

CHAPTR – ONE

INTRODUCTION

1.1 Background of The Study

The term foreign aid can be defined as transfer of resources from the advanced countries for the purpose of encouraging economic uplift in the developing countries. Foreign aid is that concept which refers to the flow of capital and technical resources either directly from the government of donor country or international channels to the government of recipient country. The resources can be transferred in various forms such as financial, technical or commodities etc. It include bilateral and multilateral grants, loans and technical assistance. So foreign aid is broadly defined as the flow of financial resources from developed countries to developing countries to expressly intended for the economics and social development of nation.

Foreign aid is one of the most original politico- Economic phenomenons at present scenari. In addition foreign aid has political emerge as foundation to North-South relation, which come up as one of the important tool for the globalization. The concept of foreign aid is not recent phenomenon. In the mid 1940s a new word ‘Aid’ came in to common use especially in the literature of economic development to describe the flow of resources from one country to another. Foreign aid, today has become a corner stone of any developing countries like Nepal.

The concept of foreign aid is not sufficient in itself. Many writers and national and international institution have given various definitions regarding the philosophy of foreign aid. P.N. Rosentain- Rodan, distinguishing foreign inflow and aid said “Aid refers only to those parts of capital inflow which normal market incentive do to provide. It consists of long terms loans, grants, soft loans, sale of surplus products of currency payments and technical assistance.”

In the global context, a country can’t stand on its isolation. It is interdependent with other countries. In the case of developing countries, there is mass poverty, lack of infrastructure, agro- based economy, subsistence level wage rate, policy failure, and other weakness as which affect the rate of capital formation. As result, there is a big gap

between supply of and demand for resources. It is clear that the gap seems to be impossible to fulfill from the internal resources of these countries. so, there is the need of external capital.

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

In the developing countries like Nepal domestic resources are inadequate to meet the financial requirement for the economic development. The level of capital formation of those countries is very and substantial increase in saving is not possible due to extremely low level of income. Public borrowing and taxation have their own limitations. Deficit financing is also not effective due to its inflationary impact. Therefore, foreign aid is advantages for the acceleration of economic growth of these countries.

The history of foreign aid in Nepal is not very old. Before second world war or even before pre-democracy period, (i.e. before 1951 A.D.), Nepal was not familiar with integration of aid or not familiar with rest of the world. Whatever Nepal received aid before these periods was more concerned with the war or military assistance. It was not for any clear purpose of economic development.

The history of foreign aid in Nepal dates back in 1968 BS, when the “Pharping Hydroelectricity Project” was established. This assistance was provided by British Government. But there is also another view that, the first foreign aid was given by India for the construction of “Rail-way” from Amlekhgung to Rakshaul of India in 1985 B.S. But in formal or official term Nepal received first foreign aid under “Point Four Programme” on 23rd January, 1951 A.D. with the government of America (USA). Before 1956 India gave Rs 7 crore and America gave Rs 3 crore foreign aid to Nepal.¹

Nepal presents a very important case concerning the use of foreign aid. One of the most underdeveloped countries in the world, Nepal received substantial amount of foreign in the last five decades. It has received various kinds of economic assistance from

1. Sharma, Neelam Kumar (2061), “Economics of Nepal,” Pairabi Prakashan (in Nepali) P 525 and 564

all donors irrespective of their political systems and ideologies. As its per capita income is one of the lowest in the world, even if resources effectively mobilized and directed to productive investment, required level of development may not be substantially achieved. An additional foreign capital can be most beneficial with the combined utilization of domestic and external financial resources result in a high rate of investment.

Nepal's first experience of foreign economic aid heralded by the point Four Program agreement signed on January 23, 1951. The American Government's assistance of Rs. 22,000.00 provided under president Harry Truman's Point Four Program was soon followed formal economic assistance from India in October in the same year (Sigdel, 1996). China and USSR joined in assisting Nepal's economic development in 1956 and 1958 respectively. Nepal's experience with economic assistance offers a valuable source of answers to the queries about aid. Thrust into prominence by its strategic position in the Himalayas fastness separating India and China, Nepal has attracted unusual attention from aid donors (Mihaler, 1965).

Nepal joined the Colombo plan in 1952, participated in the first non-aligned conference in 1955 in Bandung and became a member of the United Nations and thus attracted the interest of the developed as well as developing nations in its development efforts. The traditional policy of isolation and exclusion from the foreign acquaintance was actually replaced by a policy of open frontiers in international relations without aligning with any power block. All this further exposed Nepal to the outside world and opened up the door for diplomatic relations with a number of countries resulting in a better inflow of foreign assistance from varied sources.

In 1961, Nepal became the member of World Bank (WB) and International Monetary Fund (IMF). After 1969, WB and IMF started to give aid to Nepal. Nepal's participation in the conference of the Non-Aligned countries held in Belgrade (1961), Cairo (1964) and Lusaka (1970), further attracted the foreign countries for rendering more and more aid to support Nepal's development efforts. To the outside world, the country's neutral posture further helped expand aid program for Nepal. Participation in conference held in various places at different time also boosted for the expansion of foreign aid to Nepal. Moreover, with the formation of "Nepal Aid Group" in 1976, the quantum of foreign aid increased more significantly in Nepal. 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 Aid Group accounts for about three-fourth of the total aid disbursement. The restoration of democracy in Nepal after 1990s further gave impetus for the expansion of more and more economic aid.²

In recent years, most of the prime sectors of the economy are receiving foreign aid, and almost in every sector several bilateral as well as multilateral donors are involved. The Nepal Aid Group, now Nepal Development Forum (NDF) includes countries like Australia, Canada, France, UK, USA, Switzerland, Japan and international agencies such as ADB, IDA, IMF and UNDP. Other major donors for Nepal are China and India. Up to 1960/61, all foreign assistance to Nepal was totally in the form of grant, and it was only since 1961/62 foreign loans started to enter the country. It has been found that the overwhelming proportion of loans comes from the multilateral agencies and also from IDA and ADB (Poudyal, 1988).

Nepal has been receiving foreign aid from different countries in different ways. Nepal has been getting foreign aid from two types of donors- (i) Bilateral and (ii) Multilateral. countries such as Australia, Canada, France, UK, USA, Switzerland, Japan, USAID, GTZ, SDC of Switzerland, DFID of UK, JICA of Japan, FINIDA of Finland etc. lie under bilateral donors and aid received from the multinational organizations established by more than two countries such as WB, IMF, IDA, ADB, UNDP, UNICEF, WHO, OPEC, FAO, UNESCO etc. lie under multilateral aid.

Foreign aid has two forms – (i) Grant and (ii) Loan. The aid which is obtained in terms of not returning back is known as grant where as loan is obtained on the condition of returning back with interest. The financial assistance take the form of either grant and loan. Grants are generally gifts, they do not have repayment liability, so they should be used in the projects with long gestation period such as social services. Loan is of three types according to the period of maturity – 1) long term loan, 2) mid-term loan and 3) short term loan.

Foreign aid is classified into various forms on the basis of its nature, terms, condition and source. Foreign aid from the point of view of its nature is broadly

2. Dahal, Madan Kumar (Dec.2004). “Nepalese Economy Towards Building a Strong Economic Nation-State.” Published by CEDECON, at T.U. Kirtipur. P.512-514.

classified as i) capital aid, ii) commodity aid and iii) technical aid. Capital aid refers to the provision of capital such as balance of payments support. Commodity aid usually takes the forms of transfer of surplus products of the donors to the recipient countries and the technical assistance involves the training of the recipient's countries and the provision of skilled foreign personal experts to carry out the required development tasks in the recipient country.

It is found that foreign aid has been playing a vital role in the economic development of developing countries like Nepal. After the rise of democracy in 1951, democratic practice along with development and construction also started in Nepal. Up to tenth five years plan, foreign aid has made important contribution in the development of fields such as roads, communication, irrigation, education, agriculture, health, hydroelectricity, drinking water, etc. The first five year plan was entirely financed by foreign aid, as the development expenditure and foreign aid received during the plan both amount to Rs. 382.9 million. Foreign aid as percentage as development expenditure which was 100 percent for the first plan declined over a short period of next fifteen years, but still remained high. The share of amount during second to tenth plan periods was 77.5%, 56.1%, 45.0%, 48.1%, 61.0%, 49.6%, 44.0%, 51.8% and 57.7% respectively.³

Foreign aid helped to increase production and productivity to expand the development works and to find out suitable technologies. The final aim of foreign aid is to accelerate the development activities and try to make the country self-standing. There is such condition that generates expenditure is increasing and as a result internal resources are not sufficient to fulfill that increasing level of expenditure. That is why foreign aid is necessary for supporting development expenditure. But to achieve the goal of foreign aid, it must be used properly and transparently. Otherwise there may arise great problems like inflation in the economy.

In fact, donors have their own policies, priorities and strategies regarding aid disbursement and utilization. Therefore, developing countries like Nepal need to have a clear policy, priorities and strategies on foreign aid. The government of recipient's country must focus all its attention on certain priority areas.

3. Different Economic Plans, 1956-61 to 2002-07

well as financial and technical assistance. Those countries which are called developed in these days were also received technical assistance. Without foreign aid, major problems such as huge amount of saving- investment gap, mass poverty, lack of capital formation of developing countries can't be introduced. Hence, foreign aid is the necessary component for the economic development of developing countries like Nepal.

1.2 Statement of The Problem

Nepal is a land-locked country bordered by China in the north and India in the remaining three sides. About 80 percent of its population resides in rural areas are farmers and their literacy rate is nearly 64 percent. The per-capita income of a single Nepali is US\$ 386 (F.Y. 2006/07). Agriculture is the main occupation of Nepali people. The share of agriculture in Nepalese economy is about 36 percent in the GDP whereas the engagement of more than 80 percent people in the rural area of Nepal. The contribution of industrial sector to GDP is about 20 percent with the full time engagement which covers 6 percent economically active population in manufacturing sector.

Developing countries in the world, including Nepal, are moving around the vicious circle of poverty. Still more than 31 percent people of Nepal are under the absolute poverty line, according to the government record. But, the real situation is different. In reality, more than 50 percent people, are under the absolute poverty line. The growth rate of Nepal is around 2.5 percent of real GDP. Every year, there is high resource gap in our budget. It means our budget is called deficit budget. There is higher expenditure than revenue, due to the high growth rate of population, lack of capital, technology and skilled manpower, there is high saving-investment gap in Nepal. In this situation, foreign aid is only way to fulfill this type of gap.

Foreign aid is being received by Nepal since 1951 for economic development of the people. There is no doubt that foreign aid has been playing crucial role for economic process, if foreign aid has been used properly, transparently, co-ordinately with the full co-operation of the people of targeted group. But there are many problems in effective use of foreign aid by developing countries like Nepal. They are weak institutional system, political stability, rapid growth of population, mass poverty, illiteracy etc. The system of

foreign aid is deviating from its track. The donor countries and donor agencies have used their aid for fulfillment of their vested interest through various conditionalities. Likewise, they are provided loans, not on the interest of particular communities but on the interest of themselves. It is argued that large amount of foreign aid follows back to donors in the form of compensation to the expatriate consultants and imports of equipment and large portion of aid is siphoned by the bureaucrats, project staff and political leaders, before it reaches to the targeted group. On the other hand, commitment disbursement gap is also wide and donors lobby to appoint incompetent personnel to work in developing countries as experts. So for successful implementation of aid-financed projects such weaknesses have to be addressed .

Hence the main reachable questions in this study are:

- 1) What is the role of foreign aid in economic development of Nepal?
- 2) What are the problems of foreign aid in Nepal?
- 3) Does foreign aid really benefited for developing countries like Nepal?

1.3 Objectives of The Study

The main objectives of the study are:

-) To explore the contribution of foreign aid to the economic development of Nepal.
-) To review the trend and structure of foreign aid in Nepal.
-) To analyze the sectoral distribution of foreign aid.
-) To assess the various sources of foreign aid to Nepal.
-) To highlight the problems and constraints of foreign aid in Nepal

1.4 Needs and Significance of The Study

In developing countries like Nepal, foreign aid is widely accepted as a means for the development. Without foreign aid, the adequate mobilization of internal resources could not have been made in order to accelerate the rate of economic development and growth. For the developing countries like Nepal, foreign aid can play an important role if It is utilized efficiently⁴.

4. Vision of ECOSS, T.U., Kirtipur (2005), Vol. 2-3, Issue No. 2.

Nepal, like other developing countries in the world, are rich in their natural resources. But they are poor in skill, capital and good management. Less developing countries like Nepal, do not process a strong and stable economy. The foundation of developing economy of Nepal, is agriculture. They are unable to have economic growth because of low saving ratio, low capital formation, traditional technology and impractical education system. Internal resources are not sufficient for development activities. There is increment in resource gap.

Thus the contribution of external sources as foreign aid on government revenue and its importance on fulfilling resource gap has been chosen as a relevant topic for the study. The role of foreign aid in particular is significant. It helps to:

- I) Improve the nation's capacity to identify evaluate and adopt technology to accelerate production and productivity of the economy, which is one of the basic conditions for poverty alleviation.
- II) Channel increased resources towards priority sector of the economy to accelerate the development activity.
- III) useful and fruitful for researchers, scholars, public, interested investors, as well as, for the policy maker.

Hence foreign aid plays a significant role in the developing countries, like Nepal. Five decades have been passed in the history of foreign aid but poverty is not alleviated, economic growth is not increased significantly and all other conditions are same. Thus, this study try to find out the problems and challenges of foreign aid in developing country like Nepal.

1.5 Limitation of The Study

This study has been completed in a limited period of time as a partial fulfillment of master's degree in economics. All the research work are bounded by some limitations. This study is also not free from limitations. The main limitations of this study are:

- I) The study is mainly based on secondary data.
- II) The secondary data are used during 1975/76-2006/07.
- III) The study is conducted within the given time period and financial constraint.

- IV) Main focus is given to the contribution of foreign aid to the economic development of Nepal.
- V) Only official development assistance has been considered.

CHAPTER – TWO

REVIEW OF LITERATURE

2.1 Theoretical Framework

The concept of foreign aid is certainly not a recent phenomenon. It has been coming primitive period of classical economist. But it is generally agreed that foreign aid is originated from the disruption of the world economy that followed world war second.

In real sense, foreign aid means transfer of resources from the industrialized to the developing countries. But after the Second World War, the common meaning of foreign aid has changed and also been influenced by the political and economic interest of donor countries. “The short answer of foreign aid is that it consists of explicit transfer of real resources to less developed countries on concessional terms” (Bhangawati, Jagdis and Eckans, 1971). The development assistance committee (DAC) of the OECD of UN records has defined it as “the flow of long-term financial resources for less developed countries from multilateral agencies including official flow and expert credit”. In these two definitions much emphasis has been given on the transfer of real resource to the developing countries but technical know how and its impact on the whole economy seems to be neglected in both definitions.

“The least developed countries report defined foreign assistance as all transaction (for a country or an international organization), which result in a permanent net addition to total resources available for economic development of another country”. According to United Nations, aid consists only of outright grants and net loan term by 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.

In the modern development literature, the concept of aid and net aid are often ambiguous. Some economists have argued that special import quota, tariff reduction and preferential trade treatment are not foreign aid, but they are economic assistance. They should be excluded from the calculation of foreign aid.

According to the conventioal wisdom of most developoement economist, capital is the key, and problem of the development is to increase available capital. To do so, a

society has to save by foreign consumption today, in order to have economic growth tomorrow. The internal capital formation or saving is not a easy task because most population live on the subsistent level in most of the developing countries. Development means increasing quality of capital per worker. So society can be more productive and get more output than by using labor alone. Emphasis on capital, as opposed to the other basic factors of production, i.e. land, labor, technology, entrepreneurial resources has characterized the workers of a large number of postwar development economists.

In the process of economic development, a country faces the situation where its domestic saving are short of investment requirements and where its imports needs are longer than its export capacity for the purpose of attaining a targeted rate of economic development. By the help of foreign aid, it can fulfill its desire of development, filling 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 such countries at the initial state of economic development.

In the global context, a country can not stand in isolation. It is interdependent with other countries. In case of the developing countries like Nepal, there is saving-investment gap problem, technology gap problem and resource gap problem in the economy. In this situation, the gap seems to be impossible to fulfill the internal resources and there is need of external capital.

The reason for which bilateral aid is given may affect its usefulness in promoting development. For example, the aid may be politically motivated; that is developing countries are the recipients of the donors' largesse because they are politically or strategically important. Aid is also be given to alleviate the effects of natural disasters or increase the donor's exports as well as to promote the economic and social development of the recipient. Whatever the motivation of the donor, foreign assistance will probably influence the development process of the recipient.

Nevertheless, foreign aid will not be as useful in encouraging economic growth when the donor shapes its program with another goal in mind. The recipient may know that it is considered strategically important and may therefore be unwilling to adopt policies that would promote long term development, particularly if the policies are painful in the short run. Rather than adopt needed reforms, recipient countries may use the aid to

compensate for inefficient economic policies.

Foreign aid consists of grants or loans that one government or multilateral organization avails to a developing country to promote economic development and welfare. In other words, any money that benefits a developing country in grant concessional loans or non-concessional from a bilateral or multilateral organization is considered as foreign aid.

Many developing countries do not have sufficient funds to provide public goods such as education or transportation system or clean drinking water and waste disposal facilities. Although such goods are essential for development, developing country itself can not invest all necessary resources in such sectors.

Nepal is one of such developing countries whose savings are low because of low economic growth and vice-versa. Because of the low level of income, level of consumption is also low. To increase the consumption, level of income should also be increased.

Apart from the contribution of foreign aid for sustaining public investment, it is crucial for meeting the objective of poverty reduction through achieving high and sustainable rate of economic growth and through underpinning critical sectoral programs and activities. It helps to a) supplement and enhance Nepal's meager domestic saving so as to mobilize increasing resources for poverty alleviation, b) allocate increased resources towards priority sectors of the economy to accelerate development activity, c) create an environment for attract foreign direct investment and promoting private sector investment and d) improve the nation's capacity to identify, evaluate and adopt technology to accelerate production and productivity of the economy.

Over-time, foreign aid has proved to be an effective instrument contributing to significant improvements in the socio-economic development of the country, and much physical infrastructure such as roads, irrigation facilities, hydropower as well as education and health services, drinking water and sanitation facilities, have been constructed with foreign assistance. Foreign aid has also contributed to the development of policy dialogue, catalyzed economic reforms, enhanced the capability of public policymakers and provided financial assistance for public services.

Nepal is receiving foreign assistance since the decade of 50s but still it has fallen into extreme poverty and has failed to rise above this conditions. In 1960s, South Korea

and Taiwan, both were recipient countries but now they are aid donors. Needless to say that foreign aid can play a useful role in promoting economic and social progress in the developing countries, but success of aid depends crucially on numerous background conditions that is related to the political and economic policies of the recipient as well as the aid policies of the donors.

As the influential Pearson commission (1969:4, quoted in Colaco, 1973:16) noted: 'A good deal of bilateral aid has been dispensed in order to achieve short-term political favours, gain strategic advantages or promote exports from the donor. Much foreign aid was granted in the 1950's to enable some countries maintain large armed forces than to promote economic growth. In none of these cases was the promotion of long-term development a dominant objective of the aid given.

Another early explication of foreign aid is provided by Holl's Chenery, who defines foreign aid as an instrument of bridging various gap and relieving various bottlenecks existing in a underdeveloped economy. For a country to develop on its own, it would require "skills domestic saving, and export earnings as well as an allocation of these rising levels of income" (Chenery and Strout 1966: 680) which would be almost impossible for a developing country to achieve; the role of foreign aid would be provide capital and other resources to fill these short comings. Chenery, with co-authors Bruno (1962) and Strout (1966) has formalized this fill are the 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 as decision-maker, and assumes away any complications that fluctuations in exports and imports prices (which might affect saving, and thus investment, in a country) could bring about as a result of floating exchange rate for the domestic currency.

The "two gap" model is actually quite simplistic and very intuitive. The model starts with the familiar equation for national accounts.

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

Here Y stands for national output (which is the total production within the boundaries of a given country i.e. GDP. The gross national product GNP, would include an additional variable – the net factor income from abroad) C stands for consumption and I stands for investment. G stands for government expenditure, which is exogenous to the

consumption decisions made by citizens X stands for exports and M for imports.

Saving in this economy is the excess of production over consumption, both by private citizens and the government symbolically,

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

Plugging this equation in the national accounts identity gives.

$$S = I + X - M$$

Rearranging this equation gives the required results.

$$I - S = M - X$$

This equation states that the excess of investment over savings should be balanced by the excess of imports over exports.

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

A more mathematical exposition this model, with numerical examples is given in Thirlwall (1983). With foreign aid, and after satisfy in certain behavioral restriction, countries can be expected to reduce these gaps – and thus the constraints in their development-over time. Conditions for such results are also formalized in Thirlwall (1983).

In the context of foreign aid, several publications are published in the form of books, booklets, journals and useful articles. After realizing the importance of foreign aid many Nepalese as well as foreigner writers, have been written on foreign aid in the context of Nepal. There are also some thesis/dissertations referring to foreign aid submitted by students of economics for the partial fulfillment at their Master's Degree.

2.2 Related Studies

2.2.1 International Context

Ragnar Nurkse (1953) observed a need for “A theory of capital movements that is concerned with capital as factor of production” and a theory that would direct attention to the unequal proportions in which capital co-operatives with labor and land in the different

parts of the world, to the technical forms which capital should assume in response to different relative factor endowment, to the relations between capital movements, population growth and migration; and to other such fundamental matters only fragments of this type of capital movement theory exist today, but great awakenings is forcing the attention of economists all over the world to these basic questions with some benefits one may hope, not only the theory of capital formation and developments but to international economics generally.

Milton Friedman (1958) in his book "Foreign Economic Aid: Means and Objectives" describes the purpose of foreign aid is "to win over to our side those uncommitted nations who are also underdeveloped and poor". In the cold war period immediately following the Second World War, when the piece was written, the threat of the "Red Menace" was still strong and the "Domino Theory" has become a widely subscribed belief .

United Nations (1960) on least development countries report defined "foreign assistance as all transaction (for a country or an international organization), which result in a permanent net addition to total resources available for economic development of another country" According to the United Nations, aid consists only outright grants and net loan term by 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.

Rosenstein Rodan (1961) on "International aid for underdeveloped countries" 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 force do not provide." In the context of aid impact, he opined that aid has a positive role for development in the recipient country.

Y. P. Panta (1962) in his book "Nepal's Economic Developement on International Basis; An Analysis of Foreign Aid Utilization" writes that an underdeveloped countries like Nepal in a similar way,m in the initial stage of economic development, as provided by the inadequacy of domestic resources, which reliance will naturally have to be placed on foreign aid to increase the tempo of the development activities. Such aid is essential as the extreme poverty of the people, the regular deficit in the country's budget, absence of development of any appreciable character and lack of trained personnel make it hardly

possible for the country to find enough sources internally to finance its development. Most of the developed countries in a position to help realize the economic and political problems of underdeveloped areas. In the context of this important change in attitude coming in developed countries, Nepal can greatly benefit, if it knew properly how to develop the various fields of its economy in relation to internationalism.

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

G.M. Meier (1970), in his book "Leading Issue in Economic Development" concluded that capital accumulation is regarded as core process by which all other aspects of growth are possible capital increase investment. Investment needs more saving or foreign aid might have some limited use; aid should be given to those who help themselves. In short run; calculation of aid requirements through the industrial assumptions need to be looked at very carefully. Over the long run, it is not of much use; indeed it may be positively harmful.

Bhuchandra, Baidya (1984) entitled "Foreign Aid and Economic Development" describes that for most of the less developed countries, foreign aid is an important source of development. The role of foreign aid in such countries can be view through two perspectives: macro and sectoral. In macro perspective, it helps to fill the shortage of saving, foreign exchange and technical skills. The gap between the level of investment required for a sustainable growth and the existing level of saving is wide. To narrow the saving gap and to provide the basis for significant increase in the marginal saving rate, it is necessary to acquire foreign aid. Less developed countries suffer from deficit balance of payments. As most of less developed countries conspicuously lack the required equipments, technology and skills, a given rate of development will imply a certain volume of important needs. Under the foreign exchange gap problem, foreign aid provides foreign currency. It can be utilized wherever the nation feels need.

B.C. Upreti (1988), in his book a book "Dynamics of foreign Aid: A case study of

Indian Aid to Nepal” stressed that foreign aid as an instrument of foreign policy has acquired prominence among both the developed and the developing countries. In this book a critical review of various issues related to the concept of foreign aid, its nature, pattern and role has been made.

Kishor K. Gurugharana (1992) in his article “Development cooperation: an appraisal of the activities of donor agencies in Nepal” in NEFAS’s book foreign aid has highlighted an overview of foreign assistance in Nepal with plan wise, foreign aid as percentage of development expenditure and international comparison of per capita aid, besides these, he briefly gone through review of major bilateral donor’s assistance, multilateral assistance and its overall positive and negative impact in Nepalese economy.

According to him Nepal is receiving substantial amount of aid since the collapse of Rana regime in 1951, many bilateral and multilateral donors are keenly taken interest for investing in Nepal. There are some factors such as geo-political, socio-economic as well as non-aligned and friendly relation with all countries caused substantial aid inflow in Nepal. Some donors are provided aid purely on humanitarian basis, while others assisting us just to fulfill their vested motives. While taken in to consideration of the multilateral aid, they are provided loans aid in concessional term for the infrastructures development of Nepal in various fields.

G.M. Meir (2002) describes that “On the positive side of the factor of experience and the knowledge that has come with it. To analyze who has followed aid activity over an extended period, it is evident that the equality of aid operations has slowly continued to improve. Donor agencies have learned a great deal about the development process. They are doing better policy analysis. There is more emphasis on incentives and finding simpler and more flexible aid procedures. A development advisory committee report concluded that findings of project evaluation show that about 33 percent of aids on capital project are highly successful, 33 percent can be judged satisfactorily and 33 percent are disappointing. Of these, last 10 percent of the totals have to be regarded as a total loss”.

2.2.2 Nepalese Context

Bhawani Dhungana (1982), in his article "Foreign Aid: A Free Lunch For Nepal" describes that there has been high concern in both donor and recipient countries about the

effectiveness of foreign aid. Some weaknesses are to be pointed as foreign aid has been ineffective in delivering the expected output: first the level of resources in flow required for a substantial and meaningful change in the developing countries is quite high, but the amount that is flowing into the developing countries at present is meager in terms of their requirements. Second, the assistance that developing countries receive comes with so many conditions in terms of material imports and expertise inputs the net flow is very low. An empirical study shows net investment output of foreign assistance comes only 25 percent and about 10 percent of the total project's cost goes in terms wage salaries and targeted people poor groups benefit is too low. Third, almost foreign aided projects are either directly located in urban areas or in the close vicinity of such centers and most of the projects are certainly managed. Such kinds of realities cause some urban elite and urban well-to-do contractors to benefit highly. The poor and targeted groups are basically left out from the fruit of and foreign aid.

S.R. Poudyal (1983) in his article "Impact of Foreign Aid on Nepal's Development" explain the foreign aid is heavily concentrated on infrastructures, particularly roads and hence sectoral complementarily is lacking. The relative negligence of others has inhabited the growth in production base of the country. An empirical study shows that there is positive relationship between foreign aid and GDP growth. GDP, domestic saving and consumption are highly stable increasing functions of foreign aid. Elasticity of consumption with respect to foreign aid is lower than the elasticity of domestic saving with respect to foreign aid. This reveals the positive effect of foreign aid is more on saving than on consumption.

Ramesh Manandhar (1983), puts a question that, can Nepal survives without aid? To answer of this question, we have to look the role of foreign aid in developing process. According to him, no one seems to be worried about what happens when the aid stops. He further says that, agriculture is the backbone of Nepalese economy and industries are recent phenomenon. In such a situation, when flow of aid stops, there will be stagnating in industrial sector by lacking capital and modern technology. Thus, foreign aid is necessary for economic development of Nepal.

Harka Gurung (1984), in his book "Nepal Dimensions of Development" describes the foreign assistance to developing countries is less related with economic consideration

but more with strategic and political implication. Economically developed countries are to be externally oriented and most of foreign agencies have to rely on their own infrastructure before planning aid programs. The poor domestic saving rate and economic resources to finance the development expenditure required the external assistance. Thus, there is excess in meeting government expenditure.

S.R. Poudyal (1992), has made an effective study on different aspect of foreign aid in his article “Trends in foreign aid in Nepal.” he has analyzed the trend, composition, sources, sectoral distribution aid utilization, tying of aid that received by Nepal as assistance during 15 years. The main issues that he raised in his article firstly, Nepal’s dependence on foreign aid is increasing the influence of foreign aid- is pervasive in Nepal’s development, Secondly, composition of aid indicated a shift from grants to loans, there has been a concomitant growth debt in debt servicing liabilities, a crisis of foreign debt has been emerging, thirdly, the source at aid have changed clearly from bilateral to multilateral. Bilateral assistance is also gradually shifted towards loans, fourthly, there is a large gap between commitment and disbursement of aid, finally, tying of aid with projects gradually push up cost.

According to him, aid has substituted domestic saving, aid resources have not utilized effectively, aid is very much urban biased, and it is serving the politicians, bureaucrats, commission agents and contractor.

Keshav P. Acharya (1998), in his report “A review of foreign aid in Nepal” says that although foreign aid did not substantially contribute to the economic development of Nepal, the importance of foreign aid can not be denied, because the domestic resources mobilization of Nepal is still very low to fulfill the investment requirement. In this respect new vision and new ways of aid utilization have to be through from both donors and recipients countries have to use aid in the related or concerned sectors optimally not considering aid as a free gift.

Narayan Prasad Upadhyay (2059), in his article "The Foreign Aid Scenario in Nepal" highlights the key problems that have prevented large scale foreign investment in Nepal are the lack of a significant domestic market, the incompetent bureaucracy and lack of a skilled manpower. Enabling state programme, Nepal (2001) postulates that the major economic policies for macro-economic management of the Nepalese economy include

fiscal, monetary, credit, trade and exchange rate policies. In reality, there are a variety of structural policies designed to improve the productive capacity of the country and the efficiency of resources use. The donors have their own policies and strategies pertaining to foreign aid while Nepal has none. Therefore, it is crucial time to revive the policy in a scientific manner so as to utilize the aid money in a transparent, accountable and predictable way. In Nepalese context, after all foreign aid could be a powerful device for utilizing the economic development of the developing countries like Nepal. At the same time, the bureaucrats must be sincere, obedience and prompt in delivering effective services to the general people. If these services are conducted without any prejudices, the use of foreign aid must be used properly.

R.K. Shah (2061), in his article “utilization of foreign aid in Nepal: An Analysis”, he concluded that if foreign debt and aid utilized properly, there is no doubt that Nepal had become heaven. But large part of the foreign aid was finished by corruption. As a result the country become more and more poor and leaders become more and more rich. It must be restricted from government level by applying effective policy and clear opinion about foreign aid. This help to become a nation developed and strong.

N. K. Sharma (2061), in his book “Economics of Nepal” described briefly about the foreign aid and public debt. In this topic he described that foreign aid is “Necessary Evil” for poor and weak countries like Nepal. But on the other hand donor countries and agencies adopting the policy “No aid but trade”, due to the ineffectiveness of the foreign aid. Only after 1951, Nepal is introduced in the world. Then after Nepal started to get large amount of foreign aid. For example share of foreign aid in development expenditure of Nepal’s first five year plan in 100 percent. But the main problem in Nepal, there is reality on one side and the sectoral distribution on the other side. In other words, there is no utilization capacity of foreign aid in Nepal. This type of situation leads the country near to the “Debt Trap”.

C. Tiwari (2005), an article “Foreign Aid in Nepal: A brief analysis” published in vision of ECOSS concluded that, in developing countries, foreign aid is widely accepted as a means for the development. Without foreign aid the adequate mobilization of internal resources could not have been made in order to accelerate the rate of economic development and growth. For developing country like Nepal, foreign aid can play in

important role if it utilized efficiently. The function of aid for a development program should not be to raise standard of living in the recipient countries directly but to enable them to make the transition from economic stagnation to self sustaining economic growth. Foreign aid will be effective if it aims to utilize the internal resources to the maximum intent possible to invest the aid in private and public sectors for maximum social and economic progress and to invest in capital formation for the developmental programs.

A possible reason for the low disbursement at grant assistance can be attributed to the government's inability to come up with matching funds. Without complete transparency unrestricted access to information aid consistent and correct statistics it will be impossible to ensure efficient utilization of aid resources an into these sectors where aid funds can benefit both the country's development and the people for whom development is initiated in the first place. This calls for an urgent need to develop a transparent information management system.

M. Khanal (2005), an article "Foreign Aid Policy 2059: A Brief Review" published in vision of ECOSS, explained that there are lacuna; foreign aid policy has tried to address many issues. The policy must be precise and specific and should reflect the vision of the government. It should be based on the long term perspective. To achieve the targeted goal, government should be committed and take care to its implantation side.

Bamdev Sigdel (2062) in his article "Foreign Aid in Nepal" describes that, Foreign aid is one of the most original politico economic phenomena of the twentieth century. In addition, foreign aid has become a foundation to north-south relation 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 2 to 3 percent of their GDP. Political economic humanitarian and social concern motive especially bilateral aid from developed to developing countries. Similarly, the World Bank Groups and regional multilateral development bank's assistance program are confined to the development endeavors of de Nepal's experience of foreign aid was heralded by the point four program in 1951. Following this, China and USSR appeared in aid scenario in 1956 and in 1958. Nepal joined the Colombo plan in 1952 participated in Non-Aligned Conference in 1955 and became the member of UN, which paved the way for greater quantum of aid to Nepal

during '50s and '60s. The formation of "Nepal Aid Group" in 1976 was another milestone of Nepal's history of aid that led to substantial increase in aid during '70s, '80s, '90s. Nepal aid group accounts for about one-fourth of the total aid disbursement. The restoration of democracy in Nepal after 1990 gave further impetus for the expansion of aid through bilateral and multilateral donors.

Bamdev Sigdel (2062), in his article "Foreign Aid and Economic Development in Nepal" describes that, "In the eighties there was renewed emphasis within the development economics on the policies, institutions and incentives that promotes or constraint growth. A study of 56 developing countries found little connection between aid and per capita growth. However, among the countries in this sample had good economic management as measured by inflation, the budget deficit, trade regime, effectiveness of legal system, the extent to corruption, the connection was much stronger, those receiving substantial amounts of aid achieved per capita income growth rates of 3.7 percent while countries that received little and grew at only 2.2 percent. By contrast, the impact of aid was insignificant for the countries with bad economic management. In the real world, the opportunity costs of giving aid, benefit from receiving aid and the political concern of receiving government for its general public under go frequent changes.

G.B. Saud (2006), in his dissertation "Role of foreign aid in Nepal's development" analyze trend and structure of foreign aid, sectoral distribution of foreign aid, source of foreign aid contribution of foreign aid to the economic development of Nepal and provide suggestions and recommendation for the proper utilization of foreign aid. He used the descriptive and analytical method with secondary data in his study. He says that foreign aid play an important role in Nepal's development. But it has been unable to address the specific problem of equity and justice to ensure property in process of aid utilization. Nepal is facing a paradoxical situation in that she can neither promote her economy without aid nor she has been able to avoid the risk of becoming the victim of aid dependency.

This study has been helpful to select the research methodology, general concept about foreign aid, way of finding and analyzing data and drawing conclusions. This study also gives some information about the related literature such as books, journals etc.).

B. H. Wagle (2007), in his M.A. thesis "Foreign Aid in Nepal" presents the trend and

composition of foreign aid sectoral allocation of foreign aid, share of foreign aid in GDP, role of foreign aid in economic development of Nepal, role of foreign aid in the development of various sector and problem of foreign aid. He used completely secondary data and analyzed the data by using descriptive method.

He concluded that foreign aid helps bridge the gap between the short fall of the national saving to the national investment. It has supported to fill the gap between the excess of imports of goods and service over their exports. Foreign aid has proved to be an effective instrument contributing to significant improvements in various sectors of the roads, irrigation, facilities, hydropower as well as education and health services, drinking water and sanitation facilities have been built with foreign assistance. It has also contributed to the development of policy dialogue, catalyzed economic reforms, enhanced the capability of public policy makers and provided financial assistance for public services. Not with standing these achievement, foreign aid in Nepal has its short comings as well. Progress in economic growth and poverty reduction has not been commensurate with the inflow of aid into the country. Foreign aid has thus become very effective in some areas but less effective in others.

According to the Economic survey (2006/07), during the first eight- month of the FY 2005/06, foreign aid commitment totaled RS. 15 billion 966.2 million- commitment of grant amounted to RS. 14 billion 40.8 million (87.94percent) and the commitment of loan amounted to 1 billion 925.4 million (12.06 percent). During the same period of the current fiscal year (2006/07), foreign aid commitment amounted to RS. 25 billion 737.5 million- an increases by 61.2 percent compared to corresponding period of the previous fiscal year. Similarly, commitment at grant totaled to RS. 19 billion 574.8 million (76.05 percent) and the loan to RS. 6 billion 162.7 million (23.95 percent).

During the first eight- month period of the current fiscal year (2006/07) foreign aid commitment was rise up 40.9 percent as bilateral grant and 59.81 percent as multilateral grant. In the previous year, percentage of bilateral and multilateral grant was 65.96 percent and 34.04 percent respectively.

According to the Kantipur, Nepali National Daily, Friday, July 13, 2007 (budget speech 2064/65) gives more importance to foreign aid. According to the budget speech 2064/65, out of total amount of budget (RS. 1 kharab 68 arab 92 crore 56 lakh), the amount

of foreign aid is RS. 44 arab 82 crore 83 lakh and 44 thousand- grant is RS. 27 arab 46 crore 9 lakh and 14 thousand and loan is RS.17 arab 36 crore 74 lakh and 30 thousand. The share of foreign aid in this budget is approximately 26 percent (i.e.16 percent grant + 10 percent loan). Similarly according to the budget speech 2065/066 (2008/09), the total estimated amount of budget expenditure is Rs. 2 kharab 36 arab 1 crore and 59 lakhs. Out of this, the total estimated current expenditure is Rs. 1 kharab 28 arab 51 crore and 65 lakh, capital or development expenditure is Rs. 91 arab 31 crore and 1 lakh and principle repayment is Rs. 16 arab 18 crore and 93 lakh. The total estimated amount of foreign aid in this budget is Rs. 65 arab 79 crore and 38 lakh; which is the 27.88 percent of total estimated budget expenditure. Out of this the share of foreign grant is 19.95 percent and the share of foreign loan is 7.92 percent. On the other hand, the share of foreign aid on the total estimated capital or development expenditure is 72.06 percent. Out of this the share of foreign grant and loan is 51.58 percent and 20.48 percent respectively. This shows that the role of foreign aid in economic development of Nepal is must important. In other words, foreign aid is the necessary component of Nepalese economy.

Bishnu Aryal (2064) on his topic "The Role of Foreign Aid in Economic Development of Nepal: An Economic Analysis" describes "The estimation showed that foreign aid is significantly playing a positive role to increase the GDP per capita in Nepal. Such a positive role of the aid on GDP per capita growth leads to the conclusion that increased foreign aid helps to increase the rate of GDP per capita. Therefore, foreign aid needs to be increased in the country. A big amount of foreign aid does not necessarily mean a greater number of foreign aid agreement. Aid agreement could be less in number but disbursement has to be higher. Past data from 1974 to 2005 show that in an average 60 percent of aid is being disbursed from the total agreement amount.

Another important aspect of foreign aid is that recipient has to repay interest as well as principal if the aid is received in loan. More loan is always a big responsibility to recipient country because exchange rate could make the country to repay the loan and its interest in a higher amount in the future .

Bhubanesh Pant (2064) on the topic "Aid Effectiveness" describes that there is significant scope for improving foreign aid utilization in the country. Some measures include the following: a) development and implementation of foreign aid policy 2002 to

ensure the compatibility and convergence of foreign aided development activities with nationally determined priorities; b) improving the quality, effectiveness and efficiency of foreign aid operation and enhancing its contribution to poverty reduction through prioritization of proper projects; c) enhanced development partnership between Nepal and donor institutions; d) regular review of public expenditure to undertake procedural reform measures ; and enhance the spending capacity of the government; and e) prioritization of projects and programs to facilitate donor harmonization for aid effectiveness and coordination.

With the recent developments in Nepal, many countries such as India, the US, the EU and Japan have pledged support for the country's reconstruction and infrastructure development. Moreover, major international donors such as Germany's GTZ, World Bank, Asian Development Bank, and Britain's Department for Foreign International Development have also promised aid. Still Nepal's development experience with foreign aid reconfirms that large aid flows in a weak policy environment do hardly anything to boost growth. The sequencing of foreign aid is often more crucial for reforms and poverty reduction than the actual volume of aid.

G.K. Acharya (2064), in his article "Judging Aid Trends and Developing Experiences" explains that, here we may estimate that there is still a significant lack of leadership by recipient governments in requesting changes in donor behavior. How those assistance will be used and what their impact on at relationship will be remain unclear. The recipient governments need to be empowered to play a more proactive role in managing their relationship with donors, and overcome their fear of negative opinion of donors' performance. These conclusions clearly sketch the four elements to manage effective aid system for recipient developing countries.

- Recipient countries should develop clear policies on the criteria to accepting aid,
- Mutual commitments should replace one-sided conditionality,
- National and international forums need to be established where donors and recipients can review progress.
- New mechanism to increase the volume and predictability of aid need to be put in place.

CHAPTER - THREE

RESEARCH METHODOLOGY

3.1 Methodology

This study is mainly based on secondary data. Because of time constraint, financial constraint and other lack of resources, descriptive research (desk top research), comparative and analytical research methodologies have been used in this study. But at the same time few vital information have been generated by concerned stakeholders (key informants) dealing with the specific sector such as the foreign aid branch of Ministry of Finance as per need. This study has been adopted both quantitative as well as qualitative research method.

3.2 Nature and Source of Data

The analysis is mainly based on published materials and records of various offices. The appropriate data are collected from ministry of finance (MOF), National planning commission (NPC), World Bank (WB), Nepal Rastra Bank (NRB), central Bureau of statistics (CBS), Central Library of Tribhuvan University, Kirtipur, United Nations Development Program (UNDP) and others. Besides these, information has been collected from various articles, journals, magazines, newspapers, internet, unpublished thesis, different economic survey, budget speech, five year plan books, current three year interim plan book etc. The required data are also collected from the different practical methods such as interview with experts, professors, researchers, personnel of MOF with related to foreign aid.

3.3 Data Presentation and Analysis

Data analysis is the heart of the study that furnished (supplied) the derivation of conclusion. The collected data are processed according to the need of the study. The data acquired from secondary source has been analyzed qualitatively as well as quantitatively. The analysis of data has been done through various statistical tools like graphs, diagrams, pie-chart, tables etc, to meet the needs of the study. Other statistical tools such as simple regression model percentage and rank has been calculated where necessary and they have

been presented and analyzed in analytical way.

3.4 Statistical Tools for Analysis

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

a) Simple Regression Analysis

There are two types of variables in regression. The variable which is used to predict the variable of interest is called independent or explanatory variables. In addition, the variable whose value is to predict is called the dependent variable or explained variable. Here, GDP in time period t is supposed to be a function of foreign aid inflow in Nepal.

$$Y_{GDPt} = a + b F_{AIDt}$$

Where,

Y_{GDPt} = Gross Domestic Product at time period t

F_{AIDt} = Foreign Aid Inflow at time period t

a and b = Regression parameter

b) Double-Log Linear Model

The double log linear model depicts both the dependent and independent variables in the logarithmic form. The value of the coefficient in the logarithm form gives the

$$\ln y_t = a_0 + a_1 \ln F_t$$

where,

\ln = Natural logarithm

y_t = GDP at time period t

F_t = Foreign Aid at time period t

a_0 and a_1 = Regression parameter

3.5 Hypothesis

Null Hypothesis: $H_0 - a$: there is no significant relation between foreign aid and GDP in Nepal, i.e. $b = 0$.

Alternative Hypothesis: $H_1 - a$: there is significant relation between foreign aid to Nepal and GDP growth in Nepal, i.e. $b \neq 0$.

3.6 Statistical test of significance

a) Coefficient of determination (R^2)

Coefficient of determination explains how good is the fit of the estimated regression line to the simple observation of dependent and independent variables. Therefore, it is the measurement of the dispersion of the observations around the regression line. R^2 shows the percentage of the total variation of explained variables that can be explained by the explanatory variables of the multiple determinations and is the square of the correlation coefficient. The formula to derive R^2 is mentioned below:

$$R^2 = \frac{\sum_{i=1}^n \frac{y_i x_i}{\sum_{i=1}^n y_i^2} \left(\sum_{i=1}^n x_i^2 \right)^{-1/2} \left(\sum_{i=1}^n y_i^2 \right)^{1/2}}{\sum_{i=1}^n y_i^2}$$

Where, $y = \sum_{i=1}^n y_i$ and $x = \sum_{i=1}^n x_i$.

b) It is applied for judging the statistical reliability of the estimates of the regression coefficient. T-test, F-Test and D-W Test are implemented to test the hypothesis in the study.

T-Test

This test is applied in order to identify the statistical significance of the observed sample regression coefficient. The formula for deriving the value of T-Test is given below:

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

Where,

\hat{a}_i = estimated value of a_i

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

The calculated t values have been compared with critical or tabulated t-values at the certain level of significance for a given degree of freedom. If the calculated value of t-statistic exceeds the tabulated value, it implies that the best fit of parameter in the model.

F-Test

F-Test is used to examine the overall significance of the model. The formula for calculating F-Test is:

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

Where,

R^2 = coefficient of determination

K = number of explanatory variables

N = number of observation in the sample

The calculated value of F-statistic compared with tabulated value at the specific level of significance with (k-1) and (n-k) degree of freedom.

If $F_{cal} < F_{tab}$, we accept the null hypothesis.

If $F_{cal} > F_{tab}$, we reject the null hypothesis.

Where, F_{cal} = calculated value of F

F_{tab} = tabulated value of F

Durbin Weston (D-W) Test

D-W Test is defined as test for serially correlated (or auto correlated) residuals. One of the assumption of regression analysis is that the residuals for the consecutive observation are uncorrelated. The statistic is computed as:

$$d = \frac{\sum_{i=1}^n \hat{u}_i \hat{u}_{i-1}}{\sum_{i=1}^n \hat{u}_i^2} \quad \text{Where, } \hat{u} = \text{the estimated error term vector.}$$

3.7 Definition of the Variables

The following list of the definitions of terms and concepts are used in this study:

a) Commitment

A commitment is a firm obligations expressed in an agreement and supported by the availability of the public fund, undertaken by the donor, to furnish assistance of a specific amount under agreed financial terms and conditions and for specific purposes for the benefit of the recipient country.

b) Disbursement

Disbursement represents the actual international transfer of financial resources. They may be recorded at one of the 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.

c) Donor

The origin of funds for development assistance (multilateral, bilateral and non-government organizations).

d) Grant

A grant is the same as the provision of funds by a donor they do not require reimbursement from the recipient government/organizations. This includes “grant-like flow i.e. loans for which the original commitment stipulates that service payments are to be made into an account in the borrowing countries to the benefit of that countries.

e) Loan

The provision of resources, excluding food or other bulk commodities, for relief or development purposes, including import procurement programs, which must be repaid according to conditions established at the time of the loan agreement or as subsequently agreed.

f) Official Development Assistance (ODA)

Official Development Assistance is defined as these flows to developing countries and multilateral institutions provided by the official agencies. Foreign aid excludes the military aid and financial transfer to the INGO.

g) Recipient

The country which receive aid are commonly known as the recipient country.

3.8 Organization of the Study

This study has been organized and divided into seven chapters. The first chapter is related to introduction. This introduction chapter has been included the background of the study. Statement of the problem, objectives of the study, needs and significance of the study and limitation of the study. Second chapter is related to the review of literature. This chapter has covered the theoretical framework and related studies. Related study has further divided into two parts international context and Nepalese context. The chapter three deals with research methodology. It includes the methodology, nature and sources of data, data presentation, data analysis, statistical tools for analysis, statistical test of significance and organized of the study. The fourth chapter concern with foreign aid in Nepal. The chapter has included historical background, the beginning of the foreign assistance, mobilization of foreign aid in Nepal, aid negotiation procedure, trend and structure of foreign aid, sources of foreign aid, sectoral allocation of foreign aid, share of foreign aid in GDP and government expenditure. The fifth chapter related to contribution of foreign aid in Nepal. This chapter includes the sub-topics-resource gap and need of foreign aid, saving-investment gap and need of foreign aid, foreign aid in periodic plans of Nepal, foreign aid with various sectors. Foreign aid with various sectors has been further categorized on transport and communication sector; agriculture, irrigation and rural development sector; industrial sector; prover development sector and social sector. This chapter has also included the mathematical analysis of the study. Chapter six deals with burden and problems of foreign aid. In which the sub topics are foreign and commitment and disbursement, burden of foreign aid and measure problems related to foreign aid in Nepal. The last chapter covers the summary conclusion and recommendation.

CHAPTER - FOUR

FOREIGN AID IN NEPAL

4.1 Historical Background

The history of foreign aid in Nepal is not very old. Before Second World War or even pre-democracy period (i.e. before 1951 A.D.), Nepal was not familiar with integration of aid or not familiar with rest of the world. Whatever Nepal received aid before these periods was more concerned with the war or military assistance. It was not for any clear purpose of economic development.

The history of foreign aid in Nepal dates back in 1968 BS, when the “Pharping Hydroelectricity Project” was established. This assistance was provided by British Government. But there is also another view that, the first foreign aid was given by India for the construction of “Rail-way” from Amlekhgung to Rakshaul of India in 1985 B.S. But in formal or official term Nepal received first foreign aid under “Point Four Program” on 23rd January, 1951 A.D. with the government of America (U.S.A).

Nepal began receiving foreign aid since 1951, after the overthrow of 104 year Rana regime, that is the democratic system opened the economy outside the world. Nepal's first experience of foreign economic aid heralded by the Point Four Program agreement signed on January 23, 1951. The American Government's assistance of \$ 22000.00 provided under president Harvy Truman's Point Four Program was soon followed formal economic assistance from India in October in the same year (Sigdel, 1996). China and USSR joined in assisting Nepal's economic development in 1956 and 1958 respectively. Nepal's experience with economic development assistance offers a valuable source of answers to the queries about aid. Thrust into prominence by its strategic position in the Himalayas fastness separating Indian and China, Nepal has attracted unusual attention from aid donor (Mihaler, 1965).

Nepal joined the Colombo plan in 1952, participate in the first non-aligned conference in 1955 in Bandung and became a member of the United Nations and thus attracted the interest of the developed as well as developing nations in its development

efforts. The traditional policy of isolation and exclusion from the foreign acquaintance was actually replaced by a policy of open frontiers in international relation without aligning with any power block. All this further exposed Nepal to the outside world and opened up the door for diplomatic relations with a number of countries resulting in a better inflow of foreign assistance from varied sources.

In 1961, Nepal became the member of World Bank (WB) and International Monetary Fund (IMF). After 1969, WB and IMF started to give aid to Nepal. Nepal's participation in the conference of the non-aligned countries held in Belgrade (1961), Caris (1964) and Lusaka (1970) further attracted the foreign countries for rendering more and more aid to support Nepal development efforts. To the outside world, the country's neutral posture further expanded aid program for Nepal. Moreover, with the formation of "Nepal Aid Group" in 1976, the quantum of foreign aid increased more significantly in Nepal. 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 Aid Group accounts for about three-fourth of the total aid disbursement. The restoration of democracy in Nepal after 1990s further gave impetus for the expansion of more and more economic aid.

In recent years, most of the prime sectors of the economy are receiving foreign aid almost in every sector; several bilateral as well as multilateral donors are involved. Nepal has been getting foreign aid from two types of donors-bilateral and multilateral in the forms of the grant and loan. In the beginning, large amount of foreign aid was received in the form of grant. But gradually the share of grant is decreasing and the share of loan is increasing. Since 2002/03, the share of grant is greater than share of loan.

4.2 The Beginning of Foreign Assistance

The official record shows that Nepal has started receiving foreign aid in 1951 and the first official donor was USA, which gave \$22,000.00 under the Point Four Program in 23 January, 1951. The USA aid was immediately followed by formal economic assistance from India in October 1951. China and Switzerland commenced in 1956. The following table shows the beginning of formal aid to Nepal from different donors and their participated sectors.

Table No. 4 (A)**Different Multilateral Donors and Their Involvement (Sector-wise)**

Donors	Date	Sector
ADB	1969	Social (Education, Drinking Water), Transport (Road and Air Transport), Water Resources (Irrigation, Hydropower, Electricity Transmission), Agriculture (Cotton, Livestock, Horticulture, Agri-credit, Institution Building), Forestry and Industry.
WB	1969	Social (Education, Drinking Water Supply, Settlement), Agriculture (Extension, Research, Crop, Institution Building Storage), Water Resources (Irrigation, Hydropower) Transport (Road) Industry (Credit, Institution Building, Forestry, Other (Rural Development).
WHO	1954	Social (Health, Drinking Water, Institution Building).
UNDP	1960	Social (Education, Health, Drinking Water), Forestry, Agriculture, Industry, Water Resources (Irrigation, Hydropower), Transport (Road and Air Transport), Other (Institution Building, Decentralization, Policy Support).
UNFPA	1970	Social (Health, Population)
UNICEF	1960	Social (Health, Drinking Water Institution Building)
Kuwait Fund	1976	Water Resources (Hydropower)
OPEC Fund	1977	Social (Education), Water Resources (Irrigation, Hydropower), Transport (Road and Air Transport), Balance of Payment, Commodity Grants.
EEC	1982	Social (Drinking Water, Sewerage), Agriculture (Credit, Training, Livestock, Crop, Storage), Water Resources (Irrigation, Hydropower, Transmission, Watershed), Commerce, Local/Rural Development, Institution Building.
IMF	1969	Monetary Economy
SDF	1983	Water Resources (Irrigation, Hydropower), Transport (Road Transport), Other (Food Assistance).
IFAD	1997	Agriculture, Water Resources (Irrigation), Forestry, Others (Rural Development).

Source: Ministry of Finance (MOF)/N.

Table No. 4 (A₁)**Different Bilateral Donors and Their Involvement (Sectors-wise)**

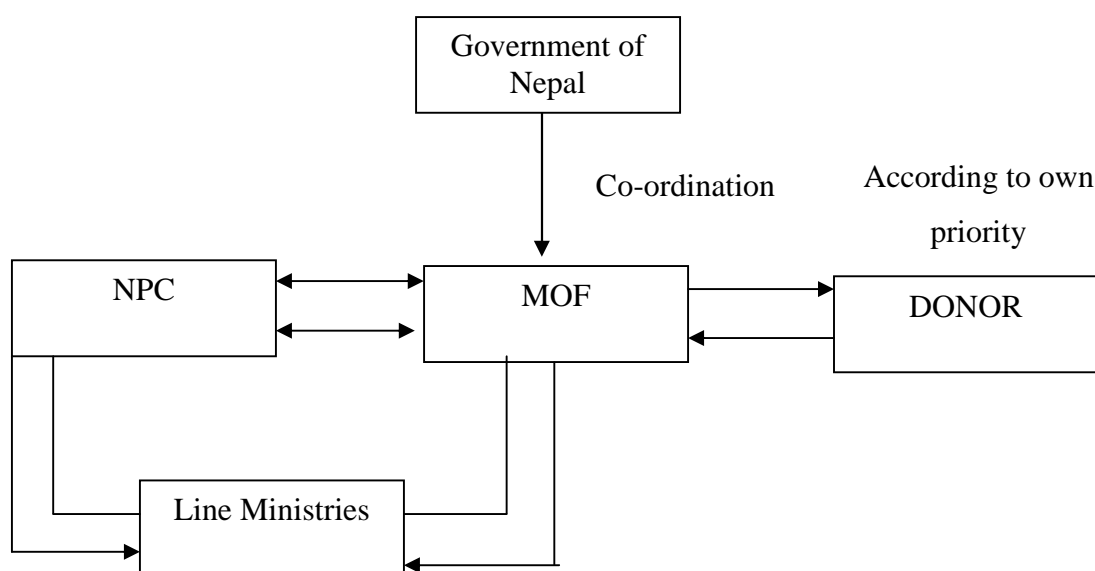
Donors	Date	Sectors
Austria	1979	Health, Education, Air Transport, Forestry, Institution Building and Rural Development.
Belgium	1982	Telecommunication
Canada	1971	Health, Education, Air Transport, Agriculture, Rural Development.
China	1956	Health, Sport, Road, Industry, Commerce, Hydropower, Irrigation.
Denmark	1980	Education, Health, Forestry, Dairy, Livestock, Telecommunication, Agriculture, Irrigation
Finland	1982	Health, Water Supply, Power, Forestry, T.U., Telecommunication, Agriculture, Irrigation Building.
Germany	1961	Health, Education, Drinking Water, Hydropower, Irrigation, Road, Air Transport, Industry, Horticulture, Veterinary, Telecommunication and Postal.
Italy	NA	Through EEC only.
Japan	1960	Health, Education, Water Supply, Hydropower, Irrigation, Road, Radio, Fishery, Store, Horticulture, Telecommunication, Electricity Distribution, Community Assistance.
Netherlands	1976	Health, Earthquake, Road, Forestry, Local Development, Bio-gas, Bee-keeping.
Norway	NA	Education, Hydropower, Watershed Management.
Sweden	NA	Through Multilateral Agencies.
Formar USSR	1959	Education, Road, Industry.
Switzerland	1956	Education, Resettlement, Health, Dairy Cheese, Veterinary, Road, Small Hydropower, Forestry and Local Development.
United Kingdom	1961	Health, Education, Water Supply, Storage, Tea, Institution Building, Road, Air Transport, Forestry.
USA	1951	Health, Education, Forestry, Institution Building (Agriculture), Local Development, Economic Liberalization, Democratic Institution Building.

Source: MOF, Donors Profile, 1996.

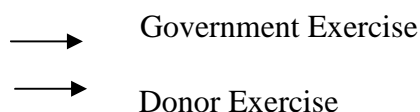
4.3 Mobilization of Foreign Aid in Nepal

In Nepal, Ministry of Finance (MOF) is the government line ministry to negotiate and modify foreign aid in the country. Besides Ministry of Finance, there are also departments, which directly or indirectly play role to mobilize aid. The following chart shows of foreign aid mobilization in Nepal.

Mobilization of Foreign Aid in Nepal



Indicator:



Source: The Post (Vol. 36, No. 147, 2055), Postal Training Center, Kathmandu

The above chart shows that according to own priority provide their aid through Ministry of Finance (MOF). MOF allocate the aid to line ministries and National Planning Commission for utilizing in priority sector. NPC makes plans and programmes for the government. After this MOF maintain the financial resources from internal and external sources. When the government tries to mobilize the external resource, MOF goes to donors with own selected priority. In short, major co-ordination role is played by MOF for mobilizing the foreign aid to Nepal. Various departments of different ministries of

Nepal generally mobilize programs through INGOs.

4.4 Aid Negotiation Procedure

Every ministry has planning and programming division headed by a chief planning officer who is responsible for

- 4) Formulation of policy plan and programs.
- 5) Preparation of the annual budget.
- 6) Development of monitoring and supervision mechanism.
- 7) Co-ordination with donors, NPC, MOF and concerned agencies.

The ministry of finance is a central agency to approve external resources received by an agency from any foreign from any foreign organization, institution and nation. In regard to the activities funded from external resources, the planning division of the concerned ministry prepares the projects proposal and forwards it to NPC for their approval and returns to the MOF. The MOF and the donor. Sometimes, the donor agency itself prepares the project proposal and forwards to the MOF directly through concerned line ministry for negotiation.

Having received the necessary comments from the concerned line ministries NPC, ministry of finance negotiates with the donor.

. The proposal is discussed with concerned authorities and related personnel. After incorporating necessary suggestion and amendments, the concerned ministry forwards the proposal to the ministry of finance for negotiation.

MOF has brought out foreign aid policy in 2002 outlining the aid guiding principles and objectives and aid priorities for the short run, major policies, major strategies, major policy instrument and future agenda. But it does not appear that these are being strictly followed in permanent and utilization of aid.

4.5 Trend and Structure of Foreign Aid

Nepal has been receiving foreign aid from both the bilateral and multilateral sources in the form of grant or loan. The pattern of foreign aid varies from projects to projects and donor to donor. In other words, the structure of foreign aid corresponding to different sources is different and depends upon the policy of donor countries. Some aid is tied up to projects, while others in the form of commodity assistance and some of the

assistance are simply in the form of the technical assistance. But broadly these various form can be grouped into the three headings: grant assistance, loan assistance and technical assistance. The share of loan was zero and all the foreign assistance was in the form of grant during FY 1950/51 to 1962/63. During FY 1963/64 to FY 1976/77, share of grant was more than 70 percent and share of loan was less than 30 percent. The share of grant is continuously decreasing and the share of loan is continuously increasing upto the restoration of democracy. After this the share of grant and loan changes in fluctuation rate.

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

- 1) Nepal's expanding international relations increased and diversified the source of aid.
- 2) The introduction of development plan helped it to rationalize the demand for aid, and
- 3) The bonus effect of the cold war and feeling of the competition among some donors pushed up the level of aid.

The following table shows the trend and structure of foreign aid in Nepal

Table No.4(B)
Trend and Structure of Foreign Aid (Rs. in million)

Fiscal Year	Total Foreign aid (Rs)	Foreign Grant (Rs)	Grant as a % of Total aid	Foreign Loan (Rs)	Loan as a % of Total aid
1975/76	505.6	359.70	71.14	145.90	28.86
1976/77	556.9	392.50	70.48	164.40	29.52
1977/78	848.8	467.00	55.02	381.80	44.98
1978/79	989.4	599.30	60.57	390.10	39.43
1979/80	1340.5	805.60	60.10	534.90	39.90
1980/81	1562.2	868.90	55.62	693.30	44.38
1981/82	1723.2	993.30	57.64	729.90	42.36
1982/83	2075.5	1089.70	52.49	985.80	47.51
1983/84	2547.5	876.60	34.41	1670.90	65.59
1984/85	2676.4	923.40	34.48	1753.00	65.52
1985/86	3491.5	1120.60	32.10	2370.90	61.90
1986/87	3314.4	952.50	28.74	2361.90	71.26
1987/88	5078.5	1984.20	39.07	3094.30	60.93
1988/89	5666.9	1478.30	26.09	4188.60	73.91
1989/90	6427.1	1798.80	27.99	4628.30	72.01
1990/91	5990	1630.00	27.21	4360.00	72.79
1991/92	7800.4	1531.00	19.63	6269.40	80.37
1992/93	9235.6	3273.90	35.45	5961.70	64.5
1993/94	11557.2	2393.60	20.71	9163.60	79.29
1994/95	11249.4	3937.10	35.00	7312.30	65.00
1995/96	14289	4825.10	33.77	9463.90	66.23
1996/97	15031.9	5989.00	39.84	9042.90	60.16
1997/98	16457.1	5402.60	32.83	11054.50	67.17
1998/99	16189	4336.60	26.79	11852.40	73.21
1999/00	17523.9	5711.70	32.59	11812.20	67.41
2000/01	18797.4	6753.40	35.93	12044.00	64.07
2001/02	14384.8	6686.20	46.48	7698.60	53.52
2002/03	15885.5	11339.10	71.38	4546.40	28.62
2003/04	18912.4	11283.40	59.66	7629.00	40.34
2004/05	23657.3	14391.20	60.83	9266.10	39.17
2005/06	22041.8	13827.50	62.73	8214.30	37.27
2006/07	25854.3	15800.80	61.11	10053.5	38.89

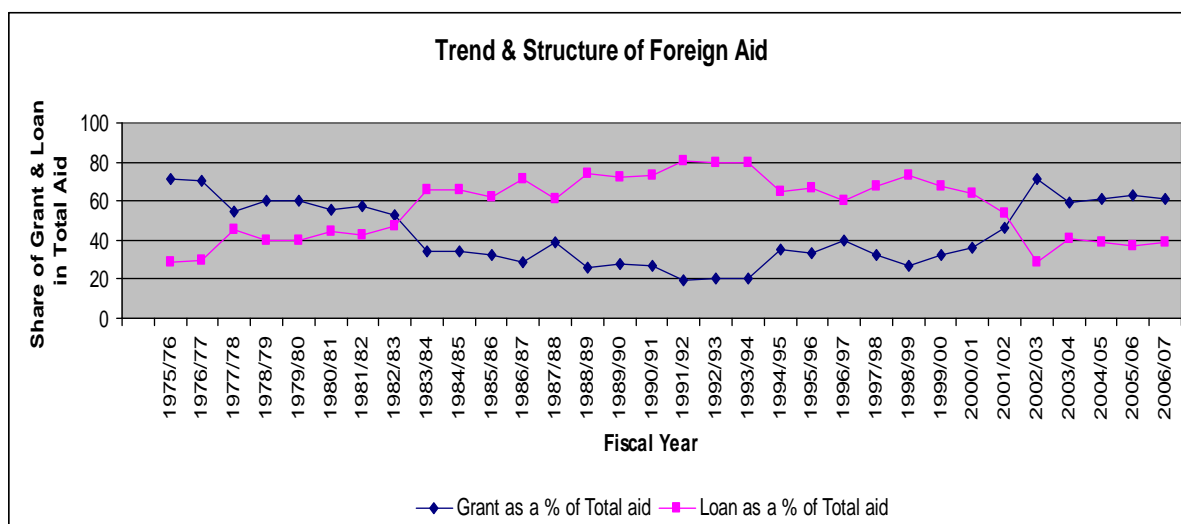
Source: Various Issues of Economic Survey, MOF/N.

Table 4(B) displays the declining share to grant aid and increasing proportion of loan assistance. During the pre-plan and first five year plan (1956-61), all assistance was entirely in the form of grants. Gradually the share of grant is decreasing. In FY 1975/76, the share of grant is 71.14 percent and the share of loan is 28.86 percent. Before the FY

1976/77, more than 70 percent of aid was received in the form of grant. But the situation changed after the year 1980s. Due to the emergence of new and bigger international leaders (especially IDA and ADB), providing bigger and bigger loan package, the share of grant began to fall. The grant component was greater than loan up to the FY 1982/83. But after the FY 1982/83, the share of loan in total aid was increasing at an increasing rate. After FY 2002/03, the share of grant is increasing and the share of loan is decreasing.

In the FY 1983/84, Nepal received Rs.2547.5 million, 34.41 percent of foreign aid in the form of grant and 65.60 percent in the form of loan. In the FY 1991/92, the foreign grant recorded the lowest, i.e. 19.63 percent of total foreign aid. After the FY 2002/03, again the grant component of foreign aid was increasing. In the FY 2002/03, Nepal received Rs.15885.5 million, 71.38 percent of foreign aid in the form of grants and 28.62 percent in the form of foreign loans. In the FY 2005/06, the share of grants is 62.73 percent and the share of loan is 37.27 percent. In this year, the total amount of foreign aid is Rs. 22041.80 million. Similarly, in the FY 2006/07, the share of grant and the share of loan is 61.11 percent and 38.89 percent respectively. In this way the share of grant is around 60 percent and the share of loan is around 40 percent during last five/six years.

Fig. 4 (A)



4.3 Source of Foreign Aid

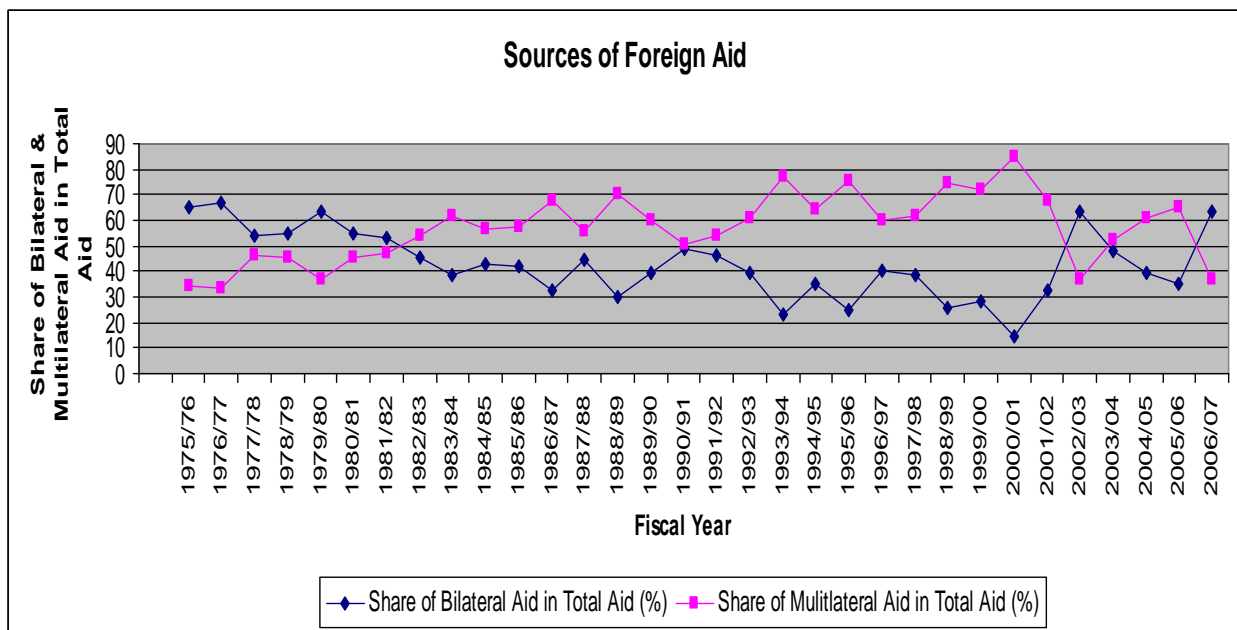
After the overthrow of the Rana Regime in 1951, Nepal has started to receive foreign aid from various sources for her economic development. Three kinds of donors stand out, who have been providing aid to Nepal over the past six decades. These kinds of donors are bilateral donors, multilateral donors and international non-government organization (INGO). The first refers to foreign government or their aid administering bodies in Nepal such as United State's USAID, Japan's JICA. Germany's GTZ, Switzerland's SDC, Denmark's DANIDA, Finland's FINIDA, the government of China, the USSR, the UK, India, France, Austria, New Zealand, Netherlands, Kuwait etc. Multilateral includes the international agencies like World Bank (WB), the Asian Development Bank (ADB), International Monetary Fund (IMF) and the UN sisters' organizations: UNDP, FAO, WHO, etc and the third type includes private organization such as Care Nepal, UMN, OXFAM, etc. The UN agencies provide mostly technical assistance and grants, where as the International Development Bank dispense both hard and soft loans. After the late 1970s, Nepal has been receiving foreign aid mostly from Nepal Aid Group.

The volume of aid from bilateral and multilateral source is presented in table below:

Table no. 4 c

Table 4 (C) show that the bilateral and multilateral sources of aid and their respective proportion in the total aid inflow. This table also presents that amount of grant and loan and their respective proportion in the bilateral as well as multilateral aid inflow. In the table, it can be seen that the share of bilateral aid has been gradually decreasing. The share of bilateral aid in total aid declined from 49.1 percent in the FY 1990/91 to 14.74 percent in the FY 2000/01, where as the share of multilateral aid in the total aid increased from 50.9 percent in the FY 1990/91 to 85.26 percent in the FY 2000/01. But in recent years the share of bilateral aid has been increasing. In FY 2002/03, the share of bilateral aid in total aid was 63.23 percent and the share of multilateral aid was 36.77 percent. In FY 2005/06, out of total amount of foreign aid, i.e. Rs.22041.8 million, the amount of bilateral aid was Rs.7658.4 million (i.e.34.74 percent) and amount of multilateral aid was Rs.14383.4 million (i.e.65.26 percent). Similarly, the share of bilateral aid in total aid was 63.46 percent and 36.54 percent respectively in the FY 2006/07. In this way, the above table shows that share of bilateral and multilateral aid decreasing and increasing in fluctuation trend.

Fig. 4(B)



4.7 Sectoral Allocation of Foreign Aid

The sectoral allocation of foreign aid shows the amount of foreign aid disbursed in different sectors and identifies the sector that has been given priorities. In other words, foreign aid assistance has been channeled in each and every sector of Nepalese economy such as agriculture, industry, transport, communication, power, social service and so on. The sectoral allocation of foreign aid is not smooth and has a fluctuating nature. Sometimes it seems that the foreign aid actually has not been allocated according to the target plan. This is due to the strategic interest of some donor countries. For example, neighboring countries such as India and China proposed certain road projects having strategic importance to them and Nepal.

All the donor countries were competing for “Prestige Projects,” which have high extrinsic demonstration effects both for donor community and Nepalese people. Some donors, who haven’t direct strategic interest in Nepal, provided aid for agriculture and institution building. In 1956, when Nepal started for planned development, it did not have required infrastructure like transportation and communication in the country. There was an indispensable need to link country through a modern transparent system, realizing its importance; road construction emerged as the priority investment at the initial periods. The following table gives the general information on sectoral aid priority during 1975/76 to FY 2006/07.

Sector

Allocation

The above table shows that foreign aid involved all major sectors of the Nepalese economy, i.e. Agriculture, Irrigation and Forestry; Transport, Power and Communication; Industry and Commerce; Social sectors and other sectors. In the FY 1975/76 the total aid distributed to agriculture, irrigation and forestry is Rs.125.1 million, transport, power and communication is Rs.230.7 million, industry and commerce is Rs.62.3 million, social sectors is Rs.86 million and other sectors is Rs.1.5 million. Maximum foreign aid is allocated on transport, power and communication during the FY 1975/76 to FY 2002/03. Second priority had been given to the agriculture, irrigation and forestry up to the FY 1996/97. In the FY 1996/97, Rs.2827.5 million was allocated on agriculture, irrigation and forestry, Rs.8504.5 million on transport, power and communication, Rs.23.4 million on industry and commerce and Rs.3665.0 million on social services. After the FY 1996/97, agriculture sector had been given to the third priority and the second priority had been given to the social services. But in the recent years i.e. FY 2003/04 to FY 2006/07, the highest amount of total foreign aid was allocated on social services, second and third larger amount was allocated on transportation sector and agriculture sector respectively. In the FY 2006/07, out of total foreign aid Rs. 15181.0 million was allocated on social services, Rs. 10525.0 million was allocated on transport, power and communication sector and Rs.3721.5 million was allocated on agriculture, irrigation and forestry sector. The least amount of total foreign aid was allocated on industry and commerce during last 25 years.

Thus, overall analysis of above it can be concluded that transport, power and communication and social sector has given the highest priority as compared to the agriculture, irrigation and forestry sector and industry and commerce sector during the last 25 years.

4.8 Share of Foreign Aid in GDP and Government Expenditure

Foreign aid plays an important role in the economic development of Nepal. In the overall welfare of the country, the increasing level of foreign aid can be argued to be necessary for further growth of economy. The increasing role of foreign aid is revealed even more clearly by the consistent rise in the ratio of aid to GDP. The following table shows the share of foreign aid in the GDP of Nepal from FY 1975/76 to FY 2006/07.

Table No.4(E)
Share of Foreign Aid in GDP and Government Expenditure (Rs. In million)

FY	Foreign Aid	GDP	Govt. Budget Expenditure	Share of Foreign aid (in%)		
				Aid/GD P ratio	%change in total aid	Govt. Budget Exp.
1975/76	505.6	17394	1,913.40	2.91	-	26.42
1976/77	556.9	17280	2,330.40	3.22	10.15	23.90
1977/78	848.8	19732	2,674.90	4.30	52.34	31.72
1978/79	989.4	22215	3,020.50	4.43	16.03	32.59
1979/80	1340.5	23351	3,470.70	5.74	36.17	38.62
1980/81	1562.2	27307	4,092.30	5.72	16.54	38.17
1981/82	1723.2	30988	5,361.30	5.56	10.31	32.14
1982/83	2075.5	33761	6,797.20	6.15	20.44	30.53
1983/84	2547.5	39390	7,437.30	6.47	22.74	34.25
1984/85	2676.4	44441	8,394.80	6.02	4.99	31.86
1985/86	3491.5	53215	9,797.10	6.56	30.54	35.64
1986/87	3314.4	61140	11,513.20	5.42	-5.07	28.79
1987/88	5078.5	73170	14,105.00	6.94	53.23	36.00
1988/89	5666.9	85830	18,005.00	6.60	11.59	31.47
1989/90	6427.1	99702	19,669.30	6.45	13.41	32.68
1990/91	5990	116128	23,549.80	5.16	-6.80	24.44
1991/92	7800.4	144932	26,418.20	5.38	30.22	29.53
1992/93	9235.6	164634	30,897.70	5.61	18.40	29.89
1993/94	11557.2	191596	33,597.40	6.03	25.14	34.40
1994/95	11249.4	209974	39,060.00	5.36	-2.66	28.80
1995/96	14289	239388	46,542.40	5.97	27.02	30.70
1996/97	15031.9	269570	50,723.80	5.58	5.20	29.63
1997/98	16457.1	289798	56,118.30	5.68	9.48	29.33
1998/99	16189	330018	59,579.00	4.91	-1.63	27.17
1999/00	17523.9	366251	66,272.50	4.78	8.25	26.44
2000/01	18797.4	393566	79,835.00	4.78	7.27	23.55
2001/02	14384.8	422244	80,072.20	3.41	-23.47	17.96
2002/03	15885.5	453698	84,006.10	3.50	10.43	18.91
2003/04	18912.4	474919	89,442.60	3.98	19.05	21.14
2004/05	23657.3	508651	102,560.50	4.65	25.09	23.07
2005/06	22041.8	646471	110,889.20	3.41	-6.83	19.88
2006/07	25854.3	719477	133,604.50	3.59	17.30	19.35

Source: Various Issue of Economic Survey, MOF/N.

From the above table, it was found that in FY 1976/77, total foreign aid was increased by 10.15 percent. In the FY 1977/78, the increased in total aid was found in double figure i.e.52.34 percent as compare to previous year. In the FY 1986/87, 1990/91, 1994/95, 1998/99, 2001/02 and 2005/06, total foreign aid was found negatively decline as comparative to respective previous fiscal year. In the FY 1987/88, the total foreign aid was found drastically increasing during the period 1975/76 to 2006/07, which was 53.23 percent.

In the FY 1975/76, the foreign aid/GDP ratio was 2.91 percent. Aid/GDP ratio was highest in the FY 1987/88, which was 6.94 percent. In the period between FY 1975/76 to 1978/79, the share of foreign aid in GDP was 3.72 percent. In the period between FY 1979/80 to FY 1989/90, the share of foreign aid to GDP, increased and reached 6.15 percent. During the period, FY 1990/91 to FY 2006/07, the share of foreign aid in GDP, was 4.83 percent. In total analysis, the share of foreign aid into GDP is increasing.

Initially, the share of foreign aid in the government expenditure was 26.42 percent. The share of foreign was increased upto 38.62 percent in the FY 1979/80. After the FY 1979/80, the share of foreign aid in the government budget was continuously decreasing upto the FY 1990/91. In the FY 1990/91, the share of foreign aid in the government expenditure was only 24.44 percent. During the FY 1990/91 to FY 1996/97, the share of foreign aid in the government budget expenditure was around 30 percent. After this, the share of foreign aid in the government budget expenditure was changed in fluctuation rate. During the FY 2000/01 to FY 2006/07, the average share of foreign aid in the government budget expenditure was 20.55 percent. In the FY 2006/07, the share of foreign aid was 19.30 percent in the government budget expenditure. Hence, it can be concluded that the average contribution of foreign aid in the government budget expenditure was around 20 percent.

CHAPTER-FIVE

CONTRIBUTION OF FOREIGN AID IN NEPAL

The contribution of foreign aid is very important in economic development of Nepal. In other words, foreign aid is necessary component of Nepalese economy. Most of the development expenditure was financed by the foreign grant and loan during last five and half decades. Today, without foreign aid Nepal is unable to construct any large and long gestation periods projects and programmes. Nepal's internal budget is only sufficient for the regular or administrative work. Hence, it is compulsion for Nepal that Nepal must attract to the large amount of foreign aid and foreign direct investment for development expenditure.

Nepal is one of such developing countries whose saving are low because of the low economic growth, high population growth, political instability and vice-versa. Because of the low level of income, level of consumption and capital formation is also low. To increase the consumption and capital formation, level of income should also be increased. To increase the income level of people government should increase the development expenditure. But there is lack of internal resources to increase the development expenditure. In this context, foreign aid is necessary component for economic development of Nepal.

Nepal had already completed the tenth five year plan during 1956 to 2007. In average, about 50 percent, of total development expenditure in every periodic plan was financed by the foreign aid. The development expenditure of first five year plan (1956-61) was completely financed by the foreign assistance. It is proposed that the large amount (i.e. about 50 percent) of development expenditure of current 11th three year interim plan is also depends upon foreign aid. In average about 25 percent of goverment expenditure in every budget of Nepal depends upon foreign aid. The share of foreign aid is 26 percent and 27.88 percent of total budget of FY 2007/08 and FY 2008/09 respectively. Most of the largest projects such as road, construction, hydroelectricity projects and irrigation projects was constructed with the help of foreign aid during last 56 years. Some small projects such as construction of school, college, hostel, health care

center etc. was also financed by foreign aid. In this way, it is concluded that foreign aid is necessary component for the economic development of Nepal.

5.1 Resource Gap and Need of Foreign Aid

The resource gap is defined as total budgetary expenditure which is more than the total budgetary revenue. When a country is spending more on investment and government expenditure than its earning from the resource through private saving and taxation, there will be 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 deficit budget system and this has supported the growing resource gap. Nepal has faces resource gap due to the centralized system of government, traditional nature of the tax administration, existence of donor's interest in aid supplies, etc. Deficit financing does not provide viable long-term solution because of its destabilishing and inflationary effect on the economy. In that situation, the proper utilization of foreign aid help to fulfill the increasing trends of resource gap. As a result development activities of a nation can be increased and the economy indicators such as economic growth rate, living standard of people, per capita income etc. will be improved. Greater stress must be placed on the mobilizing of domestic resources for financing the development efforts of Nepal. The following table shows the growing the financial resource gap in Nepal.

Table No.5(A)

		Resource Gap in Nepalese Economy					Rs in million
Fiscal Year	Expenditure				Actual Revenue	Resource Gap	% of Resource Gap with Total Exp.
	Recurrent	Capital	Principal Repayment	Total Govt. Budget Exp.			
1975/76	658.40	1,232.90	16.10	1,913.40	1,116.10	-797.30	41.67
1976/77	792.90	1,498.30	39.20	2,330.40	1,322.90	-1,007.50	43.23
1977/78	822.60	1,808.00	44.30	2,674.90	1,582.20	-1,092.70	40.85
1978/79	985.10	1,978.80	56.60	3,020.50	1,811.90	-1,208.60	40.01
1979/80	1,067.20	2,308.60	94.90	3,470.70	1,880.80	-1,589.90	45.81
1980/81	1,274.90	2,731.10	86.30	4,092.30	2,419.20	-1,673.10	40.88
1981/82	1,530.60	3,726.90	103.80	5,361.30	2,679.50	-2,681.80	50.02
1982/83	1,903.50	4,982.10	93.60	6,797.20	2,841.60	-3,955.60	59.28
1983/84	2,107.00	5,163.80	166.50	7,437.30	3,409.30	-4,028.00	54.16
1984/85	2,731.40	5,488.70	174.70	8,394.80	3,916.80	-4,478.00	53.34
1985/86	3,241.20	6,213.10	342.80	9,797.10	4,644.50	-5,152.60	52.59
1986/87	3,784.60	7,378.00	350.60	11,513.20	5,975.10	-5,538.10	48.10
1987/88	4,279.50	9,428.00	397.50	14,105.00	7,350.40	-6,754.60	47.89
1988/89	5,142.10	12,328.80	534.10	18,005.00	7,776.80	-10,228.20	56.81
1989/90	5,869.60	12,997.50	802.20	19,669.30	9,287.50	-10,381.80	52.78
1990/91	6,831.30	15,979.50	739.00	23,549.80	10,729.50	-12,820.30	54.44
1991/92	8,698.40	16,512.80	1,207.00	26,418.20	13,512.70	-12,905.50	48.85
1992/93	9,886.20	1,9413.60	1,597.90	30,897.70	15,148.40	-15,749.30	50.97
1993/94	10,511.00	21,188.20	1,898.20	33,597.40	19,580.90	-14,016.50	41.72
1994/95	16,611.90	19,794.90	2,653.20	39,060.00	2,4575.20	-14,484.80	37.08
1995/96	18,714.40	24,980.50	2,847.50	46,542.40	27,893.10	-18,679.30	40.13
1996/97	20,727.90	26,542.60	3,453.30	50,723.80	30,373.50	-20,350.30	40.12
1997/98	23,243.20	28,943.90	3,931.20	56,118.30	32,937.90	-23,180.40	41.31
1998/99	31,944.20	22,992.10	4,642.70	59,579.00	37,257.40	-22,321.60	37.47
1999/00	35,579.10	25,480.70	5,212.70	66,272.50	42,893.80	-23,378.70	35.28
2000/01	45,837.20	28,307.20	5,690.60	79,835.00	48,893.60	-30,941.40	38.76
2001/02	48,863.90	24,773.40	6,434.90	80,072.20	50,445.50	-29,626.70	37.00
2002/03	52,090.50	22,356.10	9,559.50	84,006.10	56,229.80	-27,776.30	33.06
2003/04	55,552.10	23,095.60	10,794.90	89,442.60	62,331.00	-27,111.60	30.31
2004/05	61,686.40	27,340.80	13,533.30	102,560.50	70,122.70	-32,437.80	31.63
2005/06	67,017.80	29,606.60	14,264.80	110,889.20	72,282.10	-38,607.10	34.82
2006/07	77,122.30	39,729.90	16,752.30	133,604.50	87,712.10	-45,892.40	34.35

Note: Before FY 2004/05, expenditure was classified as regular and development expenditure. Since FY 2004/05, such expenditure has been classified as recurrent, capital and principal repayment. Principal repayments used to be one of the components of regular expenditure. While coconstructing this series principal repayments has been dissegrgated from regular expenditur during FY 1975/76 (2032/33) to FY 2003-04)

Source: Economic Survey.

The above table shows that every year the resource gap has been growing up. In FY 1975/76 the initial resource gap was Rs. 797.30 million. It was increased to Rs. 12820.3 million, Rs. 30941.5 million and Rs45892.4 million in the FY 1990/91, 2000/01 and 2006/07 respectively. But the percent of resource gap with total expenditure is least in the FY 2003/04 i.e. 30.31 percent and highest in the FY 1982/83 i.e. 59.28 percent. According to the above table, the percent of resource gap with total expenditure is higher than 30 percent every year. This higher amount of resource gap is fulfilled by foreign aid. Hence foreign aid is considered as an important instrument for the economic development of Nepal.

5.2 Saving-Investment Gap and Need of Foreign Aid

In a macro-economic context, foreign aid is considered as an instrument to fill up the resource gap of the recipient economy. This gap can be defined in terms of savings, foreign exchange and technology skills. So, we can analyze, to what extent foreign aid, has been successful in bridging these three types of resources gap in Nepal, but here, we have taken into account the saving-investment gap only. In Nepal there is increasing trends of saving-investment gap. Because of the low economic growth rate and per capita income, the saving is always lower than investment in Nepal. The following table shows the saving-investment gap in Nepal during FY 1975/76 to FY 2006/07.

Table No.5(B)
Saving Investment Gap in Nepal
(at current price)

(Rs. in million)

Fiscal Year	Total Saving (S)	Total Investment (I)	Gap (S – I)
1975/76	2040.00	2632.00	-592.00
1976/77	2332.00	2768.00	-436.00
1977/78	2540.00	3507.00	-967.00
1978/79	2585.00	3514.00	-929.00
1979/80	2591.00	4270.00	-1679.00
1980/81	2974.00	4808.00	-1834.00
1981/82	3088.00	5314.00	-2226.00
1982/83	2887.00	6628.00	-3741.00
1983/84	3996.00	7351.00	-3355.00
1984/85	6239.00	10184.00	-3945.00
1985/86	5887.00	10599.00	-4712.00
1986/87	7321.00	12898.00	-5577.00
1987/88	7604.00	15237.00	-7633.00
1988/89	10150.00	19415.00	-9265.00
1989/90	8143.00	19076.00	-10933.00
1990/91	11511.00	25074.00	-13563.00
1991/92	16207.00	31619.00	-15412.00
1992/93	23172.00	39653.00	-16481.00
1993/94	29220.00	44644.00	-15424.00
1994/95	32465.00	55231.00	-22766.00
1995/96	34426.00	68017.00	-33591.00
1996/97	39162.00	71084.00	-31922.00
1997/98	41438.00	74728.00	-33290.00
1998/99	46563.00	70061.00	-23498.00
1999/00	57577.00	92272.00	-34695.00
2000/01	62018.00	99301.00	-37283.00
2001/02	51281.00	102174.00	-50893.00
2002/03	54778.00	118020.00	-63242.00
2003/04	62386.00	130993.00	-68607.00
2004/05	66336.00	154132.00	-87796.00
2005/06	64711.00	176483.00	-111772.00

Source: Various Issues of Economic Survey.

The above table of a total saving investment data shows that the gap between them is raised sharply up to Rs. 111772.0 million in the fiscal FY 2005/06 from Rs. 592.00 million in the FY 1975/76. The lowest and highest gap between saving and investment is Rs. 436.0 million in FY 1976/77 and Rs. 11172.0 million in FY 2005/06 respectively. The

above table shows that saving and investment is increasing every year. But the investment is increasing sharply than saving. Before FY 1998/99, the saving-investment gap is changing fluctuation rate. But after FY 1998/99, the saving-investment gap is increasing continuously.

Internal and external sources are the key factors that will bridge the gap prevailing in the economy. Internal borrowing first of all can be taken as a necessary element of fulfilling the gap, but it can be sufficient in itself. Because of that, country like Nepal, where GDP/GNP per capita is in the least amount instead that MPC being almost one, whatever they earn will be spent for the consumption purpose. So, internal borrowing will not be effective as we expect. On the contrary, external sources that include grant and loan can be effective means to solve the problem of saving-investment gap. The gap that exists in between saving and investment is so wide. It is not possible for Nepal to sustain her growth if she is entirely dependent on her own domestic savings. It is in this context that foreign aid seems to be almost inevitable condition of development.

5.3 Foreign Aid in Periodic Plans of Nepal

In order to improve the Nepalese economy, Nepal needs to undertake new strategy. So, the government is initiated to make plan for economic development. In 1956, Nepal has launched its first five year plan. Between 1956 to 2007, ten development plans have been implemented and 11th three year interim plan (2007-10) has already started. In different periods, the different plans have tried to solve the different problems of country and initiate various concepts of development. During these plans, foreign aid has played a significant role of Nepalese economy. The development expenditure of first five-year plan was completely financed by foreign aid. Large amount of other remaining plans development expenditure was also financed by the foreign aid. The following table shows the contribution of the foreign aid in public sector development expenditure of the different plan period.

Table No. 5(C)
Share of Foreign Aid in Development Expenses in Different Plans in Nepal
(Rs. in million)

Plan Period	Development Expenditure	Foreign Aid	Foreign Aid as an % of Development Expenditure
1 st Plan (1956-61)	382.9	382.9	100.0
2 nd Plan (1962-65)	614.7	478.3	77.81
3 rd Plan (1965-70)	1639.1	919.8	56.12
4 th Plan (1970-75)	3356.9	1509.1	44.96
5 th Plan (1975-80)	8870.6	4264.1	48.07
6 th Plan (1980-85)	21750.0	13260.0	60.97
7 th Plan (1985-90)	48345.4	23978.5	49.60
8 th Plan (1992-1997)	113519.1	74355.0	65.50
9 th Plan (1997-2002)	215154.4	114290.0	53.12
10 th Plan (2002-07)	234030.0	134620.0	57.52
11 th Plan (2007-10)	28030.1	14066.0	50.18

Source: Different Five Year and Three Year Plans.

From the above table 5(C), it is seen that the contribution of foreign aid as a percent of development expenditure has gradually decreased from 100.0 percent in first plan to 44.96 percent in the fourth plan. After the fourth plan, the percent has been fluctuating. In the eighth plan, it reached at 65.5 percent and in the ninth plan, it again decreased at 53.12 percent. In the the tenth plan it reached at 57.52 percent of the total development expenditure for 6.2 percent growth rate. For 4.3 percent growth rate, foreign aid, is estimated to finance 67.1 percent of the total development expenditure. In the 11th three year plan, it is estimated that 50.18 percent of development expenditure will be financed by foreign aid. The amount of foreign aid is Rs.14066.0 million out of total development expenditure (i.e. Rs.28030.1 million) in 11th plan. It indicates the significant role of foreign aid in Nepal.

The priority sectors of different plans seen to be different. The first and second plans had the priority to build the foundation for economic planning and the third plan concentrated with development of agriculture sector. The fourth, fifth, sixth, seventh and eighth plans have the priority in sustainable development. The ninth and tenth plans have

totally concern on reduction of poverty in Nepal. With the various priorities in different plan period, foreign aid has played significant role.

5.4 Foreign Aid with Various Sectors.

The measure of contribution of foreign aid in different sectors is very complex, because aid gives rise to multidimensional effects in the economy. Many others factors too contribute to improving the indicators of different sectors of the economy. Besides such factors, many projects were heavily supported by foreign aid. Without foreign aid there is not any important contributions of such other factors. There are various sectors such as transport and communication sector, agriculture sector, industrial sector, social sector etc. are heavily financed by foreign aid in Nepal.

5.4.1 Transport and Communication Sector

Transport and communication are taken as complementary elements for the economic development of the country because the development of all industry, agriculture, trade and several other aspects of country hinges on the degree of transport and communication development. Nepal has recorded impressive achievement with the help of foreign aid to the expansion of transport and communication system in the kingdom. Perhaps this sector is the only area where most of the donors have involved themselves. India, China, USSR, UK, etc. have undertaken road construction projects. In addition, the multilateral donors such as the UNDP and the World Bank, have also contributed to construction of the road network. The following table shows the road constructed in Nepal.

Table No. 5(D)
Road Construction by India, China and Other Countries

Name of the Road	Kilometer	Donor's Name
Tribhuvan Rajpath	116	India
Sunauli-Pokhara	200	India
Koshi Area Road	42	India
East-West Highway	504	India
Dakshinkali Road	19	India
Kathmandu-Godwari Road	16	India
Kathmandu-Trishuli	69	India
Kathmandu-Kodari Highway	104	China
Kathmandu-Pokhara Highway	174	China
Kathmandu-Bhaktapur	13	China
Gorkha-Narayanghat Highway	61	China
Pokhara-Baglung Highway	73	China
Kathmandu Valley Ring Road	28.2	China
Gorkha-Narayanghat Highway	55	China
Hetuada-Narayanghat Highway	83	ADB
Dhangadi-Dadeldhura	135	USA
Hetauda-Kathmandu	26	-
Janakpur-Simara	110	USSR
Butwal-Narayanghat	113	UK
Dharan-Dhankuta	52	UK
Jogbani-Dharan	67	UK
Total	2060.2	

Source: Department of Road

The above table shows that the major highway such as Tribhuvan Rajpath (116km), Sunali-Pokhara Road (200km), East and West with eastern position of 254 km between Kakadbhita and Dhalkewar and the western sector of 250 km between Butwal and Kohalpur, Koshi Area Road (42km), Daksinkali Road (19km), Kathmandu-Trishuli Road (69km) and Kathmandu-Godawari Road (16km) have been completed by the Indian

assistance. Upto the first eight months of FY 2006/07, the total length of road is 17,609 km including black topped, graveled and fair-weather. The total length of road construction by India is 966 km which is the 5.49 percent of total road length in Nepal.

The Kathmadu-Kodari Highway (104km), Kathmandu-Pokhara Highway (174km) and other important highways have been constructed by China. Likewise USA and USSR have been constructed the Dhangadi-Dadeldhura Road (135km) and Janakpur-Simara Road (110km) respectively. ADB and UK have been given important contribution for road network in Nepal. The share of road constructed by foreign countries is 11.70 percent.

Besides these, India and other countries had also constructed many smaller airport in various part of the country.

The transportation system has a positive impact on the socio-economic life of people of the country. The transport and communication infrastructure mentioned above represents the symbol of economic development efforts made through foreign assistance programmes. However, the development of transport network has some negative impact too.

5.4.2 Agriculture, Irrigation and Rural Development

Large number of population of Nepal has to dependent on agriculture. Agriculture is the main backbone of Nepalese economy. The contribution of agriculture in GDP and total export is approximately 36% and 70% respectively. But the agriculture production in Nepal is increasing at a decreasing ratio. So, the government has to increase agriculture productivity. Due to the lack of internal resources both farmers as well as government cannot provide sufficient investment for agriculture and irrigation projects. In such circumstances there is only way to supply the lack of investment on agriculture sector with foreign assistance.

Without irrigation facilities, agriculture productivity can not be increased. Considering the importance of this sector, foreign donors have tried to provide better irrigation facilities. Almost all major and middle irrigation facilities are provided under foreign aid programme. In the first eight months of FY 2006/07, the government agencies and the bank have provided irrigation facilities to 12530ha and 128ha of land

respectively. Besides these providing fertilizers, better seeds and machinery tools, foreign donors have also provided technical assistance. Foreign donors have also been providing food grains to meet food crisis faced in different years. Most of the US and Indian aid are used for agriculture and rural development. The following table shows the some irrigation projects constructed through foreign aid.

Table No 5(E)**Major Irrigations Projects (million US\$)**

Projects	Donors Assistance	GON	Total	Name of the Donors	Irrigated Area (ha)
1. Sunsari Morang Irrigation Project	83.47	12.61	96.08	WB, IDA	41550
2. Nepal Irrigation Sector Programme	79.77	23.85	103.02	WB	59600
3. Bagmati Irrigation Project	25.42	25.9	51.32	SDF, Japan	37000
4. Paganna Irrigation Project	4.61	0.89	5.5	KFAED	10460
5. Mahakali Irrigation Project	41.231	7.769	49	WB	11600
6. Rajapur Irrigation Project	16.62	4.1	20.72	ADB	15000
7. Irrigation Sector Program	26.468	3.3085	33.085	ADB	63400
8. Narayani Irrigation Program	NA	NA	NA	WB	24700
9. Marchwar Shipt Irrigation Project	5.638	0.776	7.414	UNCDF	7600
10. East Rapti Irrigation Project	NA	NA	NA	ADB	8516
11. Kankai Irrigation Project	NA	NA	NA	ADB	7000
12. Kamala Irrigation Project	NA	NA	NA	ADB	25000
13. Chitwan Irrigation Project	NA	NA	NA	ADB	10400
14. Manusmara Irrigation Project	NA	NA	NA	ADB	58000
15. Banganga Irrigation Project	NA	NA	NA	ADB	6500
16. Mohana Irrigation Project	NA	NA	NA	Korean	3500
17. Dhawalagiri Irrigation Project	5.585	0.97	5.585	Denmark	2196
18. Community Syalo Tubwal Irrigation	7.6	0.96	8.8	IFID	48,000
19. Community Underground Irrigation Sector Project	32.82	5.3	42.82	ADB, SIDA	69000
20. Nepal Irrigation Sector Program (Underground)	NA	NA	NA	WB	7500

Source: Department of Irrigation

NA : Not Available, GON: Govt. of Nepal.

The above table shows that largest amount of total expenditure of major irrigation project was financed by donors assistance. Such as Sunsari Morang Project was financed US\$ 83.47 million by donors and US\$ 12.61 million by government of Nepal. Hence, donors assistance played an important role for construction of major irrigation project. These irrigation project helped to increase the productivity of agriculture and living standard of Nepalese people.

5.4.3 Industrial Sector

Industrial development is a sign of developed country and industrial development mainly depends on power. The industrial development of Nepal shows a large contribution of foreign assistance. All the so-called big industries have been established with foreign assistance. These industries have changed industrial composition and modern technology in the manufacturing activity. A large number of industries established by foreign donors generally show a breakthrough from agro-based industry to diversified activities. By establishing the industrial units foreign donors have provided sufficient base for the development of tourism industry. The following shows the contribution of foreign aid for establishment of major industries.

Table No.5 (F) Foreign Aid Received in Industrial Sector

Name of the industry	Donor Countries
1. Industrial Estates in Patan	India
2. Industrial Estates in Dharan	India
3. Industrial Estates in Nepalgunj	India
4. Industrial Estates in Balaju	USA
5. Industrial Estates in Hetauda	USA
6. Harisiddhi Bricks and Title Factory	China
7. Bansbari Leather Shoe Factory	China
8. Bhirkuti Paper Mill, Gaindakot	China
9. Lumbini Sugar Mill	China
10. Birgunj Sugar Mill	Russia
11. Janakpur Cigarette Factory	Russia
12. Agricultural Tools Factory, Birgunj	Russia

Source: Ministry of Industry

The above table shows that the main industrial units such as Balaju, Patan, Dharan, Nepalgunj, Hetauda, Birgunj Sugar Mill, Lumbini Sugar Mill, Janakpur Cigarette Factory etc. are the outcome of foreign aid. In this way, the contribution of foreign aid for industrial development is also significant.

5.4.4 Power Development Sector

The contribution of foreign donors in the domain of power development is very significant. The hydropower potentiality in Nepal is estimated to be 83000 MW, of which about 43,000 MW has commercial potential. When the first-five year plan started, the economy processed 2.077 MW of hydroelectric power and 4.203 MW of diesel-generated power. At the end of FY 2005/06, a total of 556.4 MW of hydropower was generated from various power project, 55.020 MW of thermal power plant and 100 KW of solar plants. This adds up to 611.529 MW of total production. It is significant to note that almost all the hydropower projects are fully assisted or partially co-ordinated by foreign donors. The following table shows the foreign aid in hydropower development sector.

Table No. 5(G)**Foreign Aid in Hydropower Sector**

(Rs in million)

Project Name	Donor Agency Loan No.	Loan Amount
1. Kulekhani Hydro-Electricity Project	WB, OECF, IDA	114.363
2. Dumkibas Butwal 132 K.V.T.L.	French Loan	56.94
3. Bharatpur Pokhara 132 K.V.T.L.	ADB 250, NEP (SF)	3.678
4. Hetauda Biratnagar 132 K.V.T.L.	ADB 447 NEP " "	197.213
5. Butwal Nepalgunj 132 K.V.T.L.	ADB 533 NEP " "	192.883
6. Small Hydro Project	ADB 512 " "	303.087
7. Nepalgunj Mahedranagar 132 K.V.T.L.	French loan	115.144
8. Attariya Dpayal 66 K.V.T.L.	" "	15.241
9. Hetauda Gandak 132 K.V.T.L.	ADB 249 NEP	47.95
10. Biratnagar Distribution Sys. Rein.	ADB 447 NEP (SF)	36.651
11. Marshyangdi 132 K.V.T.L.	ADB 708 NNP (SF)	74.118
12. Marshyangdi Hydroelectric Project	KFW, IDA, Sondi	4841.236
13. Mashyangdi Project (interest)	GON	1056.789
14. Loss Reduction Project	IDA 1478	346.335
15. Seventh Power Project	ADB 1011, NEP (SF)	2300.925
16. Sixth Power Project	ADB 708 " "	781.432
17. Fifth Power Project	ADB 670 " "	462.487
18. Fifth Power Project	NDF/FEC 129	960.84
19. Kulekhani Dister Prevention (I)	OEFC Japan	1664.878
20. Dembre Besisahar/HV Spare Parts	NDF 37	344.888
21. Power Sector Efficiency Project	IDA 2347	2636.956
22. Khimti Bhaktapur 132 K.V.T.L.	NDF 223	135.38
23. Kulekhani Dister Prevention (II)	JIBC, NEP-6	15895.426
24. Modikhola Hydroelectric Project	Korean	851.801
25. Kaligandaki Hydroelectric Project	ADB 1452, NEP	12432.64
26. Kaligandaki Hydroelectric Project	JBIC	9029.729
27. Load Dispatch Center Ext. Project	KFW	1449.474

Source: Nepal Electricity Authority.

The above table indicates that huge amount of foreign assistance was financed for major hydroelectricity project. According to the above table amount Rs.57337.14 million foreign assistance was expended for above projects. These project had helped to generate the hydroelectricity in Nepal. In other words, the major projects such as Kulekhani, Marshangdi etc. which are financed by foreign aid helped for modernization of the country.

5.4.5 Social Sector Development

Foreign aid has played a greater role in providing more educational and health facilities as well as in implementing family planning programs successfully. Although net effect of foreign aid in social sector can't be measured quantitatively due to the absence of statistical data. It has brought a great change in the quality of life in the country. As a result, foreign aid in education, there has been an increase the literacy rate from 4.4 percent in 1954, 11 percent in 1971, and 53.7 percent in 2001.

The health sector has also developed significantly with the support from different donors agencies and institutions. Before implementation of the first year plan the number of hospitals were only 23. But upto the FY 2005/06, the number of hospitals reached 87, Health Centers 6, Health Posts 699, Ayurvedic Service Center 293, Sub-health Posts 3131 and Primary Health Center 180. To maintain that types of situation, the contribution of foreign aid is too much important. Different donors have provided significant of assistance in development of social sector. The following table shows the contribution of foreign aid in education sector in Nepal.

Table No.5(H)
Foreign Aid in Education Sector

Projects/Programs	Donors Name	Donors Contribution	GON	Total
1. Basic and Primary Education Project	WB, DANIDA, UNICEF	7.36	NA	NA
2. Basic and Primary Education Project	DANIDA, DFID, EUNORAD, FINDIA UNICEF	120.0	5.00	125.0
3. Seconadry Education Development Project	ADB, DFID, UK	34.00	NA	NA
4. Education for all Programme	DANIDA, DFID, NORAD, FINIDA, WB	158.0	NA	NA
5. Teacher Education Project	ADB	19.6	6.3	25.9
6. Secondary Education Support Programme	ADB, DANIDA	60.0	14.83	74.83
7. Primary Education Physical Facility Programme	JAPAN	17.2	1.6	18.8
8. Higher Education Second Project	WB	60.00	NA	NA
9. Food for Eucation Second Project	WFP	33.24	3.84	37.88
10. Comm.School Suppport Project	WB	5.11	NA	NA

Source: Education vision for the 21st century by Ramswrup Sinha, NA = Not Available

The above table no.5(H) represents that most of the projects, which are

related to the education are heavily financed by foreign assistance. The share of donors contribution in each projects of above is more than the contribution of government of Nepal. Such as, the second education support program was financed US\$ 60.00 million by ADB, DANIDA and US\$ 14.83 million by the government of Nepal. This indicates the high contribution of foreign assistance in education sector. Besides this, the contribution of foreign aid is also significant in health sector.

5.4.5.1 Drinking Water Sector

Since, 1975, various donor agencies such as the world Bank, UNDP, the Japanese government and the Norwegian government have been assisting expanding and improving the water supply system. The following table shows the contribution of foreign aid in the field of drinking water.

Table No.5(I)
Foreign Aid in Drinking Water

Project	(Rs. in million)			Name of Donors	% share of donor fund
	Donors Assistance	GON	Total fund		
1. First Water Supply and Sewerage Project	11.80	3.00	14.80	WB	79.73
2. Second " " "	8.00	2.50	10.50	WB	76.19
3. Third " " "	28.00	4.00	32.00	WB	87.50
4. Urban Water Supply, Sanitation and Rehabilitation Project	15.00	4.00	19.00	WB	78.95
5. Kathmandu Valley Water Supply Improvement Project	15.04	1.28	16.32	JICA	92.16
6. Monohara Drinking Water	18.00	5.00	23.00	Japan	78.26
Total	95.84	19.78	115.62		82.89

Source: NWSC, Annual Report 2061/62 (2004/05)

The table shows that the share of donors assistance in every water supply project is more than 79.7%. In average the share of foreign aid in above six major projects was 82.89 % and the share of Nepalese gov was 17.11 %. The above statistical data proved that important contribution of foreign assistance in drinking water sector.

5.5 Mathematical Analysis of the Study

For the positive impact of foreign aid on the economic growth and the overall welfare of the country, there must be positive relationship between Gross Domestic Product (GDP) and foreign aid. In other words, there must be direct relationship between GDP and foreign aid for economic development of the country. Moreover, other things remaining the same, as foreign aid increases there is also increase in GDP and vice versa, for positive impact of foreign aid on the economy. To prove the above relation, the basic starting point is the examination of a relationship between GDP and foreign aid. To calculate the regression equation, T-test, F-test, D-Wtest, R- square, standard error etc. of the table no. 4(E), there is using the SPASS program. By using this program, the following results has been obtained (for more information see appendix).

$$Y_{\text{GDPT}} = -29624.46 + 24.825 F_{\text{Aid t}}$$

$$t = (-1.92) \quad (19.64)$$

$$P = (0.064) \quad (0.00)$$

$$S.E = 15393.98 \quad 1.264$$

$$F = 385.73$$

$$R^2 = 0.928$$

$$D-W = 0.787$$

In the above equation, since the coefficient of foreign aid is positive (i.e. 24.825), it means, there is a positive relationship between GDP and foreign aid inflows. In other words, GDP is the positive function of foreign aid, i.e. if you increase one million foreign aid, the GDP will be increased by 24.825 million. This indicates the important contribution of foreign aid in the Nepalese economy. The coefficient 'a' tells us the average value of GDP, when the coefficient of foreign aid is zero. As the value of 'a' is negative its impact on GDP is also negative. In other words, if there is zero amount of foreign aid, GDP will be decreased by Rs. 29624.46 million.

The value of R^2 (unadjusted coefficient) is 0.9278, which implies that about 92.78 percent of variation in dependent variable (i.e. GDP) is explained by the independent variable (i.e. foreign aid). The value of R^2 ranges from 0 to 1. As the value of R^2 is 0.9278 or 92.78 percent approaches to 1, the regression plane thus estimated is good fit.

The above value of standard error of regression line is a good measure of

precision in the prediction of dependent variable (i.e GDP) based on the regression equation, given the value of independent variable (i.e. foreign aid). The coefficient of foreign is very significant as indicated by its 't' value, which is greater than the tabulated value of 't' at 5 percent level of significance and a given degree of freedom. The value of 'F' is also significant, as the calculated value of 'F' is larger than the tabulated value of 'F'.

From the D-W table, we find that for $n=32$, and number of explanatory variable $k=1$ at 5 percent level of significance, $d_L=1.373$ and $d_U=1.502$. Since the value of D-W or d is less than d_L (i.e, $d=0.787 < d_L=1.373$). In other words, $0 < d < d_L$, there is positive auto-correlation of the first order.

In logarithmic form the results are as follows-

$$\ln \text{GDP}_t = 2.999 + 0.9996 \ln \text{F}_{\text{Aid}t}$$

$$t = (9.36) \quad (27.24)$$

$$p = (0.000) \quad (0.000)$$

$$\text{S.E.} = (0.320) \quad (0.367)$$

$$F = 741.78$$

$$R^2 = 0.9611$$

$$\text{D-W} = 0.3723$$

The result shows that an increase in foreign aid has a positive effect on GDP. The above equation shows one percent increase in foreign aid inflow, GDP is increased by 0.999 percent. The 't' value and 'F' value is significant at less than one percent. The equation is good fit, with 96.11 percent of total variation in GDP is explained by foreign aid. The value of D.W. is less than d_L , which shows that there is positive auto-correlation.

The current budget 2065/66, gives more emphasis on foreign aid. This budget tries to attract the foreign donors by removing the unnecessary obstacles of foreign aid in Nepal. The total estimated amount of foreign aid in this current budget is Rs. 65 arab 79 crore and 38 lakh; which is the 27.88 percent of total estimated budget expenditure. Out of this the share of foreign grant is 19.95 percent and the share of foreign loan is 7.92 percent. The share of Foreign Aid on the total estimated capital or development expenditure is 72.06 percent. Out of this the share of foreign grant and loan is 51.58 percent and 20.48 percent respectively. This shows that the role of foreign aid in economic development of Nepal is must important.

CHAPTER-SIX

BURDEN AND PROBLEMS OF FOREIGN AID

6.1 Burden of Foreign Aid

The loan component of foreign aid generates the burden to the future generation of the recipient country. The exchange rate of depreciation is further aggravating the debt burden of the external loan. If the productivity of the economy doesn't increase with the inflow of foreign loan, the country may be eventually falling in serious debt trap. The term, debt trap denotes the situation when government is unable to pay the interest and principal obligation by revenue. In other words, it refers to a situation when debt is repaid only by restoring to fresh borrowing. A lower rate of interest would have reduce the volume of net borrowing in the period for repayment of the debt. A longer maturity period for the debt and hence amortization payments would have reduced the annual amount of gross and net borrowing but extended the period of indebtedness. Greater, the amount of foreign aid required, greater the burden to be faced. Moreover if foreign assistance is not used properly, foreign grants also become burdensome to the recipient economy.

The fundamental case for soft loans is that low income countries with large population, low productivity as a consequences of low level of education and skills, and perhaps relatively poor natural resources, as well as require a relatively long period of net resources inflow in order to assist them in making structural changes which are essential to sustained growth. This is particularly true of investment in human resources and certain types of economic and social overhead capital. Similarly, the structural changes required for the expansion of export will take time as a largest volume of investment resources which are directed to export industries with the help of foreign aid.

Though Nepal has been borrowing external capital since the early 1960s, debt servicing began only in the late 1960s. A few governments guaranteed loans were carrying comparatively higher rate of interest and a few other direct loans were not mature until the mid 1970s. Nepal's debt servicing burden has been reduced to some extent by the conversion of some loans into grants. Although, Nepal has been receiving

foreign loans with very low rate of interest and the time of maturity period is very long ranging from 25 to 40 years, the debt burden has been growing consequently. Table no.6(A) shows the foreign loan and debt servicing situation.

Table No.6(A)
Foreign Loan and Debt Servicing

(Rs. in million)

Fiscal Year	Net Outstanding	Principal Repayment	Interest Payment	Total Debt Service
1975/76	447.2	14.8	0.0	14.8
1976/77	629.4	16.1	0.0	16.1
1977/78	972.3	20.5	0.0	20.5
1978/79	1320.9	23.2	0.0	23.2
1979/80	1807.3	23.0	0.0	23.0
1980/81	2451.3	31.1	28.7	59.8
1981/82	3177.8	35.7	38.3	74.0
1982/83	4717.6	47.5	47.2	94.7
1983/84	6321.1	55.5	72.7	128.2
1984/85	9203.2	69.2	120.3	189.5
1985/86	10330.2	160.5	125.3	285.8
1986/87	15171.9	250.6	236.4	591.0
1987/88	20826.0	297.5	293.5	591.0
1988/89	29216.9	388.6	312.0	700.6
1989/90	36800.9	701.8	421.8	1123.6
1990/91	59505.3	589.0	479.5	1068.5
1991/92	70923.9	942.2	722.7	1664.9
1992/93	87420.8	1252.9	879.0	2131.9
1993/94	101966.8	1468.2	1020.0	2488.2
1994/95	113000.9	1828.2	1156.5	2984.7
1995/96	128044.4	1987.7	1316.6	3304.3
1996/97	132086.4	2102.4	1247.0	3349.4
1997/98	161208.0	2780.2	1421.0	4201.2
1998/99	169465.9	3196.5	1549.0	4745.5
1999/00	190691.2	3681.1	1640.3	5321.4
2000/01	200404.4	4500.6	1700.8	6201.4
2001/02	220125.6	4751.4	1816.1	6567.5
2002/03	223433.2	5497.5	2021.7	7519.2
2003/04	232779.3	5767.1	2141.8	7908.9
2004/05	219641.9	5954.5	2146.8	8101.3
2005/06	233968.6	6987.5	2163.9	9151.4
2006/07	216628.9	7538.8	2055.7	9594.5

Source: Various issue of economic survey, MOF/N.

The above table shows that the net outstanding debt was only Rs.477.2 million in

FY 1975/76, repayment was Rs.14.8 million, the component of interest payment was not introduced. The total debt servicing was Rs. 14.8 million. Before FY 1980/81, the component of interest payment was not introduced in the debt dynamics. In the FY 1985/86, the net outstanding debt was Rs.10330.2 million. This increased by 21.6 times compared to the FY 1975/76. The total debt service was Rs.285.7 million in the FY 1985/86, which increased by 19.3 times over the initial period FY 1975/76. The total debt service was increased continuously during the FY 1975/76 to FY 2006/07. The total debt service was increased from Rs. 14.8 million in the FY 1975/76 to Rs. 9594.5 million in the FY 2006/07.

In every subsequent year, the debt dynamics is increasing. In the FY2003/04, the amount of net outstanding debt was Rs.232779.3 million; repayment was Rs.5767.1 million and interest payment was Rs.2141.8 million. This shows that the net outstanding debt increased by 487 times repayment increased by 389 times and total debt service increased by 534 times compared to the FY 1975/76. This shows the real debt situation of Nepal. The amount of net outstanding, principal repayment and interest repayment was reached at Rs. 216628.9 million, 7538.8 million and 2055.7 million respectively in the FY 2006/07. If we divide the total net outstanding debt of the FY 2003/04 by the total population 23.2 million, we get the per capita external debt of Rs.10033.0 million, which shows the share of every Nepalese external loan.

6.2 Foreign Aid Commitment and Disbursement

Aid commitment shows the expression of the donors is to provide financial supports of specified amount under agreed terms and conditions for specific purpose to the recipient country whereas disbursement is the actual transfer of financial resources.

Major problem related to foreign aid is relatively lower disbursement rates compared to commitments. Most of the projects and programme which received foreign aid have been unable to utilize the total committed aid. In other words, the aid absorptive capacity of Nepal is very low. The ability of the recipient country to absorb further foreign capital is also determined by the ability of the aid receiving country Splan and projects to the satisfaction of the donor countries. In Nepal fund disbursement procedure is very time consuming. Internal socio-political chaos and administrative inefficiency

appear to be the major problem in this respect.

A typical characteristic of foreign aid to Nepal is the consistent short fall in disbursement against commitment. There is considerable gap between commitment and disbursement of aid. In other words, Nepal's aid absorption capacity remains very low, causing a substantial aid amount undisbursed in each year. The following table shows difference between commitment and disbursement and disbursement as a percent of commitment.

Table no. 6(B)
Foreign Aid Commitment and Disbursement

(Rs. in million)

Fiscal Year	Aid Commitment	Aid Disbursement	Difference	Disbursement as % of Commitment
1975/76	1415.7	505.6	910.1	35.71
1976/77	1911.2	556.9	1354.3	29.14
1977/78	1956.2	848.4	1107.8	43.37
1978/79	2417.3	996.4	1420.9	41.22
1979/80	1911.6	1340.5	571.1	70.12
1980/81	4012.6	1562.2	2450.4	38.93
1981/82	2886.1	1723.2	1162.9	59.71
1982/83	2959.2	2075.9	883.3	70.15
1983/84	3099.6	2547.5	552.1	82.19
1984/85	5991.4	2676.4	3315.0	44.67
1985/86	9504.2	3491.5	6012.7	36.74
1986/87	8727.5	3314.4	4736.6	37.98
1987/88	6449.6	5078.5	1371.1	78.74
1988/89	10403.0	5666.9	4736.1	54.47
1989/90	15830.0	6427.1	9402.9	40.60
1990/91	5665.4	5990.0	-324.6	105.73
1991/92	21084.1	7800.0	13284.1	36.99
1992/93	20526.7	9235.6	11291.1	44.99
1993/94	13172.2	11557.2	1615.0	87.74
1994/95	12876.9	11249.4	1627.5	87.36
1995/96	16537.3	14289.0	2248.3	86.40
1996/97	39643.0	15031.9	24611.1	37.92
1997/98	32022.1	16457.1	15565.0	51.39
1998/99	23927.0	16189.0	7738.0	67.66
1999/00	20448.0	17523.9	2924.1	85.70
2000/01	31287.0	18797.5	12489.5	60.08
2001/02	33227.7	14384.8	18842.9	43.29
2002/03	43202.7	15885.5	27317.2	36.77
2003/04	23738.0	18912.4	4825.6	79.67
2004/05	38152.3	23657.3	14495.0	62.01
2005/06	20924.2	22041.8	-1117.6	105.34
2006/07	37022.9	25854.3	11168.6	69.83

Source: Various Issue of Economic Survey, MOF/N.

The above table shows the total commitment and disbursement of foreign and disbursement as a percent of commitment. The above table presents that there is large gap between aid commitment and aid disbursement except the FY 1990/91 and FY 2005/06. In the FY 1975/76 the total commitment was Rs.1415.6 million. But the total disbursement was Rs.505.7 million, which was 35.73 percent of total commitment. In the FY 1990/91 disbursement 105.73 percent commitment where as in the FY 1976/77, it was only 29.14 percent of commitment. In the FY 1990/91 and the FY 2005/06, there is higher amount of disbursement than commitment. Besides these two fiscal years there is always the greater amount of commitment than disbursement. The total aid commitment and total aid disbursement between FY 1975/76 to 2006/07 was Rs. 475909.8 million and Rs. 277813.8 million respectively which is the 58.37 percent disbursement of total commitment.

This is the great problem of foreign aid in Nepal. This types of aid commitment-disbursement gap arises mainly because of the planning and political factors ensuring that aid committed in a given year is not disbursed during that year itself. The other reasons for the commitment disbursement gap are: Nepal's weak negotiation power while aid processing, highly centralized decision-making process, weak institutional arrangements for projects implementation, rigidity in financial rules and regulation, failing to meet counterpart contributions, Nepal's failure to estimate aid requirements, aid trying by donors, delay in timely implementation of project etc. To solve the aid commitment-disbursement gap problem, government of Nepal must remove the above reasons for aid commitment disbursement gap problem.

6.3 Major Problems to Foreign Aid in Nepal

Foreign aid has been playing a vital role in the development of developing countries like Nepal. Nepalese economy has been supported by foreign aid. However, it creates some problems and difficulties in the economy. It may lead to inflation, debt trap, economic dependency upon foreign countries, dominant interference of donor countries and agencies, low absorption capacity, etc.

Even with the infusion of aid at high magnitude for the last five decades, Nepal's economic development outcome has not yet been favourable. The population has not

gained tangible opportunity to uplift their living standards out of whatever development outcomes that the country has been able to reap. Fundamentals of overall economic stability and the area of reform have not strengthened. Institutional capacity to manage development campaign in a sound and systematic way has weakened. Some development efforts have become ineffective while some negative effects of the development endeavors have proved burdensome to the economy. It is rather disappointing to note that such a situation continued to persist in Nepal while she was receiving grants concessional loans, services of experts and consultants and modern technology from the donors. While analyzing these aspects one can't confidently say that both the domestic and aid resources were effectively utilized in the process of economic development of Nepal. The major problems relating to foreign aid could be categorized as below –

i. Conflict in objectives and priorities:

First, Nepal's aid policy is guided by the five year plan's priorities and as such there is no hard and fast rule, which restricts many areas for aid procurement. Second, as noted earlier, the objectives of giving and receiving aid are often contradictory, more precisely of donors and their priorities differs from those of Nepal since each donor has its own objectives and priorities. Third, priorities differ between MOF and NPC, not on the technical and intellectual ground rather on the ground of power concentration.

ii. Lack of coordination:

The responsibilities of aid coordination lie with MOF. Practice, however differ as many functions of the government are discharged by other ministries, autonomous bodies, private sectors and other agencies.

iii. Lack of National Consensus

In democracy political parties lead the nation. Election system change the government and new political parties leads the nation. The procedure of foreign aid is effecting from the nature of government. Therefore in the national priority sector, national consensus should be build between the major political parties. Without national consensus foreign aid is victimied in Nepal, foreign aid scenario, lack of national

consensus seen in many cases of foreign aid. Arun III is the example of lack national consensus.

iv. Lack of Transparency in details in Foreign Aid

Any government sector neither the Ministry of Finance nor the financial comptroller general are not responsible about the total volume and project wise foreign aid not only the government sector, foreign donors are also not published any information about their aid. Weak transparency lead corruption to both receiver and donors. Its impact is negative in reception country.

v. Donor driven Foreign Aid

Nepal has received foreign aid as per the desire or owning donor or they want to give. Lack of deciding priority sector and development model, Nepal accepts foreign aid according to people and the nation. So it has not fulfilled the actual needs of the people and the nation.

vi. Inequitable Benefits

Some aid projects that have been implemented and gave the expected return. There are numerous reason; because the project is too capital intensive or built for the prestige reason, because the political patronage determines the selection of the beneficiaries, because the inequitable distribution of gain is built into the methods of projects identification, appraisal and approval.

vii. Capital and Recurrent/Maintenance Cost

Nepal often fails to maintain the balance between development and regular budget. The result is that, many hospitals are lack of essential drugs, equipments therein are out of orders, water pumps do not deliver water, power projects do not generate electricity, students are taught under the broken and roofs fallen, women are contracepted behind the walls and many roads have crumbled into mud.

viii. Inflexibility of Aid

The lack of flexibility in most aid projects has led to the problems, delays and gap between planned targeted and disbursement.

ix. Donor's Multiplicity

In terms of aid volume, donors multiplicity has proved undoubtedly beneficial in meeting the growing development needs. However, multiplicity has created many problems.

x. Foreign aid flowing at great magnitude through the Non-Government Organizations (NGOs) could not be aligned to the areas of national priorities. Problems are many, in respect to making the source and resources of aid available through these organizations transparent.

xi. Excessive dependence on technical assistance has also not contributed to the development of our institutional capacity. The existing structure of technical assistance has not encouraged or helped to make maximum utilization of domestic technical manpower. Due to the weakned process of technology transfer, many projects could not even be operated by the nation.

xii. Project implementation capacity of the nation is not satisfactory. Project implementation system is constrained by various problems and limitations. Weak managerial aspects in the implementation of the projects have stood as major determinants to the smooth development process of the country. Projects are suffering from cost and time over runs of large magnitudes. Performance indicators of foreign aided projects along with the existing projects supervision and monitoring provisions are not adequate and effective.

xiii. Aid model is different between the donors. The condition of aid is different; matching fund is one of the conditions of foreign aid. In this condition, the beneficial

customer or governmental or local government bears the certain part of project cost. But, the lack of resources this certain part of the cost is not fulfilled and its effect in whole projects.

xiv. Foreign aid increase the dependency in Nepalese economy. Every sector of economy receives foreign aid for any development and social works which our mind needs and seeks foreign aid. Through the negative impact of foreign aid, Nepali policy makers can't imagine and can't search other resources and activities for development activities without foreign aid. The example of dependency search the donors to collect and management of the dirty things and proper recordings of foreign aid is the best example of dependency which leads to the economy in dark future and we can't do any innovation.

CHAPTER - SEVEN

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

7.1 Summary

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

Nepal has been receiving foreign aid since 1951. The American Government's assistance of Rs. 22,000.00 provided under Point Four Program on January 23, 1951. India, China and USSR joined in assisting Nepal's economic development in 1951, 1956 and 1958 respectively. With increasing the number of donors, the amount of aid received by Nepal has been increasing continuously. But there has been change in the trend and composition of aid, no sector of the economy have been remained untouched by foreign assistance. Nepal's development efforts were almost financed by foreign assistance during last 57 years. The growth rate of foreign aid is very high but the economic growth rate of Nepal is very low. Every year dependency on aid is increasing. That is why very burden of debt in Nepal is also increasing. At the same time, the growth rate GDP of Nepal is very low. In this way Nepalese economy is highly dependent on foreign resources.

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

Foreign aid helps bridge the gap between the short fall of the national saving to the national investment. It has supported to fulfill the gap between the excess of imports

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

The aims of this study are to explore the contribution of foreign aid to the economic development of Nepal, to review the trend and structure of foreign aid in Nepal, to assess the various sources of foreign aid to Nepal. To highlight the problems and constraints of foreign aid in Nepal. The hypothesis of this study are set to fulfill the objectives of this study. To meet the objectives of this study, different statistical tools are used with available official secondary data.

Foreign aid has been supporting Nepalese economy. The total inflow of foreign aid between the FY 1975/76 to FY 2006/07 was Rs 303661.4 million and the share of foreign grant and loan were 44.07 percent and 55.93 percent respectively. Until the FY 1960/61, foreign aid was only in the form of grant. Inflow of foreign aid was only in the form of grant. Inflow of foreign loan started only from FY 1961/62, but it was lower than foreign grants upto the FY 1982/83. But from the FY 1983/84 to FY 2001/02. the foreign loan has been higher than that of foreign grant. In recent years, that is after the FY 2002/03 to FY 2006/07, the share of grant has been greater than the loan in total foreign assistance. During the FY 2002/03 to 2006/07, the average share of grant and loan was 63.14 percent and 36.86 percent respectively.

The main source of foreign aid are bilateral donors and multilateral donors. From the FY 1975/76 to FY 1981/82, the share of bilateral aid was greater than the share of multilateral loan. Besides the FY 2003/04 and the FY 2006/07, the share of bilateral aid was less than the share of multilateral aid, during the FY 1982/83 to FY 2006/07. In the FY 1975/76, the amount of foreign aid Rs.505.6 million. By the time passes it increases continuously and reached to Rs.25854.3 million in the FY 2006/07.

The contribution of foreign aid has been significant in the development expenditure of Nepal. In the first five year plan, all the development expenditure has been

financed by foreign aid. Although it declined in other plans, but still its share has been more than 45 percent of the total development budget. From first to eleventh plan, the average share of foreign aid was 62.35 percent of the total development expenditure. The contribution of foreign aid in our budget also significant in every year. About 25 percent of total budget and about 50 percent of development budget was financed by foreign aid during the FY 1975/76 to 2006/07. More than 26 percent of total budget of FY 2007/08 was financed by foreign assistance.

Government expenditure has been increased due to the high growth rate of population and government's desire to provide additional public utilities to the people. From 1990 to 2002, total expenditure has been increased by 14.16 percent. From 1990/91 to 1997/98, the regular expenditure was lower than the development expenditure, but after 1997/98, the regular expenditure was greater than the development. This shows that the development activities in Nepal is not going the way it should be. So the economic development of Nepal is very low.

From the FY 1975/76 to FY 2006/07, government expenditure and revenue both have increased but government expenditure has been higher than government revenue. So, there has been gap between government expenditure and government revenue. During the FY 1975/76 to FY 2006/07, the resource gap was in between 30 percent to 50 percent. On the other hand, increasing rate of expenditure is greater than revenue. The total amount of resource gap was in Rs 470847.80 million in that period, which was the 38.23 percent of total government budget expenditure. Similarly, there is high saving-investment gap in Nepal between the FY 1975/76 to FY 2006/07. The saving-investment gap is increasing continuously in every year. Hence, the resource gap and the saving investment gap are the main problems of the Nepalese economy. To solve these types of problems, foreign aid has been playing important role.

There are many problems related to foreign aid. The main problem related to foreign aid is commitment disbursement gap. Besides, the FY 1990/91 and the FY 2005/06, the commitment is always higher than disbursement. Similarly, there are many other problems like conflict in objectives and priorities, lack of coordination, lack of foreign aid policy etc. These types of problems hamper the development process of the economy. But still there is positive relationship between foreign aid and GDP. The

contribution of foreign aid on GDP is significant. Similarly, foreign aid and GDP move in same direction. However, the growth rate of GDP is lower than the growth rate of foreign aid. Likewise, there is positive impact of foreign aid on investment was found. But the growth rate of investment is lower than the growth rate of foreign aid.

It is difficult to generalize the effect of foreign assistance in the growth of national development. Due to the inflow of foreign aid some changes have been surely brought in various fields. Though it is difficult to measure, it has led to a great change in transport and communication agriculture and irrigation, industry and power, education and social service and above all in the quality of life in the country. As Nepal's development efforts were almost all financed by foreign assistance during the last 55 years the development has taken place can be partly attributed to foreign aid.

7.2 Conclusion

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

Both expenditure and revenue of the Nepalese government has been increasing every year, but the government expenditure has been increasing rapidly. It is because, even after the induction of market economy, the state is still a prime actor to facilitate public goods and public utilities to the people. The government is bounded to spend in the field of education, health and public utilities like water supply, telecommunication, transportation and electricity. These activities require huge amount of development expenditure. Therefore, government expenditure is increasing rapidly with respect to time but the government of Nepal has not been able to increase its revenue accordingly. Lack of broad base tax system, lack of effective revenue generating programs, corruption etc. seems to be the main reasons of a slower growth rate of its revenue. The government of Nepal should find the way out to increase its revenue. It is because if this trend continues, Nepal will eventually run into the problem of debt trap.

The inflow of foreign aid has been increasing with respect to time. The share of foreign aid in the government expenditure is also increasing but the positive impact of foreign aid has not been that significant in the Nepalese economy. The growth rate of the GDP and per capita income are very low; whereas dependency on foreign aid, burden of

debt and price level are increasing rapidly. One of the main causes of these problems seems to be an unproductive and ineffective use of foreign aid. If we see the share of foreign aid in the government expenditure since FY 1975/76 to FY 2006/07, 24.65 percent of total expenditure and 39.94 percent of the development expenditure has been financed by foreign aid. It shows that foreign aid had played an important role in the government expenditure of Nepal. From this it is apparent that without foreign aid the country will degrade to far worse condition than that it is right now. It is because, in the absence of foreign aid Nepal has reduce more than fifty percent of its development activities. This type of high dependency on foreign aid is not good for our economic. It is because foreign aid is uncertain, it kills our creativeness and eventually it also makes us much more dependent on foreign aid. This type of high dependency on foreign aid should be controlled. It should be productive and it should be used to mobilize internal resources.

The government of Nepal has failed to demonstrate a reasonable degree of absorption capacity. Because of the low degree of absorption capacity, Nepal has been unable to disburse all the committed aid. Grant disbursement was far lower than grant commitment but disbursement of loan was more than it was committed. It looks like the government of Nepal accepts the strict pre-conditions that it can not fulfill while the committed amount of grant aid. Loan aid, as we know, how to be paid back with stipulated amount of interest. Hence, it is easy to take foreign loan. Probably because of this reason loan disbursement was more than loan commitment. The government should try to control this phenomenon. Even though it is easier to get loan than grant but government should not just go after loan. It is because, it can have serious consequences in the economy. Instead of just going after loan it should try to fulfill its commitment and try to use all the committed grant aid. That is to say, the government of Nepal should improve its absorption capacity of grant aid.

Regression analysis shows that there is positive relationship between GDP and foreign aid, during the FY 1975/76 to FY 2006/07. Moreover, if the foreign aid increased by Rs.1 million, GDP will be increased by Rs. 24.825 million. This result indicates that foreign aid is one of the most important variable to increase the GDP. On the other hand, the 't' value, 'f' value etc. are also significant at 5 percent level of significance and the

given degree of freedom. The value of D-W test indicates that there is positive auto-correlation between foreign aid and GDP. The value of R^2 (i.e. 0.9270) shows that the regression plane estimated is good fit. Thus, we can be concluded that foreign aid has positive impact on the Nepalese economy.

The positive relationship between foreign aid and GDP, saving, revenue, investment, etc. indicate that foreign aid helps to increase these variables. However, the impact of foreign aid on above-mentioned variables except price level has not been that high. Hence the impact of foreign aid to above mentioned variables except price level is positive and significant but not satisfactory. The main reason of low impact of foreign aid in the economy may be lack of commitment of the government of Nepal, donor's own strategic interest rather than economic development, miss-utilization of foreign aid, corruption, unnecessary political interference in the bureaucracy, weak administration, ineffective monitoring system, unproductive utilization of foreign aid, tied aid, political instability, etc. The existence of the above mentioned factors make foreign aid ineffective. The government of Nepal has to get rid of the above mentioned obstacles. If it can't get rid of these obstacles, it should minimize them to make foreign aid effective.

Every year, price level in the economy has been increasing. Nepalese people are facing the problems of inflation. The positive correlation between foreign aid and the price level indicates that the foreign aid is one of the main cause of inflation. Because of the low growth rate of output and income and a high growth rate of price level, the living standard of the people has not increased significantly. The unproductive use of foreign aid is one of the reason of inflation. On the one hand, demand for goods and services has been increasing due to inflow of foreign aid, on the other hand, due to an unproductive use of foreign aid the growth rate of output is less than that of its demand. Hence, demand pulls inflation is taking place in Nepalese economy. So, Nepalese government should use foreign aid more productively. If it can't use productively it should think twice to accept foreign aid.

Foreign aid is not bend by itself but its utilization is much more important. Foreign is only a tool, its effectiveness is depend on its utilization. Weak management and policies, corruption, weak administration, lack of proper machinery, delay in the

implementation of the project, etc. are the main reasons for ineffectiveness and productiveness of foreign aid. Therefore, the government should try to solve the above mentioned problems of foreign aid to make it more productive and effective. Besides this, foreign aid should be use in the most productive sectors of the economy.

7.3 Recommendations

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

7.3.1 Recommendation to the Government

1. According to the need of the country, the priority list should be made for the proper utilization of foreign aid.
2. A system of government should be operating that suited to its own geographic situation and at the some time competent enough to handle the modern process of structural transformation and economic development.
3. Foreign aid should be used in a transparent manner with proper accounting system of recording the movement of foreign aid.
4. Transparency and accountability should be maintained for that clear-cut policies and guideline should be formulated.
5. Nepal should adopt a critical attitude towards foreign aid. Nepal should use foreign aid only for these sectors and projects, which are vital for the economic and social development and benefits and which are shared by majority of its population particularly the poor section of the society. Nepal should seek united foreign aid to the extent possible. This will enable it to use the resources according to its own priorities. Efforts should be made to obtain grants as much as possible. But in the process seeking the foreign aid Nepal should not sacrifice its right to choose the development strategy in favour of the strategy suggested by the donor.
6. The government should set clear criteria when donors select area and project (by district, zone, region, etc. and based on locally identified needs). The relevant parties should be bear responsibilities in the case of failure of projects. Government staff should be technically and economically efficient in both project implementation and monitoring.

7. Project management efficiency should be improved and enhanced.
8. Selected projects should be implemented with full commitment regarding their objectives so that it can generate sufficient resources to payback the aid.
9. Entire freedom in the selection of the projects should not be provided to donors.
10. The parliament must have a significant influence on the performance of foreign aid. There must be an independent body to govern the assistance. The committee must be accountable to the government, the public and the donors like the house of commons committee of public accounts in the united kingdom. The body should examine the scope and balance of their evaluation in order to ensure that it covers a significantly comprehensive area of population and provide all necessary information and suggest methods of aid and implementation to make aid more effective. The committee must review periodically the benefit of aid through an impartial and independent research agency and draw conclusions and suggest appropriate actions.
11. The aid must be audited by the government auditors and the donor auditors.
12. Universities, Teaching and Training Institutions must help to demonstrate information to future managers on the usage of aid. They can also suggest methodologies on the application of latest ideas on the foreign aided project implementation.
13. There must be technical and operational involvement of private sector in aid management.
14. Adopt debt management strategy which place emphasis on debt relief based on tight financial and economic reforms supported mainly by World Bank and IMF Funding.
15. Increase export and future repayment capacity that satisfies the World Bank and IMF definition of debt sustainability.
16. Government must set time-bounded targets for reducing overall poverty and for the eradication of absolute poverty.
17. Aid policy of both recipient country as well as the donors must be transparent.
18. The priority should be given grants rather than loan.
19. The focus should be given in the bilateral donors as they provide large amount of grants than loans.
20. Improving the administrative and institutional structure for development through decentralization.

7.3.2 Recommendation to the Donors.

1. Aid to be directed to the most basic needs:

Donors should see that the aid is directed on basic needs. This approach of the donors will work to reduce poverty, illiteracy, malnutrition etc. More than 60 percent of the must be directed on social needs. This includes health, education and the development of organizations of people living in poverty.

2. Ensure full transparency of dealing:

Donors must be explicit about the usage of aid in specific areas and have to be transparent in aid dealings.

3. Prioritize aid for Growth and Development:

All donors must accept the need and their responsibility to restore aid to a growth path.

4. Provide relief towards debt burden:

Multilateral institutions must put in place measures to relieve the multilateral debt burden.

5. Donors should work as a facilitator and watchdog of projects implemented through their money.

6. Donors should provide assistance based on Nepalese real needs and requirements, instead of sticking to their own priority and interest.

7. Donors should attempt to strengthen people's capabilities to identify their needs, design and implement projects themselves.

8. Donors should allow Nepal the freedom of machine, equipments to import from cheaper source.

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

7.3.3 Recommendation to the Public

1. The general public must be aware about the aid in respect to the quality and implementation of aid.

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

Appendix

Relationship Between Foreign Aid and GDP in Nepal

```
log: C:\Documents and Settings\TV Central Dept\My Documents\Resham\Soft
> wares\Stata9\saud.smcl
log type: smcl
opened on: 4 Sep 2008, 15:00:47
.d
Contains data from C:\Documents and Settings\TV Central Dept\Desktop\dat_thesis
> .dta
obs:      32
vars:      3          4 Sep 2008 15:00
size:     448 (99.9% of memory free)
-----
      storage display  value
variable name type  format   label    variable label
-----
fy          int   %8.0g          FY
foreignaid  float %9.0g          Foreign aid
gdp         long  %12.0g          GDP
-----
Sorted by:

. tsset fy
      time variable: fy, 1975 to 2006

. reg gdp foreignaid

      Source |      SS      df      MS      Number of obs =      32
-----+-----+-----+-----+----- F( 1, 30) = 385.73
      Model | 1.1493e+12    1 1.1493e+12      Prob > F   = 0.0000
      Residual | 8.9386e+10   30 2.9795e+09      R-squared   = 0.9278
-----+-----+-----+-----+----- Adj R-squared = 0.9254
      Total | 1.2387e+12   31 3.9958e+10      Root MSE   = 54585
-----

      gdp |      Coef.  Std. Err.      t    P>|t|     [95% Conf. Interval]
-----+-----+-----+-----+-----
foreignaid | 24.82499    1.264    19.64  0.000    22.24356    27.40643
      _cons | -29624.46  15393.98   -1.92  0.064   -61063.16   1814.242
-----

. estat dw
invalid subcommand dw
r(321);
```

```
. estat dwatson
```

Durbin-Watson d-statistic(2, 32) = .7866138

```
. prais gdp foreignaid
```

```
Iteration 0: rho = 0.0000
Iteration 1: rho = 0.6148
Iteration 2: rho = 0.7221
Iteration 3: rho = 0.8390
Iteration 4: rho = 0.9901
Iteration 5: rho = 0.9940
Iteration 6: rho = 0.9914
Iteration 7: rho = 0.9932
Iteration 8: rho = 0.9920
Iteration 9: rho = 0.9928
Iteration 10: rho = 0.9922
Iteration 11: rho = 0.9926
Iteration 12: rho = 0.9924
Iteration 13: rho = 0.9925
Iteration 14: rho = 0.9924
Iteration 15: rho = 0.9925
Iteration 16: rho = 0.9924
Iteration 17: rho = 0.9925
Iteration 18: rho = 0.9924
Iteration 19: rho = 0.9925
Iteration 20: rho = 0.9925
Iteration 21: rho = 0.9925
Iteration 22: rho = 0.9925
Iteration 23: rho = 0.9925
Iteration 24: rho = 0.9925
Iteration 25: rho = 0.9925
Iteration 26: rho = 0.9925
```

Prais-Winsten AR(1) regression -- iterated estimates

Source	SS	df	MS	Number of obs = 32
Model	0	1	0	F(1, 30) = 0.00
Residual	3.4354e+10	30	1.1451e+09	Prob > F = 1.0000
Total	2.3123e+10	31	745905103	R-squared = .
				Adj R-squared = .
				Root MSE = 33840

gdp	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]

```

-----+-----
foreignaid | 6.361777 3.317889 1.92 0.065 -.4142556 13.13781
_cons | 269510.2 264495.7 1.02 0.316 -270662 809682.4
-----+-----
rho | .9924538
-----

```

```

Durbin-Watson statistic (original) 0.786614
Durbin-Watson statistic (transformed) 1.064221

```

```

.
.
.
. gen lngdp=ln(gdp)

. gen lnfy=ln( foreignaid)

. reg lngdp lnfy

```

```

Source |      SS      df    MS              Number of obs =   32
-----+-----
Model | 43.4281944    1 43.4281944          F( 1, 30) = 741.78
Residual | 1.75637221   30 .05854574          Prob > F   = 0.0000
-----+-----
Total | 45.1845666   31 1.45756667          R-squared   = 0.9611
                                          Adj R-squared = 0.9598
                                          Root MSE   = .24196

```

```

-----+-----
lngdp |      Coef.   Std. Err.      t    P>|t|   [95% Conf. Interval]
-----+-----
lnfy | .9996081   .0367022   27.24  0.000   .9246523   1.074564
_cons | 2.998625   .3203073    9.36  0.000   2.34447   3.65278
-----+-----

```

```

. estat dwatson

```

```

Durbin-Watson d-statistic( 2, 32) = .3722783

```

```

. gen fy1=foreignaid[n-1]
n not found
r(111);

```

```

. gen fy1=foreignaid[_n-1]
(1 missing value generated)

```

```

. gen fy1=foreignaid[_n-2]
fy1 already defined
r(110);

```

```
. gen fy2= foreignaid[_n-2]
(2 missing values generated)
```

```
. gen fy3= foreignaid[_n-3]
(3 missing values generated)
```

```
. gen fy4= foreignaid[_n-4]
(4 missing values generated)
```

```
. reg gdp fy fy1 fy2 fy3 fy4
```

Source	SS	df	MS	Number of obs =	28
-----+-----				F(5, 22) =	72.49
Model	1.0174e+12	5	2.0348e+11	Prob > F =	0.0000
Residual	6.1755e+10	22	2.8071e+09	R-squared =	0.9428
-----+-----				Adj R-squared =	0.9298
Total	1.0792e+12	27	3.9969e+10	Root MSE =	52982

gdp	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]
-----+-----					
fy	2512.1	6210.503	0.40	0.690	-10367.7 15391.9
fy1	9.377068	7.318845	1.28	0.213	-5.801289 24.55542
fy2	14.1735	8.570609	1.65	0.112	-3.600855 31.94785
fy3	-2.604819	10.07569	-0.26	0.798	-23.50052 18.29089
fy4	4.56726	8.054842	0.57	0.576	-12.13746 21.27198
_cons	-5007279	1.23e+07	-0.41	0.688	-3.05e+07 2.05e+07

```
. estat dwatson
```

Durbin-Watson d-statistic(6, 28) = .3054783

```
. reg gdp fy fy1 fy2 fy3
```

Source	SS	df	MS	Number of obs =	29
-----+-----				F(4, 24) =	98.45
Model	1.0575e+12	4	2.6437e+11	Prob > F =	0.0000
Residual	6.4447e+10	24	2.6853e+09	R-squared =	0.9426
-----+-----				Adj R-squared =	0.9330
Total	1.1219e+12	28	4.0068e+10	Root MSE =	51820

gdp	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]
-----+-----					

fy	1314.818	5316.886	0.25	0.807	-9658.695	12288.33
fy1	10.5264	7.043873	1.49	0.148	-4.011443	25.06423
fy2	13.8059	8.336549	1.66	0.111	-3.399897	31.01169
fy3	2.119952	7.463147	0.28	0.779	-13.28323	17.52313
_cons	-2632677	1.05e+07	-0.25	0.805	-2.44e+07	1.91e+07

```
. reg gdp fy fy1 fy2
```

Source	SS	df	MS	Number of obs =	30
-----+-----				F(3, 26) =	143.99
Model	1.0968e+12	3	3.6559e+11	Prob > F =	0.0000
Residual	6.6016e+10	26	2.5391e+09	R-squared =	0.9432
-----+-----				Adj R-squared =	0.9367
Total	1.1628e+12	29	4.0096e+10	Root MSE =	50389

gdp	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]
fy	424.4172	4444.377	0.10	0.925	-8711.13 9559.965
fy1	11.15909	6.776578	1.65	0.112	-2.770371 25.08854
fy2	15.95739	6.491571	2.46	0.021	2.613777 29.30101
_cons	-865894.3	8802952	-0.10	0.922	-1.90e+07 1.72e+07

```
. reg gdp fy fy1
```

Source	SS	df	MS	Number of obs =	31
-----+-----				F(2, 28) =	187.48
Model	1.1185e+12	2	5.5923e+11	Prob > F =	0.0000
Residual	8.3523e+10	28	2.9830e+09	R-squared =	0.9305
-----+-----				Adj R-squared =	0.9255
Total	1.2020e+12	30	4.0066e+10	Root MSE =	54616

gdp	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]
fy	2440.891	4209.634	0.58	0.567	-6182.154 11063.94
fy1	23.5789	5.259991	4.48	0.000	12.80429 34.3535
_cons	-4859085	8335888	-0.58	0.565	-2.19e+07 1.22e+07

```
. log close
```

```
log: C:\Documents and Settings\TV Central Dept\My Documents\Resham\Soft
> wares\Stata9\saud.smcl
```

```
log type: smcl
```

```
closed on: 4 Sep 2008, 15:07:58
```

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