Official Development Assistance in Nepal: A Development Perspective

Written by Yam Prasad Chaulagain

Development cooperation as we know it emerged over five decades ago against the backdrop of the Marshall Plan's success in re-building post-war Europe [1]. The prevailing view at the time was simple and optimistic: development would come quickly to the poorer areas of the world through the provision by a few countries of capital, supplemented by the judicious provision of technical know-how.[2] During this time, the cold war rivalries often used to support their client states in the developing world. This means that the disbursement priorities of foreign assistance were not beyond the strategic influences of bipolar world. In 1961, the ‘Organization for Economic Development and Cooperation’- OECD’s ‘Development Assistance Committee (DAC) measured resources flows to developing countries by paying special attention to the official and concessional part of this flow defined as “Official Development Assistance (ODA).’ DAC includes 24 member states. They are Australia, Austria, Belgium, Canada, Denmark, European Union, Finland, France, Germany, Greece, Ireland, Japan, Italy, Luxemburg, Netherlands, New Zealand, Norway, Portugal, South Korea, Spain, Sweden, Switzerland, United Kingdom, and United States. The European Union acts as a full member of the committee. The World Bank, the International Monetary Fund (IMF) and United Nations Development Program (UNDP) also participate as observers.

The DAC first defined ODA in 1969, and tightened the definition in 1972. The basic definition of ODA, which has not changed significantly since 1972, refers to:

Flows of official financing administered with the promotion of the economic development and welfare of developing countries as the main objective, and which are concessional in character with a grant element at least 25 percent (using a fixed 10% rate of discount). By convention, ODA flows contributions of donor government agencies, at all levels, to developing countries (bilateral ODA) and to multilateral institutions. ODA receipts comprise disbursements by bilateral donors and multilateral institutions.[3]

The OECD recognizes that there is some subjective interpretations of this definition and has thus identified number of limitation on ODA reporting. For example:

- **Military aid**: No military equipment or services are reportable as ODA. Anti-terrorism activities are also excluded. However, the cost of using donors’ armed forces to deliver humanitarian aid is eligible.
- **Peacekeeping**: Most peacekeeping expenditures are excluded in line with the exclusion of military costs. However, some closely-defined developmentally relevant activities within peacekeeping operations are included.
- **Nuclear energy**: Reportable as ODA, provided it is for civilian purposes.
- **Cultural programs**: Eligible as ODA if they build the cultural capacities of recipient countries, but one-off tours by donor country artists or sportsmen, and activities to promote the donors’ image, are excluded.[4]

The definition of foreign aid has been broadened by various organizations such as IMF and World Bank, along with the Congressional Budget Office of US (1997). The broader definition of foreign aid subsumes all money classified as ODA, and further incorporates military assistance, political development programs, export promotion, debt forgiveness, and no-concessional lending by all bilateral and multilateral organizations.[5] The cash disbursement of ODA includes bilateral grants, concessional loan and technical assistance as well as multilateral...
flows. Multilateral assistance can be channeled through multilateral development banks and UN agencies. Bilateral assistance is given directly government to government. Multilateral assistance adherents argue that bilateral aid is generally given for political reasons, in the form of tied aid.

The donor governments promised to spend 0.7% of GNI (Gross National Income) on ODA at the UN General Assembly in 1970. The deadline for reaching that target was the mid-1970s.[6] Since that time, despite billions given each year, rich nations have rarely met their actual promised targets. For example, US is often the largest donor in dollar terms, but ranks amongst the lowest in terms of meeting the stated 0.7% target.[7] Only five countries are currently providing ODA in excess of this target: Sweden, Norway, Denmark, the Netherlands, and Luxembourg. Sweden led with a full 1% of GNI contributed[8] though total ODA flow has grown from an annual rate of under $5 billion in 1960 to $50 billion in 2000 and to over $128 billion in 2008. [9] The UN Millennium Project’s[10] analysis indicates that if the developed country set and followed through on a timetable to reach 0.7% by 2015, the world could make dramatic progress in the fight against poverty and start on a path to achieve the Millennium Development Goals and end extreme poverty within a generation.

ODA in Nepal

Nepal has been receiving foreign aid since WWII after the establishing the diplomatic relationship with United States in 1947. On January 23, 1951, the United States and Nepal signed an agreement that began a relationship of trust, mutual respect, and commitment to the people of Nepal. With that signing, the United States became the first bilateral donor to Nepal, and in this time, the U.S. has provided more than $1.2 billion in development assistance to Nepal.[11] The newly built relationship with U.S. assertively brought the country into the theater of global politics. At the same time, the communist revolution in neighboring China in 1949 increased strategic interest in Nepal. This means that the recent flourishing tie with international community opened the new avenue for external actor beyond India’s traditional influence in Nepal’s geo-political landscape.

Nepal with the launch of its First Five-Year Plan (1956-61) joined the league of aid-recipient countries for its development financing. A substantial portion of development expenditure, averaging about 55% per year, has since been financed through foreign aid.[12] The assistance generally was directed toward developing agriculture, transportation and power generation. During that time, all aid was in the form of grants. India and United States had established aid mission to Nepal and directed aid to special projects. Both countries used to release one third of all grants. During the 1950s, other major donors were the People’s Republic of China, Soviet Union, Switzerland, Australia, Japan and New Zealand also assisted different assistance program in lesser extent, and United Nations provided technical assistance. Until the mid-1960s, Nepal depended mostly on foreign grants for all its development projects. When the multilateral assistance programs began in the 1970s, by the end of the 1980s, the huge amount of foreign aid was in the form of multilateral assistance program directed through the international development association of World Bank and the Asian Development Bank characterized as soft loan.

In 1976, World Bank established the ‘Nepal aid group’. By the 1987, this group included six countries and sixteen international agencies. From the late 1980s onward, this group provided the largest share of aid to Nepal.[13] The loan of share of foreign aid also increased 4% in the period of 1960s and 1970s to 25% in 1980s. By the 1990s, NGOs such Oxfam, Christian Aid, Himalayan American Foundation came to dominate development activities.[14] Throughout 1960s, super powers’ strategic interest in Nepal had increased the flow of foreign assistance from United States and China. However, because of the changing political situation Nepal fell behind from drawing the foreign assistance from major super power. For instance, as the US followed a policy of rapprochement with China in the beginning of 1970s, US aid to Nepal started dwindling. While between 1962 and 1965, Washington had contributed nearly 40% of Nepal’s total aid, it declined to 23% in between 1970 and 1975, and to 12% between 1976 to 1985. [15]

Channeling Bodies

development partners, government and civil society through increased dialogues, interactions and effective communication. The NDF includes donor countries, international financial institution (such as World Bank), and intergovernmental organizations (UN). Donors coordinate development aid policy through the NDF. According to MOF[16], the objectives of NDF are:

- Building understanding between Government of Nepal and its Development Partners on the adequate availability and effective mobilization of aid resources;
- Charting Nepal’s development roadmap along the path of sustained peace and resulting socio-economic transformation with the support from the Development Partners;
- Committing to create reforms agenda through reviewing the progress made and challenges encountered during the implementation of high priority projects;
- Developing a new Foreign Aid Policy of Nepal and the National Action Plan for Aid Effectiveness in consultation with the Development Partners.

2. The Foreign Aid Coordination Division (FACD):

The Foreign Aid Coordination Division (FACD) of the Ministry of Finance is mandated not only to oversee the government’s activities in the area of aid coordination, harmonization and alignment, but also has been assigned to be acting as the Secretariat to the High Level Committee on Foreign Aid Coordination and mobilization. The FACD also provides technical input to the committee in the implementation of foreign aid policy. As reported by MOF[17], its main activities are:

- Channeling foreign aid with a demand driven approach towards the prioritized sectors
- Promoting ownership in foreign aided projects
- Reducing burden of external debt
- Improving disbursement ratios
- Enhancing good governance in foreign aid coordination and management
- Enhancing the efficiency of the division

Major Donors

Foreign aid to Nepal is provided by a diverse group of donors, including OECD-DAC donors, International Financial Institutions (IFIs), United Nations agencies, global vertical funds and providers of South-South cooperation. India, China, Japan, Germany, United States are also the key bilateral donor countries of Nepal. These donors reported total disbursements amounting to US$ 1.08 billion in fiscal year 2010-11. Approximately 58 percent of these resources came from multilateral donors, while 36 percent came from OECD-DAC bilateral donors and over 6 percent from bilateral South-South cooperation partners.[18]

According to the report issued by the MOF, the top five multilaterals are the World Bank Group (US$ 256.1 million), the Asian Development Bank (US$ 184.4 million), the United Nations Country Team (US$ 112.5 million) the European Union (US$ 42.4 million) and the Global Fund to fight AIDS, Tuberculosis and Malaria (US$ 19 million)[19]. Likewise, the top five bilateral donors in Nepal for the 2010-11 fiscal years are the United Kingdom (US$ 92.1 million), Japan (US$ 58.7 million), India (US$ 50.7 million), the United States (US$ 48.5 million) and Norway (US$ 32.8 million). However, disbursements for fiscal year 2010-11 correspond to 40.6 US$ of foreign aid per capita[20], a relatively low figure if compared with countries with a similar level in the human development index such as Senegal (84$ per capita), Uganda (55$ per capita), Tanzania (67$ per capita). Foreign aid represents 5.8% of Nepal’s Gross Domestic Product (GDP).

Aid Composition and Disbursement:

According to the report published by Ministry of Finance of Nepal, aid received in fiscal year 2010-2011 shows that grants represents 57% of disbursement, with loan standing at 24.3% and technical assistance (TA) at 18.5%. Out of those amount, 55 percent of disbursements reported by donors for fiscal year 2010-11 have been
associated with activities which have a nationwide impact, either because they address policy or capacity issues at the central level (e.g. capacity development for a ministry), or because they are implemented in all districts of the country. On the other hand, 45 percent of disbursements have targeted specific regions or districts. A closer look at these disbursements provides an initial snapshot of the areas prioritized by foreign aid funded projects. In absolute terms, Central region remains the most targeted, followed by Mid Western, Far-Western, Eastern and Western region.

Bilateral and multilateral agencies disburse ODA under the modality of project support, sector wide approach, program support and humanitarian assistance. For example, in 2010-2011, they disbursed 63.1% for project support, 21.1% for sector wide development, 12.9% for program support and 2.9% for humanitarian assistance. However, the amount of disbursement is less than that of commitment.

Donors' Strategic Interest

Western international donor community since the late 1970s started making their aid program conditional behind the veil of good governance and structural adjustment policies. Their objectives were to carryout market oriented neo-liberal policies that would promote their economy and shape long term political interests. Bilateral donors also began providing official assistance to the countries they perceive aid as being vital for the survival and stabilization of regimes in which they had strong political interest. However, in early 1990s, as the international donor community was widely criticized for their failure to transform living conditions in many aid recipient countries, a new paradigmatic shift in international aid architecture from donor led structural adjustment policies to country driven poverty reduction strategies was promised in the process for development lending at least principally.

Nepal also couldn’t remain untouched with the donors driven neo-liberal wave of economic restructuring and good governance. After the 1990, the government of Nepal did what the donors asked to do. It also privatized several governments run enterprises, appointed foreign expert to run the government aided banks, entrusted the drinking water scheme to the foreign company and yet not satisfactory result came from the foreign aid. In general, donors’ strategic interest in Nepal can be pointed out as follows:

United States: The strategic location of South Asia and potential risk to this region was exposed to form communist powers, and this motivated the US to provide aid to countries like Nepal.[21] It means that containing a possible threat of communism in Nepal was the pre-cold war US objective to Nepal. Even after the end of cold war, the United States continues to maintain its foreign policy interest.

India: Many of the Indian aided projects had direct link with its interest of northern India especially with the water resource management. Indian aid, though very important to Nepal, was seen with suspicion and rarely remained out of controversy.[22]

China: During the cold war, Chinese interest in Nepal was influenced by its ideology. China’s interest in Nepal at present is concerned with Tibet’s safety from the outside world and it also wants to be sure that Nepal would never be a part of western design that could foster an encirclement of China.[23]

Changing internal politics: In the aftermath of the cold war era, Nepal’s home grown Maoist insurgency started in 1996 began capturing the attention of international community. During the insurgency, most of the bilateral and multilateral agencies provided foreign assistance to Nepal government. Most of the foreign assistance still continue to support the post-conflict situation. Critics say the donors’ main objective in this matter is to provide support on humanitarian issues as well as to combat the Maoist presence in Nepal.

Multilateral agencies: The loan and grants provided by the multilateral agencies-World Bank and Asian Development Bank- have played an important role in funding Nepal get through its financial difficulties. However their painful conditions deter subsidies in important commodities and demand financial sector reform at the cost of general people. Unlike the aid provided by the two superpowers and the immediate neighbors, the aids of the
above countries like- Australia, Canada, Germany, New Zealand, Switzerland, Netherlands, Belgium, Norway, Finland to a greater extent seem to be motivated by humanitarian impulses.

Donors’ shifting interest: The major donors such as USAID, CIDA, and EU have shifted their priorities from humanitarianism and sustainable development to freedom and international security. To be clearer about the changing dynamics of international aid, consider what British Prime Minister Gordon Brown said recently in Paris: “We understand that it is not just morally and ethically right that developing countries move from poverty to prosperity, but that it is a political imperative – central to our long-term national security and peace – to tackle the poverty that leads to civil wars, failed states and safe havens for terrorists.”[24] Other major donors like the Danish Development Co-operation Agency (DANIDA), Norwegian Development Co-operation (NORAD), Swiss Development Co-operation (SDC) and Department of International Development (DFID) have started to prefer long term institutional development.

ODA’s Role in Nepal’s Development

Foreign aid plays an important role in Nepal’s socioeconomic development, representing 26 percent of the national budget[25] and 60 percent of development budget.[26] Primarily, Nepal receives external support on education, local development, health, road construction, energy, agriculture, drinking water and peace and rehabilitation. Beside these, various economic reconstruction, economic reform and financial reform programs are also heavily funded by external bilateral and multilateral donor agencies. According to the Ministry of Finance (MOF), Nepal receives ODA from over 40 donors, including 35 resident agencies and half of aid resource use national system such as the budget or procurement system, and a significant portion of aid is spent outside national system.[27] Nepal’s development plans have also been significantly financed by ODA over the years. Nearly 78% of the total outlay of Nepal’s second development plan(1962-1965) and 56% of the third plan(1965-1970) were financed by foreign aid. A world Bank report in 1990 claimed that between (1976-1977) and (1987-1988), the proportion of foreign financing in development expenditure was higher than 49%. The foreign aid contributed to nearly 70% percent of the public investment in Nepal’s seventh plan (1985-1990). In terms of contribution to the Gross National Product (GNI) of the country, in the late 1980s the share of foreign aid increased from 8% to almost 13%.[28] According to Chief of Foreign Aid Coordination Division of Ministry of Finance, Lal Shanker Ghimire, over 70% of capital expenditure is financed by foreign aid. The ratio between bilateral and multilateral is fifty-fifty. Ghimire further argues that if we see the last 5 years’ average received in foreign aid, Nepal received a sum equivalent to Rs. 51 billion annually. Nepal is unable to spend the money as it has funds equivalent to Rs 200 billion as unused money.[29]

Effectiveness of ODA

Despite the rises in ODA, Nepal is only country in South Asia that has not experienced any significant improvement in micro and macroeconomic aspects. In 1996, several donor agencies introduced poverty reduction as a major goal of their aid. They made consensus in the Paris Declaration (five principles of declaration are- ownership, alignment, harmonization, result and mutual accountability) on Aid Effectiveness in March 2005, came up with the 2008 Accra Agenda for Action in 2008(ownership, inclusive partnership & delivering result) and recently they met in Busan, Republic of Korea. However, all this is mere rhetoric. The recent experience of Nepal exposes donors’ unethical behavior and weak commitment with respect to their earlier promises. As reported in the media, three donor agencies- DFID, SDC and FINNIDA put money directly into the project without going through the governmental channel, committees formed to drive the program had taken a decision to provide Rs. 1.27 billion directly to ‘Rupantaran’ Nepal.[30] Donor agencies in Nepal have been setting up offices in district headquarters and sometimes even at the local level, and are increasingly subcontracting development through an interconnected web of INGOs that undermine donors’ stated commitment to ‘country ownership’ and ‘use of country system’.[31] According to a report issued by International Aid Transparency Initiative(IATI), out of 58 donor agencies only nine agencies achieved a score of over 60%, listing World Bank fairest among the nine. Some other nine agencies have been featured in moderate category, 25 are featured in poor category and 15 donors are featured in the very poor aid transparency category.[32]
Beside aforementioned study, other important economic indicators are also not seen as favorable as they used to be in the earlier year. For example: GDP growth rate has decreased from 6.1% (2008) to 4.6% (2010) and unemployment rate increased from 42% (2004) to 46% in recent year. The data of GDP composition by sector is also not so optimistic. According to the recent study, it comprises of – agriculture(32.8), industry(14.4) and services (52.8%). Labor force by occupation includes- agriculture (75%), industry (7%) and services (18%). Furthermore, the population below poverty line is 24%.[33] According to a recently published report of Human Development Index (HDI), Nepal is placed in 157th position under the low human development category. This indicates that either there is institutional gap in mobilizing acquired resources or government mechanisms have been not well functioning. It seems that the foreign division of the Ministry of Finance, the National Planning Commission, parliament and civil society (including the NGO Federation of Nepal) are also apathetic or ignorant about the trend.

Conclusion

The study shows that both donors and government are equally responsible for the poor performance of ODA in Nepal. To insure its effectiveness, donors should be transparent on providing their assistance, eliminating unnecessary conditionality to the recipient government. However, conditionality on cross-cutting issues such as-governance, inclusion, accountability, transparent, political stability should be welcomed by the government of Nepal. There is seemingly a mismatch of priorities between the donors and government of Nepal. This contradiction creates resources gaps, overlapping and duplication, and eventually needy sectors remain uncultivated. Hence, to make effective disbursement of foreign aid in prioritized sectors, donors should conduct PEST analysis- political, economic, socio-cultural and technological- to country specific problem before they disburse any kind of aid. At the same time, Nepal’s government is also equally responsible in this issue. As mentioned in foreign aid policy 2009, broader objectives are- to reduce poverty by ways of effectively utilization of foreign aid through high inclusive, and sustainable economic growth with distribution equity, focusing on productive employment and improved linkage among public sector. However these objectives have remained in paper slogan. Nepal's political instability, massive corruption, unaccountable and nontransparent government mechanism are the major constraints that often hinder the effectiveness of foreign aid.

Under the MOF, the role of FACD in channelizing the fund has not been seen in a progressive way. NDF, which is responsible for dealing with the Nepal government and its development partner, has not been able to produce a conducive environment with regards to acquiring the quality foreign aid. It clearly indicates that Nepal still lacks stable institutions and appropriate policies to achieve overall development effectiveness. Thus, in addition to above described points, crucial tasks such as infrastructure development and institution building have appeared to be vital in this regard. As the Paris Declaration suggests, the accountability issue is very important to ensure aid effectiveness. The best way to ensure accountability is to ensure transparency in the way aid is managed and used. As defined in Rostow’s Stage Growth model, the theoretical underpinning suggests that Nepal’s economic development is in the stage of ‘pre-conditions for takeoff’ where technical assistance and critical rate of investment may require for the achievement of level of income and saving sufficient to assure self sustaining growth. However, development history shows no country has achieved sustainable growth without expanding trade flows. The expansion depends on the quality of domestic policies, institutions and infrastructure. This is exactly what Fukuyama says in his book ‘State Building’- State’s scope is the ability to create and enforce law and policies. Strength is the ability of state to plan and execute policies and enforce laws cleanly and transparently-what is now commonly re-offered to as institutional capacity.

Bibliography


Official Development Assistance in Nepal: A Development Perspective
Written by Yam Prasad Chaulagain


[7] Ibid;


[14] Ibid;


[18] Disbursements on some of the turn-key projects implemented by Southern partners may be under-reported


Official Development Assistance in Nepal: A Development Perspective
Written by Yam Prasad Chaulagain


[27] Foreign Aid Coordination Division. (2010). p. 2


[31] Subedi, Rabin. (Nov. 27, 2009).


Written by: Yam Prasad Chaulagain
Written at: University of Warsaw
Written for: Prof. Karina JÄ drzejowska
Date written: June 23, 2012