

**AN ANALYSIS OF IMPACT OF DANISH AID ON
ECONOMIC GROWTH OF NEPAL**

A Thesis

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RECOMMENDATION LETTER

This thesis entitled "**An Analysis of Impact of Danish Aid on Economic Growth of Nepal**" has completed by Mr. Padam Bahadur Shahi under my guidance and supervision. This dissertation is the outcome of his own intensive and independent research work and has been prepared in the form as required by the Central Department of Economics. Therefore, I recommend it for examination by the thesis committee of the degree for Master of Arts in Economics.

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APPROVAL LETTER

The Thesis entitled “An Analysis of Impact of Danish Aid on Economic Growth of Nepal “submitted by Padam Bahadur Shahi has been accepted as a partial fulfillment of the requirement for the degree of Master of Arts in Economics.

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LIST OF ACRONYMS

ADB	=	Asian Development Bank
AEPC	=	Alternative Energy Promotion Centre
CAS	=	Country Assistance Strategy
CBS	=	Central Bureau of Statistics
CEDA	=	Centre for Economic Development and Administration
CEDECON	=	Central Department of Economics
DAC	=	Development Assistance Committee
DANIDA	=	Danish International Development Association
DCs	=	Developed Countries
DFID	=	Department of International Development
DKK	=	Danish Kroner
EEC	=	European Economic Community
ESAP	=	Energy Sector Assistance Program
ESAT	=	Education Sector Advisory Team
et.al	=	and others
EU	=	European Union
FDI	=	Foreign Direct Investment
FM	=	Frequency Modulation
FY	=	Fiscal Year
GDP	=	Gross Domestic Product
GNP	=	Gross National Product
GON	=	Government of Nepal
HDI	=	Human Development Index
HDR	=	Human Development Report
HUGOU	=	Human Rights and Good Governance Unit
IBRD	=	International Bank for Reconstruction and Development
ICS	=	Improved Cooking Stove (s)
IDA	=	International Development Agency
IFAD	=	International Fund for Agriculture Development
IMF	=	International Monetary Fund
INGOs	=	International Non-Government Organizations
LDCs	=	Least Developed Countries

MOF	=	Ministry of Finance
MTEF	=	Medium Term Expenditure Framework
NAG	=	Nepal Aid Group
NGOs	=	Non-government Organizations
NRB	=	Nepal Rastra Bank
NPC	=	National Planning Commission
NRs	=	Nepalese Rupees
ODA	=	Official Development Assistance
OECD	=	Organization for Economic Co-operation and Development
OPEC	=	Organization for Petroleum Exporting Countries
SDF	=	South Asian Development Fund
TU	=	Tribhuvan University
UK	=	Union Kingdom
UN	=	United Nation
UNCTAD	=	United Nations Conference on Trade and Development
UNFPA	=	United Nations Population Fund
UNICEF	=	United Nations Children's Fund
UNDP	=	United Nations Development Program
USA	=	United States of America
USSR	=	Union of Soviet Socialist Republics
WB	=	World Bank
WFP	=	World Food Program
WHO	=	World Health Organization

CHAPTER - I

INTRODUCTION

1.1 Background Information

Nepal is a small and one of the poorest countries in the world. Nepal is lying on the southern slopes of central Himalayas between China in the North and India in the South. Its location is $26^{\circ}22'$ N to $30^{\circ}27'$ North latitude and its longitude $80^{\circ}41'$ to $88^{\circ}12'$ E. It is a landlocked country of 147,181 sq.km. Its length is 885 km from east to west and its width is not conform, mean width of 193 km. north to south (CBS, 1996). Nepal is in initial stage of development process. Development is the first need of a country. But the term "Development" is not so easy in the context of our country where physical infrastructures such as initial stage. Geographical diversity, pattern of the population, attitude of society, cultural problems are also the hindrances of the economic development.

Though there is possibility of economic development the main obstacle is capital should be invested for the rapid economic growth. Since Nepalese people are in the vicious circle of poverty as in other developing countries so they can't save from their income to invest. There are some limited wealthy people who can invest but they spend their income to purchase luxurious goods rather than investment for productive activities. Consumption is always high therefore marginal propensity to save (MPS) is about near to zero.

In global context, a country cannot stand on its own being separated from other countries. Foreign aid shows the interdependent with other countries. In case of developing countries, there is mass poverty, policy failure and other weaknesses as which affect for the rate of capital formation. As a result, there is big gap between supply and demand resources. It is clear that the gap seems to be impossible to fulfill from the internal resources of the developing countries. So there is need of external capital.

Foreign aid is not a new concept. Its nature and objectives have been changing from time to time. Today it has become a cornerstone of any developing country.

Foreign aid can be defined as transfer of resources from the advanced countries for the purpose of encouraging economic uplift to the developing countries.

Many writers, national and international institutions have given various definitions regarding the philosophy of foreign aid. R. Rodan distinguished foreign inflow which normal market incentive do to provide. It consists of long term loans, grants, soft loans, and sale of surplus of currency payments and technical assistance. Wilern Gnataff Zeyletra "co-operation with a foreign state or autonomous political unit with the objective of assisting that state of autonomous political unit in furthering its economic growth and social process." "Foreign aid is the international transfer of public funds in the form of loan or grants either directly by one government to another [bilateral assistance] or indirectly through the vehicles of a multilateral agency like IBRD" [Todaro, 1974].

The function of aid for a development program is not directly to raise standard of living in the recipient countries but permit them to make the transition from economic stagnation to self-sustaining economic growth. Foreign aid is classified into various forms on the basis of its nature, terms and conditions and sources. From the point of view of its nature, it can be broadly classified as (a) capital aid, (b) technical aid and (c) commodity aid.

Firstly capital aid refers to the provision of capital in case or in kind for the implementation of projects as well as for assistance such as balance of payment support. Technical assistance includes export advisory in the field and commodity aid includes food and raw materials. The function of aid for a developed program is not directly raise standard of living in the recipient country but to enable them to make self sustaining economic growth.

The history of foreign aid in Nepal is not so long. It was 1951, with point four program of United States of America (USA). During 1950s and the early 1960s; India and United States were only two donor countries for Nepal. After that Nepal got many opportunities to have aid from many countries, like Union of Soviet Socialist Republics (USSR), China, Union Kingdom (UK), France, Germany, Canada etc. After late 1970s Nepal has been receiving foreign aid mostly from Nepal Aid Group (Australia, Belgium, Canada, Finland, Denmark, Austria, France, Germany, Japan,

Kuwait, Netherlands, Switzerland, Sweden, Saudi Arabia, UK, USA and six multilateral donors International Development Agency (IDA), International Monetary Fund (IMF), European Economic Community (EEC), United Nations Conference on Trade and Development (UNCTAD), Asian Development Bank (ADB) and United Nations Development Program (UNDP). Besides there, Nepal has receiving foreign aid from other bilateral as well as multilateral donors like World Health Organization (WHO), International Fund for Agriculture Development (IFAD), Organization for Economic Co-operation and Development (OECD), Development Assistance Committee (DAC), United Nations Children's Fund (UNICEF), NORAD, Danish International Development Association (DANIDA) and etc.

Foreign aid has been making significantly large contribution in financing development expenditure of Nepal. More than other two third of the development expenditure is being financed by foreign aid. The contribution of foreign aid in the three years interim plan goes estimated 50.2 percent of development expenditure (NPC, 2007).

Nepal receives much aid from bilateral and multilateral sources, among them Denmark is one of the major donors of Nepal. Denmark has provided development assistance to Nepal since 1973, with a loan assistance of Danish kroner 20 million for the dairy development schemes and the establishment of slaughter house in the country, later this loan was converted in grant assistance in 1980. In 1989, when Nepal was included in Denmark's program countries, then Denmark has extended its assistance to Nepal on various sectors of the economy. The main objective of Danish Development Assistance is poverty alleviation in consideration of crosscutting issues such as gender issues, environment, democracy and human right (Partnership Profile, 2006). Danish assistance to Nepal has been mainly directed to expanding the telecommunication system, strengthening the dairy sectors energy, education, environment and natural resource administration, reorganizing forestry, women-in-development and good governance etc.

1.2 Statement of the Problem

The world is characterized by a minority of rich and majority of poor countries. The developing countries face huge resource gap. This gap is difference

between total expenditure and total revenue of the government country. In order to fulfill this gap internal sources are inadequate due to low level of income and poverty or saving investment gap, for this external assistance is required. Therefore in developing countries, desired economic growth is possible only if domestic savings are supplemented by foreign aid. Thus in Nepal it is very hard to deny the importance of foreign aid. Foreign aid has become an important source to meet saving investment gap because "Foreign aid has inspired the nations left behind by the technological revolution to mobilize the resource for economic growth. It has also produced a transfer of resources on an unprecedented scale from richer to poor countries" (Byres, 1972). In this way foreign aid has been taken as a means of reducing gap.

When we study about foreign aid inflow in Nepal, it seems to be controversy that on one hand, the disbursement of the foreign aid has been increasing steadily resulting and increases in expenditure, while on the other hand, Nepal has been facing a problem of under spending at the time. It may happen due to inefficiency of development administration and also due to over calculation of donor countries.

In Nepalese case, there are many country-specific constraints, such as shortcomings in institutional capacities, its geographical location and mountainous terrain, widespread poverty, its high rate of population growth and urgent environment concerns, among others, which pose daunting challenges to development and the effective absorption of aid. While examining the problems relating to foreign aid, it is essential that these special challenges confronting Nepal to be borne in mind. Some times this is not the case, suggesting that there is probably need for enhanced mutual understanding among some of Nepalese development partners with regard to these problems. The growth impulses generated from past investments have remained weak, fundamentals of overall economic environment continue to remain shaky, absorptive capacity has not significantly increased and institutional capacity in many areas is inadequate to respond to development needs (Foreign Aid Policy, 2002).

Nepal has been receiving grant and loan as foreign aid. After 1970's, the amount of outstanding loan has been increasing. All aid is received in US dollar. Every year, Nepalese currency is getting devaluated with US dollar. Because of this foreign exchange rate change, the size of outstanding debt is increasing too. So the analysis of the impact of foreign exchange rate is also important.

Foreign aid has been playing crucial role for economic growth of Nepal. But the problem is that foreign aid has not been able to bring economic growth and development as expected. Various issues of economic survey published by MOF, Nepal government show that on the one hand the disbursement of foreign aid has been increasing steadily and resulting increase in expenditure, while on the other hands, Nepal has been facing a problem of under spending at time. From FY 2001/02 to FY 2002/03 aid disbursement has increased from 14384.8 million to 15888.5 million. Similarly, in FY 2002/03 aid commitment was 43202.7 million and disbursement was 15885.8, it is clearly seen that there is huge gap (27317.2 million) between commitment and disbursement. Donors are not providing their committed aid due to various reasons such as lack of clear commitment from the government, donor's own strategic interest rather than economic development, corruption, ineffective monitoring system of recipient country. It also creates uncertainties to start projects. It may happen due to inefficiency to administration, non-availability of suitable contractors and resulting delays in implementation of projects and also over calculation of donor countries. Although aid in Nepal is used for the construction of various projects, sometimes the donors are using aid as an instrument to serve their own interest rather than representing the interest of Nepal and Nepalese people. Another problem is that the large amount of foreign aid flows back to donors in the form of compensation to expatriate consultants and imports of equipment instead of that large portion of aid (about 40% - 50%) siphoned up the bureaucrats, project and political leaders before it reached to the targeted groups. Utilization of foreign aid is very low in Nepal due to country's low absorptive capacity and low productivity.

Danish aid to Nepal is gradually increasing and it covers most important sectors of Nepal such as education, environment, natural resources, energy, strengthening of democracy. The main significance of this study about Danish aid is to analyze the trend, volume, pattern, projects and programs of Danish aid to Nepal impact of aid being provided by Denmark for economic development in various sectors. In this study we are trying to find out the answers of the following questions.

- What are the types of projects conducted by Danish aid?
- Why is foreign assistance in Nepal increasing?
- What is the overall impact of Danish aid on Nepalese economy?

1.3 Significance of the Study

Nepal is one of the least developed countries in the world, so to give the way for the development process there requires much aid for the different purposes to development. Foreign aid plays a crucial role in the economic development of developing countries like Nepal. In developing country, domestic saving and taxation only cannot achieve the required investment for the meaningful economic growth. Nepal faces huge problem of deficiency in resource mobilization due to low saving and high consumption so that there is serious resource gap in Nepalese economy. Nepal is receiving foreign aid since FY 1951/52. Foreign aid has multiplier effect on income and accelerator effect on investment and ultimately the country can be self sufficient to finance investment. Thus, foreign aid can be taken as a cornerstone of a developing economy.

Denmark is being one of the donor countries of Nepal and has been providing assistance to Nepal since 1973. It is gradually increasing and it covers the important sector of Nepal such as education, poverty, agriculture, electricity, industry and mining etc. Therefore this research study aims to analyze the trend and volume of Danish aid in economic development of Nepal. This has been a guidance to which it concerns.

1.4 Objectives of the Study

The general objective of this study is to analyze the impact of Danish aid on Nepalese economy. The specific objectives of this study are as follows:

- To analyze the trend, pattern, volume, projects and programs of Danish aid to Nepal.
- To examine the impact of Danish aid in economic growth of Nepal.
- To provide suggestions and make necessary recommendations to enhance Danish aid in Nepal.

1.5 Limitations of the Study

Due to budget and time constraints and achieve specific goal of the study there are following constraints:

- The study is based on secondary data and no attempt has been made to check the variability of the secondary data.
- The data has been analyzed in their nominal values.
- Only official development assistance (ODA) has been considered.
- This study covers the period from FY 1989/90 to FY 2007/08.
- This study has been concentrated on limited economic indicators.

1.6 Organization of the Study

In chapter I, we have explained about our research problem along with the significance, objective and the limitations of the research. Chapter II describes the research done in the field of foreign aid especially in the Danish aid till this time. In chapter III, the tools and techniques we have used for the completion of the research are described. In Chapter IV, we have analyzed the foreign aid in Nepal since 1951/52 to 2007/08. In chapter V, we have explained the trend, pattern and volume of Danish aid in Nepal. Chapter VI shows the empirical analysis of Danish aid on GDP and foreign aid and GDP. Finally, the main results, summary, conclusion and special recommendations are kept in chapter VII.

CHAPTER - II

LITERATURE REVIEW

The concept of foreign aid is certainly not a recent phenomenon. It formally started just after the Second World War to reconstruct the war devastated European countries in their recovery program which is generally known as the 'Marshall Plan'. The 'Marshall Plan' is considered as forerunner of aid programs of the developing countries.

Literature review gives a clear as to what is relevant for the researcher in order to get real findings. So it is necessary to review important books, and research works conducted by different institutions articles review here.

According to the conventional wisdom of most development economists, capital is the key and problem of development is to increase available capital. They assume that output is limited by other factors of production. But these factors are also facilitated with the help of capital, so the output, in the long run, is limited by capital. Hence to increase the capital formation, a society has to save by foregoing consumption today in order to have economic growth for tomorrow. But the internal capital formation or saving is not an easy task for developing countries, because these countries encounters the fundamental bottleneck of low level of voluntary saving due to low level of income, structural rigidities in the economy, large level of unemployment, over population and so on. In the primary stage of economic development every country may be faced with such situation. With the help of foreign aid, a country comes out from these problems. Foreign aid fulfills the gap between saving and investment. So, foreign aid plays a supplementary role to solve the foreign exchange problem, the saving gap problem and technology gap problem, which are hindrances for developing countries at the initial stage of economic development. Hence, foreign aid has significant role in economic development.

Actually in the field of foreign aid, several publications are published in the form of books, booklets, journals, and many useful articles in various magazines. Likewise, there are several books, booklets, journals and articles written by Nepalese

writer as well as foreign writers in the context of foreign aid in Nepal. The students of economics have also submitted theses and dissertations relating to foreign aid.

The role of aid in the development of recipient countries was one of the most debatable issues of the 1970s and early 1980s. However, the genesis of the debate dates back to 1950s and 1960s when a group of economists (Rodan, Milikan, Rostow and Chenery) viewed that aid had a positive role for development in the recipient countries. They argue “There was a clear cut relationship in which more aid led more investment and that to more growth”. They are in favour of more aid because they think that without aid the condition in the poor countries would be even worse.

However, such argument was criticized by a number of economists through their empirical findings. No wonder foreign aid has been very helpful, and significant, however it has its own drawbacks. The weaknesses mainly stem from the way it is being implemented. The problem in implementation in achieving the proposed results emerges from the recipient country and the administration policy of donors. A group of economists, who advocates against the foreign aid, do not regard foreign aid as conducive to economic growth in LDCs. They think that foreign aid does not help but hinder economic growth. They, therefore, suggest that developing countries should try to do away with foreign aid and achieve economic self-reliance as soon as possible.

Economists, who advocate of the negative impact of aid, argue that the recipient country have various sorts of political pressures from donor countries. As a result of foreign aid dependence on other countries for financial resources, foreign machinery equipment and raw material increases. If foreign assistance is suspended or stopped for one reason or the others, it creates difficulties and uncertainties prevail in the formulation and implementation of development plans.

Another argument against foreign aid is that, when foreign aid is easily available the country does not make efforts to promote export, aid substituted imports. Similarly, the government does not make any efforts to raise the domestic rate of saving and investment. Without the increase in domestic saving and investment, it is argued that self-sustained economic growth cannot be attained. This is why some economists regard foreign aid as antigrowth.

Another disadvantage of foreign aid is that it raises the burden of public debt because much of the foreign assistance is in the form of loans rather than grants. We have to pay interest every year on them and when these loans mature we have to return the principal amount borrowed. Thus, it adds to the burden of the country. Foreign aid is further criticized on the ground of that it is mostly concentrates on the development of modern sectors. As a result it has increased the gap between rich and poor and income inequalities.

United Nations (1960), defined foreign assistance as “All transaction (for a country or a international organizations), which result in a permanent net addition to total resources available for economic development of another country”. According to the United Nation, aid consists only of out right grants and net long term leading international organization. Nowadays giving foreign aid either in the form of grant or loans has been considered as the responsibility of the international community.

Rodan (1961), one of the development economists as well as a very famous writer of economics, speaks about the external supply of capital. He states the purpose of an international program of aid is to accelerate economic development of countries up to a point where a satisfactory rate of growth can be achieved on self sustaining basis. He also includes technical assistance as part of aid. It is not a normal capital inflow, because it is a form of transfer of skills, which can result in economic growth. According to him, foreign aid assumes much importance as means to break the vicious circle of poverty and to accelerate the growth rate.

He argued that foreign capital inflows and foreign aid are not synonymous concepts. “Aid properly speaking refers only to those parts of capital inflows which normal market forces do not provide”. In the context of aid impact, Rodan opined that, aid has a positive role for development in the recipient countries.

Rodan also asserted that a reasonable amount of aid is determined by the absorptive capacity of the developing countries economy. He pointed out that aid should be fore generating capacity or efforts and ideally aid was therefore to be allocated where it would have the maximum catalytic effect in mobilizing additional national resources. He listed out the major achievements of aid, which are; increase in

the life expectancy, the fall infant mortality, the rate of growth, development of socio-economic overheads etc.

Chenery has defined foreign aid is an instrument of bridging various gaps and relieving various bottlenecks existing in an underdevelopment economy. Chenery, Byron (1962), MacEwan (1966) and Strout (1966) have formalized this argument in a "two gap" model. Foreign aid is expected to fill the two gaps, i.e. saving, investment gap and the foreign exchange gap. Centralized planning and a fixed exchange rate regime seem to be the implicit assumptions behind this concept, for this model, the author presumes on omnipotent inter-temporal decision maker and assumes away any complications that fluctuations in export and import prices could bring about as a result of floating exchange rate for the domestic currency.

The "two gap" model is actually quite simplistic and very intuitive. The model starts with the familiar equation for national accounts using the national income accounting identifies, uses of national income is equal to disposable of national income, using the symbols, this can be expressed as :

$$C + I + G + (X - M) = C + S + T \text{ ----- (1)}$$

C = Household Consumption

S = Private Saving

T = Taxation

I = Business Investment

G = Government Expenditure

X = Export of goods and net factor service

M = Import of goods and services and net factor income

Cancelling 'C' term from both sides and rearranging the other terms of equation (1), we obtained the relations

$$(I + G) - (S + T) = (M - X) \text{ ----- (2)}$$

Equation (2) is fundamental relationship reflecting a developing economy's domestic resource gap and its foreign exchange gap. As long as a developing country like Nepal is spending more on I and G then its earning from domestic resources released through private S and T, there will be a domestic resource gap that will translate into the balance of payments with M greater than X. The inflow of foreign

aid is assumed to help in filling the domestic resource gap ($I + G > S + T$) and foreign exchange gap ($M > X$). By providing additional domestic resources, foreign aid also supposed to facilitate and help to accelerate the development process, thereby eliminating the long term need to further aid transfers.

Jain (1967), has explained the need of foreign assistance for following causes:

- In recent years the acceleration in the tempo of economic development has led the country to experience a server balance of payments crisis that could only be met by imports of machinery and equipment essential raw materials and other strategic goods and even foodstuffs. The developing country has always felt on urgent need for external assistance to complete the major plan projects.
- The flow of foreign assistance is significant for the merchandise imports for the support of decreasing merchandise export.
- The need of foreign assistance arises in the payments have as they are to made for variety of service such as transport, insurance, servicing of foreign debts and other services. So that contribution of foreign assistance has been particularly vital.

Jain, who has discussed about the impact of foreign assistance, said external economic assistance has contributed to the productive capacity of the country in various ways. It has helped the national economy in creating capital formation or in releasing domestic resources for capital formation in the country. It is extremely difficult to quantify the impact of the foreign aid in the different fields of economic activity.

Hawkins (1970), has written that foreign aid is only a recent phenomenon, originating in the international scene after Second World War. Foreign aid will remain as a permanent part of international economy and will continue to precede development and thinking, which will influence the amount and character of foreign aid.

Papanek (1973), finds that foreign aid has a greater effect on growth than the other variables after a cross country regression analysis of thirty four countries, treating foreign aid, foreign investment other flows and domestic saving as explanatory variable. He explains, "Aid is supposed to be specifically designed to foster growth and, more importantly, is biased toward countries with a balance of payment constraint". He also finds a strong negative correlation between foreign aid and domestic savings, which he believes co-contributed to the growth performance.

Pant (1974), has written on the topic of external assistance in a separate chapter. According to him, the external assistance available to the least developed small countries can be discussed under the heading of foreign aid in the form of grants, loans and technical assistance. Shortage will be supported by foreign aid at least in the initial stage of development plans. He further says that rapid formation of capital for accelerating the growth of LDCs cannot be possible without foreign aid, even if domestic resources are mobilized to the optimum level.

Pant claims that the international flows of resources lower the stage of development, greater the percentage of import of net loans and grants. The efforts of advanced countries and international agencies are to instill knowledge and skill to developing countries, though technical assistance has been increasing in recent years.

He points out that the volume of international economic assistance has also been a below the capacity of developing countries to utilize it effectively. So it is important that provided foreign aid should have to be increased in higher amount but not under any condition and donor countries interest should not be imposed on the recipient countries must be free to use foreign aid according to their national interests.

Meier (1976), writes that capital accumulation is regarded as a core process by which all other aspects of growth are possible. Capital increases by investment and investment need more saving or foreign assistance. In his view, foreign aid might have some limited use; aid should be given to those who help themselves. In short run, calculation of aid requirement through the industrial assumption needs to be looked at very carefully. Over the long run, it not much use indeed, it may be more harmful.

Dhungana (1981), says that there is not even one sector which is free from foreign assistance. In this article, he has shown beautifully the percentage of external assistance in different plan periods of Nepal. According to his view, the impact of foreign aid is a small resource. In this sense foreign aid has only marginal effect on recipient countries. He further adds that net foreign investment out of the gross foreign assistance comes only about 25 percent.

Poudyal (1983), looks at the complementary of foreign aided project aid and saving, and aid and consumption in Nepal. The main objective of this study was to examine whether the project is financed by foreign aid on GDP, saving and consumption.

The study is primarily based on secondary data and materials and field observation. Both descriptive as well as quantitative techniques are used to examine the issues. The study has taken western development region for the case study. To evaluate the effects of foreign aid on GDP, saving and consumption number of linear single equation models are used. The main findings of study were:

- a) Foreign aid is being concentrated on infrastructure and neglected other sectors,
- b) The GDP, domestic saving and consumption are highly stable functional of foreign aid,
- c) Elasticity between GDP and domestic saving is higher than that of between GDP and foreign aid.

Suggesting that, GDP growth is more than responsive to domestic saving than foreign aid; positive effect of foreign aid is more on saving than consumption.

Baidya (1984), states that from the recipient point of view, the broad goal of seeking aid is to prompt economic growth and development. He has analyzed the rate of foreign aid in economic development. He has analyzed the rate of foreign aid in economic development from two perspectives i.e. macro perspective and sectoral perspective.

The macro perspective of analyzing the foreign aid is known as "Graperly view" because it considers aid as a means of filling resource gaps of the recipient economics. Chenery distinguishes three types of impediments inherent in less developed countries viz. these are: saving gap, the foreign exchange gap and the technology gap. In view of this gap, he concludes that foreign aid may be viewed on significant to resource to fill these three gaps. In initial stages, foreign aid plays a significant role in the development of less development countries.

From sectoral perspective, developing countries are traditional economics with weak modern sector. They characteristically lack infrastructure facilities. The expansion of these services experts a powerful multiplier effect on economic development and also strengthens a country's capacity.

In conclusion, he states that there is no viable escape from foreign aid, it appears that its only alternative to aid at present his expended, improved and well coordinated aid but it does not mean that foreign aid is sufficient and the singular condition of development.

Gurung (1984), examines the impact of aid programs in developing countries. According to him the idealism of the point four program to embark on a bold new program for making the benefits of hour scientific advances and industrial process available for the improvement and growth of under developed countries, was due to the lack of capital and technology and external infusion of these ingredients would transform their economy and lead to economic growth.

Singh (1985), finds that foreign aid has a strong positive impact on economic growth in less developed countries for the periods 1960-1970 and 1970-1980. He concludes that this is a very possible when state intervention is not taken into account. When the state intervention variable is included in the regression, the effect of foreign aid gets statistically weak.

Poudyal (1988), examines the effect of overall foreign aid (grant plus loan) in the saving and growth of Nepalese economy. He employed the technique of simple and multiple regressions with the time series data taken from the secondary sources covering the period FY 1964/65 to FY 1980/81. His conclusion was that foreign aid to Nepal positively contributed to the country's GDP growth but substituted domestic

savings. He also made a descriptive data analysis to know the contributing share of foreign aid in the total government expenditure. His study found that there was more than 50 percent contribution of foreign aid to financing the development plans. There existed a gap between foreign aid commitment and disbursement and aid utilization capacity of Nepalese economy was the main problem in this regard. His data analysis also found a noticeable shift of foreign aid from transport and industry towards agriculture, power and social services.

Dharamdasani (1988), explains that foreign aid has played a significant role in the economic development of the developing and underdeveloped countries during the last few decades. It has been used by the donors as an instrument of foreign policy to influence the domestic and external behaviour of the recipient nations and has been a vital factor in the newly emerging countries struggle against poverty and their quest for self-sustained economy and political stability.

Gurugarana (1992) says that external assistance for over 40 years has not appreciably succeeded in alleviating poverty, improving human development situation and fostering overall growth. He states that there is insufficient amount of aid relative the requirements composed to the ad-hoc nature and changing priorities of aid on the one hand and weak institutional and managerial capacity, inappropriate macro-economic and sectoral projects and lack of proper planning and commitment in government side on the other hand, made the amount of foreign assistance insufficient. Nepal has not yet received the quantum of aid comparable to those of Korea and Taiwan or Europe under the Marshal Plan. It is like giving a medicine below the prescribed dose. The effect not only prolongs the disease, but also eventually increases its severity.

Khadka (1998), writes that Nepal heavily relies on aid. Its reliance on aid increased from 45 percent development expenditure in 1975 to about 56 percent in 1986 and Aid GDP ratio increased from 2.6 percent to 6.9 percent during the same period.

The main objectives of this study were to examine the socio-culture and political constraints to developments, to find out the source wise and sector wise

allocation of aid over the past three decades, and to analyze the policy implications for aid and development in future.

The above objectives of his study regarding the aid inflow are significant. These objectives try to examine every aspects of aid clearly so far aid has not been effective in alleviating poverty in Nepal. On the contrary aid has created socio-economic dualism by favouring urban sectors rather than rural areas where development process is almost stagnated. It is urban biased. It caused huge gap between urban and rural areas in terms of consumption, it further widened gaps between have and have-not; and social disparity is still growing. Neither aid contributed to attain the goals, nor helped to establish institutional political machineries. Hence aid failed to alleviated poverty of the country because it was unable to grasp the majority of population who live in the rural areas. Actually, there was a euphoric support for increasing the volume of aid from the capable and developed to the weak and underdeveloped countries in order to make later group capable of attaining the desired ratio of growth of output. The first phase of euphoria remained until sixties through this international concern contributed to some extend to the nominal flows of fact declined in real terms by the 1970s. The aid GNP ratio endorsed by international organizations and bodies also remained unfulfilled.

Jhingan (1997) says, foreign capital can enter a country in the form of private capital or public capital. Public foreign capital is more important for accelerating economic development than private foreign capital. The financial needs of LDCs are so great that private foreign investments can only particularly solve the problem of financing. He has also focused his study against the foreign aid. According to him foreign aid has failed to improve the income earning capacity of LDCs and they are now saddled with large external public debts. Foreign aid frequently influences policies into inappropriate directions.

Pant (1988), examines carefully the effects of foreign aid on the economic growth of the least developed country like Nepal, together with social cost-benefit evaluation of two foreign aided projects. The analysis was principally based on Shibuya Yamasita and the Unido.

The objectives of the study were the following : to measure the effects of foreign aid on economic growth, saving an investment to gauge the extent to which the Nepalese economy is dependent on foreign aid, to elaborate contribution of projects, particularly these appraisal were undertaken by them to analyze the impacts of foreign aided projects through the social cost-benefit approach on the basis of objectives implicitly, to provide details on aid administration and to recapitulate the main findings and suggest some policy implications.

Finally, the researcher puts some recommendation regarding foreign aid. Firstly the government should respect to the donors to finance agro-based industries that could reduce the cost of production directly, emphasized on the road project which could help to generate income and employment, thirdly government of Nepal (GON) should request such donors to accommodate the local people in training and learning process so as to enable them to maintain and operate the projects satisfactorily after handover.

Mishra (1999), argues that concept of foreign aid in Nepal has been modified since 1980s. Till 1970s foreign aid was understood as a flow of grants or soft loans in terms of goods or cash.

Mihaly (2002), states that economic assistance was often regarded as simply a means of financing development rather as a political tool. His study has attempted to demonstrate that the nations and agencies which extend economic aid to Nepal, with few though significant expectation, failed to accomplish what they set out to accomplish. Aid has both the short-term and long-term impact. Because of the shape and directions, donors gave to the aid programs. Aid not only failed to give a significant boost to Nepal's economy but it may even have made growth more difficult to achieve.

Acharya (2002), states that although foreign aid did not substantially contribute to the economic development of Nepal, the importance of foreign aid cannot be denied, because the domestic resources mobilization of Nepal is still very low to fulfill the investment requirements. In this respect, new visions and ways of aid utilization have to be thought from both donors and recipient countries have to use these aids in related to concerned sectors optimally not considering aid as a free gift.

He further stressed on the effective utilization of foreign aid after making list of priority of the urgent needs of the recipient countries and most urgent projects will have to be selected with full of enthusiasm for implementing effectively so that it can generate sufficient resources to pay back to aid corruption is a burning problem which is gradually destroying our economy so that it should be minimized or checked even from the top level to the grass roots level. Transparency and dedication should be maintained in the economy to deal with corruption issues.

Pyakuryal (2002), states that foreign aid is indispensable to Nepal's development due to reduction of government ability to sustain recurrent expenditure. Foreign assistance constitutes over six percent of GDP per annum per capita foreign assistance is higher in South Asia but the volume of foreign aid is found inelastic in bringing positive changes in the per capita GDP of the nation. As a result progress in economic growth and poverty reduction has not been commensurate with the inflow of aid. This has complicated the mission of aid utilization, quality enhancement of reduction of aid depending as a short, medium and long term goal of the foreign aid. He further stresses that poor expenditure prioritization, weak designing, top down planning, poor supervision; monitoring, leakage and misuse of resources have created problems in aid effectiveness.

For this he recommends that there should be holistic strategy on foreign aid that properly addressed its donor and recipient perceptiveness. The capability of entire government machinery including the project staff needs to be enhanced to make them capable of handling the finished projects with the locally available resources. The donor agencies need to equip the projects with necessary spare parts and technical manpower in case of projects with more sensitive equipment and machinery.

Bulir and Laha (2002), focus on the macro-economic aspects of fiscal management in aid receiving countries. Despite the declining share of aid in budgets of donor countries, aid continues to play an important role in many developing countries. They first discussed the implications of aid in the economy as a whole and highlight the possibility of Dutch-disease effects of aid. Second it discussed the implications of aid for short term fiscal policy management in particular, how actual or anticipated change in aid receipts should be reflected in government spending.

Sigdel (2004), says that foreign aid is one of the most original political-economic phenomena of the twentieth century. In addition, foreign aid has become a foundation of North-South relations, which emerged as one of the principal levers for the globalization of social policies. Despite the influx of foreign aid to developing countries from industrialized nations, it is still diminutive in comparison to their economies, which falls between two to three percent of their GDP. Political, economic, humanitarian and social concerns motivate especially bilateral aid from developed to developing countries. Similarly, the World Bank Groups and Regional multilateral development bank's assistance programs are confined to the development endeavors of developing countries.

Mahat (2005), states that it is one thing to depend upon foreign aid for development finance and another to depend upon foreign aid for development itself. More aid does not necessarily translate into greater external development. It becomes so when aid does not lead to corresponding enhancement of the development capacity of the recipient nation and leads to some erosion in it instead and when it develops a tendency to fuel the greed of some in the name of the need for many.

Arellano, Gulir, Lale, and Lipshitz (2005), examine the effects of aid and its validity on consumption, investment and structure of production in the context of an intertemporal two-sector general equilibrium model. A permanent flow of aid finances mainly consumption, a result consistent with the historical failure of aid inflows to translate into sustained growth. Shocks to aid are reflected mainly in investment fluctuation, as a result of consumption smoothing. Aid shocks result in substantial welfare losses, suggesting that aid variability should be taken into account in designing aid architecture. These results are consistent with the evidence from cross-country regressions of manufacturing exports.

Finally, they suggested that aid variability has potentially large welfare effects, which should be taken into account in designing aid architecture. These effects of aid variability attenuate, but do not eliminate, the welfare benefits of receiving aid. The benefits of reducing aid variability or better yet tailoring the provision of aid to ensure recipients against productivity shocks could be very substantial.

Review of the Achievement of Tenth Plan

For the Tenth Plan period, a total of Rs. 134.77 billion foreign loan of constant price of the FY 2001/02 was estimated to be required to realize the desirable economic growth rate. The total foreign grant mobilized during the Tenth Plan period was Rs. 57.25 billion in excess of the estimate, while the foreign loan mobilization amounted to Rs. 34.6 billion, for too short of the estimate. The total foreign aid mobilization in the plan period was Rs. 91.31 billion. (NPC, 2007)

Foreign Aid Policies and Working Policies in Three Year Interim Plan (FY 2007/08 - FY 2009/10)

- Special emphasis will be given to increase the grant proportion in total foreign aid and the concessionary loan will be devoted to the development of infrastructure and other productive sectors on a priority basis.
- Technical assistance will be used with a focus on the objective of achieving sustainable national capacity development.
- Accountability of government and local stakeholders' role in development projects and programs will be ensured.
- In the management of development programs and projects, institutionalized and it will be ensured that the project implementation would be completed on the stipulated time, quantity and quantity cost, with a view to utilize resources in a sustainable manner.
- Foreign aid utilization will be enhanced through improvement in management, operational procedure and system simplification. Foreign aid conditionalities shall be improved.
- Promotion of indigenous skill, efficiency and technology will be the condition of foreign aid acceptance.
- All foreign aid will be reflected in the national budget.

- Effectiveness of foreign aid will be enhanced by coordinating the donor's interest with the National Policies and priorities.
- Effectiveness of foreign aid utilization will be ensured, by mapping the areas of co-operation between the government and donors, so that the duplication of aid mobilization and utilization is eliminated.
- Foreign aid will be utilized in the reconstruction of infrastructure destroyed during the conflict.
- Sense of government ownership of development projects and programs will be promoted.
- Initiatives shall be taken by the concerned ministries to prepare project/program bank as a basis of foreign aid mobilization.
- Priority will be given to the re-habilitation and re-integration of the displace people during the conflict while institutionalizing foreign aid.
- Infrastructure such as roads, bridges, electricity and communications will be given priority for foreign aid mobilization.
- In order to channelize foreign aid exclusively to the sector programs and projects and national interest and priorities, the following measures will be initiated.
 - Foreign aid mobilization will be focused on the priority sector identified in this plan.
 - Foreign aid flow to potential private sector investments will be discouraged.
 - Aid flow to the public-private partnership program, local level organizations and the community-based-professional agencies will be considered with due care.
 - Implementation plan for all the priority sectors will be drafted.

- A "Foreign Aid Efficiency Monitoring Committee" chaired by the concerned sectoral member of the National Planning Commission with membership of the sectoral ministry will be setup, to ensure the effective use of foreign aid.
- Project/program/sector/budgetary support as offered by participating donors with gradual transformation towards sectoral SWAPs and budgetary support mechanism.
- Priority will be given to augment the amount of grant assistance. In this situation lacking such assistance, the policy of mobilizing concessionary loans to high yield productive sector, human resource development and to the essential infrastructure construction will be continued.
- Technical assistance will be utilized to promote national capacity building.
- Foreign Aid Policy 2002 will be reviewed to make its implementation friendly and more practical.
- Special attention will be given to ensure foreign aid mobilization and its utilization consistent with the national policy, plan and the provisions of law.
- In order to ensure that the aid received from INGOs is mobilized for the optimal benefit of national priority endeavors, a national policy will be drafted and necessary legal provisions will be made for its enactment aid.
- Project bank will be located in the Ministry of Finance and the National Planning Commission.
- To establish a mechanism of economic diplomacy in Nepalese embassies abroad, a system of swift communication and coordination will be developed for facilitating an old mobilization effort.

- Active participation of all the stakeholders in project and program identification through monitoring and evaluation will be emphasized.
- Efforts will be focused to ensure that the commitments made under the Paris declaration and such other international forums are met.
- In coordination with the development partners, procurement for project activities will be executed in accordance with the Public Procurement Act, 2006.
- Emphasis will be given to a uniform system of project/program monitoring, evaluation, auditing and progress reporting.
- Common financial plans for project/programs will be prepared and implemented.

Foreign Aid Policy 2002

The main objectives of foreign aid policy 2002 are:

- To ensure the compatibility and convergence of foreign aided development activities with nationally determined development priorities.
- To improve the quality, effectiveness and efficiency of foreign aid operation.
- To enhance the contribution to poverty reduction through enabling higher rate of economic growth while ensuring distributional equity. This would require improved linkages with civil society organizations and the private sectors.
- To facilitate the transition to a more equal partnership between Nepal and donor institutions. The major focuses of this policy including both short term and long term were the launching of initiatives like MTEF to address the concern of the donors and their Nepalese counterparts as

well as associated changes in budget allocation and management process.

Sectoral programs would be emphasized and basket funding approaches would be encouraged to fund them. As such MTEF (Medium Term Expenditure Framework) focuses on outputs and service delivery aspects of key programs instead of traditional input focused approach. Foreign aid was expected to support such a shift by providing more recurrent cost funding. GON would improve implantation and expenditure monitoring as well as technical assistance program in consolation with donors. At this juncture, long term foreign aid would be channeled to national priority sectors, which include infrastructure development, agriculture, irrigation, forestry, environment, human resource and social development, education, health, population, poverty alleviation, employment generation and backward region development. Key projects in each of the priority areas would be identified and masked in terms of sectoral priorities and would be subjected to careful scrutiny and evaluation, so that donors who wish to take up free standing projects would be able to do so within a sectoral context.

In the line of these above objectives and focuses of this policy of Nepal we can critically examine that, in the long term foreign aid should be channeled to national priority sectors which include infrastructure development (energy, transport, tourism, science and technology agriculture, irrigation, forestry, environment, human resource and social developments, education, health etc.). Within these broad sectors, emphasis will be given to rural infrastructure, electrification, rural roads, public-health, drinking water and population problems. Government should reduce reliance on technical assistance gradually by building internal capacity. No loans should be used for technical assistance, foreign aid should be used to encourage partnership among the government, the private sector, civil society, NGOs and donors to develop project management leadership then only it can enhance benefit and sustainability and eliminate corruption. All projects which are financed by foreign aid should be examined from the social, economic, financial, managerial, technological environmental perspectives. For this relevant measures would be:

- To establish sector wide and nation wide merit order to project.

- To allocate resources according to merit order.
- To allocate resources according to merit order.
- In value beneficiaries, stakeholders and civil society from spark to finish the productivity and benefit of aid should be maximized to enhance its impact in economic growth and poverty alleviation with respect to the project goals, development strategies are realities.

Finally, it can be concluded that to get the positive impact of foreign aid in economic growth, there should be procedural improvements to enhance the effectiveness of foreign aid, financial management of foreign aided projects should be strengthened for this financial disbursement should be closely linked to the reporting of expenditure and physical progress, financial accountability system should be developed, foreign aid policy should be self-reliant in the long run so that in the long run we would be self-dependent for this there should be given more emphasis in revenue mobilization of private sector in major relevant areas.

Foreign aid in Economic Survey 2008/09

MOF (2009) states that the foreign aid commitment in FY 2007/08 had increased by 32.9 percent in comparison to 76.9 percent growth registered in FY 2006/07 than its preceding fiscal year. In monetary term, committed foreign aid amounted to Rs. 37.23 billion in FY 2006/07 while such aid in FY 2007/08 totaled to Rs. 49.186 billion. Of the total foreign aid commitment, bilateral assistance constituted Rs. 13.106 billion, whereas the multilateral assistance totaled to Rs. 36.080 billion. While classifying the foreign aid into grants and loans component for FY 2007/08, foreign grants amounted to Rs. 8.122 billion. As compared to the previous year, foreign grants had increased by 33.1 percent and loans by 31.8 percent in FY 2008/09.

While analyzing the foreign aid commitment in FY 2007/08 on a sectoral basis, the share of foreign aid commitment for agriculture, irrigation and forestry was 8.8 percent, electricity 5.5 percent, local development 13.7 percent, education 8.7 percent, transport and communication sector 6.8 percent and others 56.5 percent.

Dahal (2008), states that foreign aid is highly competitive and conditioned to higher level of democracy, human rights, governance, liberalization and economic reforms backed by decelerating states of corruption and conflict in recipient countries. Unfortunately Nepal does not have capacity to argue and campaign for more foreign aid as per requirements attributing to poor economic strength combined to a diminutive GDP. The prime concern of the foreign aid is of raising its productivity through effective utilization. Foreign aid needs to be directed towards achieving the overarching national goal of inclusive growth.

He says that at the backup of theoretical underpinning of foreign aid is essential not only for sustaining development activities and poverty reduction, but also for improving efficiency to enhance competitiveness of both government and the private sector, which would be instrumental in maximizing benefits from globalization and liberalization. Foreign aid has played a crucial role in the process economic development and poverty reduction in Nepal for more than five decades since the inception of the first five year plan in 1956. The donor communities have been generous to provide external assistance to Nepal uninterruptedly during and after the political change in 1990. However, recent experiences with the performance of foreign aid have been frustrating attributable to both internal as well as external factor.

Finally, he concludes that Nepal is passing through a critical juncture of poverty and stagnation, Nepal needs greater quantum of foreign aid from neighboring countries especially India and China and other industrialized economics not only to sustain inclusive growth and accelerate process of poverty reduction, but also for achieving durable peace and stability in the country through implementation of reconstruction, rehabilitation and reintegration programs.

The quantum of foreign aid flow advanced economics to Nepal is relatively small and, therefore, there is need to gear up the size of external assistance to maximum level by improving the status of democracy, human rights, governance with scaling back of corruption. The foreign aid policy paradigm demands a shift from donor driven to demand driven. It is also necessary to revitalize the economic strength of Nepalese economy to galvanize multilateral loans on a greater scale to expedite mega projects ensuring inclusive, sustainable high growth.

CHAPTER - III

RESEARCH METHODOLOGY

3.1 Research Design

Research design is the plan, structure and the strategy of investigation conceived so as to obtain answers to research questions. The aim of this study is to find out the impact of foreign aid with reference to Danish aid in the economic growth of Nepal. So, for this purpose, we have developed production type model and the variables used in the model have explained in this methodology. The model has been estimated by using ordinary least square method. To identify the significance of result, different statistical methods of different tests like t-test, F-test, D.W.-test etc have been used.

3.2 Sources of Data

The study is totally based on secondary data because it is purely a desk research while will be collected from the publications of Ministry of Finance (MOF), Economic Surveys, Danish Embassy, National Planning Commission (NPC), central Bureau of Statistics (CBS), World Bank (WB), UNDP, NRB, Foreign aid division of MOF, various economic surveys along with various magazines, newspaper as well as published and unpublished documents of various research institutions.

3.3 Data Processing and Data Analysis

In the process of data analysis the available secondary data from various sources are collected, classified, tabulated and interpreted to meet the stated objectives of the study. Most of the data has been presented in percentage, tables, graphs, diagrams, pie-charts according to the situation and requirements of the study. The Danish aid has been disaggregated into loans, grants and technical aid flow in Nepal. For time series data analysis simple statistical tool such as simple regression analysis is used to establish the relationship between dependent variable and independent variable and for verification and validity of hypothesis.

3.4 Hypothesis

This research will test the following hypothesis:

Null Hypothesis, H₀: There is no significant relationship between Danish aid to Nepal and GDP growth in Nepal.

Alternative Hypothesis, H₁: There is significant relationship between Danish aid to Nepal and GDP growth in Nepal.

3.5 Statistical Tools for Analysis

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

a) Regression Analysis

Regression equation has been used mainly to analyze the relationship between dependent variable and one or more independent variables. It is used to show the degree and direction of the relationship between variables and it also provides a mechanism for prediction or forecasting. The theoretical statement of this regression model is that Gross Domestic Product (GDP) is depends upon the Danish aid. This shows the relationship between GDP and total foreign aid and Danish aid. Mathematically, this can be written as:

$$Y_t = a + bTA_t \quad (1)$$

$$Y_t = a + bDA_t \quad (2)$$

Where,

Y_t = GDP in time period 't'

TA_t = Total foreign aid in time period 't'

DA_t = Danish aid in time period 't'

a and b – Regression parameters.

b) Log Linear Model

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

$$\text{Log } Y_t = a_0 + a_1 \text{ log } TA_t$$

$$\text{Log } Y_t = a_0 + a_1 \text{ log } DA_t$$

Where,

Log = Natural logarithm

Y_t = GDP in time period 't'

TA_t = Total foreign aid in time period 't'

DA_t = Danish Aid to time period 't'

a_0 and a_1 – Regression parameters.

3.6 Statistical Test for Significance

a) Co-efficient of Determination (R^2)

It is used for judging the explanatory power, which measures the dispersion of observations around the regression line. It is essential, because the closer the observation to the line, the better the goodness of fit, that is, the better explanation of the variables of Y by the change in the explanatory variables. R^2 shows the percentage of the total variation of the dependent variable that can be explained by the independent variables of the multiple determinations and the square of the correlation coefficient. The formula to derive R^2 is mentioned below:

$$R^2 = 1 - \frac{\sum e^2}{\sum y^2} = \frac{\hat{a}_1 \sum yx_1}{\sum y^2} = \frac{\hat{a}_1 \sum yx_1 + \hat{a}_2 \sum yx_2 + \dots + \hat{a}_n \sum yx_n}{\sum y^2}$$

Where,

$$y = Y - \bar{Y}$$

$$x = X - \bar{X}$$

Y = Dependent variable

X = Independent variable

Similarly,

Adjusted (R^2) can be calculated by following formula.

$$\bar{R}^2 = 1 - \frac{\sum e^2 / (n - k)}{\sum y^2 / (n - 1)}$$

Where,

n = total number of observation

k = number of parameter

b) Test of Significance of the Parameter Estimates

It is applied for judging the statistical reliability of the estimates of the regression coefficient. The following tests will be performed to test the hypothesis in the study.

t-Test

This test is performed in order to identify the statistical significance of an observed sample regression coefficients. The formula to derive the value is mentioned below:

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

Where,

\hat{a}_i = estimated value of a_i

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

F-Test

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

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

Where,

R^2 = Coefficient of determination

K = Number of explanatory variables

N = Number of observations in the sample.

The calculated F value will be compared with the tabulated value at the specific level of significance with $(K-1)$ and $(N-K)$ degrees of freedom. If F_{cal} is less than F_{tab} , we accept null hypothesis and otherwise we reject null hypothesis.

Durbin Watson (D.W.) Test

This test is used for detecting serial correlation. In the presence of autocorrelation (serial correlation) the ordinary least square estimators remain no

longer efficient. As a consequence usual t and F test cannot be legitimately applied.

D.W. test being a most celebrated test can be computed as,

$$D.W. (d) = \frac{\sum_{i=2}^N (e_i - e_{i-1})^2}{\sum_{i=2}^N e_i^2}$$

Where,

e = the estimated error

CHAPTER - IV

FOREIGN AID IN NEPAL

4.1 Historical Background

The system of helping one country by another in whatever form is as old as the human civilization. The evolution of foreign aid dates back to the early period of colonization when UK (United Kingdom) used to provide economic assistance to its colonies. It could also be seen as a continuity of United States' Dollar Diplomacy in Asia and Latin America in the years after the First World War. So internationally no precise date could be assigned as to when had actually the history of foreign aid begun. But quite a good numbers of economists in this field believed that it has commenced systematically after the termination of the second world war when the USA, first proposed the 'Marshall Plan' to help the war devastate European allies in their reconstruction program. So the history of foreign aid is generally agreed that it is originated from the disruption of the world economy, which is followed by Second World War. After the Second World War, the United States of America initiated Marshall Plan was to reconstructing the war vanquished and developmental into two blocks. The bipolar world, one led by the communist union of Soviet Socialist Republic (USSR), and the other by the United States of America (USA), both tried to gain as much international support as possible. The emergence of the foreign assistance has been encouraged by this situation because each of them tried to gain support through foreign aid and the economic relation.

The history of official aid to Nepal was actually begun before the UN report, with the signing of the "Point Four" agreement with the United States on January 23, 1951. The American government's assistance of Rs. 22000.00 provided under President Harry Truman's point four programs, was soon followed by formal economic assistance from India in October in the same year (Sigdel, 1996). China and USSR came into the strategically located Himalayan country's foreign aid scenario in 1956 and 1958 respectively. The role of strategic location evidenced from the fact that up to FY 1979/80, the US, India and China together provided more than three fourth of the total bilateral grants.

Nepal joined the Colombo Plan in 1952, participates in the first non aligned conference in 1955 in Bandung and become a member of the United Nations. Such sort of accession provided Nepal a good forum to attract the interests of the developed as well as developing nations in the economic development efforts of the country.

In 1976, Nepal aid group was formed in order to channelize foreign aid in a coordinated and internationally agreeable manner under the auspices of the World Bank. This group was formed to provide a forum to coordinate the growing level of foreign aid in line with the country's development priorities. Nepal development forum comprises countries like Australia, Canada, Denmark, Italy, France, UK, USA, Germany, Switzerland, Norway, Japan and International agencies namely IPA, WB, IME, EU, UNCTAD, ADB and UNDP. Nepal aid group, accounts for about three fourth of the total aid disbursement. Other major donors for Nepal are China and India. Nepal received multilateral aid since 1954 when, WHO provided aid in social sector. The major multilateral agencies who provided aid to Nepal are; UNICEF, ADB, UNDP, WB, UNFPA, IMF, OPEC fund, EEC, SDF, IFAD, UNCTAD, IDA, IBRD, WFP, OECD Kuwait fund etc.

The restoration of democracy in Nepal after 1990 further gave impetus for the expansion of more and more economic aid. Many international donors as well as multilateral agencies have taken on interest of providing aid on different sectors of the Nepalese economy because of transparency and accountability from the government side.

4.2 Trend of Foreign Aid to Nepal

Since 1951, Nepal began to receive foreign aid and the size of aid inflow began to expand steadily after 1956. The main reasons for the remarkable increase in the aid receipts of Nepal are:

- i) The introduction of development plan helped it to rationalize the demand for aid.
- ii) Nepal's expanding international relations and diversified the source of aid and

- iii) The bonus effect of cold war and feeling of the competition among some donors pushed up the level of aid to developing countries like Nepal.

When we received the year to year aid inflow, the trend was quite erratic up to 1972/73 but thereafter a consistently increasing trend was observed. The last five and half decade of foreign aid in Nepal shows the magnitude of foreign aid in Nepal has been bringing as a substantial change in the composition of foreign aid.

4.3 Resource Gap in Nepalese Economy

Resource gap is the difference between total expenditure and total revenue of the government of a country. When a country is spending more on investment, and government expenditure is more than its internal sources, there will be a resource gap within the economy. The resource gap creates the problem of the balance of payments and foreign exchange gap. Nepal has been experiencing a serious and growing resource gap in her regular as well as development finance. The outlook of resource gap can be seen as follows:

Resource gap 1 = expenditure - revenue

Resource gap 2 = resource gap 1 - foreign grants

Resource gap 3 = resource gap 2 - foreign loans.

To fill the ditch of growing resource gap, a large amount of external aids, loans and internal loans has to be borrowed but scarcity of resource seems to be never ending phenomenon in Nepal. Nepal faces the problem of a resource gap that is increasing over time. It is mainly due to:

- a) A traditional nature of the tax administration.
- b) The inflow of easy money through various channels.
- c) A centralized system of government.
- d) The existence of donor's interest in aid supply.
- e) A less generous economy and a slow change in the traditional structure and
- f) Increasing tendency of government's regular expenditure.

Table 4.1: Resource Gap in Nepalese Economy (FY 1990/91 - 2007/08)

FY	Total Expenditure	Total Revenue	Resource Gap 1	Foreign Grants	Resource Gap 2	Foreign Loans	Resource Gap 3
1990/91	23549.80	10729.90	12819.90	2164.80	10655.10	6256.70	4398.40
1991/92	26418.20	13512.70	12905.50	1643.80	11261.70	6816.90	4444.80
1992/93	30897.70	15148.40	15749.30	3793.30	11956.00	6920.90	5035.10
1993/94	33897.40	19580.80	14016.60	2393.60	11623.00	9163.60	2459.40
1994/95	39060.00	24575.20	14484.80	3937.20	10547.70	7312.30	3235.40
1995/96	46542.40	27893.10	18649.30	4825.10	13824.20	9463.90	4360.30
1996/97	50723.70	30373.50	20350.20	5988.30	14361.90	9043.60	5318.30
1997/98	56118.30	32937.90	23180.40	5402.60	17777.80	11054.50	6723.30
1998/99	59579.00	37251.00	22328.00	4336.60	17991.40	11852.40	6139.00
1999/2000	66272.50	42893.80	23378.70	5711.70	17667.00	11812.20	5854.80
2000/01	80483.30	48893.90	31589.40	6753.4.	24836.00	12044.00	12792.00
2001/02	80752.40	50445.60	30306.80	6686.20	23620.60	7698.00	15922.60
2002/03	83939.90	56229.70	27710.20	1139.10	16371.10	4546.40	11824.70
2003/04	89601.90	62331.00	27270.90	11283.40	15987.50	7629.00	8358.50
2004/05	104184.40	70122.70	34060.70	14391.20	19370.50	9266.10	10404.40
2005/06	110.106.20	72282.10	37724.10	13827.50	23993.60	8214.30	15782.30
2006/07	133604.50	87712.20	45892.30	15800.80	30091.50	10053.50	20038.00
2007/08	161350.00	107620.50	53729.50	20320.70	33408.80	8978.90	24428.90

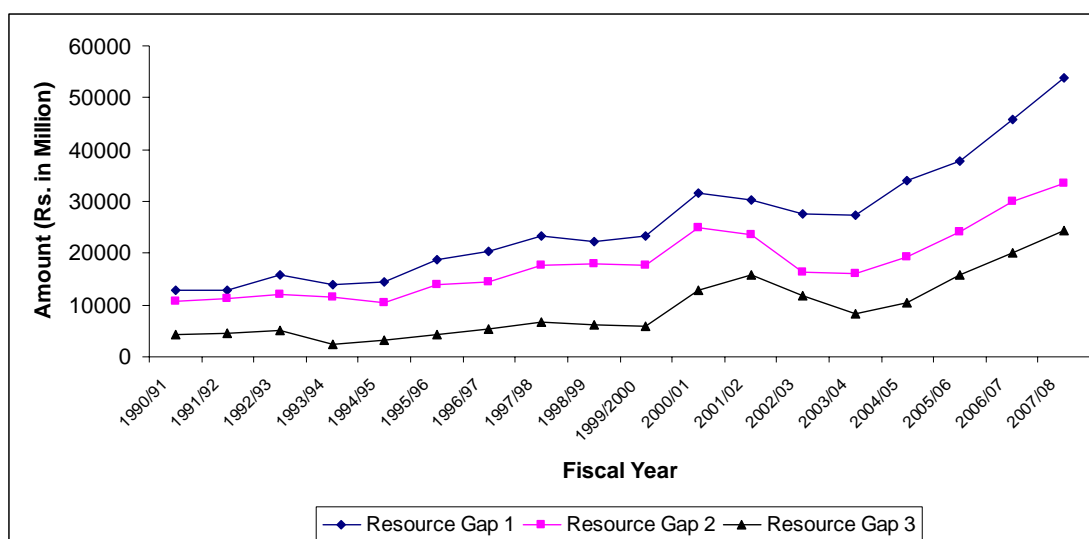
Table 4.1 shows that resource gap 1 which is difference between total expenditure and total revenue is in increasing trend. In the FY 1990/91 the resource gap was Rs. 12819.90 million and reached up to 53729.50 million in FY 2007/08. Due to the increment in regular and development expenditure, the resource gap has widened from year to years. This increase in resource gap indicates the poor performance of domestic resource mobilization.

Resource gap 2, which is the difference between expenditure and revenue plus foreign grants, is also in increasing trend. This type of resource gap started since the budget of FY 1956/57. This gap was 10655.10 million in FY 1009/91 and reached to 33408.80 million in FY 2007/08. This gap was minimum in FY 1994/95 under the study period.

The picture of resource gap 3, which is the difference between expenditure and total revenue plus foreign grants plus foreign loan, is still not promising. It was increase from 4,398.40 million in FY 1009/91 to 24,428.90 million in FY 2007/08. This increasing magnitude of resource gap clearly indicates that there is urgent need for effective mobilization of additional resources.

The increasing gap between government expenditure and revenue and high fiscal deficit have contributed economic distortion such as increasing in prices, large flow of imported goods and services, low level of domestic savings and heavy reliance on external debt, leading the economy to the state of external dependency. Increase in regular and development expenditure of government, burden of debt servicing charges, poor utilization of natural resources, poor economic growth, inadequate tax efforts, political instability, rising inflation etc are the reason for growing resource gap in Nepalese economy.

Figure 4.1: Resource Gap in Nepalese Economy (FY 1990/91 to FY 2007/08)



4.4 Foreign Aid Commitment and Disbursement

Nepal is considered late starter in the development in the South Asian Region. The country was opened to the outside world only in the early fifties, and planned development effort and aid inflow began almost simultaneously. According to Nepal development cooperation report 2000, the key definition of commitment is a firm obligation expressed in agreements and supported by the availability of public funds, undertaken by the donor, to furnish assistance of a specific amount under agreed

financial terms and conditions and for specific purpose for the benefit of the recipient country. Disbursement represents the actual international transfer of financial resources. They may be recorded at one of several stages, provision of goods and services, placing of funds at the disposal of the recipient in an earmarked fund or account payment by the donor of invoices on behalf of the recipient, etc. In order words, aid commitment shows the expression of the donors to provide financial support of specific amount under agreed terms and conditions for specific purpose to the recipient country. Therefore, disbursement is the actual transfer of financial resources from donor.

The following table shows the status of aid commitment and disbursement of foreign aid.

Table 4.2: Foreign Aid Commitments and Disbursement (Rs. In Million)

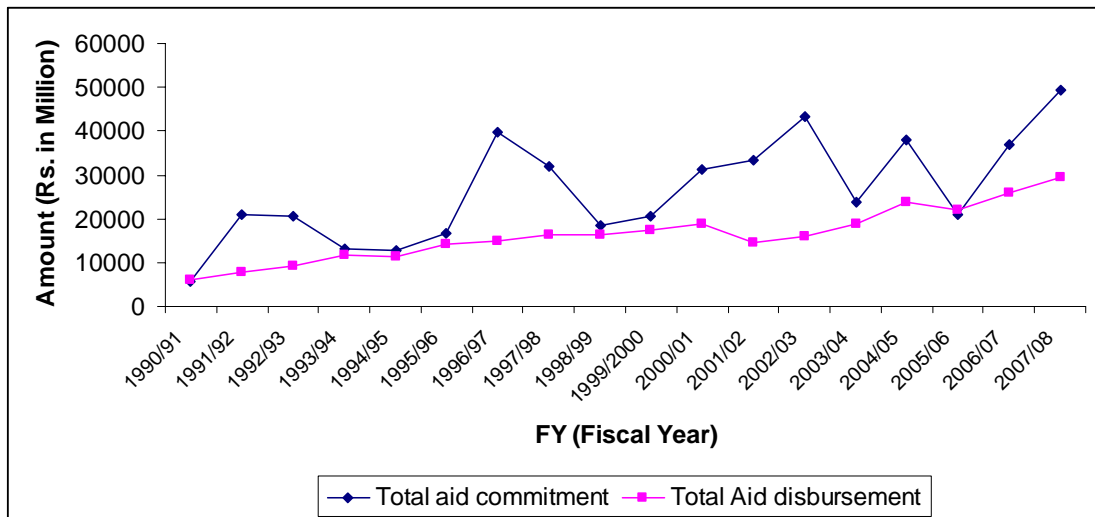
FY	Total aid commitment	Total Aid disbursement	Disbursement as % of commitments
1990/91	5665.40	5990.64	105.70
1991/92	21084	7800.40	37.00
1992/93	20526.70	9235.60	45.00
1993/94	13172.20	11557.20	87.70
1994/95	12876.90	11249.40	87.30
1995/96	16537.30	14289.00	86.40
1996/97	39643.00	15031.90	37.90
1997/98	32022.10	16457.10	51.40
1998/99	18352.50	16189.00	88.20
1999/2000	20448.00	17523.90	85.70
2000/01	31287.00	18797.40	60.10
2001/02	33227.70	14384.80	43.30
2002/03	43202.70	15885.50	36.80
2003/04	23783.00	18912.40	70.80
2004/05	38152.30	23657.30	62.01
2005/06	20924.20	22041.80	105.30
2006/07	37022.90	25854.30	69.80
2007/08	49186.00	29301.00	59.57

Source: Various Issues of Economic Survey, MOF, GON.

From the above table it can also be noted that, during FY 1990/91 to FY 2007/08 aid commitments have always been exceeded disbursements. In FY 1990/91 and FY 2005/06 the amount committed was quite low. The donor countries disbursed the foreign aid in the amount which they committed. There has been considering

improvements in the aid disbursement or percentage of commitment in some of years i.e. FY 1993/94, 1994/95, 1995/96, 1998/99 and 1999/2000. The aid absorptive capacity of Nepal is found to be quite erratic. For example the total disbursement of aid exceeded the level of commitment which was as high as 105.7 percent in 1990/91 and 105.3 percent in 2005/06, while it was just 36.8 percent lowest in 2002/03. The volatile nature of absorptive capacity of foreign aid to Nepal often delayed implementation of various foreign aided projects. The priorities of the donor countries including the levels of interest and complexities of their bureaucracy, also limit the absorptive capacity of recipient country. The above table clearly shows that there is greater fluctuation in commitment amount than disbursement amount. The absorptive capacity of Nepal is found to be quite erratic for the increase in percentage of aid disbursement. Donors seek to provide the assistance in their own priority on installment basis and they also observe the performance in implementing the projects in different sectors. If they do not find good performance of foreign aid utilization, they will not disburse the committed aid so that the commitment has always been exceeded disbursements.

**Figure 4.2: Commitments and Disbursement of Foreign Aid
(FY 1990/91 to 2007/08)**



4.5 Sectoral Allocation of Foreign Aid

The sectoral allocation shows the amount of economic plans and programs in different sectors and identifies the sectors that have received priorities. The sectoral distribution of foreign aid is not smooth and has a fluctuating nature. The largest share of foreign aid had been allocated to develop transports, power and communication at the early three plans. From the beginning of the 4th plan the priority occurs on irrigation. Table 4.3 shows the general information on sectoral aid priority during FY 1990/91 to FY 2007/08.

Table 4.3: Distribution of Foreign Aid by Major Sector (Percent of Total Aid)

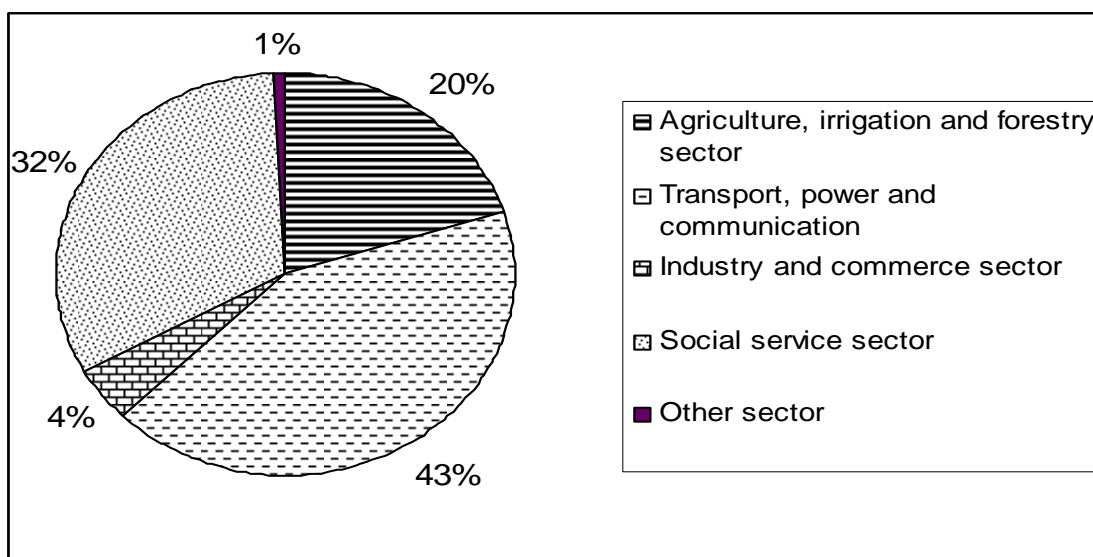
FY	Agriculture, irrigation and forestry sector	Transport, power and communication	Industry and commerce sector	Social service sector	Other sector
1990/91	20.90	42.90	23.20	11.10	1.70
1991/92	24.90	31.80	27.80	15.20	0.10
1992/93	20.80	42.60	7.50	28.80	0.10
1993/94	47.50	36.00	3.40	12.70	0.10
1994/95	30.70	40.60	4.20	23.80	0.40
1995/96	23.70	56.30	0.10	18.40	1.20
1996/97	18.80	56.50	0.10	24.30	0.10
1997/98	17.30	54.60	1.20	26.80	-
1998/99	20.90	48.70	2.40	27.40	0.30
1999/2000	18.30	46.50	1.70	33.00	0.30
2000/01	20.00	49.10	0.10	30.60	0.10
2001/02	22.80	41.00	2.60	32.50	0.96
2002/03	13.70	48.90	2.50	33.50	1.34
2003/04	12.80	40.00	0.78	46.20	0.18
2004/05	10.80	41.70	0.52	45.40	1.40
2005/06	10.90	32.40	0.48	50.60	5.90
2006/07	14.40	25.70	0.45	58.70	0.67
2007/08	13.20	22.90	0.20	62.10	1.60
Average	20.15	42.50	4.40	32.35	0.90

Source: Various Issues of Economic Survey, MOF, GON

From the above table, it is obvious that, foreign aid is distributed to agriculture, irrigation and forestry, transport, power and communication, industry and

commerce, social services and others. During the last 18 years, the share of foreign aid for agriculture, irrigation and forestry sector has been quite erratic. Up to the FY 2007/08; transport, power and communication have continued to receive the large share of foreign aid, except for the fiscal years, 1991/92, 1993/94, 2005/06, 2006/07 and 2007/08. Since last 13 years, a sectoral disbursement of foreign aid is increasing gradually in social service except in FY 2000/01. During the last 18 years, it can be seen that the transport, power and communication sector has absorbed the largest share i.e. 42.2 percent of the total aid. Social services sector and agriculture, irrigation and forestry sector have accounted for 32.35 percent and 20.15 percent respectively and industry and commerce sector covers 4.4 percent. Thus it can be seen that transport and communication sector has got the highest priority compared to social sectors during last 18 years. From the table it can be seen that aid on social service is increasing now days. It clearly shows that donors are more interested in helping to build infrastructure and social service than other sectors.

Figure 4.3: Sectoral Allocation Of Total Foreign Aid (FY 1990/91 to FY 2007/08)



CHAPTER - V

DANISH AID TO NEPAL

5.1 Background Information

Denmark is one of the members of European Union. It provides assistance to twenty programmed countries that are chosen based on their level of economic and social development as well as their specific needs and absorptive capacity. Especially through the EU, Denmark played an active role and made a difference in those international contexts that are of particular importance for the developing countries. Danish Development Co-operation Program is based on the strategy of Denmark's Development policy adopted in 1994. Main objectives of the strategy are to assist developing countries in their efforts to achieve sustainable development based on the improvement of living conditions through socially balanced economic growth and to promote equal and free opportunities for the individual in accordance with the aims and principles of UN character. The strategy confirms the principles of poverty alleviation as the basic objectives of Danish Development.

The diplomatic relationship was established between Nepal and Denmark on 15th December 1967. Then Denmark has provided development assistance to Nepal since 1973 starting with a loan assistance of Danish Kroner 20 million for the dairy development schemes and establishment of the slaughterhouse in the country.

In 1980, the Danish Government converted all outstanding loan amounts into grant (20 million Danish Kroner). Technical cooperation agreement between the two countries was signed in July 1988. This agreement expired in October 1995. Another development cooperation agreement between government of Nepal and the government of Denmark was signed in October 1995. Nepal is included in the list of its 15 aid receiving countries. Denmark opened its residential embassy in Kathmandu

in April 1991 at the level of charge d' affaires e.g. the embassy was upgraded with the ambassador from September first 2005 (Development Partners' Profile 2006). In 1989 when Nepal was included in Denmark's program countries then Denmark has been constantly showing keen interest in Nepalese economic development. Denmark has been contributing according the priority given by government. Danish cooperation has aimed at stimulating the process of development in tune with her priorities. There are different projects launched by Denmark in different districts. Denmark is one of the donor countries in education and forestry sector. Among them Basic and Primary Education Project has been implemented in more than 38 districts of the country. Likewise community forestry projects have been implemented in more than 37 districts. Other projects are tree improvement and minor projects. Denmark has provided different types of cooperation through her NGOs to Nepal.

5.2 Objectives of Danish Assistance

Danish official development assistance (ODA) is provided in accordance with the strategy for Denmark's development policy 'Partnership 2000: Poverty reduction is the overriding objective of Danish development policy. Denmark has contributed to reduce poverty in the world through long term and binding partnership with developing countries. The main objective of these partnerships is to strengthen the ability of developing countries to create sustainable development processes that will benefit the poor. The main objective of Danish development assistance is poverty alleviation in consideration of cross cutting issues such as gender issues, environment, democracy and human rights. In June 2006, in light of the reinstallation of democracy, the Danish minister for developmental cooperation approved an interim strategy for Nepal. The interim strategy outlines the framework for Danish development assistance to Nepal for the implementation of the difficult peace process, including

the establishment of a constitutional assembly. The overall medium-term strategic objectives of Danish engagement in Nepal are :

- To facilitate and promote the development of a democratic political environment, respect for human rights and rules of law, and a peaceful resolution of the armed conflict, and
- To contribute to poverty reduction through the improvement of service delivery targeting the poorest segments of the population (www.ambkathmandu.um.dt).

Denmark has been providing significant amount of economic assistance in important sectors such as dairy sector, education, environment and natural resources, administrations, human rights, democracy and good governance. During FY 1973-91, it was estimated that total aid flow of Danish assistance exceeded US \$ 54.7 millions (approximately 3829 millions). This amounted for 4.9 percent of the total aid received by Nepal during the same period.

5.3 Trend of Danish Aid to Nepal

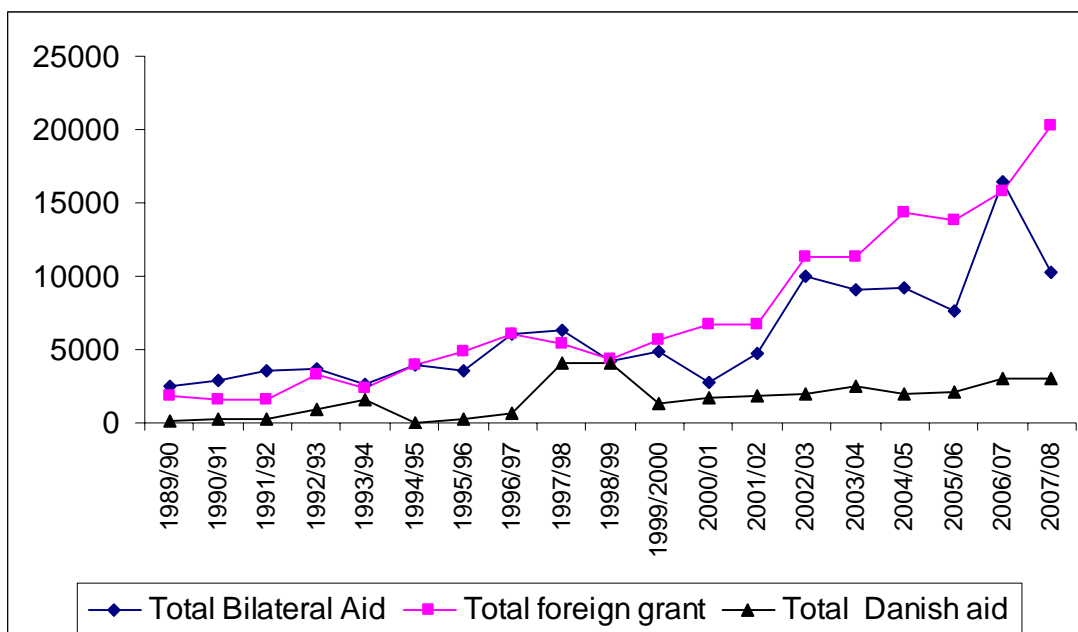
Nepal is receiving foreign aid from various countries. Because of friendly relationship between Denmark and Nepal, Denmark has been one of the major suppliers of aid to Nepal. We find the unforgettable assistance for the different sectors of Nepal. Danish aid started in Nepal since 1973, with the loan assistance of Danish Kroner 20 million for the dairy development schemes and the establishment of the slaughterhouse in the country and the quantum of Danish aid expanded steadily after FY 1992/93. The trend of Danish aid to Nepal is at increasing rate but is fluctuating up to FY 1991/92. It can clearly be seen from the following table 5.1.

Table 5.1: Trend of Danish Aid to Nepal (FY 1989/90 to FY 2007/08)

FY	Total Bilateral Aid	Total foreign grant	Total Danish aid	Share of Danish aid in total bilateral aid (%)	Share of Danish grant in total grant (%)
1989/90	2544.90	1798.80	193.80	7.62	10.77
1990/91	2939.00	1630.00	322.92	10.98	19.81
1991/92	3597.30	1531.00	217.60	6.05	14.21
1992/93	3638.50	3273.90	873.95	24.02	26.70
1993/94	2627.10	2393.60	1603.31	61.03	66.97
1994/95	3988.70	3937.10	14.29	0.36	0.36
1995/96	3533.30	4825.10	269.30	7.62	5.58
1996/97	6012.70	5988.30	623.10	10.36	10.40
1997/98	6297.70	5402.60	4053.00	64.36	75.01
1998/99	4167.60	4336.60	4033.77	96.79	93.01
1999/2000	4929.10	5711.70	1327.56	26.93	23.24
2000/01	2771.20	6753.40	1731.80	62.49	25.64
2001/02	4675.30	6686.20	1855.50	39.69	27.75
2002/03	10044.40	11339.10	1979.20	19.70	17.45
2003/04	9013.20	11283.40	2480.50	27.52	21.98
2004/05	9230.80	14391.20	1996.50	21.63	13.87
2005/06	7658.40	13827.50	2059.40	26.89	14.89
2006/07	16406.40	15800.80	2961.20	18.05	18.74
2007/08	10207.70	20320.70	2993.56	29.30	14.70

Source: 1 - Various Issues of Economic Survey, MOF, GON
2 - MOF, Foreign Aid Division GON
3 - Danish Embassy of Nepal

Figure 5.1: Trend of Danish Aid to Nepal



The Danish aid inflow is increasing at increasing rate over the period of last 18 years, received a total of Rs. 37036.6 million. Beginning with the small amount 20 million Danish kroner in terms of loan assistance in 1973, the quantum of Danish aid was regularly only after the restoration of democracy in Nepal which is clearly seen from above table. The Danish economic cooperation became more significant in Nepalese economy only after FY 1997/98, and reached at highest in 1998/99 which accounted for 96.79 percent of total bilateral aid. Similarly the lowest amount was only 14.29 million in 1994/95 which was 0.36 of total bilateral aid. In FY 2007/08 it was 29.30 percent of total bilateral aid and this happened due to various causes of donors and recipient country.

5.4 Areas of Danish Assistance

Denmark is a major donor country of Nepal and its contribution to various sectors of Nepalese economy is significant. It is one of the most important donors for Nepal since six years after the establishment of diplomatic relations between two nations in 1967. Denmark has been giving aid as grant assistance since 1980. In the FY 1980/81 Denmark converted all its outstanding loan into grant. According to the available data Danish assistance was not found during the period of 1980 to 1988.

Since 1989 all Danish development assistance has been provided on grant terms (MOF, Foreign Aid Division). Denmark has been providing significant amount of economic assistance in important sectors such as education, energy, natural resources management, human rights and decentralization etc.

In the years ahead, Danish-Nepalese development cooperation is concentrated on the following areas:

- Education
- Energy
- Industry and mining
- Human rights and good governance.
- Decentralization.
- Peace process.

The main target group of Danish development cooperation in Nepal is 'the poor'. In the selection of sectors emphasis is laid on poverty reduction and opportunities to benefit women in particular. The major sectors of Danish aid are:

5.4.1 Education and Training

Education sector is one of the most beneficiaries sectors of Danish aid. Denmark has been involved in education in Nepal since 1992 is currently supporting basic and primary education, including pre-school and non-formal education; "EFA 2004-09", as well as secondary education, "SESP 2003-09". Basic and primary and secondary education plays a key role in a strategic framework for the realization of the both the Danish and Nepalese objectives targeting poverty reduction and sustainable development. Improvement of schools and in particular the quality of teaching is needed to cart to the persistent rise in the population under the age of 15 as they constitute about 40 percent of Nepalese population (website of Danish embassy). In this sector two programs are working in the present. They are:

Basic and Primary Education Program (BPEP)

BPEP II is a Nepalese government reform program for basic and primary education. It plays a key role in a strategic framework for the realization of the both the Danish and Nepalese objectives targeting poverty reduction and sustainable development. The program is perusing to consolidate the achievements of first

development phase (1993-98) i.e. provide access to quality primary education in a sustainable manner to all children of Nepal. Improvements of schools and-in particular the quality of teaching is needed to cater for the persistent rise in the population under the age of 15 as they constitute 40 percent of Nepal's population. Increase priority is being attached to primary and secondary education in Nepal's development strategy to support strengthening of education in Nepal with institutional capacity development as the cornerstone. From the fiscal year 2001/02 program is covering all 75 districts in Nepal. BPEP II helps especially for girls, economically and socially weaker groups, adults' illiteracy population and disadvantaged groups.

Secondary Education Support Program (SESP 2003-09)

SESP is designed to support Nepal in achieving its larger development goal of poverty reduction through human development. The objectives of SESP are to promote human development by expanding access to and improving the quality and efficiency of secondary education in Nepal. The principle policy goal of SESP is to strengthen the involvement of local communities in the running and funding of their own schools, with assistance from and under the supervision of the national government. This program has been developed jointly by the government of Nepal, Asian Development Bank (ADB) and Denmark, to expand quality public secondary education.

SESP has three main objectives

- To improve the quality of public secondary schooling.
- To improve access to public secondary schooling particularly for girls, students with disabilities and students from poor and disadvantages groups and districts.
- To develop the institutional capacity of central and local governments, and local communities to sustain and deepen the school improvement process.

The Danish support to the SESP is designed to facilitate poverty reduction through the improvement of access to secondary education for the population as a whole and for females, the poor and disadvantaged groups in particular.

5.4.2 Danish Support to Energy and Environment Sector

Danish development assistance in Nepal has addressed environments concerns since 1989. The first initiatives addressed re-establishment of forest coverage and soil conversation, and this was followed up with support to promote renewable energy.

More than 85 percent of the Nepalese populations live in rural areas, where majority of people depend on firewood for meeting their energy requirements. The major concern of the rural energy sector in Nepal is related to rural electrification and providing efficient forms of energy for cooking. Rural based program and activities are a key priority in Nepal own poverty reduction strategy with special emphasis on remote rural areas. Danish development assistance maintains a strong geographical focus on these remote and often difficult accessible areas.

The energy sector assistance program (ESAP), phase I which has a focus on rural energy, was approved in 1998 and implemented from 1999 to 2006. The program has assisted in developing sustainable energy solutions with micro-hydro installations (off-grid), solar energy home system and energy efficient household cooking stoves. The program in its first phase also succeeded to develop a renewable energy policy for Nepal. The total grant for the first phase was DKK 191.3 million.

The second phase of energy program (ESAP II, 15 March 2007-14 March 2012) was approved in November 2006 and a government to government agreement was signed on 15 March 2007. ESAP II is financed jointly by Denmark and Norway (Denmark contribution with DKK 150 million). The overall objective of the program is to improve the living of the rural population by enhancing their access and affordability to rural energy solutions that are efficient, environment-friendly and that address social justice'. The immediate program objective is: "regulatory and instructional arrangements are in place, technology solutions are available with quality assurance according to income strata and credit facilities are available to promote investments".

5.4.3 The Danish Supported Human Rights and Good Governance Program

Danish support to democratization in Nepal was initiated soon after the establishment of the interim government in 1990 and in the following years, Danish assistance to human rights and democratization increased considerably and was

broadened in scope. DANIDA has supported interventions related to the legislative, the judicial and the executive as well as to free media in their roles as the fourth estate and to civil society organizations.

Denmark's strong presence in the area of human rights and good governance is a response to the governance and human rights crisis in Nepal over the recent years. Targeted projects and special initiatives aim at addressing the human rights situation and the systematic problems of accountability and transparency all problems, which have been further compounded by the conflict and the political and the constitutional crisis. However, including the cessation of hostilities and initiation of a peace process (since the second quarter of 2006), have opened avenues for support to projects and initiatives that further advance the national agendas on peace, human rights, good governance and democratization.

The second phase of the Danish human rights and good governance program is being implemented with the following development objectives: "a functional and inclusive democracy based on respect for human rights established".

A clear focus of the program is the disadvantages sections of the Nepalese society, who not only suffer from human rights violations but also face immense problems in getting heard, accessing justice and participating in the democratic processes. A key feature of the program is its conflict sensitiveness and the in-built capacity to adopt and adjust its approaches to rapidly changing political, social and security environment.

The Danida Human Rights and Good Governance Program Office (HUGON) are implementing the program. In order to address the issues of human rights and good governance at different levels, the program includes support to state institutions as well as to civil society organizations as partners. This program period is 2003 to 2008 and total grant for this program is DKK 94.9 million.

The program is comprised of seven components:

- Human rights organization components
- Social inclusion component
- Media component
- Justice component
- Elections and democratic process component
- Anti-corruption component
- Local governance component.

5.4.4 Danish Aid to the Decentralization Reform of Nepal

Decentralization is high on political agenda in Nepal and a number of donors support the government's efforts in devolution decision making power to the local level. Danish assistance in support of decentralization and strengthening of local authorities was initiated since 1992. This support has been developed and expanded after the establishment of decentralization advisory support unit in 1999. The overall objective is to support the establishment of well functioning local democratic bodies that are capable of planning, implementing, and monitoring activities in an accountable, transparent and effective manner.

5.4.5 Danish Support to the Peace Process

Denmark provides dedicated support to the peace process in Nepal. Only a successful peace process will lead Nepal towards sustainable development thus promoting democracy, stability and economic growth.

On the basis of the Interim Strategic Framework for Danish Development Assistance to Nepal, the board of Danida in March 2007 approved a grant of 50 million Danish Kroner to support the ongoing peace process. Another grant of 50 million Danish Kroner was approved by the board of Danida in August 2008.

5.5 Danish Projects in Different Districts

Denmark has operated different projects under its technical and grant assistance in different districts of Nepal through different NGOs such as:

- DANIDA
- CARE Denmark
- The Danish Association for International Cooperation
- Lions Club
- Danish Club
- Danish Club
- The Danish Trade Union Council for International Development etc.

The districts covered by the different projects are mentioned in following table:

Table 5.2: Danish Projects in Different Districts

Projects	Total Number	Name of Districts
Basic and primary education program	38	Achham, Bajhang, Bajura, Baitadi, Chiwan, Dadeldhura, Dailekh, Dang, Darchula, Dhankuta, Dhanusha, Doti, Gulmi, Ilam, Jhapa, Kalikot, Kanchanpur, Pakilbastu, Kaski, Lamjung, Mohottari, Morang, Mugu, Mustang, Nawalparasi, Nuwakot, Parsa, Pyuthan, Rukum, Rautahat, Salyan, Sarlahi, Siraha, Sunsari, Surkhet, Syangja, Tanahun, Udayapur
Community forestry projects	37	Achham, Arghakhanchi, Bajhang, Bajura, Baitadi, Bhaktapur, Dadeldhura, Dailekh, Darchula, Dhading, Dolpa, Doti, Gorkha, Gulmi, Ilam, Jajarkot, Jumla, Kalikot, Kaski, Kathmandu, Khotang, Lalitpur, Lamjung, Makawanpur, Manang, Mugu, Sindhuli, Solukhumbu, Surkhet, Syangja, Taplejung, Udayapur.
Tree Improvement	30	Baglung, Bara, Bhaktapur, Chitwan, Dhading, Dhanusha, Gulmi, Kathmandu, Kavre, Lalitpur, Lamjung, Makawanpur, Manang, Mohottari, Mustang, Myaddi, Nawalparasi, Nuwakot, Palpa, Parbat, Parsa, Ramechhap, Rasuwa, Rautahat, Rupendehi, Sarlahi, Sindhuli, Sindhupalchowk, Syangja, Tanahun.
Minor Projects	24	Baglung, Bajura, Banke, Bardiya, Chitwan, Dang, Dhading, Dhanusha, Dolakha, Gorkha, Kaski, Kailali, Kathmandu, Kanchanpur, Kapilbastu, Kavre, Lamjung,

		Mohottari, Parbat, Ramechhap, Salyan, Sindhupalchowk, Sunsari, Tanahun
Backward Society Education	4	Bardiya, Dang, Kanchanpur, Salyan
Watershed Management Project	4	Dhading, Nuwakot, Rasuwa, Syangja
Reorganization of National Library	3	Kaski, Kathmandu, Lalitpur
Professional Skills Program	2	Gorkha, Lamjung
Natural Resource Management	1	Mustang
Bardiya Area Development	1	Bardiya
Support to National Dairy Development Board	1	Kathmandu
Support to NTC, Cable Network Planning Department	1	Kathmandu
Human Rights Education	1	Kathmandu
Support to Parliament	1	Kathmandu
Regional Media Resource Center	1	Morang

Source: Nepal Development Cooperation Report 2000 UNDP.

The above table gives detail projects lunched by Denmark in different districts of Nepal. Among them basic primary education program has been implemented as many as 38 districts of the country. Thus basic and primary education program covered wide area. Likewise community forestry projects have been implemented in 37 districts. It has taken second position after education. After this tree improvement and minor projects are in third and fourth position respectively.

5.6 On Going Economic Cooperation

S.N.	Project	Period	Amount	Implementing Authority	Remarks
1	Education for all (EFA)	2004-2009	DKK 202.7 m grant	Ministry of education	<ul style="list-style-type: none"> • Main aim of the program is children's access to education, quality of public school. • According to EFA agreement, Denmark, ADB, UNICEF, WB, Finland, Norway, DFID have joined as pooling partner
2	Secondary education support program (SESP)	2003-2009	DKK 283.9m grant	Ministry of education	<ul style="list-style-type: none"> • National reform program for secondary education • Special activities are being implemented in poorest 10 districts.
3	Human rights and good governance program	2003-2008	DKK 94.9m grant	Various state and civil society organizations	7 components: <ul style="list-style-type: none"> • Human rights - strengthening the capacity of human rights organization. • Media-working for free independent, pluralist and

					<p>competitive media environment</p> <ul style="list-style-type: none"> • Justice-support for independence of the judiciary. • Social inclusion-capacity development of national level dalit, janajaties, and women umbrella organizations. • Anti corruption-partnership with civil society and media organization within the field of anti corruption. • Election and democratic process-support for election commission for free fair and genuine elections. • Local government-building capacity for demanding service delivery at local level, local governance and social inclusion.
4	Energy sector assistance program (ESAP II)	15 march 2007-14 march 2012	DKK 150m grant	Alternative energy promotion centre, MOEST, NEA, MOWR	<p>Main aim easy access to energy technologies with better performance for improving living standards of rural population</p> <p>3 projects :</p> <p>Kailali-Kanchanpur Rural Electrification Project (2006-.8), Waste water treatment plant (WWTP) 2006-09 under MOICS; Air quality monitoring system 2006-2009.</p>
5	Peace process in Nepal	2007-08 2008-09	Approx. DKK 50m	GON, peace fund, UNMIN, Carter	

			grant for 2007 and approx. DKK 50m is expected for 2008	Centre and local NOGs	
6	Revenue administration support (RAS) project	+1 year up to 2007 December	Remaining balance DKK 20m.	IRD	Focus on Instructional development and capacity building
7	Local grand authority (LGA)	2007-2011	DKK 10m grant each year	Gov. and semi Gov. bodies	
8	Danida's business to business (B2B) program and PPP program	2007-08	DKK 2-5m grant each year		Danish and Nepalese companies in cooperation with embassy of Denmark

Source: Nepal's Development Partner's Profile (August, 2006)

5.7 Completed Projects on Danish Assistance

The major projects completed with Danish assistance up to 2007 are as follow:

- Dairy development schemes in Kathmandu, Hetauda and Pokhara.
- Slaughterhouse, Hetauda (It has been stopped failure)
- Livestock development, Kavre.
- Fourth and fifth telecommunications projects and institutional support to Nepal telecommunication authority.
- Assistance to election commission for general elections and local elections.
- Assistance to parliament secretariat.
- Skillmed milk powder plant at Biratnagar.
- Malaria control program
- Strengthening of local authorities in Nepal.
- Support to the media centre
- Project to support national dairy development board.
- Media development fund
- Value added tax project
- National resource management sector assistance program
- Watershed management project in Rasuwa, Nuwakot and Dhading districts.

Source: Nepal's Development Partner's Profile (August 2006)

5.8 Future (Pipeline) Economic Cooperation

Annual technical consultation meeting was held on 30 may 2007 between the two governments. The meeting decided to implement business to business (B2B) program and public private partnership (PPP) program. A memorandum of understanding (MOU) in this regard has been signed in 29th of July 2008 at Ministry of Finance.

5.9 Sectoral Forecast of Development Assistance

Denmark is in the process of extending development assistance to the education sector. Human rights and good governance, energy and support to peace process.

**Table 5.3: Danish Development Aid to Nepal (2005-2011) is as follow
(Amounts million DKK)**

Sector	2005 actual spending	2006 actual spending	2007 expected spending	2008 budget	2009 budget	2010 budget	2011 budget
Education	61	107	120	89	85	85	85
Energy	36	16	35	32	32	33	33
Human rights, good Gov.	18	17	24	29	35	35	35
peace process	-	-	34	50	25	25	25
Minor projects, RAS etc	11	13	7	10	10	10	10
Total	126	153	220	210	187	188	188

Source: Nepal's Development Partner's Profile (August 2006).

CHAPTER - VI

EMPIRICAL ANALYSIS

Foreign aid is said to have effects on economic growth and overall welfare of the country. Larger amount of foreign aid becomes essential for the further growth of the country. In this situation there may arise some questions like, whether foreign assistance has proved beneficial for Nepal or not? Has foreign assistance shown positive effects on the economic growth of the country? If the answer to these queries is found positive then to some extent, it can be argued that foreign aid has played positive role in Nepalese economy and is necessary for the further growth of economy.

Different types of studies were under taken in order to understand the impacts of foreign capital inflows (FCIs) on the economic development. And the different methods and variables were used to analyze the role of foreign aid in economic development. Some studies focused on the study of aid's impacts on the domestic savings, investments and capital formation. Some other studies focused upon the impact of aid on the different sectors of the economy like agriculture sector, energy and the industrial sectors, social sectors (like health and education etc.).

It is difficult to analyze the effect of foreign aid on all the sectors and variables, as described above, in a single paper. Therefore, this study narrows down the analysis of only one variable, that is, the GDP growth. Here I have tried to analyze the impacts of foreign aid on GDP. To study the impact of total aid and Danish aid on the economic development of Nepal, the present study has used regression equation by using ordinary least square method in log linear (e-base) forms. All the data in the analysis are taken from various economic surveys and Danish aid book during the period FY 1989/90 to FY 2007/08. Regression equation is used to analyze cause and affect relationship between GDP with total aid (TA_t) and Danish aid (DA_t). In statistical analysis, number in parenthesis below indicates the t values of the

coefficients. To identify the validity of regression estimates and the value of parameters, various statistical tests have been used. On the basis of values of the parameters, we have analyzed the impact of total aid and Danish aid on the economic development of Nepal. All regression equations in this chapter are computed by using SPSS program.

6.1 Impact of total Aid on GDP

This analysis shows the relationship between GDP and total foreign aid by using the regression equation.

The result of this regression model is:

Table 6.1: Regression Analysis of Total Aid and GDP (FY 1989/90 to 2007/08)

Statistics → Foreign Aid	Estimate β	Standard Error of	R (Correlation coefficient)	R^2 (coefficient of determination)	$\overline{R^2}$ (adjusted R^2)	F statistics	D-W statistics	t- Statistics
Total Aid	0.607	0.140	0.724	0.524	0.496	18.737	1.176	4.329

Interpretation of the Result

Equation (i) is log linear model with base 'e'. The beta coefficient explains the elasticity of Nepal's GDP with respect to total aid. The elasticity coefficient is 0.607 implies that 1 percent changes in total aid results into the 0.607 percent change in GDP of Nepal positively. The adjusted R^2 value is 0.496 implying that 49.6 percent of total variations in the dependent variable i.e. GDP is explained by the independent variable i.e. total aid. The value of correlation coefficient (R) is 0.724 shows that there is positive relationship between related dependent and independent variables. The coefficient of determination (R^2) measures the goodness of fit of regression. The R^2 for total aid is 0.524, which indicates that the association between GDP and total aid holds good. The f-value is also significant at the level of 1 percent. The value of t-statistics, which gives the significance of parameters, is also significant at 1 percent. The value of d-statistics in this case is 1.716, this shows that there is positive

autocorrelation at given degree of freedom and significant at 1 percent level of significance.

6.2 Impact of Danish Aid on GDP

This analysis shows the relationship between GDP and Danish Aid by using the regression equation.

The result of this regression equation is:

Table 6.2: Regression Analysis of Danish Aid and GDP (FY 1989/90 to 2007/08)

Statistics → Foreign Aid	Estimate β	Standard Error of	R (Correlation coefficient)	R^2 (coefficient of determination)	$\overline{R^2}$ (adjusted R^2)	F statistics	D-W statistics	t- Statistics
Total Aid	0.281	0.081	0.646	0.417	0.382	12.144	0.791	3.485

Interpretation of the Result

The beta-coefficient explains the elasticity of Nepal's GDP with respect to Danish Aid. The elasticity coefficient is 0.281 implies that 1 percent change in Danish aid results into the 0.281 percent change in GDP of Nepal positively. The adjusted R^2 value is 0.382 implying that 38.2 percent of total variations in the dependent variable i.e. GDP is explained by the independent variable i.e. Danish aid. The value of correlation coefficient (R) is 0.646 shows that there is positive relationship between related dependent and independent variables. The coefficient of determination (R^2) measures the goodness of fit of regression. The R^2 for Danish aid is 0.417, which indicates that the association between GDP and Danish aid holds good. The F-value is also significant at the level of 0.3 percent. The value of t-statistics, which gives the significance of parameters, is also significant at 1 percent. The value of d-statistics in this case is less than 1 i.e. 0.791, this shows that there is positive autocorrelation at given degree of freedom and significant at 1 percent level of significance.

We have set null hypothesis for the purpose holds that there is no significant relationship between Danish aid to Nepal and GDP growth in Nepal. But above all result indicates that there is positive impact between Danish aid to Nepal and GDP growth in Nepal. So we reject null hypothesis and accept alternative hypothesis i.e. there is significant relationship between Danish aid to Nepal and GDP growth in Nepal.

Analysis of sector-wise impact of Danish aid on the process on economic development of a country is difficult because it consists of short as well as long term effect, tangible and intangible effects. In certain areas, like education, infrastructure, the contribution of aid does not give immediate results. Similarly foreign aid may change socio-economic environment of the country, improvement in the health of the public but the impact in these areas is invisible. So it is difficult to evaluate the impact of foreign aid quantitatively.

CHAPTER - VII

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

7.1 Summary

For the developing country like Nepal economic development is a prerequisite for raising the standard of living of Nepalese people. But economic development is not an easy task. Nepal is poor in mobilizing internal resources for development program. So, it is bound to depend on external aid and assistance.

Nepal is one of the least developed countries of the world with a very poor economic and social infrastructure for development. It suffers from serious resource gap with low saving and low investment creating a vicious circle of poverty. Foreign aid can play an important role in economic and social development of Nepalese economy. Nepal began to receive foreign aid formally after the 1951. All development plans of Nepal have heavily relied on foreign aid since Nepal embarked on a planned development. The first plan was fully financed by foreign aid where as it is estimated that the total share of foreign aid in the three year interim plan will be 50.2 percent. The technology and the foreign exchange gap are equally striking. Nepal faces severe problem of deficiency in resource mobilization. Fiscal deficit is growing every year.

In the line of these above problems, foreign aid has been playing major role. It may be observed that foreign aid has been instrumental in bringing about substantial improvements in the areas like: agriculture, irrigation, forestry, transportation, power, communication, industry, commerce and social service in Nepal. According to the data, trend of foreign aid should that since the very beginning, the transportation, power and communication services have the biggest recipient of foreign aid. The industries and commerce sector has declined in priority successively, possibly due to the governments adaptation of privatization policy. The social sector has also reminded an important sector from the perspective of aid receipt. This sector is provided with grant assistance mainly.

The capacity to utilize the committed amount of aid productively continues to remain as a crucial problem for the Nepalese government ever since it began to

receive aid. It becomes clear if one goes into the gap between the commitment and disbursement of aid, as disbursement is simply an expenditure statistics. This does not say anything whether this money has or has not been productively utilized. If the disbursement is considered in real prices and in terms of efficient use, then only 25 percent of the aid is efficiently absorbed (Neupane, 2002). This type of absorptive capacity is the outcome of the political instability, lack of commitment of ruling authorities, bureaucratic delay, corruption and lack of proper management of development projects. The value of GDP is increasing ratio. The national GDP of country is proportionately related with the foreign aid. In the FY 1989/90, the total volume of GDP was Rs. 99702 million and in FY 2007/08, it was Rs. 781262 million. Comparing the volume of GDP of FY 1989/90 and FY 2007/08, the GDP during FY 2007/08 was 7.83 times greater than the FY 1989/90. In FY 1990/91 the contribution of foreign aid in national budget amounted 25.5 percent and in FY 2008/09 it was around 28 percent in total budget and 53 percent in development budget (budget speech 2008/09). It seems that the contribution of national budget is high aid dominant. So Nepal's budget is heavily dependent on foreign aid. So there is interrelationship between growth of GDP, foreign aid and national budget.

The role of Danish aid has become important after 1989. Denmark has given different types of co-operation to Nepal which has been flowing continuously since 1989/90. Though Denmark began to have economic co-operation with Nepal by providing loan assistance, now a days it has provided only in the form of grant and technical assistance to Nepal. Danish aid to Nepal covers the sectors such as education, communication, energy, natural resource management, human rights, good governance, democracy, environmental preservation and peace process etc.

The major findings of the study can be summarized as follows:

- Foreign aid has covered many fields like agriculture, irrigation and forestry, transport, power and communication, industry and commerce, as well as social services for socio-economic development in Nepal.
- Nepal has been experiencing a serious and growing resource gap in her regular as well as development expenditure to low level of per capita income. The low rate of income creates low rate of capital formation

which has become one of the main barrier to economic development. The only alternative to meet such gap is external assistance.

- The trend of foreign aid shows many fold increase in the quantum of aid flows to Nepal. Trend analysis clearly shows that the proportion of loans have been increasing consistently with commensurate declines in grants which implies an increasing debt burden. The proportion of grants used to be far higher than the foreign loans till FY 1982/83.
- Aid disbursement has been much lower than the commitments by huge proportions except in FY 1990/91 where disbursement is higher than commitment.
- Sectoral allocation of aid from FY 1990/91 to FY 2004/05 clearly shows that 45 percent of total foreign aid covers transport, power and communication sector. This means foreign aid has given more emphasis on infrastructures.
- The Danish economic cooperation program was started in 1973 with a loan assistance of small amount 20 million Danish kroner whereas the diplomatic relationship was established between Nepal and Denmark in 1967.
- Denmark has been constantly showing keen interest in Nepal's economic development when Nepal became one of Denmark's program countries in 1990. After 1980, Danish aid to Nepal is in the form of only grant and technical assistance. In 1994 Denmark was the 2nd top most donor country of Nepal. Since 1995, Denmark has cancelled outstanding ODA funded debts with developing countries.
- The main objectives of Danish aid development assistance is poverty alleviation in consideration of crosscutting issues as gender issues, environment, democracy and human rights.

- Danish development assistance has highly concentrated in poverty alleviation, education, environment, human rights, good governance, democracy, decentralization and peace process.
- Different projects under Danish assistance have been operated in different districts. Such as SESP (2003-09) which is one of the major project of education sector.
- Empirical analysis has clearly shown that impact of Danish assistance in Nepal's growth has positive effect.

7.2 Conclusion

The current study shows positive effects of foreign aid on the economic development. Foreign aid has helped in boosting the GDP growth. Through structural transformation of the economy laid foundations of the industrial and agriculture sectors, provided technical assistance, policy advice and modern technology, assisted in overcoming the budget deficits and the BOP deficits and has also funded the projects for the social sector development projects. As the regression analysis of the GDP and the ODA confirms the positive affect of official development assistance (ODA) on the GDP. GDP increases as the flow of foreign capital increases. Thus, the overall impact of the aid on the economic development is positive.

With the policy of liberalization, donors are gradually pushing Nepal to replace grants by concessional loans, concessional loans by commercial loans. Most of the foreign aided projects have been launched in the urban areas. Foreign aid in Nepal appears to be less effective on focusing on the need of majority of the people and also maintain accountability. It has been unable to address the specific problems of equity and justice to ensure propriety in process of aid utilization.

The policies are also important in the effectiveness of foreign aid, as the aid has a more positive impact on growth in with good fiscal, monetary and trade policies. In the presence of poor policies, on the other hand, aid has no positive effect on growth. Accordingly, there is a need of not only good policies but also the implementation of these policies as well as the proper monitoring of the aid-utilization

projects is necessary in order to avoid the misutilization and the mismanagement of the foreign capital resources.

Consequently we can say, the aid may be helpful in boosting economic growth only under the presence of appropriate monetary, fiscal and the trade policies.

7.3 Recommendations

Although foreign aid did not substantially contribute to the economic and social development of Nepal, the role and importance of foreign aid cannot be denied. The foreign assistance is still important in Nepalese economy because the domestic resource mobilization of Nepal is very low to fulfill the investment requirements.

In relation with the amount of foreign aid mobilized, progress achieved towards sustainable economic growth, balanced and inclusive development and poverty alleviation has remained less than satisfactory. The government's decisive capacity in the context of foreign aid mobilization and utilization continues to be weak. The total amount of foreign aid on the whole, could not be channeled through the government budget. Foreign aid management continues to suffer from proper coordination among donors, the government and the concerned parties.

On the basis of the findings and conclusion of this study the following recommendations are suggested to remove problems/ weaknesses to get fully positive impact on Nepal's growth regarding foreign aid and especially to Danish aid.

- Foreign aid should be accepted in accordance with the development need and the development priority of the country instead of accepting anything that is available from the external sources.
- Foreign aid should be used in transparent manner with proper accounting system of recording the movement of foreign aid.
- Effective decentralization strategy should be implementing in foreign aided programs and projects such as people's participation should be increased when projects are launched by foreign aid.

- Systematic anti-corruption reform should be put in place and should be driven from within. Efforts to combat corruption are most successful when change is driven internally, and when political leadership is strong.
- Political stability and peace should be needed that investors invest freely.
- At the time of implementation of foreign aided projects, Nepali contractors and laborers should be employed as far as possible in the construction works.
- Select the projects according to the priority list of government with full commitment should be implemented so that it can generate sufficient resources to pay back the aid.
- Priority should be given to grants rather than loans and used only for productive sectors.
- Long term loan should be taken at low interest rate with long maturity period.
- Heavy dependence on foreign aid should be reduced by better mobilization and efficient utilization of domestic resources.
- The problem of inflation is created due to the unproductive utilization of foreign aid. Hence the government should control the unproductive use of foreign aid.
- Effectiveness of foreign aid should be enhanced by coordinating the donors' interest with the national policies and priorities.
- Foreign aid utilization should be enhanced through improvement management, operational procedure and system simplification.
- Infrastructure such as roads, bridges, electricity and communication should be given priority for foreign aid mobilization.

- Technical assistance should be used with a focus on the objective of achieving sustainable national capacity development.
- Promotion of indigenous skill, efficiency and technology should be the conditions of foreign aid acceptance.
- The government's decisive capability in foreign aid mobilization and utilization should make strong. All foreign aid should be reflected in the national budget.
- Foreign aid should invest in agricultural development and promotion of tourism.
- From this study, impact of Danish assistance in Nepalese socio-economic field has been found very significant and remarkable, so Nepal should make attractive foreign aid policy.
- Denmark has been providing more aid in education, human rights and good governance sector. This assistance should be extended to infrastructure development sector.
- Under Danish assistance, major projects are in different urban areas. Only minor projects are in remote and backward areas, so these major projects should also be extended in rural and remote areas.

Annex - 1

The Inflow of Foreign Aid to Nepal (1951/52 - 2007/08)

FY	Total aid Inflow	Total Grant	Percent of Grant in Total Aid	Loan	Percent of loan in Total Aid
1951/52-55/56	95.00	95.00	100.00	-	-
1956/57	27.30	27.30	100.00	-	-
1957/58	58.10	58.10	100.00	-	-
1958/59	35.10	35.10	100.00	-	-
1959/60	125.30	125.30	100.00	-	-
1960/61	125.10	125.10	100.00	-	-
1961/62	182.60	181.60	99.50	1.00	0.50
1962/63	88.10	76.50	86.80	11.60	13.20
1963/64	177.30	165.90	93.60	11.40	6.40
1964/65	146.90	141.00	96.00	5.90	4.00
1965/66	178.60	175.30	98.20	3.30	1.80
1966/67	145.90	142.20	97.50	3.70	2.50
1967/68	158.10	158.10	100.00	-	-
1968/69	185.90	185.90	100.00	-	-
1969/70	151.30	243.7.	97.00	7.60	3.00
1970/71	303.20	270.70	89.30	32.50	10.70
1971/72	281.00	242.10	86.20	38.90	13.80
1972/73	227.60	180.20	79.20	47.40	20.80
1973/74	310.50	222.60	71.70	87.90	28.90
1974/75	386.70	282.80	73.10	103.90	26.90
1975/76	505.60	359.70	71.70	145.90	28.90
1976/77	556.90	292.50	70.50	164.40	29.50
1977/78	848.40	466.60	55.00	381.80	45.00
1978/79	989.40	599.30	60.60	390.10	39.40
1979/80	1,340.50	805.60	60.10	534.90	39.90
1980/81	1,562.20	868.90	55.60	693.30	44.40
1981/82	1,723.20	992.50	57.60	730.70	42.40
1982/83	2,075.90	1090.10	52.50	985.80	47.50
1983/84	2,547.50	876.60	34.40	1,670.90	65.50

1984/85	2,676.40	923.40	34.50	1,753.00	65.50
1985/86	3,491.50	1,120.60	32.10	2,370.90	67.90
1986/87	3,314.40	1,078.30	32.50	2,236.10	67.50
1987/88	5,078.50	1,984.20	39.10	3,094.30	60.90
1988/89	5,666.90	1,478.20	26.10	4,188.70	73.90
1989/90	6,427.10	1,798.80	28.00	4,628.30	72.80
1990/91	5,990.00	1,630.00	27.20	4,360.00	72.80
1991/92	7,800.40	1,531.00	19.60	6,269.40	80.40
1992/93	9,235.60	3,273.90	35.50	5,964.70	64.50
1993/94	11,557.20	2,393.60	20.70	9,163.60	79.30
1994/95	11,249.40	3,937.10	35.00	7,312.30	65.00
1995/96	14,289.00	4,825.10	33.70	9,463.90	66.20
1996/97	15,031.90	5,988.30	39.80	9,043.60	60.20
1997/98	16,457.10	5,402.60	32.80	11,054.50	67.20
1998/99	16,189.00	4,336.60	26.80	11,852.40	73.20
1999/2000	17,523.90	5,711.70	32.60	11,812.20	67.40
2000/01	18,797.40	6,753.40	35.92	12,044.00	64.08
2001/02	14,384.80	6,686.20	46.78	76,98.60	53.52
2002/03	15,885.50	11,393.10	71.38	4,546.40	28.62
2003/04	18,912.40	11,283.40	59.40	7,629.00	40.30
2004/05	23,657.30	14,391.20	60.80	9,266.10	39.20
2005/06	22,041.80	13,827.50	62.73	8,214.30	37.27
2006/07	25,854.30	15,800.80	61.10	10,053.50	38.90
2007/08	29,300.60	20,320.70	69.30	8,979.90	30.70

Annex - 2**Total Danish Aid and GDP**

Fiscal Year	GDP (Y)	Danish Aid (D)
1989/90	99702	193.8
1990/91	116,127	322.92
1991/92	144,933	217.60
1992/93	165,350	873.95
1993/94	191,596	1,630.31
1994/95	209,974	14.29
1995/96	239,388	269.30
1996/97	269,570	623.10
1997/98	289,798	4,053.00
1998/99	330,018	4,033.77
1999/2000	366,251	1,327.56
2000/01	425,454	1,731.80
2001/02	444,052	1,855.50
2002/03	473,546	1,979.20
2003/04	517,993	2,480.50
2004/05	566,579	1,996.50
2005/06	630,301	2,059.40
2006/07	696,989	2,961.20
2007/08	781,262	2,993.56

Annex - 3
Total Aid and GDP

Fiscal Year	GDP (Y)	Total Aid (TA)
1989/90	99,702	6427.10
1990/91	116,127	5990.00
1991/92	144,933	7800.40
1992/93	165,350	9,235.60
1993/94	191,596	11,557.20
1994/95	209,974	11,249.40
1995/96	239,388	14,289.00
1996/97	269,570	15,031.90
1997/98	289,798	16,457.10
1998/99	330,018	16,189.00
1999/2000	366,251	17,523.90
2000/01	425,454	18,797.40
2001/02	444,052	14,384.80
2002/03	473,546	15,885.50
2003/04	517,993	18,912.40
2004/05	566,579	23,657.30
2005/06	630,301	22,041.80
2006/07	696,989	25,854.30
2007/08	781,262	29,300.60

Annex - 4
REGRESSION

Descriptive Statistics

	Mean	Std. Deviation	N
GDP	26.4624	.61375	19
Total Aid	23.27601	.73273	19

Model Summary^b

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.724 ^a	.524	.496	.43557	1.176

a. Predictors: (constant), Total Aid

b. Dependent Variable: GDP

ANOVA^b

Model	Sum of Squares	df	Mean Square	F	Sig.
1. Regression	3.555	1	3.555	18.737	.000 ^a
Residual	3.225	17	.190		
Total	6.780	18			

a. Predictors: (constant), Total Aid

b. Dependent Variable: GDP

Coefficients^a

Model	Unstandardized Coefficients		Standardized Coefficients	t	sig.
	B	Std. Error	Beta		
1. (Constant)	12.345	3.263	.724	3.784	.001
Total Aid	0.607	.140		4.329	.000

a. Dependent Variable: GDP

Residuals Statistics^a

	Minimum	Maximum	Mean	Std. Deviation	N
Predicted Value	25.0026	26.9626	26.4624	.44441	19
Residual	-.7170	.9761	.0000	.42330	19
Std. Predicted Value	-3.285	1.126	.000	1.000	19
Std. Residual	-1.646	2.241	.000	.972	19

a. Dependent Variable: GDP

Annex - 5
Regression

	Mean	Std. Deviation	N
GDP	26.4624	.61375	19
Danish Aid	20.6938	1.41131	19

Model Summary^b

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.646 ^a	.417	.382	.48233	.791

a. Predictors: (constant), Danish Aid

b. Dependent Variable: GDP

ANOVA^b

Model	Sum of Squares	df	Mean Square	F	Sig.
1. Regression	2.825	1	2.825	12.144	.003 ^a
Residual	3.955	17	.233		
Total	6.780	18			

a. Predictors: (constant), Danish Aid

b. Dependent Variable: GDP

Coefficients^a

Model	Unstandardized Coefficients		Standardized Coefficients	t	sig.
	B	Std. Error	Beta		
1. (Constant)	20.653	1.971		12.362	.000
Danish Aid	.281	.081	.646	3.485	.003

a. Dependent Variable: GDP

Residuals Statistics^a

	Minimum	Maximum	Mean	Std. Deviation	N
Predicted Value	25.2781	26.8635	26.4624	.39619	19
Residual	-.6846	.7922	.000	.46874	19
Std. Predicted Value	-2.989	1.012	.000	1.000	19
Std. Residual	-1.417	1.642	.000	.972	19

a. Dependent Variable: GDP

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