

# Foreign Aid and Economic Development in Nepal: A Revisit

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## Introduction

The revenue surplus, domestic debt and foreign aid are the tools to finance the development of a developing country. Foreign aid is the receipt from savings of the foreign citizens. In particular, foreign aid is the transfer of free or heavily discounted economic resources by a donor government to a recipient government either directly or via an international organization, for the purpose of assisting the recipient in improving its economic and social welfare (Arase, 2010). Foreign aid is necessary to meet the domestic resource gap. Moreover, aid is said to fulfill the import-export gap, investment-saving gap and technology gap faced by developing countries.

Foreign aid can be in the form of grants or concession loans or both. It also can be in the form of cash, commodity, reimbursable or direct payment from the donor. It can be bilateral or multilateral. The military aid is not considered as foreign aid. However, aid can be received as technical assistance to build the capacity of recipient country. The modality of aid can be program support, project support, sector wide approach (SWAP), humanitarian assistance and budget Support. The most common form of aid is known as official development assistance (ODA). The loans in the form of ODA also contains compulsory grants component of 25 percent.

## From Foreign Aid to Development Cooperation

Going through the history of foreign aid, it is mainly a artifact of the ideological confrontation between the US and the Soviet Union in the time of cold war which

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dominated international politics for 45 years (1945-1990). After the end of the Second World War, aid was started as a program to assist the short-term economic recovery of Western Europe which was known as the Marshall Plan. The broad aim of the Marshall Plan was to stop the spread of communism to France and Italy and stabilize conditions in West Germany.

In January 20, 1949, United States President Harry S. Truman in his inaugural address announced The Point Four Program which was a technical assistance program for developing countries. The main motive of this technical assistance was to win the hearts and minds of the developing world and make US ties strong. Since Marshall Plan, the aid architecture has changed many times and even shifted towards new paradigm. The last two decades have witnessed various important changes which have pushed the aid agenda in new and interesting directions. In the recent years, new aid issues have emerged which are quite influential in policy circles.

In 2002, the UN conference named as Financing for Development, held in Monterrey. In the context of the Millennium Development Goals (MDGs) to be met by 2015, this conference had widespread consensus among bilateral donors and multilateral agencies which could successfully take a major step forward in redecorating the aid agenda. Afterwards, various initiatives towards aid dynamics aimed at improvement of whole coordination effort in the donor community. The most important ones include the Declaration on Aid Harmonization in Rome in 2003 and the Paris Declaration on Aid Effectiveness in 2005, which emphasized that donors should move fast towards aid coordination to accelerate progress with aid effectiveness and MDG attainment. The declaration clearly emphasized five indicators of aid effectiveness as- ownership, harmonization, alignment, mutual accountability and financing for development results.

The Third High-Level Meeting on Aid Effectiveness held in Accra reviewed the progress made in implementing the Paris Declaration. Further the Accra Forum was closely followed by the Follow-up International Conference on Financing for

Development to review the implementation of the Monterrey Consensus in Doha at the end 2008. In Busan, the Fourth High Level Forum on Aid Effectiveness held in 2011 and reviewed the progress of implementation of the principles of the Paris Declaration and reached to a consensus of Busan Partnership Agreement for Effective Development Co-operation. In 2014, the first High-Level Meeting of the Global Partnership for Effective Development Co-operation held in Mexico which marked a major milestone in the global fight against poverty and also reaffirmed the importance of effective development co-operation in meeting the MDGs and as a key part of the next global development framework.

From Marshal Plan to Mexico conference, the paradigm of aid architecture has changed from foreign aid to development cooperation. The relationship between the donors and recipients is not only as the lenders and borrowers but as the development partners to get the mutual benefit and shared prosperity of development in this globalized world.

### **Foreign aid in Nepal**

Nepal received the first foreign aid from the US government under the Point Four Program in 23 January 1951. It was a technical assistance of 2000 American Dollars. Since then, Nepal has been a recipient of foreign assistance since when it joined the Colombo Plan for Cooperative, Economic, and Social Development in Asia and the Pacific in 1952. The plan was established in 1951 under Commonwealth of Nations. During the 1950s, many Nepalese student received scholarships through the Colombo Plan for higher study in the technical and professional fields.

In 2002, Nepal formulated the first foreign aid policy. Due to the gradual development in the principles and the best practices widely adopted in global aid architecture, the policy needed to be updated. Therefore, the Government of Nepal launched its new Development Cooperation Policy (DCP) in 26 June 2014 which internalized all the principles and practices of aid effectiveness such as global commitments reflected in the Paris Declaration and Busan Outcome Documents, South-South Cooperation and so on.

The main goal of DCP 2014 is to build a self-reliant economy and transform Nepal into a prosperous country through effective mobilization of development cooperation. According to Development Cooperation Policy (MOF, 2014), the main features of this policy are - it emphasizes to the use of country system, mobilizes aid in priority areas, introduces thresholds for development cooperation aiming at reduced aid fragmentation and focused aid operations. The threshold allowed by this policy is US\$ 5 million for Grant, US\$ 10 million for Concessional Loan and US\$ 20 million for hard term Loan. Moreover, this policy was a major shift in the foreign aid policy of Nepal from foreign aid to development cooperation.

A glimpse of foreign aid in Nepal is shown in the table. The table has revealed the different aspects of foreign aid in Nepal for 14 years since 2000/01. It shows the Gross Domestic Product (GDP) of Nepal, total budget, total disbursed aid, disbursed aid as percentage of GDP, aid as percentage of budget, disbursed aid as percentage of committed aid, share of loans and grants in foreign aid and share of bilateral and multilateral aid in total aid. Looking at the table we confine that in the period of 14 years (2000/01-2013/14), the disbursed aid to GDP ratio ranges from 2.8 to 4.3 percent. In 2000/01 it was 4.3 percent and in 2013/14 it reached to 3.1 percent.

**Table: A Glimpse of Foreign Aid in Nepal**

| Year   | Nepalese Rupees in Ten Millions |                 |                     |                |                   |                        | Loans<br>as % of<br>Total<br>Aid | Grants<br>as %<br>of Total<br>Aid | Bilateral<br>as % of<br>Total<br>Aid | Multilateral<br>as % of Total<br>Aid |
|--------|---------------------------------|-----------------|---------------------|----------------|-------------------|------------------------|----------------------------------|-----------------------------------|--------------------------------------|--------------------------------------|
|        | GDP (at<br>Producers<br>Price)  | Total<br>Budget | Total Disbursed Aid |                |                   |                        |                                  |                                   |                                      |                                      |
|        |                                 |                 | Amount              | as %<br>of GDP | as % of<br>Budget | as % of<br>Commitments |                                  |                                   |                                      |                                      |
| 2000/1 | 44151.9                         | 7983.5          | 1879.7              | 4.3            | 23.5              | 60.1                   | 64.1                             | 35.9                              | 14.7                                 | 85.3                                 |
| 2001/2 | 45944.3                         | 8007.2          | 1438.5              | 3.1            | 18.0              | 43.3                   | 53.5                             | 46.5                              | 32.5                                 | 67.5                                 |
| 2002/3 | 49223.1                         | 8400.6          | 1588.6              | 3.2            | 18.9              | 36.8                   | 28.6                             | 71.4                              | 63.2                                 | 36.8                                 |
| 2003/4 | 53674.9                         | 8944.3          | 1891.2              | 3.5            | 21.1              | 79.7                   | 40.3                             | 59.7                              | 47.7                                 | 52.3                                 |
| 2004/5 | 58941.2                         | 10256.0         | 2365.7              | 4.0            | 23.1              | 62.0                   | 39.2                             | 60.8                              | 39.0                                 | 61.0                                 |
| 2005/6 | 65408.4                         | 11088.9         | 2204.2              | 3.4            | 19.9              | 105.3                  | 37.3                             | 62.7                              | 34.7                                 | 65.3                                 |
| 2006/7 | 72782.7                         | 13360.5         | 2585.4              | 3.6            | 19.4              | 69.8                   | 38.9                             | 61.1                              | 63.5                                 | 36.5                                 |

|         |          |         |        |     |      |      |      |      |      |      |
|---------|----------|---------|--------|-----|------|------|------|------|------|------|
| 2007/8  | 81565.8  | 16135.0 | 2930.1 | 3.6 | 18.2 | 59.6 | 30.6 | 69.4 | 34.8 | 65.2 |
| 2008/9  | 98827.2  | 21966.2 | 3635.2 | 3.7 | 16.5 | 75.8 | 27.4 | 72.6 | 25.7 | 74.3 |
| 2009/10 | 119277.4 | 22710.7 | 4976.9 | 4.2 | 21.9 | 51.5 | 22.6 | 77.4 | 46.0 | 54.0 |
| 2010/11 | 136695.4 | 25749.5 | 5799.8 | 4.2 | 22.5 | 54.7 | 20.8 | 79.2 | 44.6 | 55.4 |
| 2011/12 | 152734.4 | 29485.1 | 5189.3 | 3.4 | 17.6 | 52.9 | 21.4 | 78.6 | 61.8 | 38.2 |
| 2012/13 | 169501.1 | 30205.4 | 4719.9 | 2.8 | 15.6 | 41.0 | 25.4 | 74.6 | 55.1 | 44.9 |
| 2013/14 | 194162.4 | 37022.7 | 6020.5 | 3.1 | 16.3 | 45.1 | 29.9 | 70.1 | 48.2 | 51.8 |

**Source:** Prepared based on Ministry of Finance, Economic Surveys, Various Issues

Regarding the share of foreign aid in financing the budget expenditure, we see that it ranges from minimum of 15.6 percent in 2012/13 to maximum of 23.5 percent in 2000/01. In the recent year (2013/14) it was 16.3 percent. The data shows the low absorption capacity of foreign aid in Nepal. The disbursement to commitment ratio was 60.1 percent in 2000/01 and 45.1 percent in 2013/14. The highest disbursement to commitment ratio was seen in 2005/06 as 105.3 percent. This is because of the reason that this might be the final year of disbursement of the aid for many foreign aid funded projects.

While analyzing the share of loans and grants in foreign aid, we see that loans are decreasing and grants are increasing. Share of loans and grants were 64.1 percent and 35.9 percent in 2000/01 but they were 29.9 percent and 70.1 percent in 2013/14. Similarly, bilateral aid is increasing while multilateral is decreasing. Bilateral aid was 14.7 percent in 2000/01 but increased to 48.2 percent in 2013/14. In contrary, multilateral aid was 85.3 percent of total aid in 2000/01 but decreased to 51.8 percent in 2013/14.

In recent years, it is said that the aid servicing capacity of Nepal has increased and the multilateral development partners have already announced the curtailment of grants for Nepal. This implies that Nepal will only receive loans from multilateral development partners like the World Bank and the Asian Development Banks in future though loans also contains 25 percent of compulsory grants component as the part of ODA.

According to Development Cooperation Report 2013/14 (MOF, 2015a), Nepal received total of US \$ 1.112 billion as development cooperation in 2013/14. Among which 52% was multilateral and 48% was bilateral. Similarly 71% was on budget and 29% was off budget cooperation. While going through the development cooperation according to financial instrument, 60% was project support, 19% was sector wide approach (SWAp), 13% was program support, 5% was budget support, 1% was humanitarian assistance and 2% was others.

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

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

Regarding the positive view Jeffrey Sachs in his popular book “The End of Poverty” argues that if the rich world had committed \$ 195 billion in foreign aid per year between 2005 and 2025, poverty could have been entirely eliminated by the end of this period (Sachs, 2005). In contrary, regarding the negative view, Dambisa Moyo in her book “Dead Aid” and William Easterly in his book “The White Man’s Burden” argue that aid does more bad than good for economic development (Moyo, 2010, Easterly, 2006). They further opined that aid prevents people of developing countries from searching for their own solutions, while undermining and corrupting local institutions. In addition, foreign aid also creates self-perpetuating lobby of aid agencies and more dependency in developing countries. Easterly clearly favors homegrown development rather than the development funded by foreign aid.

The evaluation of aid effectiveness in Nepal has shown mixed results (MOF, 2011). Due to the low absorption capacity, lack of fully aligned aid with the country

system, lack of mutual accountability and dearth of result based projects and donor driven syndrome are the major causes for the hindrance of aid effectiveness in Nepal. In summary, aid effectiveness is a controversial issue of debate. It appears that aid has been successful in some countries like in Rwanda but not many others and the hot issue for empirical research in identifying the relationship between aid and economic development of the developing countries.

The figure of outstanding foreign debt is gradually increasing in Nepal. Since, the total cumulative outstanding foreign debt is Rs. 346.8 billion in 2013/14 (MOF, 2015b), even a newly boomed Nepali baby bears almost 20,000 rupees as outstanding debt among which 12,574 is the outstanding foreign debt per capita. Since the burden of foreign debt is increasing and the growth rate is sluggish, it is a quite debatable issue - Is foreign aid fruitful for development or just increasing the burden? Is foreign aid helping to reduce poverty? What is the role of foreign aid in economic growth? These questions are almost unanswered in Nepalese context. There is no any evidence based study to find the answers to these questions.

## **Conclusion**

It has been more than six decades that Nepal is receiving foreign aid for financing development in Nepal. However, the economic growth rate of the last decade is less than four percent and still one fifth of the population is under absolute poverty. If foreign aid had played a crucial role, it would have had higher growth rate and less poverty. Lack of evidence based research shows that we need an empirical study to know the impact of foreign aid in the economic development of Nepal which would certainly help the planners and policy makers to make better policies regarding the foreign aid in Nepal.

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