norms or religions. Despite the vested interest of donor countries or agencies, international aid and assistance provides opportunity for the developing countries like Nepal to gear up their developmental activities. Nepal should be able to drive foreign aid according to her interest and necessity rather than donor's interest. For this Diplomatic bodies must show proper negotiation skill. During aid dealing, coming out of the begging mentality, they should conduct aid diplomacy according to the interest and need of nation.

### 5.5.1.3 Foreign Aid in Implementation of Various Periodic plan

Periodic plan was started from 1956 in Nepal. During that period, Nepal was not even at the position of running administration without any foreign aid. Since then, Nepal has been receiving various forms of foreign aid and assistances. The successful implementation of the planning depended on foreign aid because foreign aid is taken as an important source of Government of Nepal's resource in different plan periods. Different development projects as well as procedures are generally incorporated and guided by foreign donors. The share of foreign aid and expenditure in Various periodic plan are given in the table 5.5.1.3 below:

Table 5.5.1.3

Share of Foreign Aid in Development Expenditures in different Plan (In Million)

<b>Periodic Planning</b>	<b>Development Expenditure</b>	<b>Foreign Aid</b>	<b>% of foreign aid in development expenditure</b>
1 <sup>st</sup> Plan (1956-61)	382.9	382.90	100
2 <sup>nd</sup> Plan (1962-65)	614.7	478.30	77.80
3 <sup>rd</sup> Plan (1965-70)	1639.1	919.81	56.10
4 <sup>th</sup> Plan (1970-75)	335.69	1509.10	45.0
5 <sup>th</sup> Plan (1975-80)	8870.6	4264.10	48.10
6 <sup>th</sup> Plan (1980-85)	21750.0	1326.00	61.00
7 <sup>th</sup> Plan (1985-90)	48345.4	23978.50	49.60
8 <sup>th</sup> Plan (1992-97)	111919.80	74355	65.50
9 <sup>th</sup> Plan (1997-2002)	215154.4	111546.00	51.10
10 <sup>th</sup> Plan (2002-07)	234030.0	134620.00	57.50
11 <sup>th</sup> Plan (2007-10)	140660.0	38695.60	27.51
12 <sup>th</sup> Plan (2010-13)	364340.0	175180.0	48.08
13 <sup>th</sup> Plan (2013-16)	329976.00	189455.00	57.41

Source: Various issues of Economic Survey, MOF (2003/4- 2015/16)

The table above shows the contribution of foreign assistance as a percent of development expenditure had gradually declined from 100 percent in the first periodic plan to 45 percent in fourth periodic plan. The percent has been fluctuated after the fourth plan. In fifth plan, it was 48.1% while in the sixth it increased to 61 percent. In the seventh plan, it was decreased to 49.6 % and in the eighth plan, it increased to 65.5%. Then, in ninth plan the share of foreign aid was 51.10 %. In the tenth plan it was decreased to 57.5 % and again in 11<sup>th</sup> plan it was decreased to 27.51%. Similarly, in twelfth and thirteenth plan there seems gradual increase in development expenditure i.e., 48.08 % and 57.41 % respectively. The data above also shows the gradual increase of foreign aid as well from the initial first periodic plan to 13<sup>th</sup> periodic plan.

This analysis shows the heavy dependency of foreign aid for financing development expenditure for the successive operation of Periodic Plans. The data shows that without foreign Aid, the country would have to face many economic challenges to execute the development plans.

#### **5.5.1.4 Foreign Aid during disaster resilience**

Immediate rescue and response from various bilateral and multi-lateral donors are made to the country hit by unpredicted natural calamities like earth quake, floods, cyclones etc. Assistance in this situation might come directly from the country or through various channels of non- governmental organization working in the host country. Recently, an earthquake struck Nepal on 25<sup>th</sup> April,2015 with a magnitude of 7.8 Richter scale. It was the most powerful earthquake to strike Nepal since the 1934 Nepal-Bihar Earthquake. Aftermath the earthquake, many bilateral and multi -lateral

donor agencies were actively involved in disaster rescue and response programmes through various type of assistance and support.

Within minutes of the earthquake, the Government of India, via the Indian Armed Forces, initiated Operation Maitri (Operation Amity), created humanitarian missions with the primary objective of conducting relief and rescue operations in Nepal. Many countries and organizations have donated aid including the United Kingdom, which has been the largest bilateral aid contributor, China and the United States, all of which provided or funded helicopters as requested by the Nepali government. Numerous charitable organizations, such as UNICEF and Doctors without Borders, were delivering aid on the ground. Israel provided a large team of people to the relief effort in Nepal, second only to India.

After the 2015 earthquakes, Nepal government had organized 'International Conference on Nepal's Reconstruction -2015' to raise foreign aid for post-earthquake recovery. The main agenda of the conference was gathering donors support to the Government's plan for the post-earth quake rehabilitation and reconstruction. At the conference, Nepal's development partners pledged financial assistance amounting to US\$ 4109.52 million. But according to Development Cooperation Report 2016/ 17, out of the total committed amount only 16 percent amounts have been disbursed. The rate of disbursement is low because of the political instability and poor management system of government administration. But the overwhelming support from the international arena was very helpful and appreciable in case of the management after the disaster.



## **5.5.2 Negative impact of foreign aid in Nepal**

Beside positive impacts, there are some of the side effects of foreign aid that Nepal has been prescribed officially since early 1950s, and on which Nepal is continuously dependent.

### **5.5.2.1 Harm in Social harmony and national sovereignty**

Social harmony is broken and disorder is created when there is involvement of foreign aid through NGO and INGO. For example, by making foreign aid available for raising churches, mosques and temples rather than financing in schools, health posts and community service center. Additionally, foreign aid is also found to be readily available to elites, meaning it breeds a class struggle as well. Finally, a rather damaging and subtle side effect of foreign aid is its utilization in impairing sovereignty of the recipient country. Sovereignty gets impaired when foreign aid finances more often not directly but indirectly through international and national non-governmental organizations and their representative's participation in international seminars, deliberations, symposiums, etc.

### **5.5.2.2 Corruption**

Another side effect of foreign aid is donors' perceptions about robust system at work in the recipients. However, anomalies like maneuvering misuse, corruption and improper use cannot be ruled out even in countries where robust systems are at work. In other words, in Nepal donors complain on lack of effective public financing management, lack of efficient procurement and transparent bidding administration, lack of counterpart fund; and more often frequent changes of counterpart staffs and project managers. Foreign aid, nonetheless, hardly finds any news about the

correlation between corruption and foreign aid - recipient, for that matter people are forced to believe that corruption happens only within the domestically funded part of the project forgetting that more than, say 50 % or more foreign fund was put together in a project account. Foreign aid talks about frequent changes of managers, however, it hardly talks about the changed manager is proved to be competent and result oriented than the replaced one.

### **5.5.2.3 Poaching effect**

One cannot say that senior civil servants or other senior public officials and dignitaries work for donors in a visible way, while they are still sitting. However, when they get retired, they immediately join donors' offices - some of them the very next day. Their joining to donors' offices, as staff members or as an advisor, experts or consultants which create a gap of skills and experiences within the recipient, at the same time, helps donors to design and implement parallel projects and creating parallel units. Such practices weaken recipient entities, meaning foreign aid finds it ways as well as justification to perpetuate to help develop recipient's capacities.

### **5.5.2.4 Gap between the poor and rich**

Firstly, foreign aid has created a gap between people living in the rural areas and those living in the urban areas. Most of the foreign aided projects are urban biased. Rural Nepal is still traditional, whereas urban Nepal is in the grip of western culture. Secondary, a huge amount of foreign aid goes back to donors in the form of compensation to expatriate consultants and import of equipment. Thirdly, foreign aid has worsened corruption in Nepal. Between 40 % and 50 % of the project budget is siphoned out by politicians, bureaucrats and projects staffs.

#### **5.5.2.5 Dependency Syndrome in Nepalese People and Leaders**

Nepal and Nepalese people has been much dependent over foreign aid since sixty decades and even more. The over dependence on foreign aid and assistance has decreased the self-confidence of Nepalese leader and people.

Mentality of no developmental work is possible without the effort of donors prevails in both leaders and people and this has been the major hindrances for the development of Nation.

#### **5.5.2.6 Donor driven foreign aid and assistance**

Foreign aid and assistances from bilateral and multilateral donor has always been driven according to the donor's interest in context of developing countries like Nepal. Developing countries like Nepal has to face aid-conditionality further set by donors for the specific assistance they provide to Nepal. Whatever the aid and assistance come in Nepal most of them are driven by the hidden strategic interest of donor itself rather than the interest and necessity of the recipient country Nepal.

## CHAPTER VI

### FOREIGN AID MANAGEMENT FOR POVERTY REDUCTION

#### 6.1 Aid management processes and information system

According to the Ministry of Finance (MOF) Development Cooperation Report (DCR), development planning and financing are led by the National Planning Commission (NPC) which reports to the National Development Council headed by the Prime Minister. Implementation of the periodic development plans is monitored by action committees at the central, ministerial and district levels. In terms of core processes and systems to collect, share and use aid information, the DCR highlights the local development partners meeting, sectoral planning and coordination meeting as well as the annual high-level Nepal Portfolio Performance Review (NPPR).

As the MOF is currently developing relevant policies, it remains to be seen how these processes will evolve during the federalization process. In principle, The Constitution of Nepal 2015 mandates three spheres of government (central, seven provinces and seven hundred fifty-three local governments). Constitutionally, the federal level has the primary right and responsibility to mobilize and manage aid, with the provincial governments being able to mobilize donor funding with consent from the center. According to The Constitution of Nepal 2015, the local level has no specified role with regard to aid. There is, however, significant responsibility for development-critical service delivery (e.g., in health and education) for provincial and local governments, and shared responsibility for disaster management. However, future policies for aid mobilization and management will be defined and implemented, and government, civil society actors and development partners will

require detailed information on needs, resources and results along federal, provincial and local dimensions to plan, coordinate and monitor key interventions.

Nepal's Aid Management Platform (AMP) is emphasized as the core aid data system and information tool used by the government and the annual DCR is based on AMP data. First established in 2010, the AMP is operated by the MOF's International Economic Cooperation Division (IECCD). Developed by Development Gateway, it has over time received financial support from United Nations Development Program (UNDP) Department for International Development (DFID), Danish International Development Agency (DANIDA), United States Agency for International Development (USAID) and the Australian government. In 2017, a process of redesigning the AMP was initiated, led by the IECCD with support from UNDP and DFID. The redesign will have a particular focus on interoperability of foreign aid data with other fiscal management systems. As part of this process the IECCD has solicited feedback from development partners on their experiences of supplying and using the AMP.

Nepal's Development Cooperation Policy, 2014 specifies both a government commitment to ensuring public access to aid information through the AMP, as well as requirement for development partners to report to it. In recent years, the MOF has increased efforts to ensure INGO reporting to AMP as well as to provide technical assistance to publishers. Though the DCR considers the AMP to be comprehensive, noting its inclusion of South-South cooperation, the report acknowledges challenges for the government to adequately capture all finance, particularly in the area of humanitarian aid.

## **6.2 Foreign aid transparency**

The major problem of foreign aid is its transparency and the information system that all stakeholders should know. There is no proper channel and information system to manage the foreign aid properly. For all stakeholders, more specific needs for data and information derive from these overall motivations and interests. A number of these are common to different groups of actors, but there are also particular requirements.

A key distinction is needed to be made in this context between data and information. While detailed data is needed to be collected and be accessible in order to produce information. Not all stakeholders will be using data in the strict sense. In fact, while respondents did not necessarily distinguish clearly between the two in their answers, there was a strong indication that multiple stakeholders in fact desire more analytical information, which places available data in context and provides interpretation relevant to policy and practice. A common need is for information about on- and off-budget support from all development partners, including humanitarian actors; forward-looking data; and project-specific data on objectives, sectors, locations, timelines and durations, donors, implementers, and budgets (planned, committed, spent).

There are also common interests in data on aid allocation and results of on- and off-budget aid in the federalized context and with regard to the Sustainable Development Goals (SDGs) agenda. Repeatedly, stakeholders pointed to the need for better data on off-budget assistance (primarily on technical assistance and I/ NGO contributions), as well as more forward-looking data. Donors in particular highlighted a desire for more analytical information on aid allocations and results, while I/NGOs emphasized detailed project and location-based data, including data on results, as a key priority.

## CHAPTER VII

### CONCLUSION AND FINDINGS

#### 7.1 Conclusion

Foreign aid is crucial factor to achieve higher and sustainable economic growth and development of poor countries. However, aid must be linked with sustainable growth and poverty reduction. Overall environment for aid required, aid coordination and harmonization and development output and outcomes must be closely linked. Government must attempt to be in driver's seat. Priority should be based on our potential and need rather than external or donor interest. Absorptive capacity must be increased by enhancing the capacity of bureaucracy. In conclusion, aid is not bad and must be effectively utilized to attain national objective.

It has been more than six decades that Nepal is receiving foreign aid for financing development in Nepal. The economic growth rate of the last decade is less than four percent and still one fifth of the population is under absolute poverty. If foreign aid had played a crucial role, it would have had higher growth rate and less poverty. Foreign aid is considered a key factor in enhancing competitiveness of development projects and expediting economic activities especially in least developed countries (LDCs) like Nepal. However, when it comes to utilization of foreign aid or its effectiveness, Nepal still seems to be far away in the picture. Over-dependency on foreign aid has made the people parasites. But when it comes to utilizing aid (both loans and grants) productively for self-reliance, Nepal is lagging behind. As foreign aid is composed of loans and grants, of the total commitments, Nepal has been able to use less than 50 percent as of now. The MDG implementation process in Nepal has been affected and shaped by the country's changing political, economic and social

context. The MDG project highlighted eight major aims. Among them the first aim is to eradicate extreme poverty and hunger. In this aim Nepal has achieved both partial and complete objectives. Regarding other goals like educational, poverty gap and maternal and child mortality rate, much improvement has been made in proportion to foreign aid received. In these above aspects the objectives were almost fully achieved while in the field of poverty percentage below the poverty line is partially achieved.

The size of government expenditure, gross domestic product, foreign aid is increasing when we observe the latest trend of the foreign aid, GDP and government expenditure. The increase is not linear in nature. The data reveals that all variables are increasing but increase in foreign aid is less rapid which a serious threat to our economy. GDP of our nation is not progressing accordingly. Earthquake of 2072 B.S, flood and landslides of various years were some of the disturbances factors to increase GDP in projected manner. There is a gap between foreign aid commitment and disbursement which also is a problem of Nepalese economy.

The poverty in Nepal is an acute problem in terms of the number of poor populations, intensity of poverty and its severity. Bureaucracy was/is the fundamental means to deal with poverty alleviation since poverty was officially defined in 1976. However, in spite of a great deal of bureaucracy over the years, the level of poverty has not been reduced as per the targets set by the state. The fundamental reasons behind widespread poverty are inefficient and corrupt administration, huge amount of black money generation, sluggish growth rate relative to rapid population growth, mismanagement of foreign assistance, political exclusion etc. Looking at the number of lapses associated with bureaucratic means and past experience of poverty reduction, the study concludes that the campaign against poverty alleviation cannot be



succeeded only through bureaucratic means. NGOs, INGOs and Civil Society can also be promoted as the key means to the formation of social capital in the campaign of poverty alleviation in addition to bureaucratic networks.

## **7.2 Findings**

This section of the study presents various findings about the foreign aid provided to Nepal and the poverty situation at the time. Since the start of foreign aid in Nepal there are considerable effects on the economic development. As economic development focus on various sector interconnected like health, infrastructure, education, social aspects and many others, it is a diverse topic to deal with. After analyzing the relation of the different variables like GDP, government expenditure and the foreign aid provided to Nepal following findings are achieved through this research paper.

Foreign aid is necessary to meet the domestic resource gap. Moreover, aid is said to fulfill the import-export gap, investment-saving gap and technology gap faced by developing countries.

Nepal has not been successful in attracting FDI as expected, because of internal factors such as prolonged political instability and lack of investment friendly environment. In this context, foreign aid helps to create environment for attracting foreign direct investment and promoting private sector investment.

The top five multilateral DPs in FY 2017/18, in terms of disbursement, were the WB Group, ADB, EU, the United Nations country team and the International Fund for Agricultural Development. Similarly, the five top-disbursing bilateral DPs for FY 2017/18 were the UK, USAID, Japan, China and India.

The size of government expenditure, gross domestic product, and foreign aid is increasing when we observed in the trend of foreign aid but the increase is not linear in nature. The gap between foreign aid and government expenditure is increasing which highlights the ineffective management of the foreign aid in economic development.

The composition of public expenditure, which can be easily manipulated by government, together with corruption and inequality, are strong determinants of aid ineffectiveness. Hence, with the new conditionality approach, donors can orient public expenditures to the pro-poor sectors, increasing the effectiveness of aid in terms of poverty alleviation.

Fragmentation of the aid, political instability, aid management processes and information systems effectiveness and foreign aid transparency are the major factors responsible for the gap between foreign aid received and expenditure made on the developmental projects to uplift the poverty situation.

The successful implementation of the planning depends on foreign aid because foreign aid is taken as an important source of Government of Nepal's resource in different plan periods. Different development projects as well as procedures are generally incorporated and guided by foreign donors. During 11<sup>th</sup> plan (2007 -2010) the contribution of foreign assistance as a percent of development expenditure was decreased to 27.51 % while on every plan there was about 45-60 % contribution.

Nepal has aligned its national policies, strategies and plans to achieving the MDGs. The National Planning Commission (NPC) took the lead in MDG implementation. The MDG implementation process in Nepal has been affected and shaped by the country's changing political, economic and social context.

Foreign aid is also found to be readily available to elites, meaning it breeds a class struggle as well. The direct means of donor agency is simple through government means but there are possibilities of indirect means like donor led development programs which may threaten the sovereignty of the recipient country. The indirect approaches may be through international and national non-governmental organizations and their representatives' participation in international seminars, deliberations, symposiums, etc.

Foreign aid donors complain on lack of effective public financing management, lack of efficient procurement and transparent bidding administration, lack of counterpart fund and more often frequent changes of counterpart staffs and project managers.

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