

CHAPTER-I

INTRODUCTION

1.1 Background of the Study

Situated in South Asia, Nepal is bordered by the Tibetan region of China in the North and by India in the East, West and South. Nepal is an independent landlocked country. Modern Nepal was consolidated in the last quarter of the 18th century by King Prithivi Narayan Shah, the great of Gorkha who conquered and unified a number of small principalities that flouted existence at that time. Nepal is one of the least developed countries in the world. In the process of development; the higher availability of resource is one of the major conditions. But the availability of resource in Nepal is very low as compared to other developed countries. The per-capita income of Nepalese people is very low which is around 270 US dollars (Economic survey, 2004) and the economic growth is not satisfactory. The economy is based on agriculture. With such a low per-capita income, a higher domestic savings cannot be expected. The low rate of income is due to low rate of productivity which creates low rate of capital formation.

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

In Nepal, the systematic development started with the first plan in 1955/56. Since then, foreign aid has been playing a crucial role in the process of development in Nepal. Foreign aid occupies significantly a large

volume in the development expenditure of Nepal. More than often, two thirds of development expenditure is financed by foreign aid. The contribution of foreign aid in Tenth Plan is around 58 percent of development expenditure.

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

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

The essence of foreign aid is that it consists of explicit transfer of resources financial and or technical from the donor to the recipient countries on concessionary terms. At this stage one should make a distinction between foreign aid and foreign resource. Foreign resources also include foreign private investment which may not be included in aid because the flow of private investment is normally based on commercial considerations of profit expectations, and there is no emphasis on ‘aid’ as such. On the other hand, foreign aid is a “Co-operation with a foreign state or autonomous political unit in furthering its economic growth and social progress. Foreign aid may, therefore, be defined as transfer of capital and know-how from one country

to another, which is made on concessionary term such as in terms more favorable than those obtaining concurrently in the World capital markets. The transfer of resources which does not involve a certain degree of favorable terms than those available commercially does not 'grant element' and as such, a transfer like this can hardly be called aid. While loans contain only some elements of aid, grants of freely convertible currency constitute aid in the full sense of term. The aid component of a loan depends upon the span to the grace and amortization periods and the rate of interest. It varies directly with the length of the grace and the amortization period and inversely with the rate of interest.

Under the narrower definition, loans given by some international agencies may not be considered as aid because the repayment schedule is less than ten years and the rate of interest over 6 percent or so, as in the case of some World Bank loans. But loans from the WB are also taken as aid because individual recipients benefiting from these loans may not be in a position to raise on their own similar sums on comparable terms from the World capital markets.

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

Some experts have defined foreign aid as explicit transfer of real resources to the less developed countries on concessionaire terms in order to

uplift the developing economy and the living standards of the poor. “Foreign aid is the international transfer of public funds in the form of loan or grant either directly by one government to another (Bilateral assistance) or indirectly through the vehicle of a multilateral like “IBRD” (Todaro, 1988).

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

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

After more than five decades of effort, the country is still entangled in its vicious circle of poverty and is unable to find the best way out. In the one side, more than 30 percent population lives in miserable state of poverty and their income is one of the lowest in the World. On the other side, Nepal faces severe problems of deficiency in resources mobilization due to low saving and high consumption ratio. Above all there is serious resource gap problem in Nepal. Therefore, fiscal deficit is growing every year. So in this

context huge amount of foreign aid in the form of capital as well as financial and technical assistance is needed to solve these problems.

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

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

stability in prices, foreign aid can play a useful role in raising the rate of investment by filling the saving gap.

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

1.2 Statement of the Problem

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

Most of the specialists say that foreign aid has been playing crucial role for the economic progress of Nepal. In the study about foreign aid inflow in Nepal, there seems to be a controversy that on one hand, the disbursement of the foreign aid has been increasing steadily resulting and increasing in expenditure, but on the other hand, Nepal has been facing a problem of under spending. There in also the problem of huge gap between foreign aid commitment and disbursement. The amount of foreign aid has

increased in each and every year, but it has not brought the satisfactory change in the Nepalese economic growth. This may be due to inefficiency of administration, non-availability of suitable contractors, and resulting delays in the implementation of donor countries. In this context foreign aid in Nepal is used in the different sectors of the economy for infrastructure development and construction of various projects. But sometimes the donors are using aid in their own interest rather than representing the interest of Nepal and Nepalese people. Similarly, donors often lobby to appoint incompetent experts to work in developing countries as experts.

Being a least developed country, Nepal is getting aid from different countries and organizations in the form of bilateral as well as multilateral assistance. The composition of foreign aid has been heavily in favor of grant but later on since 1961/62 foreign loans started to enter the national economy. There is fluctuating trend in the proportion of loans to the total aid, but it is on an increasing trend. The data shows that Nepal has the highest degree of foreign aid as a percentage of government expenditure. Every year more than 40 percent of total government expenditure is financed by foreign aid in Nepal. So in the overall context of foreign aid, it is necessary to study why assistance inflow in Nepal is increasing? What is the importance and needs of foreign aid in Nepalese economy?

1.3 Objective of the Study

The specific objectives are as follows:

- (i) To analyze the trend and structure of the foreign aid inflow in Nepal.
- (ii) To analyze the role of foreign aid in Meeting Resource Gaps.
- (iii) To analyze the impact of foreign aid on GDP.

1.4 Importance of the Study

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

The study of foreign aid provides the idea about aid, being provided by foreign countries for various development works and infrastructure building. This study may help for the researcher, planners and others to decide whether to bring in more aid or reduce dependences of it. The study is also focused on impact of foreign aid in GDP.

1.5 Limitations of the study

- 1 The analysis is made on the basis of availability of the data
- 2 The data only covers the 1985/86 to 2004/05 in the study.
- 3 This study does not cover the political as well as military aid.
- 4 The study is conducted within limited time frame and financial limitation.

1.6 Research Methodology

1.6.1 Data Collection

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

1.6.2 Research Design

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

1.6.3 Data Processing and Analysis

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

1.6.4 Statistical Tools for Analysis

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

a) Regression Analysis

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

$$Y = a + bX$$

Where,

Y = Computed value of Y, i.e. GDP (dependent variable)

X = Computed value of X, i.e. Foreign Aid (independent)

a = autonomous increase in Y

b = Slope of Y on X (b measures how the change in dependent variable (Y) exists with the change in independent variable (X))

b) Log Linear Model

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

$$\text{Log } Y = a_0 + b_0 \log X$$

Where,

Log = Natural logarithm

Y = GDP (Dependent variable)

X = Foreign aid (Independent variable)

a_0 & b_0 = Regression parameters

1.6.5 Hypothesis

Null Hypothesis: There is no significant relationship between Foreign aid and GDP growth in Nepal.

Alternative Hypothesis: There is significant relationship between foreign aid and GDP growth in Nepal.

1.6.6 Statistical Test of Significance

a) Coefficient of Determination (R^2)

After the estimation the regression parameters, R^2 is used for judging the explanatory power, which measures the dispersion of observation

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

$$R^2 = \frac{\hat{a}_1 y_{X_1} + \hat{a}_2 y_{X_2} + \dots + \hat{a}_n y_{X_n}}{y_2}$$

Where,

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

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

b) Test of Significance of the Parameter Estimates

It is applied for judging the statistical reliability of the estimates of the regression coefficients. T-test test is performed to test the hypothesis in the study.

T-test

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

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

Where,

\hat{a}_i = estimated value of a_i

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

The calculated t-values have been compared with tabulated t-values at a certain level of significance, for a given degree of freedom. If the calculated t-value exceeds the table value, it is inferred that estimated coefficient is significantly different from zero.

F-test

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

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

Where,

R^2 = Coefficient of determination.

K = Number of explanatory variables

N = Number of observation in the sample

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

CHAPTER -II

REVIEW OF LITERATURE

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

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

2.1 Definition of Foreign Aid

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

United Nations in 1960, when it launched first development Decade, defined foreign assistance as “All transactions (for a country or an international organization), which result in permanent net addition to total resources available for economic development of another country.” According to the United Nations, aid consists only of outright grants and net

long term lending for non-military purposes by government and international organization. In international affairs, in principle and practice, aid has been accepted as part of the responsibility of the international community.

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

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

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

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

2.2 Impact of Foreign Aid

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

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

Lord Bauer, one of the main advocates of the negative impact of aid, argued that the consequences of aid in suppressing the fundamental laws of the market efficiency through state intervention in the economy because “It often served to underwrite and prolonged extremely damaging policies commonly pursued in the name of comprehensive planning.” He further argued, “Foreign aid is plainly neither a general necessity nor a sufficient condition for emergence from poverty.” According to him, what is necessary for development is the presence of conditions for development other than capital and if these are present capital becomes automatically available. He also believed that foreign aid permits concentration of power in a recipient country by promoting state power, corruption and inequality.

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

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

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

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

Here,

Y = National output/Gross Domestic Product (GDP)

C = Consumption within the Economy

I = Investment

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

$X = \text{Exports}$

$M = \text{Imports.}$

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

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

Plugging this equation the national accounts identity gives:

$$S = I + X - M$$

Rearranging this equation gives the required results:

$$I - S = M - X$$

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

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

Giffen and Enos (1970) argue that aid is motivated more by political considerations rather than the development of the recipient country and hence its utility in improving the economic conditions of a poor country is rather lower. They explain that the inflow of foreign capital may reduce domestic saving in various ways. First, the government may rely on it as a substitute for domestic saving and relax its efforts to raise taxes or force certain institutional changes for rising domestic saving. Secondly, the government may expand its consumption expenditure by raising the salary of its employees, or increasing the size of army, or the number of civil

servants, or constructing bungalows and purchasing automobiles for high ranking officials, and so on. Thirdly, foreign aid may lower private domestic savings by being accessible on easy terms through development banks and other institutions.

2.3 Foreign Aid According to Nepalese Writers

S.R. Poudyal (1982) states that, foreign aid appears to have played a laudable role in as much as it has inspired successive government in Nepal to demonstrate their commitment to development. Even if the desire to the people in Nepal for better living standard was a product of endogenous stimuli, every thing else form the objectives of development to be influenced by foreign aid. Channeling to funds was not significant until the beginning of Nepal's first five-year plan in 1956. Since, then foreign aid from various sources has been meeting a large proportion of the cost of Nepal's development program.

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

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

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

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

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

Govind Ram Agrawal (2039) in his book “Current Issues in Nepalese Development,” has written that some what different approach to the discussion of foreign aid than the patterns seen in the other sessions. All of us are found of throwing number growth rates, percentages, changes ratios etc. He would like to examine why we have developed such a dependency on foreign aid and look at the tangible and intangible effects of foreign aid. He said that there was no any sector free from the foreign aid influences.

In his sub-heading “development preference” point out that poverty exists because of the prevalent socio-economic structure of the society. Some-how the other there has been a tendency to maintain the present

structure and the sustenance of the present social structure has resulted in nothing except feeding the poverty and in enriching the well to do.

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

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

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

necessary for economic growth, poverty reduction and sustainable development. Nepal hence has to seriously consider making the effective use of foreign resources in order to attract on increasing amount of external resources.

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

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

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

third factor is the political change within Nepal in the early fifties; the overthrow of the family oligarchies role in Nepal and its awakening for modernization and development accompanied by the unfolding of all these new forces.

G.P. Subedi (1982) in his dissertation, “Role of America aid in the Developing Process of Nepal,” has tried to explain the role of foreign assistance in different plan project in one hand. On the other hand, he has shown the decreasing trend of US aid in different plan period. In the first plan, its rate is 58.88 percent out of total foreign aid, in the second 45.57 percent, in the third 22.55 percent, in the fourth 14.3 percent and the fifth plan is down to 10.94 percent. Then it gradually decreases and flow minimum amount of Nepal, through US aid from the out of foreign aid.

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

2.4 Problems of Foreign Aid

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

The effect not only prolongs the disease, but also eventually increases its severity.

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

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

Meena Acharya (1992) has pointed out that, basically, aid has been used to substitute domestic savings. Instead of complementing domestic savings it has probably replaced domestic savings altogether. This is a very alarming sign given at the current investment requirements of the country. At the same time, if we look at the external debt ratio, the figure itself, in an absolute way, is not very alarming. In that respect, Nepal is probably weakest amongst all the different South Asian countries. The capacity to repay is governed by the exporting capacity. It is the more serious problem.

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

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

CHAPTER-III

FOREIGN AID TO NEPAL

3.1 Historical Background of Foreign Aid in Nepal

Foreign aid has been a major source of financing the development projects/programs since the early fifties. The first instance of foreign aid was heralded by Point Four Program Agreement on January 1951. The United State Government's gift of NRs. 22000000 was provided under the President Harry Truman's Point Four Program. Since then, the United States has provided technical assistances as well as capital aid to various sectors of economy like agriculture, education, health and transport etc.

The American assistance was followed by formal economic assistance from India in October in the same year. After signing formal agreements, India has helped Nepal in virtually every field of economic and social development. Some of the major areas where Indian aid has been utilized are in transportation, hydropower, irrigation, agriculture including horticulture and telecommunications. A very significant part of Indian aid has been in the form of training facilities in various technical fields for Nepali Nationals.

The major aid contribution for the county, until 1956 A.D., was from India and USA. Since the mid-1960s, the number of donors, both bilateral and multilateral, grew considerably. The expansion of sources of foreign aid helped to increase the volume of aid to Nepal. There are certain reasons for the diversification and expansion of sources of aid;

- In 1956 Nepal initiated the planned process of development. This provided the basis for receiving increasing amount of aid.
- After 1956, Nepal has started to expanding its foreign relations with several donor countries which contributed to increase aid flow;

- The spread of Cold War throughout the world accounted for increasing foreign aid as instrument for winning allies helped directly in securing more aid, and
- The UN Generally Assembly resolution which stated in the need to help the least developed countries in their development endeavor by increasing the amount of such aid by the developed countries.

The significance of these external links with the Himalayan country was not lost a People's Republic of China and former USSR who came in the foreign aid scenario in 1956 and 1958 respectively. Multilateral assistance also started in early fifty's with UN assistance for technical support, WHO assistance for Malaria Eradication Program and FAO assistance for Dairy Development. After 1975, Russian aid to Nepal eventually became insignificant; an important feature of the foreign aid scenario of Nepal after 1975 is the emergence of Japan as a major bilateral aid donor to Nepal. (Khadka, 1991)

In the second half of the 1970s and 1980s, the emergence of multilateral source of aid has been seen in Nepal. From that time, the multilateral aid has started to dominate bilateral aid. The World Bank and its affiliate, IDA and ADB, UNCTAD and some other multilateral agencies have started playing a much greater role in providing aid to Nepal than before.

Gradually, with the expansion of Nepal's external relations, the number of donor countries and multilateral agencies who provide assistance to Nepal has also increased. At present, Nepal receives assistance from twenty bilateral countries such as Austria, Australia, Bangladesh, Britain, Canada, China, Denmark, France, Germany, India, Japan, Netherlands, Saudi Arabia, Sweden, Switzerland, USA, UK etc. and almost an equal number of multilateral agencies including UNDP, ADB, WB, IFAD, FAO,

ECC and OPEC Fund, etc. These bilateral and multilateral donors have provided aid to Nepal in different sectors of the economy. (Shakya, 2059 B.S.)

Foreign aid has financed a very substantial portion of development expenditures in Nepal. It has helped to create a reasonable degree of economic and social infrastructure, which was partially non-existent prior to the emergence of foreign aid as phenomenon in the political economy of Nepal. The first Five-year Plan (1956/61) was entirely financed by foreign aid but the share of external assistance in the country in development expenditure exhibited a downward trend from 77.8 percent in the second Three-year plan period to 56 percent in 9th Plan. In 10th Plan, the expected foreign aid is 57.5 percent in total development expenditure. (NPC, 2004)

Table 3.1
Donor-wise Commitment of Foreign Aid
(2001-2005)

(Rs. in millions)						
SN	Bilateral	Grant	Loan	Total	% of Grant	% of Loan
1	Denmark	6449.1	-	6449.1	100	0
2	USA	8866.7	-	8866.7	100	0
3	Norway	4906.7	-	4906.7	100	0
4	Japan	14155.2	-	14155.2	100	0
5	UK	12112.1	-	12112.1	100	0
6	Switzerland	2042.1	-	2042.1	100	0
7	Australia	949.3	-	949.3	100	0
8	Sweden	980.0	980	1960.0	50	50
9	Belgium	0	295.8	295.8	0	100
10	Canada	693.9	-	693.9	100	0
11	Finland	980.3	-	980.3	100	0
12	India	2499.4	-	2499.4	100	0
13	China	1914.6	-	1914.6	100	0
14	Netherlands	1722.1	-	1722.1	100	0
15	France	27.6	-	27.6	100	0
16	Germany	3596.7	-	3596.7	100	0
	Total	61895.8	1275.8	63171.6	97.9	2.1
	Multilateral	Grant	Loan	Total	% of grant	% of loan
1	SNV	50.0	-	50.0	100	0
2	NDF	-	675.9	675.9	0	100
3	OPEC	-	1022.7	1022.7	0	100
4	ADB	526.8	24387.15	24913.9	2.1	97.9
5	ILO	262.7	-	262.7	100	0
6	IFAD	89.9	2272.3	2362.3	3.8	96.2
7	WB	6466.6	23639.3	30105.9	21.5	78.5
8	UNICEF	5624.7	-	5624.7	100	0
9	UNFPA	2769.0	-	2769.0	100	0
10	WFP	6064.3	-	6064.3	100	0
11	FAO	73.4	-	73.4	100	0
12	EC	1246.0	-	1246.0	100	0
	Total	23173.4	51997.4	75170.8	30.8	69.2

Source: Ministry of Finance.

Above Table 3.1, shows the latest donor-wise foreign aid commitment from FY 2001 to 2005. Bilateral aid has dominated by multilateral aid, and Japan has become a major bilateral aid donor country among them. Whereas, WB has become a major multilateral aid donor organization, among the multilateral aid donor organizations.

In Nepal, major sources of aid from donors can be classified by three categories: bilateral, multilateral, and INGOs. The major bilateral donors are Japan, USA, UK, Germany, China, India, Australia, Denmark, France, Netherlands, Norway, Switzerland, Finland etc. Major multilateral donors are UNDP, ADB, EU, WB, UNSCO, UNICEF, ILO, IMF, etc. Up to now, many INGOs are flowing money to Nepal. Directly and indirectly, they are involved in different sectors. Among them, Action Aid, CARE, INF, PLAN, Save the Children are the major ones.

3.2 Basic Features of Foreign Aid in Nepal

3.2.1 Review of Foreign Aid policy of Nepal

“Foreign Aid Policy of Nepal-2003” gives the different provision about the foreign aid. The main features of policy are as follows:-

1. Provision for soft loan
2. Provision for grant
3. Provision for Technical Assistance.
4. Provision for optimum utilization of revenue.
5. Provision for promoting the private sector.
6. To increase the role of civil society for the utilization of foreign aid.

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

3.2.2 Extent of Aid

Nepal has begun to receive foreign aid since 1951/52. The size of foreign aid flow began to expand steadily after 1956. The important factors responsible for a marked increase in aid receipts were three in number.

- Nepal has expanded international relations and diversified the sources of aid;
- The introduction of development Plan helped it to rationalize the demand for aid, and
- The bonus effect of the Cold War and feeling of competition among some donors pushed up the level of aid.

In earlier years, the portion of grant used to be far higher than the foreign loans. This scenario continued until the year 1982/83. That was the last year in which grant had exceeded loans. Since then, loan has always been higher than grants. Till now, foreign loan has been increasing every subsequent year. The share of loan has started to jump especially after the World Bank made a provision of special window of long-term soft loans to underdeveloped countries. When we review the foreign aid inflow, the trend is quite erratic up to 1972/73. Then it is on the increasing trend, which is clearly shown in the following table.

Table-3.2 (A)
The total Foreign Aid inflow in Nepal
(Rs. in Million)

FY	Total Aid Inflow	Grant		Loan	
		Amount	Percent	Amount	Percent
1951/52-55/56	95.0	95.0	100.0	-	0
1956/57	27.3	27.3	100.0	-	0
1957/58	58.1	58.1	100.0	-	0
1958/59	35.1	35.1	100.0	-	0
1959/60	125.3	125.3	100.0	-	0
1960/61	125.1	125.1	100.0	-	0
1961/62	182.6	181.6	99.5	1.1	0.5
1962/63	88.1	76.5	86.8	11.6	13.2
1963/64	177.3	165.9	93.6	11.4	6.4
1964/65	146.9	141.0	96.0	5.9	4.0
1965/66	178.6	175.3	98.2	3.3	1.8
1966/67	145.9	142.2	97.5	3.7	2.5
1967/68	158.1	158.1	100.0	-	0
1968/69	185.9	185.9	100.0	-	0
1969/70	251.3	243.7	97.0	7.6	3.0
1970/71	303.2	270.7	89.3	32.5	10.7
1971/72	281.0	242.1	86.2	38.9	13.8
1972/73	227.6	180.2	79.2	47.4	20.8
1973/74	310.5	222.6	71.7	87.9	28.9
1974/75	386.0	282.8	73.7	103.9	26.9
1975/76	505.6	359.7	71.7	145.9	28.9
1976/77	556.9	392.5	70.5	164.4	29.5
1977/78	848.4	446.6	55.0	381.8	45.0
1978/79	989.4	599.3	60.6	390.1	39.4
1979/80	1340.5	805.6	60.1	534.9	39.9
1980/81	1562.2	868.9	55.6	693.3	44.4
1981/82	1723.2	993.3	57.6	729.9	42.4
1982/83	2075.9	1090.1	52.5	985.8	47.5
1983/84	2547.5	876.6	34.4	1670.9	65.6
1984/85	2676.4	923.4	34.5	1753.0	65.5
1985/86	3491.5	1120.6	32.1	2370.9	67.9
1986/87	3314.4	1078.3	32.5	2236.1	67.5
1987/88	5078.5	1984.2	39.1	3094.3	60.9
1988/89	5666.9	1478.2	26.1	4188.7	73.9
1989/90	6427.1	1798.8	28.0	4628.3	72.0
1990/91	5990.0	1630.0	27.2	4360.0	72.8
1991/92	7800.4	1531.0	19.6	6269.4	80.4
1992/93	9235.6	3273.9	35.5	5961.7	64.6
1993/94	11557.2	2393.6	20.7	9163.6	79.3
1994/95	11249.3	3937.1	35.0	7312.2	65.0
1995/96	14289.0	4825.1	33.8	9463.9	66.2
1996/97	15031.9	5988.3	39.8	9043.6	60.2
1997/98	16457.1	5402.6	32.8	11054.5	67.2
1998/99	16189.0	4336.6	26.8	11852.4	73.2
1999/00	17523.9	5711.7	32.6	11812.2	67.4
2000/01	18797.4	6753.4	35.9	12044.0	64.1
2001/02	14384.8	6686.2	46.5	7698.6	53.5
2002/03	15885.5	11339.1	71.4	4546.4	28.6
2003/04	18912.4	11283.4	59.7	7629.0	40.3
2004/05	23657.3	14391.2	60.8	9266.1	39.2

Source: Foreign Trade, Aid and development of Nepal (Sriram Poudyal, 1978) & various Issues of Economic Survey.

Table 3.2 (B)
Foreign Aid Population Ratio and Foreign Loan Population Ratio
(Rs. in million)

Years	Foreign aid (FA)	Foreign Loan (D)	Population	$\frac{FA}{Population}$	$\frac{D}{Population}$
				<i>Population</i>	<i>Population</i>
1981	9291.9	2665.6	15022839	0.00062	0.00018
1991	48283.3	28683.5	18491097	0.00261	0.00155
2001	186414.1	110808.6	23151432	0.00805	0.00479
2005	259254.1	139948.7	25300000	0.01025	0.00553

Source: Calculated from Table 3.2 (A), Economic Survey and CBS

The grant element in foreign aid has been progressively declining while loans have been continuously increasing. The increasing loan element in the foreign aid package has not increased accountability of either the government of the donors. The composition of foreign aid between loans and grant is shown in table 3.2 (A). This table shows the declining share of grant aid and increasing proportion of loan assistance. During the pre-plan, First Plan (1956-61) and Plan gap year, all assistance was entirely in the form of grants. From the early stage of the Second Plan (1962-65), the loan component began to play a minimum role. Though, the share of loan was reduced comparatively in the Third Plan (1965-70) to a near 3 percent, it has shown as upward trend since then.

From the initial year 1951/52 to 1960/61, initiated by the United States America and West Germany, to strengthen the Nepal industrial Development Corporation (NIDC), which was set up to nourish private industries. This meant that the country did not have any loan obligation to the international community in the early decades of its development process. But, ever since, increasing amount of loan, both in absolute amount and in its share of total aid, has been permanent phenomenon in Nepal.

The share of loan component introduced from 1961/62 was Rs. 1.0 million or 0.5 percent of total aid. Before 1976/77, 70 percent of aid was received in the form of grant. But the situation has changed after the year 1980s. Due to the emergence of new and bigger international lenders

(especially IDA and ADB), providing more loan package, the share of grants began to fall. The grant component was greater than loan in 1982/83. After 1982/83, the share of loan in total aid was increasing at an increasing rate. In 1983/84, Nepal received total aid of Rs. 2547.5 million, 34.4 percent of foreign aid in the form of grants and 65.6 percent of the aid in the form of loans. In the FY 1991/92, the foreign grant recorded the lowest, i.e. 19.1 percent of the total foreign aid. After the FY 2001/02 again the grant component of foreign aid was increasing. In the FY 2002/03, Nepal received Rs. 15885.5 million, 71.4 percent of foreign aid in the form of grants and 28.6 percent in the form of loans. And the FY 2003/04, the total foreign aid was Rs. 18912.4 million, the share of grant was 59.7 percent and the loan was 40.3 percent. At the end of the year 2004/05 the total foreign aid was Rs. 23657.3 million, 60.8 percent of foreign aid in the form of grants and 39.2 percent in the form of loan. Nepal has received the total foreign aid Rs. 259254.1 million. The average share of grant and loan are 41.4 and 58.6 percent respectively.

From Table No. 3.2 (B), it is seen that foreign aid population ratio and foreign loan population ratio has been continuously increasing since the year 1981 to 2005. The foreign aid population ratio in the year 1981 was Rs. 0.00018 million whereas in the year 2005, it was 0.01025 million. Similarly, the foreign loan population ratio in the year 1981 was Rs. 0.00018 million whereas in the year 2005, it was 0.00553 million.

3.3 Sources of Foreign Aid

Prior to 1956, due to the several reasons, including the die exposure, donors to Nepal were very few and India and USA had dominated the entire scenario of aid. The increase in the number of donors since 1956 is spectacular. Donor represents the origin of funds for development assistance

(Bilateral and multilateral). There are three kinds of donors who have been providing aid to Nepal over the past fifty years:

- Bilateral foreign aid
- Multilateral
- International non-governmental organization (INGO's)

Bilateral donors refer to foreign government or their aid administrating bodies in Nepal such as USAID of USA, JICA of Japan, GIZ of Germany, SDC of Switzerland, DANIDA of Denmark, FINIDA of Finland and Government of People's Republic of China, former USSR, India, UK etc.

Multilateral donors refer to the international agencies like the WB, ADB, IME, and UN sister agencies like UNDP, FAO, and WHO etc. The UN agencies provide mostly technical assistance and grants whereas the international development Bank dispenses both hard soft loans.

International Non-Government Organizations (INGO's) refer to the private organizations such as CARE, UMN, OXFAM and others. Nepal has been receiving foreign aid since 1951 and after the late 1970s. Nepal has been receiving foreign aid mostly from Nepal Aid Group (Australia, Austria, Belgium, Canada, Denmark, UK, and USA etc.) and six multilateral donors (IDA, UNDP, ECC, INCTAD, ADB, WB).

3.3.1 Bilateral and Multilateral Aid to Nepal

Nepal receives a huge amount of capital and technical aid from bilateral as well as multilateral basis. Foreign aid, thus received has been utilized for socio-economic development of the country. Nepal has been receiving financial as well as technical aids and assistance from the international agencies and regional organizations, namely the UNDP, WHO, UNESO, FAO, WB and ADB etc. Multilateral and bilateral aid has been receiving in Nepal since Point Four Program. But in this study, the data include from 1985/86 to 2004/05. The following table shows the bilateral and multilateral aid to Nepal.

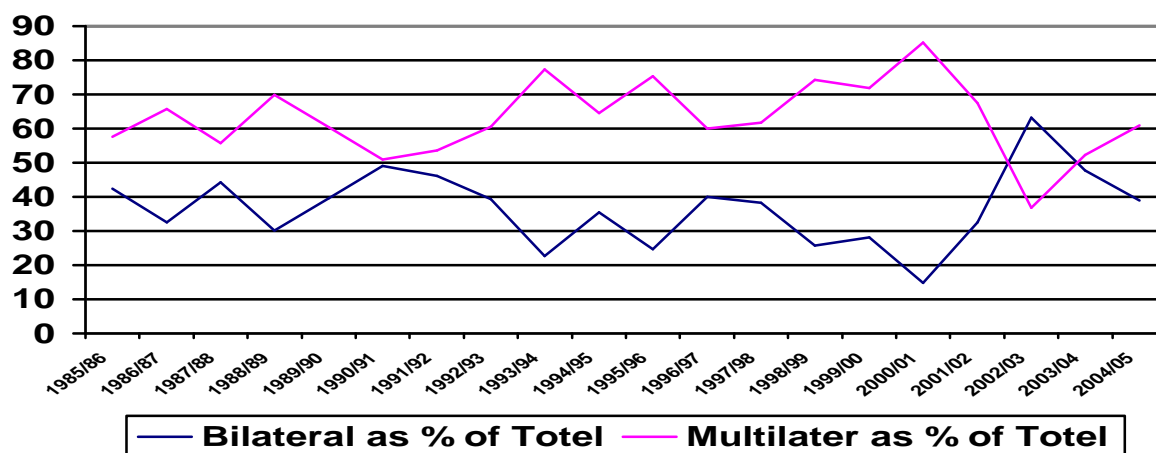
Table 3.3
Bilateral and Multilateral Aid to Nepal

(Rs. in Million)

FY	Bilateral (B)	Multilateral (M)	Total Aid	B as % of total	M as % of total
1985/86	1481.1	2010.4	3491.5	42.4	57.6
1986/87	1078.4	2236.1	3314.5	32.5	65.7
1987/88	2251.6	2826.9	5078.5	44.3	55.7
1988/89	1707.7	3959.2	5666.9	30.1	69.9
1989/90	2544.9	3882.2	6427.1	39.6	60.4
Average	1812.7	2982.9	4795.6	37.8	62.2
1990/91	2939.9	3050.1	5990.0	49.1	50.9
1991/92	3597.3	4203.1	7800.4	46.1	53.6
1992/93	3638.5	5597.1	9235.6	39.4	60.6
1993/94	2627.1	8930.1	11557.2	22.7	77.3
1994/95	3988.7	7260.7	11249.4	35.5	64.5
Average	3358.3	5808.2	9166.5	38.6	61.4
1995/96	3533.3	10755.7	14289.0	24.7	75.3
1996/97	6012.7	9019.2	15031.9	40.0	60.0
1997/98	6297.7	10159.4	16457.1	38.3	61.7
1998/99	4167.6	12021.4	16189.0	25.7	74.3
1999/00	4929.1	12594.8	17523.9	28.1	71.9
Average	4988.1	10910.1	15898.2	31.5	68.5
2000/01	2771.2	16026.2	18797.4	14.8	85.2
2001/02	4675.3	9709.5	14384.8	32.5	67.5
2002/03	10044.4	5841.1	15885.5	63.2	36.8
2003/04	9013.2	9899.2	18912.4	47.7	52.3
2004/05	9230.8	14426.5	23657.3	39.0	61.0
Average	7145.0	11180.5	18325.5	39.0	61.0

Source: Various Issues of Economic Survey/Ministry of Finance

Figure 3.1
Trend Lines of Bilateral and Multilateral Aid



The above table and figure show the bilateral and multilateral source of aid and their perspective proportions in the total aid inflow. In FY 1985/86, the total aid inflow in Nepal was Rs. 3491.5 million. The share of bilateral aid was Rs. 1481.1 million and the share of multilateral aid was Rs. 2010.4 million. After the FY 1990/91 the multilateral aid has heavily increased as compared to bilateral aid. After 1990, Nepal adopted open liberal and market oriented economic polices. Therefore, influence of multilateral agencies in Nepal has increased in foreign aid. It may be because of profit-making motive of multilateral agencies. In 2004/05 the total aid remained Rs. 23657.3 million in which bilateral aid was Rs. 9230.8 million and multilateral aid was Rs. 14426.2 million. The total aid increased by nearly 7 times and bilateral aid and multilateral aid increased by more than 6 times and 7 times respectively in 2004/05 taking FY 1985/86 as a base year. But the trend line shows the multilateral aid was always higher than bilateral aid before the FY 2001/02.

3.4 Foreign Aid Allocation by Sector

The strategic interests of some major donors as well as the development theory of the early 1940s and 1950s, suggested that the developing countries craving for development, should go for heavy and capital-intensive projects in order to maximize GNP per-capita. In the case of Nepal, its dire need for the creation of socio-economic overhead facilities coincided with the donor's emphasis on the infrastructure or so-called "Prestige Projects" in line with this development theory. The sectoral priority attached by Nepal government in each successive development Plan shows that more than 30 percent of the resources estimated were invested in transport; communication and power generation projects.

In case of the neighboring countries such as India and China certain road projects having strategic importance were proposed by them and accepted by Nepal. Other donors, who did not have direct strategic interests in Nepal, provided aid for agriculture and institution building. All in all, donor countries were competing for "Prestige Projects," which have high demonstration effects both for the donor community and the population of Nepal, a poverty-stricken country starving for fund and technology and an easy partner for "Co-operation."

Another important factor why donors are competing in granting aid to Nepal is that the immediate effects of aid are sharply visible and direct. Since most of the heavy projects are concentrated in urban areas, that could draw sufficient attention of the elites and powerful section of its population as well as the tourists visiting Nepal. So over a period of time what we find in Nepal is the growing number of donors and multiplicity of projects and sectors, ranging from infrastructure, agriculture, family planning to rural development.

The sector-wise annual aid disbursement shows that the percentage share of agriculture in the eighties was very low compared to other non-agriculture sector (Table 3.4).

Table No. 3.4
Sector-wise Allocation of Foreign Aid in Nepal

(Rs. in Million)

FY	Total aid	Agriculture, Irrigation & Forestry	Transportation, Power & communication	Industry &Commerce	Social Service	Others
1985/86	3491.5	1298.8 (37.2)	1321.2 (37.8)	275.7 (7.9)	586.4 (16.8)	9.5 (0.3)
1986/87	3314.5	1037.6 (31.3)	1473.7 (44.3)	183.4 (5.5)	585.4(17.7)	34.3 (1.0)
1987/88	5078.5	1226.3(24.1)	2784.6 (54.8)	445.7 (8.8)	522.3 (10.3)	99.6 (2.0)
1988/89	5666.9	1466.8 (25.9)	3120.1 (55.0)	191.2 (3.4)	845.0 (14.9)	43.9 (0.8)
1989/90	6427.1	1489.7 (23.2)	2679.1 (41.7)	656.6 (10.2)	1555.8 (24.2)	49.9 (0.7)
Average	4795.7	1303.8 (27.2)	2275.7 (47.5)	350.5 (7.5)	819.0 (17.1)	47.4 (0.9)
1990/91	5990.0	1253.2 (21.0)	2575.6 (43.9)	1390.9 (23.2)	667.9 (11.1)	102.4 (1.7)
1991/92	7800.4	1945.4 (24.9)	2485.1 (31.9)	2174.3 (27.9)	1191.6 (15.3)	4.0 (0.04)
1992/93	9235.6	1927.4 (20.9)	2939.6 (42.7)	696.9 (7.5)	2667.6 (28.9)	4.1 (0.04)
1993/94	11557.2	5519.1 (47.8)	4169.4 (36.1)	389.9 (3.4)	1468.6 (12.7)	10.1 (0.1)
1994/95	11249.4	3462.4 (30.8)	4574.9 (40.7)	480.3 (4.3)	2680.1 (23.8)	51.7 (0.4)
Average	9166.5	2821.5 (30.8)	3348.9 (36.5)	1026.5 (12.2)	1735.2 (18.9)	172.3 (2.0)
1995/96	14289.0	3399.6 (23.8)	8052.7 (56.4)	15.9 (0.1)	2636.2 (18.4)	184.6 (1.3)
1996/97	15031.9	2827.5 (18.8)	4504.5 (56.6)	23.4 (0.2)	3665.0 (24.4)	11.5 (0.1)
1997/98	16457.1	2852.1 (17.3)	8989.6 (54.6)	198.1 (1.2)	4417.3 (26.8)	-
1998/99	16189.0	3383.9 (20.9)	7892.2 (48.7)	404.7 (2.5)	4446.4 (27.5)	61.8 (0.4)
1999/00	17523.9	3209.8 (18.3)	8159.3 (46.6)	298.5 (1.7)	5794.0 (33.0)	62.3 (0.4)
Average	15898.2	3134.6 (19.7)	7519.7 (47.3)	188.1 (1.2)	4191.8 (26.4)	64.1 (0.4)
2000/01	18797.4	3774.8 (20.1)	9235.1 (49.1)	19.9 (0.1)	5759.5 (30.6)	8.1 (0.04)
2001/02	14384.8	3285.8 (22.8)	5905.7 (41.1)	368.7 (2.6)	4685.8 (32.6)	138.8 (0.9)
2002/03	15885.5	2177.9 (13.7)	7774.1 (48.9)	401.2 (2.5)	5321.0 (33.5)	211.3 (1.3)
2003/04	18912.4	2429.6 (12.9)	7570.8 (40.0)	146.8 (0.7)	8730.1 (46.2)	35.1 (0.2)
2004/05	23657.3	2595.7 (11.0)	9860.0 (41.6)	123.9 (0.5)	10746.8 (45.4)	330.9 (1.4)
Average	18327.5	2852.8 (15.6)	8069.1 (44.0)	212.1 (1.2)	7048.6 (38.5)	144.8 (0.8)

Source: Various Issues of Economic Survey & MOF

Note: figures in parentheses show percentage in total aid.

From the above table, it is clear that the main aid recipient sectors are agriculture; irrigation and forestry, transport; communication and power, industry and commerce, social service and others sectors. In the FY 1985/86, the total disbursed aid (Rs. 3491.5 million) was allocated to agriculture; irrigation and forestry at 37.2 percent of the total, transport; power and communication 37.8 percent, industry and commerce 7.9 percent, social services 16.8 percent and other 0.3 percent. In FY 2004/05, these sectors received respectively, 11.0 percent, 41.6 percent, 0.5 percent, 45.4 percent and 1.4 percent. The agriculture sector received 47.8 percent aid in FY 1993/94, which was the highest percent of the agriculture sector. The lower percent (11.0) aid was received in FY 2004/05. The transport, power and communication sector have always been receiving large amount of foreign aid. In FY 1996/97, this sector received the largest portion of aid, which was 56.6 percent of the total aid. In industry and commerce sector, the share of foreign aid was relatively small than other sectors. In this sector 6.1 percent of the total aid has been utilized. The social service sector has been given priority in subsequent years. In FY 1993/94, only 12.7 percent of total aid was disbursed while in FY 2003/04, 46.2 percent was disbursed in the social sector. On the average, the share has been 23.3 percent of the total aid. In others sectors, the share of aid was lower. The transport, power and communication sector has utilized the highest portion which was around 45 percent on the average.

3.5 Foreign Aid Allocation in Different Plan Period in the Development Expenditure

Development plans became popular among the underdeveloped countries since the Second World War, while they are still being viewed with some suspicion as an instrument of socialism in the donor countries. Although planning and development plans are now almost universally

recognized as essential in promoting growth and the efficient in promotion of resources, there is considerable debate regarding the value of certain types of plans and great skepticism regarding value of money of the plans that have been formulated.

The methodological and superficial nature of most national development plans greatly limit their usefulness to foreign aid agencies as a basis for specific project evaluation, or for the formulation of aid strategies. They are often deficient in basic statistics and lack analysis in depth at the sectoral level. Frequently they involve little more than statement of growth and employment targets and projections of such aggregates as consumption, employment, private and public investment, saving, taxation, imports, and gap-filling external capital requirements on the basis of models employing parameters having little basis in either historical performance or what might be expected from change in economic policies.

During the Rana Regime (1846-1951), no serious attempts were made for initiating economic development on a systematic basis except a couple of initiatives. In 1935, a development agency was constituted by the name of UDYOG PARISHAD (Development Board). The Development Board soon followed by a host of specialized development agencies.

In process of planning in Nepal, a 20-year plan framed by Juddha Shamsher, a 15-year program of development framed by National Planning Committee in 1949, institution of planning sub committee in 1953 etc. were the previous steps taken by the Nepalese Government to formulate development process in planned way. But these steps were confined only in paper. However, government became successful in implementing smooth planning procedure from 1956.

The successful implementation of the planning depended on foreign aid because foreign aid is taken as an important source of HMG resource in

different plan periods. Different development projects as well as procedures are generally incorporated and guided by foreign donors. But the problem of defining foreign aid became more acute as different donors used to assist in different fields and as an attempt was made to compare aid from different countries. Here in this study, a foreign resource provided with the purpose of developing recipient's economy is understood as foreign aid.

Foreign aid has played the important role in the implementation of different plans. Foreign aid has flown in a smooth way only with the first Plan Period. In early years, Nepal was not at a position even to run its administration without any foreign aid.

The economic plan in Nepal may be said to have taken some formative shape only towards the end of 1955, when the draft outline of the Five Year Plan was announced by a Royal Proclamation. It is believed that the Draft Plan was also prepared primarily for its being incorporated in the Colombo Plan, when Nepal attended its Singapore Session on October 17, 1955 as a full-fledged member country. It took about a year when at last the final draft of the Five Year Plan was announced on September 21, 1956. "Between" 1956-2002, Nine Periodic Plans been implemented and the Tenth Plan (2002-07) is already completed. The priority sectors of different plans seem to be different. The share of foreign aid in development expenditure in different plans is shown in Table 3.5.

Table No. 3.5
Share of Foreign Aid in Development Expenditure in Different Plans
(Rs. in Million)

Plan period	Development Expenditure	Foreign Aid	Foreign aid % of Development Expenditure
1 st plan (1956-61)	382.9	382.9	100.0
2 nd plan (1962-65)	614.7	478.3	77.8
3 rd plan (1965-70)	1639.1	919.8	56.1
4 th plan (1970-75)	3356.9	1509.1	45.0
5 th plan (1975-80)	8870.6	4264.1	48.1
6 th plan (1980-85)	21750.0	13260.0	60.1
7 th plan (1985-90)	48345.4	23978.5	49.6
8 th plan (1992-97)	113519.1	74355.0	65.5
9 th plan (1997-02)	129105.0	72420.0	56.1
10 th plan (2002-07)	234029.0	134620.0	57.5

Source: Different Plans, NPC

The First Plan (1956-61), was implemented with the purpose of increasing production, employment, standard of living and general well being throughout the country. In this plan, the foreign aid had played the vital role. The development expenditure of first plan was Rs. 382.9 million and the share of foreign aid was also 382.9 million. So the share of foreign aid in development expenditure is cent percent in this plan.

Increasing dependence on foreign aid was not suitable in the successive implementation of planning because foreign aid was generally limited to few development projects. So the dependence on aid needed to be diminished. For this purpose, the government felt the need of mobilizing the internal resources in the second plan. Due to the ignorance of actual

conditions and the development potentialities of the country the plan was proved unsatisfactory. The main objective of the Second Plan (1962-65) was to create an atmosphere required for the formulation and implementation of a more comprehensive plan in future. It had respectively given priority for developing different sectors as transport, communication and power, industries, social services, agriculture etc. Through the government tried to reduce the dependency on foreign aid and to mobilize the internal resources. In Second Plan, the development expenditure was Rs. 478.3 million. So the foreign aid as the percent of development expenditure in second plan is decreased than first plan and it became 77.8 percent.

Besides other plans, the Third Plan (1965-70) was implemented with wider objective. This plan had a long term perspective of doubling the national income in fifteen years. In the third plan a significant trend was to mobilize internal resource as much as possible which resulted in reducing contribution of foreign aid to 56.1 percent only in the development expenditure. In this plan the amount of development expenditure was Rs. 1639.1 million and the share of foreign aid was Rs. 919.8 million.

As other plans, the Fourth Plan (1970-75) also put the target to increase the development process in a planned and faster way. Emphasis was also given for the development of transport, communication etc. Total development expenditure in the Fourth plan was Rs. 3556.9 million and Rs. 1509.1 million was to be met by foreign aid (45.0 percent). Thus the fourth plan also could not ignore the important role of foreign aid. However, the ratio of foreign aid declined from 100.0 percent to 45.0 percent in the fourth plan.

The basic objectives of the Fifth Plan (1975-80) were significantly different from the other four plans. The fifth plan gave main priority to the “People oriented production” and maximum utilization of manpower and

emphasized quick yielding projects etc. The total development outlay of the fifth plan was kept at Rs. 8870.6 million. The contribution of foreign aid was Rs. 4264.1 million which accounted for about 48.1 percent of the total development expenditure.

In the Sixth Plan (1980-85), agriculture had been given top priority and industrial policy, hydropower etc. were also emphasized. In this plan period, Rs. 217500.0 million was put development expenditure and the foreign aid has contributed Rs. 13260.0 million which accounted for about 60.1 percent of the total development expenditure. After the completion of sixth periodic development plans, the country had at least achieved basic physical and social infrastructure.

Therefore, the Seventh Plan (1985-90), had to look towards fulfilling minimum basic needs of people. The objectives in the seventh development plan were to increase production at a higher rate, to increase opportunity for production, employment and to fulfill the minimum basic needs of the people. The total development expenditure allocated was Rs. 48345.4 million out of which Rs. 23978.5 million from the foreign aid.

In the years, 1990-92, there was no plan. This time remained plan holiday. After that Democratic government formulated the Eighth Plan (1992-97), before Eighth plan, neither the targeted growth rate was achieved nor was poverty alleviated. So the broad objectives of the eighth plan were suitable economic growth, poverty alleviation and reduction of regional imbalances. This plan gave priority to agricultural intensification and diversification, energy, rural infrastructure, employment and human resources development etc. It also gave priority for the macro economic stabilization, reforms in development administration, monitoring and evaluation. In this plan, Rs. 113519.1 million was outlay in the development expenditure. But the foreign aid has contributed Rs. 74355.0 million in the

total development expenditure which is 65.5 percent in the total expenditure.

In Ninth Plan (1997-2002), a clear implementation strategy was formulated for meeting the target of poverty alleviation, and brings about improvement in the living standard of the poor community. In keeping with this fact, the target of an average 6 percent annual growth of GDP at factor cost was set in the Ninth plan, and agriculture sector 4 percent and non-agriculture sector 7.3 percent. In Ninth plan actual foreign aid had contributed 56.1 percent in the development expenditure. The development expenditure in Ninth plan amounted Rs. 12905.0 million. And the share of foreign aid was Rs. 72420.0 million in the development expenditure.

The Tenth plan was implemented from fiscal year 2002/03 to 2006/07. As policy continuation of the eight and ninth plan, this plan has envisaged to expedite poverty alleviation by giving priority to high economic growth, good governance and social justice. Based on the experiences of the Ninth plan programs promotion poverty alleviation and social justice will be implemented more effectively in the Tenth Plan. In this context, strategies are directed towards achieves the set goal through participatory development process together with establishing the effective role of women in the national economic and social development etc. The total foreign aid in development expenditure was 57.5 percent estimated in the Tenth Plan. The total development expenditure was Rs. 234029.0 in tenth plan and the share of foreign aid was Rs. 134620.0 million.

The data and analysis presented in the preceding paragraphs clearly show the heavy dependency of Nepal on foreign aid for financing development expenditure of successive plans. It seems that without foreign aid, the country could not have executed the development plans.

3.6 Foreign Aid Commitment and Disbursement

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

3.6.1 Foreign Aid Commitment by Source

The following table shows that the amount of foreign aid that was committed by donor countries and agencies since 1985/86 to 2004/05. This clearly depicts the tendency of donors' commitment to provide foreign aid, which is increasing with some fluctuations.

Table 3.6
Foreign Aid Commitment by Source

(Rs. in Million)

Years	Bilateral	Multilateral	Total	Grants	Loans
1985/86	4656.3	4847.9	9504.2	4484.6	5019.6
1986/87	5127.0	3600.5	8727.5	2509.4	6218.1
1987/88	3478.5	2971.1	6449.6	294.0	3509.6
1988/89	3532.3	6870.7	10403.0	4759.0	5644.0
1989/90	6605.4	9224.6	15830.0	6238.8	9591.2
Average	4679.9	5503.0	10182.9	4186.4	5996.5
1990/91	3494.9	2170.5	5665.4	2769.9	2895.5
1991/92	7643.2	13440.9	21084.1	8061.1	13023.0
1992/93	12650.0	7878.7	20526.7	15997.7	4529.0
1993/94	7402.3	5769.9	13172.2	7426.0	5746.2
1994/95	9744.8	3132.1	12876.9	11166.8	1710.1
Average	8187.0	6478.4	14665.4	9084.3	5581.1
1995/96	10355.9	6181.4	16537.3	11066.4	5470.9
1996/97	19768.0	19875.0	39643.0	13743.7	25899.3
1997/98	13797.8	18224.3	32022.1	18368.4	13653.7
1998/99	13787.4	4665.0	18352.5	13304.2	5048.3
1999/00	11293.4	9154.6	20448.0	12860.2	7587.8
Average	13800.5	11620.1	25420.6	13868.6	11552.0
2000/01	17495.9	13791.0	31287.0	14289.1	16997.9
2001/02	18438.7	14789.0	33227.7	23340.2	9887.5
2002/03	15312.4	27890.3	43202.7	27357.6	15845.1
2003/04	8223.6	15514.4	23738.0	8957.0	14781.0
2004/05	21225.4	16926.9	38152.3	25392.7	12759.6
Average	16139.2	17782.3	17917.5	19867.3	14054.2
Total	214033.2	206818.9	420850.2	232386.8	188463.4

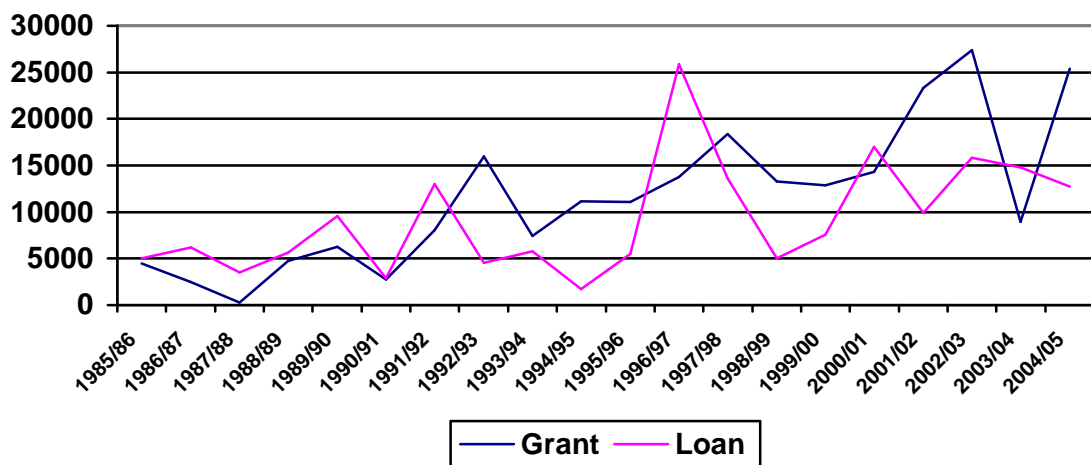
Source: Various Issues of Economic Survey

From the above table, the total foreign aid commitment in last twenty years (From 1985/86 to 2004/05) amounted to Rs. 420850.2 million. The

share of bilateral aid was Rs. 214033.2 million (50.9 percent) and the multilateral aid was Rs. 206818.9 million (49.1percent). Bilateral aid commitment is greater than multilateral aid commitment. On the other hand, out of the total aid commitment the share of committed grant was Rs. 232386.8 million (55.2 percent) and the loan was Rs. 188463.4 million (44.8 percent), which is lower than grant. If more grants can be utilized, it is better for the national economy.

Most of the programs and projects that received foreign aid are unable to utilize the total commitment. Programs and projects are not getting aid properly and they are also unable to absorb the aid from the donors. In-built feature of foreign aid program (i.e. transportation, power, etc.), lack of matching fund, rules and regulation binding the aid, inadequate technical manpower, weak institution; low administration efficiency etc. are the reasons of the lower use of committed foreign aid.

Figure-3.2
Trend lines of Committed grant and loan



The above figure 3.3 shows the trend of grant and loan commitment. The loan was continuously high till 1991/92 and then it was decreased than grant till 1995/96. In this fiscal year the loan becomes Rs. 5470.9 million and the grant was Rs. 11066.4 million. The pick point of loan commitment

is achieved in 1996/97, in it same year the amount of loan was Rs. 25899.3 million. On the other hand grant was high in 2002/03; the amount of grant was Rs. 27357.6 million. From this figure, the trend of grant and loan commitment is fluctuating.

3.6.2 Foreign Aid Disbursement by Major Source

The following table shows the actual disbursement of foreign aid by major source from 1985/86 to 2004/05.

Table-3.7
Foreign Aid Disbursement by Major Source

(Rs. in Million)

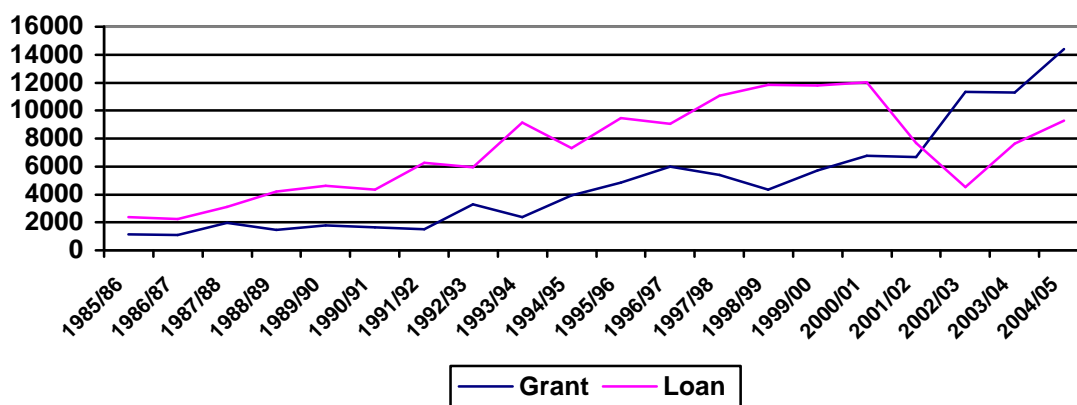
Years	Bilateral	Multilateral	Total	Grants	Loans
1985/86	1481.1	2010.4	3491.5	1120.6	2370.9
1986/87	1078.4	2236.1	3314.4	1078.3	2236.1
1987/88	2251.6	2826.9	5078.5	1984.2	3094.3
1988/89	1707.7	3959.2	5666.9	1478.2	4188.7
1989/90	2544.9	3882.2	6427.1	1798.8	4628.3
Average	1812.7	2983.0	4795.7	1492.0	3303.7
1990/91	2939.9	3050.1	5990.0	1630.0	4360.0
1991/92	3597.3	4203.1	7800.4	1531.0	6269.4
1992/93	3638.5	5597.1	9235.6	3273.9	5961.7
1993/94	2627.1	8930.1	11557.2	2393.6	9163.6
1994/95	3983.7	7260.7	11249.4	3937.1	7312.3
Average	3357.3	5808.2	9166.5	2553.1	6613.4
1995/96	3533.3	10755.7	14289.0	4825.1	9463.9
1996/97	6012.7	9019.2	15031.9	5988.3	9043.6
1997/98	6297.7	10159.4	16457.1	5402.6	11054.5
1998/99	4167.6	12021.4	16189.0	4336.6	11852.4
1999/00	4929.1	12594.8	17523.9	5711.7	11812.2
Average	4988.1	10910.1	15898.2	5252.9	10645.3
2000/01	2771.2	16026.2	18797.4	6753.4	12044.0
2001/02	4675.3	9709.5	14384.8	6686.2	7698.6
2002/03	10044.4	5841.1	15885.5	11339.1	4546.4
2003/04	9013.2	9899.2	18912.4	11283.4	7629.0
2004/05	9230.8	14426.5	23657.3	14391.2	9266.1
Average	7147.0	11180.5	18327.5	10090.7	8236.8
Total	86525.5	154408.9	240934.4	96938.9	143995.5

Source: Various Issues of Economic Survey

From Table 3.6, the total foreign aid disbursement was Rs. 240934.4 million. The share of total bilateral and multilateral aid disbursement was

Rs. 86525.5 and 154408.9 million respectively. Comparatively bilateral aid is less than multilateral aid disbursement. Out of total aid, disbursement of grant was Rs. 96938.9 million and the loan was 143995.5 million whereas the loan is greater than grant.

Figure 3.3
Trend Lines of Grant and Loan Disbursement



From the above figure 3.4, the trend of loan and grant disbursement is increasing but the amount of loan is always higher than grant besides FY 2002/03, 2003/05 and 2004/05. This trend clearly depicts that the government is unable to utilize the committed amount of grant.

3.6.3 Difference between Aid Commitment and Disbursement

Most of the projects and programs which received foreign aid have been unable to utilize the total committed aid or indicating a very low absorptive capacity. Due to the delay in timely implementation of the projects, they are inefficient to disburse the committed amounts of foreign aid. The main cause of the short-falls in disbursement is the time lag because aid for the projects is committed in one year, and the amount is disbursed in subsequent years.

A typical characteristic of foreign aid to Nepal is the constant short fall in disbursement against commitments. There is considerable gap

between commitment and disbursement of aid. The following table shows the foreign aid commitment as percent of disbursement.

Table- 3.8
Foreign Aid Disbursement as % of Commitment

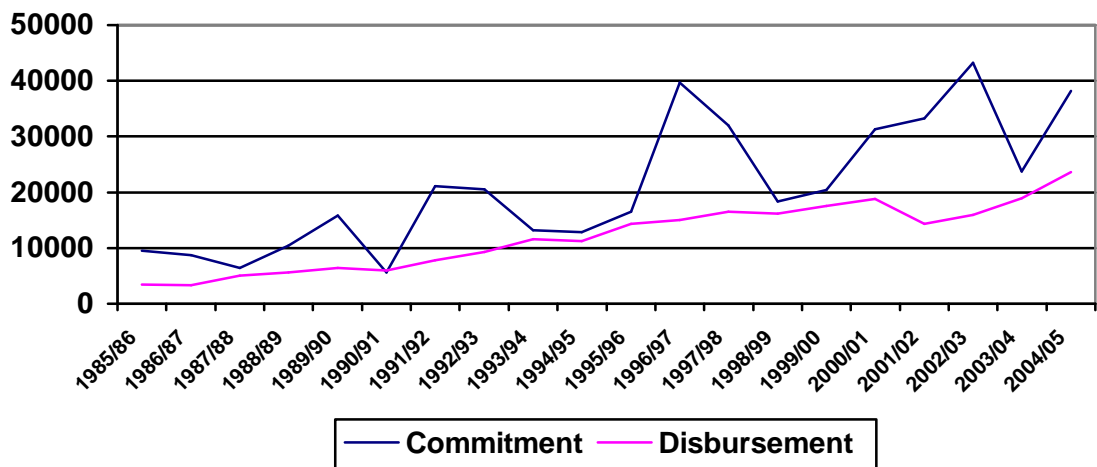
(Rs. in million)

FY	Commitment	Disbursement	Difference	Disbursement as % Of Commitment
1985/86	9504.2	3491.5	6012.7	36.7
1986/87	8727.5	3314.4	5413.1	38.0
1987/88	6449.6	5078.5	1371.1	78.7
1988/89	10403.0	5666.9	4736.1	54.5
1989/90	15830.0	6427.1	9402.9	40.6
1990/91	5665.4	5990.0	-324.6	105.7
1991/92	21084.1	7800.4	13281.1	37.0
1992/93	20526.7	9235.6	11291.1	45.0
1993/94	13172.2	11557.2	1615.0	87.7
1994/95	12876.9	11249.4	1627.5	87.4
1995/96	16537.3	14289.0	2248.3	86.4
1996/97	39643.0	15031.9	24611.1	37.9
1997/98	32022.1	16457.1	15547.0	51.4
1998/99	18352.5	16189.0	2163.5	88.2
1999/00	20448.0	17523.9	2924.1	85.7
2000/01	31287.0	18797.4	12491.7	60.1
2001/02	33227.7	14384.8	18842.9	43.3
2002/03	43202.7	15885.5	27317.2	36.7
2003/04	23738.0	18912.4	4825.6	79.6
2004/05	38152.3	23657.3	14495.0	62.0

Source: Various Issues of Economic survey

Figure-3.4

Trend Line of Commitment and Disbursement of Aid



The above table and figure show that the average disbursement as percent of commitment is 62.1 percent of the twenty years after the FY 1985/86. From the above mentioned data we find a huge gap between the amount committed by the donors and the actual amount received by Nepal. A typical characteristic of foreign aid to Nepal is the constant shortfall in disbursement against commitment. Such low absorption capacity results in cost overruns and lower returns to investment, etc.

Foreign aid commitment varies year to year depending on the magnitude of assistance provided under agreement signed with the donors on large or small and short or long duration projects. In the fiscal year 2002/03, there is huge amount of gap between commitment and disbursement. In this year the gap is Rs. 27317.2 million whereas the committed amount is Rs. 43202.7 million and the disbursed amount is Rs. 15885.5 million.

Nepal's failure to estimate aid requirements, rigidity in financial rule and regulations, easy access to aid, highly centralized decision-making process all contribute to a slow disbursement. Donors further exacerbate the problem. Most multilateral donors; the WB, ADB and IMF in particular,

attach many conditionalities and preconditions with the aid packages ranging from a change in Act to the elimination of subsidies and changing the tariff rates. While negotiating, Nepal accepts them for fear of losing money but during the implementation, it fails to fulfill them, since many changes apparently become politically undesirable. Aid provided by bilateral donors take long times to produce goods and services. So these can be the cause of slow disbursement of aid. Nepal's project implementation performance has been poor but it became poorer from 1990. The movement for restoration of democracy and subsequent political change, unstable political situation, weak political commitment reinforced the deteriorating condition of project implementation performance since 1990 causing poor absorptive capacity of foreign aid.

Delay in obtaining government clearance for projects, delay in the recruitment of consultant, delays in finalizing contract award, high turnover of key project staffs and inadequate counter parts funds are the main cause of poor project performance and low rate of aid disbursement. The responsibilities of aid co-ordination lie with MOF. Practices however differ as other ministries, autonomous bodies, private sectors and other agencies discharged the many functions of the government. Some aid projects are spent, only partial benefit is realized. So the poor project performance, lack of co-ordination and lack of result may be the cause of increasing difference between aid commitment and real disbursement.

CHAPTER-IV

FOREIGN AID and RESOURCE GAP

Systematic flow of foreign aid in Nepal began with signing of agreement with the United States of America under the Point Four Programs in 1951. After the dawn of democracy, Nepal commenced the First Plan from 1956-61. Since then, Nepal has started to heavily receive foreign aid from developed countries like USA, UK, India, China, Japan, Germany, Netherlands, and Australia, etc. and from different multilateral organizations like ADB, WB, IMF, UNDP, UNFPA, WHO, FAO etc.

In the First Plan (1956-61), above 99 percent of development expenditure were financed by foreign aid. This aid contained most of the aid as grant element rather than loan. Continuously in second, third, fourth, fifth, sixth, seventh, eighth and ninth plans, the share of foreign aid in development expenditure was 77.8, 56.1, 45.0, 48.1, 49.6, 65.5, and 56.1 percent respectively. The total foreign aid in development expenditure is 57.5 percent estimated in the tenth five year plan.

Nepal is a tiny beautiful Himalayan Kingdom sandwiched between the two Asian giants, China in the North and India in the East, West and South with an open border. Nepal is least developed, landlocked, geographically disadvantageously placed, an economically vulnerable nation of enormous ecological, cultural and ethnic diversity. Nepal is said to be rich in biodiversity possessing 2.3 percent of the world's hydro resources with a broad variety of topography experiencing tropical, tundra etc. climates. Instead of that, preliminary geographical survey shows, the country is considered to be rich in minerals such as iron, copper, gold, lead and zinc, limestone, slate mineral oil and gas, coal etc. However, all of these have not been yet fully tapped. These natural resources are not properly

used up to now due to the lack of capital, skilled manpower, and infrastructure development.

Nepal is an agrarian country where still around 80 percent of people depends upon agriculture. Nearly 38 percent of Nepalese are below the poverty line (In 2003-04, estimated poverty headcount was 31 percent in Nepal-CBS). The per-capita income of the people is very low as compared to the other advanced countries of the World. So this per-capita income reduces the size of saving of the people and this low saving results low capital formation in the country. This creates the resources gap problem of the country. Nepal has been facing these kinds of problem.

4.1 Resource Gap in Nepalese Economy

The resource gap is defined as total budgetary expenditure less the resource mobilized internally. When a country is spending more on investment and government expenditure than it's earning from the resources released through private saving and taxation, there will be a resource gap within the economy. The resource gap creates the problem of the balance of payment and foreign exchange gap. Nepal has been experiencing a deficit budget system and this has supported the growing resource gap.

According to Gunanidhi Shrama (1998), Nepal has been facing the problem of a resource gap that is increasing over time. It is mainly due to:

- A traditional nature of the tax administration.
- A centralized system of governance.
- The inflow of easy money through various channels.
- The existence of donor's interest in aid supply.
- A less generous economy and a slow change in traditional structure.

Thus the resource gap constitutes the expenditure-revenue gap, saving-investment gap and export-import gap.

4.1.1 Expenditure-Revenue Gap

Nepal is experiencing a serious and growing resource gap since the start of first five year plan and it is a common phenomenon of developing countries like Nepal. This is because the annual growth rate of public expenditure has outpaced its revenue collection resulting into the financial resource gap in the budgetary system of Nepal. This compels a government to confront choice between the sources of financing: external and domestic.

In the past few years, i.e. 1951/52 to 1961/62, the government of Nepal used to finance such gap with foreign grant. However, since the 1964/65, the government has been receiving foreign grant as well as loan to fill up the resource gap. The following table shows the Expenditure Revenue gap.

Table 4.1
Expenditure-Revenue Gap

(Rs. in Million)

FY	Total Expenditure	Annual % Growth rate of Expenditure	Total Revenue	Annual % Growth rate of Revenue	Gap	Annual % Growth rate of Gap
1985/86	9797.1	-	4644.5	-	5152.6	-
1986/87	11513.2	17.5	5975.1	28.6	5538.1	7.5
1987/88	14105.0	22.5	7350.4	23.0	6754.6	21.2
1988/89	18005.0	27.6	7776.9	5.8	10228.1	51.4
1989/90	19669.3	9.2	9287.5	19.4	10381.8	1.5
Average	14617.9	15.4	7006.9	15.4	7611.0	16.3
1990/91	23549.8	19.7	10729.9	15.0	12819.9	23.5
1991/92	26418.2	12.1	13512.7	26.0	12905.5	0.7
1992/93	30897.7	17.0	15148.4	12.1	15749.3	22.0
1993/94	33597.4	8.7	19580.8	29.2	14016.0	-11.0
1994/95	39060.0	16.2	24575.2	25.5	14484.8	3.3
Average	30704.6	14.7	16709.4	21.6	13995.1	7.7
1995/96	46542.4	19.1	27893.1	13.5	18649.3	28.7
1996/97	50723.7	9.0	30373.5	9.0	20350.2	9.1
1997/98	56118.3	10.6	32937.9	8.4	23180.4	13.9
1998/99	59897.0	6.7	37251.0	13.0	22628.0	-2.4
1999/00	66272.5	10.7	42893.8	15.1	23378.7	3.3
Average	55910.8	11.2	34269.9	11.8	21637.3	10.5
2000/01	79835.1	20.4	48893.6	14.0	30941.5	32.3
2001/02	80072.2	0.3	50445.5	3.2	29626.7	-4.3
2002/03	84006.1	4.9	56229.8	11.5	27776.3	-6.2
2003/04	89442.6	6.5	62331.0	10.9	27111.6	-2.4
2004/05	102560.4	14.7	70122.7	12.5	32437.7	19.6
Average	87183.3	9.4	57604.5	10.4	29578.8	7.8

Source: Various Issues of Economic Survey

As presented in the table 4.1, shows that, the amount increment of expenditure is of continuous in nature, similarly, the revenue is increasing continuously, from period 1985/86 to 2004/05. The deficit of the resource

gap, here, is the different between total expenditure minus total revenue and is generally known as overall deficit in the budgetary system. The overall growth trend of revenue deficit is between -11.0 percent in 1993/94 to 51.4 percent in 1988/89. The amount of overall deficit is increasing year to year but the growth trend of revenue deficit is fluctuation rate. The amount Rs. 32437.7 million is the maximum gap found in review period of FY 2004/05. From the table 4.1, the average annual growth rate of expenditure is 12.7 percent where as the annual growth rate of revenue is 14.8 percent in the review years. This clearly reflects that the trend of revenue growth rate is higher than growth rate of expenditure in relative term, but not sufficient to meet the expenditure in absolute term.

The average annual growth rate of revenue gap is 10.6 percent resulting in the fiscal problem in the budgetary system and indicates the growing demand for government expenditure.

4.1.2 Saving Invest Gap in Nepalese Economy

Saving is defined as the excess of income over consumption expenditure ($S = Y - C$). Keynes's aggregate saving is the direct result of the saving of individual units in the economy, current saving depends upon current income. But Robertson believes that current saving is more a function of the past income. On the other hand, capital is considered to the critical factor in economic growth and as such, occupies central place in the growth theories. This is more so in the case of under developed economics like Nepal, which need to achieve the higher rate of growth of production of improving the living standard of majority of people. This requires that larger share of available resource go for production purposes (Capital investment).

In the absence of capital, other available resources (Land and labor) remain either unutilized or don't get their optimal use and hence can not fully contribute to the production and national wealth creation process. The

saving growth depends upon various factors such as Per capita income of the country and its growth rate, population growth rate, interest rate on saving, banking and financial facilities, and net factor income. Saving is the part of income left over consumption and investment is the expenditure made for the formation of the fixed capital.

The biggest chunk of investment requirement in any economy is met from the resources generated by the economy itself and its mobilization. The internally generated resources come from the savings of the household, government and firms and companies. The mobilization of saving implies transfers of resources from the hands of surplus units to deficit unit, in these connection financial intermediaries play a vital role in mobilization of voluntary saving. But the amount of saving of a typical house in Nepal is very small due to limited opportunities for investment. The following table shows the overall trend of saving invest gap.

Table 4.2
Saving-Investment Gap in Nepal

(Rs. in Million)

FY	GDP	Investment	I/GDP%	Saving	S/GDP%	S-I	Growth rate (S-I) %	S-I/GDP%
1985/86	55734	10599	19.0	5887	10.6	4712	-	8.4
1986/87	63864	12898	20.2	7321	11.5	25577	18.4	8.7
1987/88	76906	15237	19.8	7604	9.9	7633	36.9	9.9
1988/89	89270	19415	21.7	10150	11.4	9265	21.4	10.3
1989/90	103416	19076	18.4	8143	7.9	10893	17.6	1.5
1990/91	120370	25074	20.8	11514	9.6	13560	24.5	11.2
1991/92	149487	31619	21.2	16207	10.8	15412	13.7	10.4
1992/93	171474	39653	23.1	23172	13.6	16481	6.9	9.5
1993/94	199272	44644	22.4	29220	14.7	15424	-6.4	7.7
1994/95	219175	55231	24.9	32465	14.6	22766	47.6	10.3
1995/96	248913	68017	27.3	34426	13.9	33591	47.5	13.4
1996/97	280513	71084	25.1	39162	12.8	31922	-4.9	12.3
1997/98	300845	74728	24.8	41438	13.8	33290	4.3	11.0
1998/99	342036	70061	20.5	46563	13.6	23498	-29.4	6.9
1999/00	379488	92272	24.3	57577	15.2	34695	47.7	9.1
2000/01	411275	99301	24.1	62018	15.1	37283	7.5	9.2
2001/02	422807	102174	24.1	51281	12.1	50893	36.5	12.0
2002/03	456675	118020	25.8	54778	12.0	63242	24.3	13.8
2003/04	496745	130993	26.4	62386	12.6	68607	8.5	13.8
2004/05	533538	154132	28.9	66336	12.4	87796	28.0	16.5

Source: Various Issues of Economic Survey

During the period under review, the investment ratio (I/GDP) has been oscillating within a range of 18 to 28 percent. From the table 4.2, the

rates of investment in the recent years (2000/01 to 2004/05) have been relatively higher, between 24-28 percent compared to 18-23 percent in the proceeding years expect 27.3 percent in 1995/96 and 24.9 percent in 1994/95. The relatively higher investment rates in the recent years do not seem to have occurred as a result of higher domestic saving rate.

The saving rate reached a peak of 15.2 percent in 1999/00, remained almost same in 1994-1996 and in 2000/01, declined to 12 percent in the next few year from the peak. As a consequence, the saving gap as percent of GDP ($S-I/GDP$) has increased in the recent years. This alarming consequence of poor saving performance in the recent years has been the increasing dependence of the economy on external resources to meet the capital requirements. Therefore, the major donors have expressed aid as the mechanism to support the development process of the resources poor countries.

Again, from the table 4.2, it is clear that, the amount of saving and investment has increasing in a little bit oscillatory magnitude. The rate of saving is also growing with compare to investment, but till now, it is inadequate to meet the desired investment. This is because of higher investment demand and lower saving rate. The growth percentage of saving gap is fluctuating with a large range of -29.4 percent to 47.7 percent in the review years between 1985/86 to 2004/05.

4.1.3 Export-Import Gap in Nepalese Economy

Nepalese economy has been embarked on planned development efforts since more then five decades, its overall performance is low and can be explained in terms of its limited resource base, rapid population growth, environment degradation and the inefficient government bureaucracy, resulting into low level of social development and widespread poverty. This

dismal achievement in the past is due to the unfavorable foreign trade balance.

The performance trends of export and import in Nepal's foreign trade are discussed with data based observations.

Table-4.3
Export- Import Gap in Nepalese Economy

(Rs. in Million)

FY	Export (X)	Growth %	Import (M)	Growth %	X-M	Growth %	GDP	X/GDP %	M/GDP %	X-M/GDP
1985/86	3078.0	-	9341.9	-	-6263.2	-	53215	5.8	17.6	11.8
1986/87	2991.4	-2.3	10905.2	16.7	-7913.8	26.3	61140	4.9	17.8	12.9
1987/88	4114.5	37.5	13869.5	27.2	-9755.0	23.3	73170	5.6	18.9	13.3
1988/89	4195.3	1.9	16263.7	17.3	-12068.4	23.7	85831	4.9	18.9	14.1
1989/90	5156.2	22.9	18324.9	12.7	-13168.7	9.1	99702	5.2	18.4	13.2
1990/91	7387.5	43.3	23226.5	26.7	-15839.0	20.3	116127	6.4	20.0	13.6
1991/92	13706.5	85.5	31940.0	37.5	-18233.5	15.1	144933	9.5	22.0	12.6
1992/93	17266.5	25.9	39205.6	22.7	-21939.1	20.3	165350	10.4	23.7	13.3
1993/94	19293.4	11.7	51570.8	31.5	-32277.4	47.1	191596	10.1	26.9	16.3
1994/95	17639.2	-8.6	63679.5	23.5	-46040.3	42.6	209974	8.4	30.3	21.9
1995/96	19881.1	12.7	74454.5	16.9	-54573.4	18.5	239388	8.3	31.1	22.8
1996/97	22636.5	13.8	93553.4	25.6	-70916.9	29.9	269570	8.3	35.6	26.3
1997/98	27513.5	21.5	89002.0	-4.9	-61488.5	-13.3	289798	9.5	30.7	21.2
1998/99	35676.3	29.7	87525.3	-1.7	-51849.0	-15.7	330018	10.8	26.5	15..7
1999/00	49822.7	39.7	108504.9	23.9	-58682.2	13.2	366251	13.6	29.6	16.0
2000/01	55654.1	11.7	115687.2	6.6	-60033.1	2.3	394052	14.1	29.4	15.2
2001/02	46944.8	-16.0	107389.0	-7.2	-60444.2	0.7	406138	11.6	26.4	14.9
2002/03	49930.6	6.8	124352.1	15.8	-74421.5	23.1	437546	11.4	28.4	17.0
2003/04	53910.7	8.0	136277.1	9.6	-82366.4	10.7	474919	11.4	28.7	17.3
2004/05	58705.7	8.9	149473.6	9.7	-90767.9	10.2	508651	11.5	29.4	17.8
Average	25775.2	17.7	68227.3	15.5	42452.1	15.4	245868.5	9.1	25.5	16.3

Source: Various issues of Economic Survey

Table 4.3 shows that the trade deficit of Nepal has been increasing over the period of 1985/86 to 1996/97, and started to decline till 1999/00

and again started to increase till now. Though export has increased at the average rate of 17.7 percent per annum, import has increased at the rate of 15.5 percent per annum during the review period.

The average ratio of trade deficit to gross Domestic Product (X-M/GDP) for the period recorded 16.3 percent on an average. This trade deficit ratio to gross domestic product reached at the peak value 26.3 percent in 1996/97. The export GDP ratio (X/GDP) during the period was only 9.1 percent on average, while the import GDP ratio (M/GDP) was more than 25 percent on an average. The growth rate of import is much higher compared to export, which is not a favorable indication for the economy.

In monetary values, the total amount of export was Rs. 3078.0 million in 1985/86, which was increased to Rs. 58705.7 million in 2004/05. Similarly, import increased from Rs. 9341.9 million in 1985/86 to Rs. 149473.6 million in 2004/05. The growth rate trends of import is increasing with fluctuation rate, similarly, in the export side there is fluctuating trends.

4.2 Annual Growth of Saving, Investment, Foreign aid and Foreign Aid GDP Ratio

A low level of revenue at a time when the need for investment is growing in basic social and economic infrastructure development and administrative expenses has together compelled the government to resort to foreign aid, for financing their economic activities.

Developing countries like Nepal are always facing the problems of funds, tax payment capacity of the general public is very low, which leads the low level of government revenue, resulting the increasing demand for development needs force to foreign aid. Thus, external finance is considered as an instrument to collect the needy fund in underdeveloped economy.

Foreign aid contributes to resource mobilization, capital accumulation and industrialization. Substantial portions of Nepal's development expenditure averaging about more than 55 percent per annum during all plan periods have been financed through foreign aid (table-3.5). The foreign loan financing alone contributed significantly to the development expenditure of Nepal, which was around 65 percent during 1985/86-2004/05 (From table-3.2). However, the increasing burden of debt service has drained resources by curtailing the investment from socio-economic development and infrastructure buildings. It is particularly because of the significant amount of the development expenditure financed through foreign aid on the one hand and the increased size and magnitude of external debt on the other. The following table depicts the annual percent growth rate of saving, investment and foreign aid inflow.

Table- 4.4
Growth Rate of Saving, Investment, Foreign Aid, and Foreign Aid GDP Ratio
(1985/86 to 2004/05)

(Rs. In Million)

Years	Growth rate % of $S = \frac{\Delta S}{S}$	Growth rate % of $I = \frac{\Delta I}{I}$	Growth rate % of $FA = \frac{\Delta FA}{FA}$	Foreign aid GDP Ratio $= \frac{FA}{GDP}$
1985/86	-	-	-	0.065
1986/87	21.7	24.4	-8.2	0.054
1987/88	18.1	3.9	-26.1	0.069
1988/89	27.4	33.5	61.3	0.066
1989/90	-1.7	-19.8	52.2	0.064
1990/91	31.4	41.4	-64.2	0.052
1991/92	26.1	40.8	272.2	0.054
1992/93	25.4	43.0	-2.6	0.056
1993/94	12.6	26.1	-35.8	0.06
1994/95	23.7	11.1	-2..2	0.054
1995/96	23.1	6.0	28.4	0.06
1996/97	4.5	13.8	139.7	0.056
1997/98	5.1	5.8	-19.2	0.057
1998/99	-6.2	12.4	-42.7	0.049
1999/00	31.7	23.7	11.4	0.048
2000/01	7.6	7.7	53.0	0.048
2001/02	2.8	-17.3	6.2	0.035
2002/03	15.5	6.8	30.0	0.036
2003/04	11.0	13.3	-45.1	0.04
2004/05	17.7	6.3	60.7	0.047

Source: Calculated from Tables 3.3, 4.2 and 4.3

From Table 4.4, it is seen that the annual growth rate of saving is being oscillating from -6.2 percent to 31.4 percent whereas investment growth rate is oscillated between -17.3 to 43.0 percent. The annual saving growth rate was minimum -6.2% in 1998/99 and maximum 31.4% in 1990/91 respectively. And on the other side, the annual investment growth rate found minimum -17.3% in the 2001/02 and maximum 43.0% in the 1992/93. Similarly, annual growth rate of foreign aid is being oscillated within the range of -64.2 to 272.2 percent. The minimum foreign aid growth rate found -64.2% in the 1990/91 and maximum 272.2% in the FY 1991/92.

Aid GDP ratio shows positive contribution to GDP. Above table shows that aid contributes to GDP minimum 3.5% (in 2001/02) to maximum 6.9 % (in 1987/88).

But from Table 4.3, it is seen that saving and investment both are increasing in relative terms but in absolute term, saving is less than investment which increase the saving investment gap. From table 3.2 foreign aid inflow is being increased continuously.

From the above data, it is seen that national financial resource cannot fulfill the investment saving gap. In this way, a contradiction is seen that how long we have to depend on external financing? Dependency upon foreign aid for the country is not always good due to:

- Robbed the government of its autonomy to pursue policies which is judges to the necessary: - most of the donors want to adopt their interest, not the necessity of recipient countries. In this way, they are successes to rob the autonomy of the government
- Elite Class: - Foreign aid generally goes to the hand of elite class first who are the main official for the mobilization of foreign aid. So, foreign aid promotes the interest of elite class

- Experiments in institution and programs: - donors want to make experiment upon new programs that may be success or failure.

National saving is one of the circulating factors, so that it plays a vital role in economic growth (development). But miss-utilization of the external resources may be the one important factor for the unsatisfactory growth rate of saving. Different experts argue that foreign aid is being spent in unproductive activities. Similarly, due to the corruption and lack of coordinating body, foreign aid has not been utilized properly.

In other words, the saving capacity of the economy is limited to around 9.7 percent of GDP during the review period indicating the public sector debt is even more alarming. This is mainly so because of the misuse of borrowed funds (particularly) on unproductive sector and the decision making about the priority setting of project is irrational causes the foreign aid unproductive.

In conclusion, it can be said that the dependency of foreign aid cannot avoid recently due to the lack of sufficient domestic financial resources, which is shown by increasing resources gaps. So for the optimum utilization of foreign aid, we have to make an appropriate rules and regulations by the related body.

4.3 The Implication of Foreign Aid on Different Gaps

From the above empirical observation it is clear that the government sector is characterized by a large and increasing financial deficit, resulting from the poor resource base, growing demand for development expenditure, low level of saving etc. However, saving is not the only condition for capital formation; other important factor is the entrepreneurial ability and capability. Because of the low capital formation, the government has to accept foreign aid. In case of Nepal, very low level of savings accompanied with high requirements of investment has been widening this gap every year

at an alarming pace calls for need of foreign aid. In the context of Nepal, the development expenditure, without hesitation we can say, is a function of foreign aid. Thus, in order to meet the financial deficit, the government of under developed countries, like Nepal, heavily depends on foreign aid to accelerate the pace of economic activities. Similarly, the need of public finance, results because of the resource gap i.e. saving as well as trade gap. This compels a government to confront with the choice between the sources of financing: external and domestic.

In the context of Nepal, the sources of meeting the resource gaps are foreign aid and internal loan and by change in cash balance. In FY 2004/05, the total deficit amount Rs. 18.5 billion was met by these sources. An analysis of sources of meeting focal deficit shows that 50.1 percent (Rs. 9.27 billion) was met through foreign loan, 48.3 percent (Rs. 8.94 billion) internal loan and remaining 1.6 percent (Rs. 0.16 billion) through change in cash balance (Economic Survey, 2004/05).

4.4 Impact of Foreign Aid on GDP (Empirical Analysis)

This sub-chapter intends to analyze the impact of foreign aid to the Gross Domestic Product (GDP) of Nepal. Thus, the basic starting point is the examination of a direct relationship between the GDP and the amount of foreign aid. The simple log regression model has been used to analyze the impact. The model has been estimated in log linear form. All the data in the analysis are taken from Annex-A, for the period 1985/86 to 2004/05. In all statistical analysis, numbers in parenthesis below the coefficient of independent variables indicates their respective t-values. All regression lines in this chapter are conducted by using ‘SPSS’ program.

Regression line

$$\ln Y = 0.496 + 0.951 \ln F_{AID}$$

(2.052) (19.979)

$$R^2 = 0.957, \text{ Adj. } R^2 = 0.954, F = 399.165, N=20$$

Where,

Y = Gross Domestic Product (GDP)

F_{AID} = Foreign Aid

The null hypothesis set for this analysis holds that there is no significant relationship between foreign aid to Nepal and GDP growth in Nepal. But the above result indicates that there is positive impact between foreign aid and GDP growth in Nepal.

The above regression line is a log linear model. The beta coefficient explains the elasticity of Nepal's GDP with respect to the Foreign Aid. The elasticity coefficient of 0.951 implies that 1 percent change in foreign aid results into the 0.951 percent change in GDP. The adjusted R² value is 0.954 implying that 95.4 percent of the total variation in dependent variable being explained by the independent variable. F-test is 399.165 implying the high significance of this model. T-test also shows the best fit to the model

4.4.1 A Comparison with Past Results

In the study of Sriram Poudel, a title of "Impact of Foreign Aid in Nepal" shows that the correlation coefficient between Gross Domestic Product (GDP) and foreign aid is 0.95 and its determination is 0.91. Similarly, the elasticity of GDP with respect to foreign aid is 0.48.

Similarly, in the study by Buddhi Prased Acharya, "Impact of US Aid in Economic Development of Nepal" shows that the correlation coefficient between GDP and foreign aid is 0.822 and its determination is 0.676. Similarly the elasticity coefficient is 0.793.

By the comparison of above results with the result obtain in this study; it seems very close i.e. the values of R, R² and elasticity coefficient are 0.978, 0.957 and 0.951 respectively. These all results show that there is a positive impact of foreign aid on GDP.

CHAPTER – V

SUMMARY, CONCLUSION AND RECOMONDATION

5.1 SUMMARY

Nepal is one of the least developed countries of the World with very poor economic and social infra-structure for development. It suffers from a serious resource gap with low saving and low investment. Foreign aid can play an important role in the economic and social development of Nepal. Foreign aid has been a major source of financing development Project or Program around the fifty-five. Nepal first traces of foreign aid were heralded by point four program agreements on January 1951. Then after that Nepal has been getting foreign aid from different bilateral and multilateral agencies as in the form of loan and grant.

The study of fifty-five years of foreign aid in Nepal shows may distinctive features; the volume of aid has been increasing each year and each Plan and the numbers of donors have been remained touched by foreign aid. It has covered almost every field of development in Nepal like agriculture, health, social, education, transport, communication, construction, industry and commerce etc.

In the initial period of aid to Nepal, all the aid was in the form of grants and was bilateral in nature. But over the years, the share of bilateral as well as grants assistance has declined. Nepal has faced different problem to management of foreign aid. Though, the amount of external assistance has been increasing.

In the FY 2000/01 the bilateral assistance was only 14.8 percent of total aid and multilateral was 85.2 percent of total aid. Similarly the share of grant assistance in FY 1999/00 was only 32.6 percent and loan was 67.4 percent. It indicates increasing burden of foreign debt in the economy.

Though, the total amount of foreign aid has been increasing. Nepal has not been able to use the entire committed amount. In the FY 2002/03, only 36.7 percent of total committed aid was disbursed. It shows the poor absorptive capacity of the economy and delay in the implementation of projects. The study of foreign aid depicts the tendency of donor's commitment to provide the foreign aid. In the different years, the trend of total foreign aid has been fluctuant increasing.

Foreign aid has played the important role in the process of different plan period. The amount of foreign aid to implementation of different plan period has been increasing. In the Ninth plan, 56.1 percent to total development expenditure was financed by foreign aid whereas it is estimated that the total share of foreign aid in the Tenth plan will be 57.5 percent. Foreign aid has also played the role in the different sector of the economy. During the period of 20 years that is i.e. from 1985/86 to 2004/05, the agriculture, irrigation and forestry 23.3 percent have been allocated in average of total foreign aid. Similarly, Transport, power and communication sector 45.6 percent, industry and commerce 5.7 percent, social service sector 24.7 and other sector 0.7 percent have been allocated in average of total foreign aid respectively. The transport, power and communication sector was met the higher percent share of total foreign aid during the same years.

To fulfill the development plan outlay and to narrow the resource gap the role of external resource considered to be a significant instrument. The foreign aid has been contributed to fulfill the resource gap i.e. saving as well as trade gap. In the fiscal year 2004/05, the total deficit amount Rs. 18.5 billion was met by three financial sources, i.e. foreign loan, internal loan and change in cash balance. An analysis of sources of meting focal deficit shows that 50.1 percent (Rs. 9.07 billion) was met through foreign loan,

48.3 percent (Rs. 8.94 billion) through internal loan and remaining 0.6 percent (Rs. 0.16 billion) through change in cash balance (Economic survey, 2004/05).

The empirical study shows that there is positive relationship between inflow of foreign aid and GDP of Nepal. The beta coefficient is 0.951 implies that 1 percent change in foreign aid results into the 0.951 percent change in GDP of Nepal. The adjusted R^2 value is 0.954 implying that 95.4 percent change in GDP is explained by the change in foreign aid. T-test and F-test also shows the best theoretical fit of the parameters.

Though Nepalese economy is foreign aid based, utilization of foreign aid indicates that there is extreme necessary to improve the method of utilization of foreign aid. The absence of effective and transparent policy on the mobilization of foreign aid is the main problem of the Nepalese economy. In extreme necessity cases we must accept foreign loan and properly utilize it, in order to get more benefit through own development works (Foreign aid policy, 2003).

5.2 Conclusion

Foreign aid is widely accepted in the developing countries for various sectors. Mobilization of internal capital is not sufficient to accelerate the rate of economic development and growth without foreign aid. An underdeveloped economy like Nepal is marked by the deficiency of capital. Foreign aid can play a vital role in the overall development efforts of the country as in Nepal.

For the last fifty-five years, foreign aid has remained an integral part of the Nepalese economy. There has been many fold increase in the quantum of aid flows to Nepal. During this period, there has been some improvement in the physical and socio-economic indicators of Nepalese

economy. It has helped for implementation of the various project and programs. Nepal's development efforts were almost all financed by foreign aid assistance in one form or another during the last 55 years.

Foreign aid helps bridge the gap between the shortfalls of the national saving to the national investment. It has support to fill the gap between the excess of imports of goods and services over their exports. There we hardly any economic activities in Nepal, particular relatively to the Government of Nepal, that does not have the element of foreign aid. Many of the Nepal's economic, social and political policy making are done with the support of foreign aid.

The trend of donor's priorities for aid to Nepal indicates that each donor is trying out to finance specific projects; which are mostly untouched by other donors. The shift is the sectoral composition of aid from other donors would be turning fundamentally with their own aid priority determined by the capability and technical and resource endowments. The sectoral priorities of multilateral source have a marked preference for heavy capital intensive projects such as power, irrigation and water supply for the urban areas.

The capacity to utilize the committed amount of aid productively continuous to remain as a crucial problem for the Nepalese government over since it began to receive aid. It becomes clear if one goes into the gap between the commitment and disbursement of aid. Disbursements, too is simply an expenditure statistics. This does not say anything on whether this money has or has not been productively utilized. The low absorptive capacity is the outcome of political instability, lack of commitment of ruling authorities, bureaucratic delay, and absence of institutionalization of development administration, corruption and lack of proper management of development project.

More aid is necessary for the effective aid, and effective aid is necessary for the economic growth, poverty reduction and sustainable development. Nepal hence has to seriously consider making the effective use of foreign resources in order to attract an increasing amount of external financial resources. In order to derive maximum advantage from the foreign assistance policy, it is necessary that the policy be implemented effectively, that aid is made a more effective tool for poverty reduction in the context of the overarching objective of the Tenth plan, that wasteful and ineffective implementation of development programs is eliminated or reduced, that trust and cooperation between donors, government and society is built and that national ownership of development strategic, priorities and programs is ensured.

If we look at different aspects of Nepalese economy, it shows the gloomy picture of it, the country is already in debt trap; foreign loan per head is more than Rs. 5500. Loan amount is increasing overwhelmingly in comparison to the grant component. Resource gap has been increasing over the years; still about more than 30 percent of people live below the poverty line. On the other side, foreign aid component is declining due to political instability and other reasons.

It is being seen that, the political parties in the government evaluate themselves and think successful if they beg money from the donors without rethinking its effect and impact on the whole economy, it has paralyzed the very core of the administrative machinery and institutionalized system. Especially, while concentrating on foreign aid to Nepal, the total aid inflow to Nepal is not satisfactory as it has been in the previous years, still it is not effectively occupying its necessary place. It has been unable to address the specific problems of equity and justice and to

ensure propriety in the process of aid utilization. Even if it is so, foreign aid has been playing a major role in the Nepalese economy.

Therefore, it can be said that the dependency of foreign aid cannot avoid recently due to the lack of sufficient domestic financial resources, which is shown by increasing resource gaps. So for the optimum utilization of foreign aid, we have to make appropriate rules and regulations by the related body.

Having said all these, the fact remains that a new beginning has been made in terms of enhancing the utilization of foreign assistance. A process of deliberation and dialogue can be started in a manner that is characterized by more frankness closer consultations and partnership with the development partners than what so far has existed.

5.3 Recommendations

Nepal has been receiving foreign aid for a long period. There are debates about the usefulness of foreign aid. Many people are critical of overseas aid. They argue that donor government uses it to their political and economic interest. It is also claimed that many of the large-scale development projects and programs supported in the past by the foreign aid have resulted in increased living standard for urban elite in developing countries rather than providing real benefit to poor and needy. This problem is now recognized and there is a trend toward supporting smaller projects, which focus on poverty alleviation among rural and urban communities.

Foreign aid has played important role in economy. Although, it may not be substantially contribute to the economic development of Nepal. But 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 of the successful plan period. In this respect new vision and

ways of aid utilization should be thought from both donors and recipient countries. One of the most important factors is that the recipient countries must be thought about aid is not as a “Free Lunch.”

Foreign aid is important for economic development but it depends upon the effective utilization, monitoring, accounting etc. Following recommendations have been put forward based on the above analysis.

- Government should make the priority list of the economic sector according to the development needs of the country for utilization of foreign aid.
- Government should utilize foreign aid to enhance productive capacity and strengthen national economy and meet the required target of the different plan.
- It would be better to have more aid in the soft loan which is long term payable with low interest rate.
- Foreign aid should be utilized effectively in the targeted sector of the agriculture by government.
- Foreign aid should be used in a transparent manner with proper accounting system of recording the movement of foreign aid. A appropriate accounting and auditing system, an effective management and information system, a hierarchy specifying right, duties and responsibilities the like should be in place.
- People’s participation should be increased for the development work.
- Government should accept the donor’s offer which is favorable for the country.
- Trust and cooperation among donors, government and society should be built.

- Domestic financial resources should be used perfectly in order to control the large amount of expenditure of foreign assistance.
- Since corruption is the destructive virus of the nation, it should be minimized or controlled or checked from top level of introducing anti-virus programs, for that, transparency and decimation should be maintained in economic dealings.
- Nepalese technicians should be used in order to control the large amount of expenditure of foreign technicians.
- Development works which are conducted by the foreign aid should be monitored strongly by donors.

Annex – A

Total Foreign Aid and GDP (1985/86 to 2004/05)

(Rs. in Million)

Years	GDP	Foreign Aid	Log GDP	Log Foreign Aid
1985/86	53215	3491.5	4.7260	3.5430
1986/87	61140	3314.5	4.7863	3.5204
1987/88	73170	5078.5	4.8643	3.7057
1988/89	85831	5666.9	4.9336	3.7533
1989/90	99702	6427.8	4.9987	3.8080
1990/91	116127	5990.0	5.0649	3.7774
1991/92	144933	7800.4	5.1612	3.8921
1992/93	165350	9235.6	5.2184	3.9655
1993/94	191596	11557.2	5.2824	4.0629
1994/95	209974	11249.4	5.3222	4.0511
1995/96	239388	14289.0	5.3791	4.1550
1996/97	269570	15031.9	5.6307	4.1770
1997/98	289798	16457.1	5.4621	4.2164
1998/99	330018	16189.0	5.5185	4.2092
1999/00	366251	17523.9	5.5736	4.2436
2000/01	394052	18797.4	5.5956	4.2741
2001/02	406138	14384.8	5.6087	4.1579
2002/03	437546	15885.5	5.6410	4.2010
2003/04	474919	18912.4	5.6766	4.2767
2004/05	508651	23657.3	5.7064	4.3740

Source: various Issues of Economic Survey

Annex – B

The Member of Nepal Aid Group

- Asian Development Bank
- European Union
- Canada
- Denmark
- France
- Germany
- International Fund for Agriculture Development
- International Monetary Fund
- Italy
- Japan
- Netherlands
- Norway
- Organization for Economic Cooperation and Development
- Saudi Fund for Development
- Switzerland
- United Kingdom
- United Nations Development Program
- United States of America
- World Bank

ANNEX – C

List of Bilateral, Multilateral Donors and INGOs

- **Bilateral**

Australia, Canada, China, Denmark, France, Germany, Italy, India, Israel, Japan, Netherlands, Norway, Switzerland, United States of America, United Kingdom, Finland and Republic of Korea.

- **Multilateral**

ADB, European Union, FAO, IDA, IFAD, ILO, IME, ITU, UNCDF, UNDP, UNESCO, UNFPA, UNICEF, UNIFEM, UNV, UPU, WFP, SFD, UNCHR, and WHO.

- **INGOs**

Action Aid, CARE Nepal, Communication Cultural Promotion Foundation, International Nepal Fellowship, Lutheran World Federation, PLAN, Save the Children (USA), Save the Children (UK), Save the Children (Norway) , The Asia Foundation, Terres de Hommesuisse, United Mission to Nepal, World Neighbor inc., Danish Association for international Cooperation, Frederic Neumann Foundation, Sir Edmund Hillary Foundation, Canadian Lutheran World Relief, Camrose International Institute, Canadian Jesuits international, South Asia Partnership, DISVI etc.

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