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AN ASSESSMENT OF FOREIGN AID EFFECTIVENESS:

SOURCES, USES AND DEVELOPMENT

Dilli Raj Khanal, PhD

ActionAid International Nepal
2023

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Foreword

Sujeeta Mathema
Executive Director
ActionAid International Nepal

It is with esteemed regard and a sense of collective responsibility that ActionAid International Nepal introduces the study report "An Assessment of Foreign Aid Effectiveness: Sources, Uses and Development" in a book form.

In our deeply interconnected world, foreign aid is expected to play a crucial role in fostering development and transforming the economies of the countries like Nepal for people's wellbeing and prosperity. However, because of the inability of aid to contribute to realize such cherished gaols in many developing and poor countries of the world, the aid effectiveness agenda has come to the fore since long. Now there is a broad consensus at the international level that for making the aid effective it has to be country-led, result-oriented, inclusive, and transparent. Taking such bases of the analysis, the present study after closely reviewing the global developments on the aid effectiveness agenda, concentrates on assessing the aid effectiveness in Nepal in the light of aid policies of the past and present. More broadly, after delving the intricacies of Foreign Aid in Nepal and identifying the gaps in complying with the commitments made by the development partners and delineating the lapses on the part of our governments , it, as a way forward, suggests some possible better alternatives to make the aid more effective and result printed, at a time when Nepal faces bigger resource constraint problem amidst economic slowdown and looming economic crisis with added challenges to accomplish the SDGs in stipulated time.

It is hoped that it, apart from generating further debate in the critical issue, will be useful to the policy makers, actors, influencers, academicians, media, CSOs and development partners.

I want to express my gratitude to Dr. Dilli Raj Khanal, notable economist for undertaking the study. I acknowledge and appreciate Rahul Dewan, ActionAid International Nepal, for his contribution to collect, compile and present data in various forms. I also appreciate Mr. Saroj Pokhrel, Head of Programme Policy and Devendra Pratap Singh, Education and Youth Specialist, ActionAid International Nepal, for their feedback and suggestions to enrich the book and the encouragement they showed to make it happen.

Contents

Executive Summary

In the interdependent world we live in today, foreign aid is expected to play a pivotal role in fostering development and transforming economies, with a focus on well-being and prosperity. However, the effectiveness of aid has been a longstanding concern, prompting a global agenda on it. After many years of debate, discussion and revisions, aid is regarded to today as being effective if it is country-led, result-oriented, inclusive, and transparent. The study "Assessment of Foreign Aid Effectiveness: Sources, Uses and Development critically examines Nepal's aid policies and their effectiveness taking such developments into account.

In the beginning, it briefly appraises the factors that have contributed to advance the idea of aid immediately after the Second World War which is followed by review of the aid effectiveness agenda. While reviewing the aid effectiveness agenda, the underlying reasons necessitating the alteration and reprioritization of aid agenda overtime are closely looked into particularly to find out to what extent the global commitments have been fulfilled to improve the aid performance in the aid recipient countries. Thereafter, the overall long-term trend in the type of aid, its sources and role of it in financing Nepal's budget is examined. A critical review of the past and ongoing aid policies is one of important salient features of this study. In this, it besides comparing the aid or development cooperation policies with those of global aid effectiveness agenda identifies the gaps between the stated policies and actual conditions under which the policies are supposed to be implemented effectively. In such an analysis, the conditional aid program as well as LDC program of actions implemented simultaneously are closely assessed to see to what extent there is consistency among global agenda, Nepal's aid policies and such programs.

The major focus of the study is on the assessment of aid effectiveness in Nepal. Taking both direct and some proxy indicators, it identifies areas where aid has made some positive contribution and areas where there are huge critical gaps. As the assessment reveals, aid has been ineffective in Nepal to a great extent. Noticeably, however, as the assessment reveals, both external and internal factors are equally responsible for this. Accordingly, the study through ways forward suggests that at first there is a need of strengthening a global aid system in which the commitments are translated into the realization along with the ensuring of policy coordination among the global institutions and actors. In the way forward, it is also stressed that to make the aid highly effective and result oriented, there is a need of overhauling in the planning, budgetary and implementation system grounded on sweeping reforms and changes in the structural, institutional, policy and governance fronts.

Chapter 1

Introduction

Introduction

1.1 GENERAL BACKGROUND

After the first budget in 1951 which was preceded by the establishment of democracy, Nepal saw the beginning of aid inflow in a more systemic manner. The technical assistance of the USA in 1951 was the first of its kind. The multilateral development support followed this under the Colombo Plan in 1952. Larger aid inflow started to come along with the implementation of the First Plan (1956-60). Indeed, the first plan was fully funded by external aid. During the early period of development with no resources at the disposal of the governments and no perceptible existence of the private sector, there was an urgency of a larger flow in aid to address the serious problems of deprivation, poverty and underdevelopment which had been perpetuated for an extended period under the repressive feudal system. Since the mid- 1950s, there has been a continued expansion in the aid. Though the share of foreign aid in total development plans and annual budgets has decreased overtime considerably, the total aid volume has steadily increased despite changes in aid composition, from grants to the loan[2]. The aid comprised of grants, loan, technical assistance and humanitarian support. Aid mainly comes through bilateral and multilateral sources. The channeling and utilization of aid through international non-governmental organizations (INGOs) has also been impressive in recent years which at the same time both induced and supported domestic non-governmental organizations. More recently, along with the emergence of a more conservative approach to aid amidst increased protectionist tendencies there are attempts, among others, to shift aid from the public sector to the private sector in specific areas. It is also noticeable that with the mounting climate crisis affecting poor and other developing countries due mainly to the greenhouse gas emissions in the developed and some emerging economies, pressures are being intensified for high priority to the climate aid to such countries. It has been well known that Nepal is one of the countries which is highly vulnerable to the climate change in the world. Consequently, there is a tendency towards the changing of the nature and pattern of aid apart from low priority to it[3].

Amidst such dispositions, it is apparently noticeable that aid commitment has not been the major constraining factor in Nepal as quick examination of the development budgets reveal[4]. But such a commitment neither entails the gap between supply and demand nor reflects many critical issues that are associated with the agenda of aid effectiveness. It also overlooks the exchange rate effect. As such, the level alone cannot be regarded to be optimal without observing the overall country's needs, sector and area specific allocations, actual disbursements, uses and effectiveness besides assessing the exchange rate effect.

Nonetheless, there are a number of factors that have contributed to the steady increase in aid commitments in nominal terms without many disruptions or swings in Nepal. Firstly, Nepal's planned development efforts along with sweeping political changes overtime and rising people's expectations followed by the country's changing priorities have played a significant role for continued rise in aid commitment in Nepal. Secondly, the pursuance of a non-alignment foreign policy during the cold war period along with a relatively more neutral stance upon different global issues amidst the strategic location of Nepal has created an enabling environment in receiving aid from all major advanced countries besides its two neighboring countries, India and China which have established themselves, now as big global economic power houses. Thirdly, the categorization of Nepal as one of the least developed countries in 1971 with global commitments to provide especial support to such countries have also contributed to the regular expansion of aid through both multilateral and bilateral sources. As an offshoot, ten-year program of actions evolved with the concurrence of development partners for LDCs and their adoption

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[2] Various economic surveys and annul budgets of the MOF corroborate such a trend.

[3] Lack of recognition to the aid as the right of the poor and other developing countries and their people has continuously made aid as a major contentious issue.

[4] Such findings are apparent in various studies including the Development Cooperation Studies carried out regularly by the MoF in certain time intervals. For early findings in those lines see Khanal et al 2008 and Khanal 2011.

by Nepal have additionally helped this. Fourthly, typically Nepal has been one of the countries on the forefront in readily implementing almost all conditional programs evolved and implemented by the World Bank and the IMF through Structural Adjustment Program (SAP), Enhanced Structural Adjustment Facility (ESAF), Poverty Reduction Strategy Paper (PRSP)[5] and recent austerity linked aid programs. Fifthly, Nepal has also made strong commitments in the international forums to abide by the international resolutions besides trying to proactively implement the UN initiated global development agenda like SDGs which are now under implementation. Finally, Nepal has continuously revised and updated aid policy taking internal as well as external developments into account in which aid effectiveness policy measures developed and modified overtime by the development partners and aid recipient countries jointly have also been the bases of such revisions and updates which have also helped to receive positive responses from the development partners[6].

Understandably, all these initiatives or efforts to mobilize foreign aid have been made on the expectation that it will work as an important catalyst towards Nepal's development and prosperity. As an offshoot, it was also hoped that the creation or expansion of socio-economic infrastructural bases with the help of aid as pre-requisites of accelerated development would noticeably lead an overtime reduction in aid dependency. However, considering the performance of the economy in different critical areas amidst continued expansion in foreign aid inflow in Nepal, except in few, progresses in most of the areas has been disappointing. In the areas such as health, education and consumption poverty some satisfactory progresses have been made[7]. Such progresses have enabled Nepal to qualify for LDC graduation as Nepal has satisfied the Human Assets and Economic and Environment Vulnerability criteria despite Nepal's per capita income remaining below the threshold per capita income level. Consequently, Nepal's graduation from LDC is to take place in 2026[8]. Besides meagre growth performance with an average growth rate hardly surpassing 4 percent on average in the last 4 decades with great oscillation from one year to another, the improvement has been dismal on the labor market front with more than 2200 youths leaving the country every day in search of employment[9]. Besides quality being a big dilemma in health and education sectors, poverty intensity and inequality are increasing and presenting themselves as serious problems[10]. Lately, along with backlog effect of COVID-19, the economy is facing the problem of stagflation which if should it persist for long will further intensify growth, unemployment, poverty and inequality problems. As an offshoot, Nepal will lag far behind in achieving the SDGs. There are also fears of mounting debt outstanding and debt servicing problems[11] with the added threat of a further rise in external aid dependency. More worrying is that the worsening economic condition may jeopardize the progresses made so far in areas such as health and education. All these indicating the fragile nature of the economy[12] amidst the absence of a progressive transformation of the economy portray added threat of intensification in the hardship and vulnerability of Nepali people in general and the poor and disadvantaged people in particular. The spillover effect of worsened economic situation has been experienced in the government revenue mobilization front as well with the biggest revenue shortfall in the last fiscal year 2022/23[13] compared to the targets with more adverse effect on development programs. In such a situation, the role of foreign aid in Nepal would be still critical for overcoming the mounting resource crunch problem and bringing about a transformation in the economy in a rapid and sustainable way.

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[5] How Nepal readily accepted the strong conditions under the SAP, ESAF and ORSP can be found in Khanal et al 2005 and 2008 respectively.

[6] Taking both internal and external developments, Nepal has frequently changed aid/development cooperation policy. The current development cooperation policy 2019 replaces such a policy of 2014.

[7] It is, however, noticeable that out of total poverty reduction major contribution has been made by remittances inflow (CBS 2011). This means that which factor played a decisive role for such progresses has to be interpreted cautiously. Moreover, some studies show that apart from step rise in inequality measured through Gini-coefficient there is very little progress on poverty reduction once income criteria is used for such a measurement (Oxfam, HAMI and SAAPE 2019).

[8] For examining the performance in critical areas of human development and graduation criteria see Khanal, Pandey and Sharma 2020.

[9] See National Accounts Data of CBS of last four decades for growth numbers. For gauging the extent of labor market problems and unemployment, see CBS 2017/18. For youth outflow of last fiscal year see DOL 2023.

[10] See for details OXFAM, HAMI and SAAPE 2019.

[11] See PDMO 2022.

[12] It should be noted that despite qualifying for graduation as a result of meeting two other criteria, Nepal yet to qualify the income criteria partly the indicating the persistence of structural problems with higher fragility of the economy.

[13] See MoF 2023.

1.2 RATIONALE OF THE STUDY

The concept of aid or Official Development Assistance (ODA) has its roots in the Charter of the United Nations after a conference held in San Francisco on June 26th, 1945. With commitments to promote social progress and improve the standards of living of people worldwide, the conference agreed to employ international machinery to that end. The conference, thus, highlighted the importance of global institutions such as Breton Wood as a critical international machinery. In the post Second World War Period, the main concern was to rebuild the war destroyed world economy and promote economic development of the newly liberated colonies as well as other poor and underdeveloped countries. The United States launched the Marshal Plan to provide aid to its European allies. The success of the Marshall Plan added optimism about the prospects of helping the poor from the developing countries through aid. Parallelly, the Breton Wood Institutions established immediately after the Second World War with the responsibility promoting the development of poor countries and maintaining financial as well as economic stability globally initiated development aid to the poor countries in a larger way. Noticeably, while providing aid, it was assumed that aid besides being additive to the domestic saving as a prerequisite to boost investment will also ensure better returns through, among others, higher productivity of the aid. To augment aid in a coordinated manner, the Development Assistance Group (DAG) was established in 1960 which was later renamed the Development Assistance Committee (DAC) in 1961. In the same year, a resolution on common aid effort was adopted in London. In the resolution, DAC members realized the need to help less-developed countries by increasing economic, financial and technical assistance. They further agreed to provide aid in the form of grants or loans in favorable terms. Consequently, ODA started to flow in a big way[14].

Similarly, from the standpoint of concessional aid and aid priority to the poor countries, the least developed country (LDC) category established in 1971 by the United Nations can be regarded to be critical and important. This category was established based on the level of income, human assets and economic vulnerability criteria which justified the rationale for special support measures to these countries[15]. Accordingly, the program of action has been developed and implemented in the LDCs. Currently the Doha Program of Action for the decade (2022-2031) is under implementation. The programs developed with the concurrence of the development partners' aim to transform LDCs to the developing category in an accelerated manner by ensuring rapid productive and structural transformations of these economies that could also immensely contribute to minimize the vulnerabilities of these economies[16].

But despite increased inflows of concessional aid and other support measures to the poor countries, the developmental problems became steadily more pervasive in these countries[17]. Consequently, there were attempts to find out the underlying reasons for such a situation. The debate particularly focused on identifying the reasons for the economic successes of East Asian countries vi a vis failure of the poor Asian and African countries during the same period. Many studies showed that the government's role in setting and implementing sound market friendly economic policies with less state intervention added by focus on export-oriented industrialization were the major reasons for the successes in the East Asian countries[18]. Studies also revealed that poor and inward-looking industrialization and trade policies, overvalued exchange rates, heavy government regulations including higher spending, governance failures and political and social instability were responsible for the poor outcome or performance of many poor countries despite increased inflows of aid[19]. In a way it advanced the notion that the foreign aid inflow will be less helpful or counterproductive to the poor and developing countries unless drastic reforms are made in the policy front. Thus, citing the Successes of East Asian countries, the World Bank and

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[14] *For such background information from international aid perspectives see Kanbur 2003.*

[15] *For details see UNCTAD 2016 and CDP and UN/DESA 2018*

[16] *See UN 2022 for rationale and content of program of action.*

[17] *See Griffin and Enos 1970*

[18] *Numerous studies are found explaining such factors contributing to their successes. For more realistic assessment see Wade 1999.*

[19] *Such findings are most common that justify the minimization of state role and maximization of the market role. See for understanding the major problems with state protective policy regimes Krueger 1974, Krueger et al 1989 and Bhagabati 1982.*

the IMF jointly developed and implemented Structural Adjustment Program (SAP) in the 1980s by containing aid conditionality in a way that the developing countries could be pursued or forced to adopt liberalization policies by replacing state led protection policies. This was followed by the implementation of Enhanced Structural Adjustment Facility (ESAF) program in the early 1990s by the IMF after phasing out of the SAP in which more big bang liberal policies with draconian aid conditions were pushed. Again in 1995, ten policy agendas[20] to be consistent with market fundamentalism were introduced by the World Bank and the IMF jointly which is popularly known as Washington Consensus (WC). Though it was initially directed to the Latin American countries, it was pushed to all poor and developing countries worldwide. In line with market fundamentalism, it gave added priority on deregulation, privatization, further liberalization of FDI and the financial sector, exchange rate system and FDI policy apart from stressing on the need of ensuring property rights.

However, such strong conditional programs or agendas imposed grounded primarily on technical reasoning's by overlooking pre-existing structural and institutional constraints including governance constraints in poor and developing countries led to worsening socio-economic conditions in these countries. Not only was there a slowdown in economic growth, unemployment, inequality and poverty problems increased markedly along with rise in prices, debt servicing and BOP problems[21]. This resulted in wider criticism. The discontent[22] also rose globally. The micromanagement of national economies by the multilateral institutions, lost country ownership and economic sovereignty became a major bone of contention. During the same period economic crisis occurred in many East Asian countries and intensified thereafter[23] which in turn further eroded the faith on SAP driven conditional programs. It was quite natural because these were the countries that were termed as economic miracles in a book published by the World Bank in 1993[24] and the SAP in many instances was justified claiming that the East Asian Countries success was rooted in the liberal economic policy regime.

Against this backdrop, the Poverty Reduction Strategy Paper (PRSP) was revised by the World Bank and the IMF in the late 1990s. The paper emphasized country ownership and participatory processes which led to the preparation of PRSPs by the authorities of the developing countries themselves. Under this, the World Bank and the IMF provided Poverty Reduction Support Credit (PRSC) and Poverty Reduction and Growth Facility (PRGF) loan respectively to the poor and developing countries. As the name of the Paper entails, it gave emphasis on poverty and related social development programs in which equal stress was given on governance and institutional reforms. With this, two developments were noticeable. One, unlike the SAP period involving the Finance Ministries and Central Banks by bypassing major domestic stakeholders, it developed a framework which ensured domestic participation and ownership of the program and thereby created a wider support base domestically that to some extent helped to reflect the needs and priority of the aid recipient countries. Second, unlike the phenomenal rise in loan during the SAP period, certain changes in the aid composition took place leading to relative rise in the share of the grant. Notwithstanding these positive developments, the major deficiency of the program was such that there is no fundamental departure from the kind of policy advice that was made under the "Washington Consensus"[25]. More specifically, a study comparing the agenda under the

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[20] The ten elements popularly known as Washington Conesus are: (i) Fiscal discipline, (ii) reorienting of public expenditure priorities, (iii) tax reform, (iv) liberalizing interest rates, (v) a competitive exchange rate, (vi) trade liberalization, (vii) liberalization of inward foreign direct investment, (viii) privatization, (ix) deregulation, and (x) property rights.

[21] There are numerous studies deriving such findings. For critical review of various conditions and their ramifications see Mosley et al 1995. See also Rodman 2007. In African context see Heidhues, F. and Obare, G. 2011, among others. For critical review on SAP and ESAF along with social cost of adjustment in the Nepali context can be found in Khanal et al 2005.

[22] There were situations in which attempts were made to disrupt World Bank, IMF and the WTO annual meetings.

[23] The Eat Asian crisis started in 1997 from Thailand and extended to the other East Asian countries with larger contagion effect which raised the questions on the superiority of the policies.

[24] A book with the name of East Asian Economic Miracle was published by the WB in 1993.

[25] For details see UNCTAD 2002.

WC and PRSP derives the conclusion that PRSP[26] is simply an Augmented Washington Consensus with several additional layers of policy reforms, focusing heavily on institutional and governance areas. It adds that empirically it is at odds with the advanced countries' own historical development experience. It further notes that it does not come with a well-defined list of priorities and hence applied in practice, it is as likely to make things worse than to make them better[27]. Thus, despite some priority changes and domestic ownership embedded in the PRSP framework, the neo-liberal agenda was further pushed without attempting to bring coherency between the programs and policies taking past bitter experiences into account. At the functional level, ten agendas set under the PRSP[28] became more dominant and hence it was also detrimental to the economy and people of the poor and developing countries to a larger extent.

Consequently, the debate on the underlying reasons for the poor outcomes of the aid continued. Many researchers came to the conclusion that foreign aid is often provided due to donor's interest rather than due to developmental or humanitarian reasons. It was also found that foreign aid is predominantly used to promote geostrategic interests, build and maintain foreign bases, to strengthen alliances, or to keep allied regimes in power. It was also concluded that the EU is increasingly moving closer to the United States in that its foreign assistance is more explicitly focused on security matters. In my instances, studies reported that foreign aid was used to open foreign markets to multinational corporations, to subsidize donor's domestic firms, or to provide employment for the donor's domestic experts or workers. It was also evidently proved that recipient countries providing favorable climate for foreign investment and trade were receiving more assistance. The commercial motives of foreign aid through aid tying practices were found to be dominant[29].

Thus, unlike the customary of blaming recipient countries for their poor performance after aid, the need for mutual responsibility gradually emerged. Consequently, both donors and recipient countries began to work jointly to improve the efficiency and effectiveness of aid. There were attempts to reduce duplication of work among donors (harmonization) and ensure that donor's support is driven by national development plans and programs of the aid recipient countries (alignment). There was also increased emphasis on accountability and involvement or participation of stakeholders in the aid commitment and delivery processes for strengthening democratic ownership of aid. To these ends, donor and recipient governments signed the Rome Declaration on Aid Harmonization in 2003. This was followed by the Paris Declaration on Aid Effectiveness in 2005 which is regarded to be a milestone towards enhancing effectiveness of aid through collective responsibilities in specified areas. The Aid Effectiveness agenda which is often said to be the Paris Declaration (2005) has laid out five principles which include 1) country ownership 2) donor alignment 3) harmonization of procedures and information sharing 4) managing for and measuring of results, and 5) mutual accountability between donors and developing (recipient) countries. Thus, the Paris Declaration set the 5 agendas as the basis of assessing the effectiveness of aid. Accordingly, a new beginning of regular review of aid effectiveness grounded on these 5 criteria was initiated.

Considering the poor outcomes of the Paris Aid Effectiveness agenda[30] amidst changing development landscape as well as emergence of many new aid sources, a new Accra Agenda for Action was agreed upon in 2008. It laid down the action plan for accelerated advancement towards the Paris targets. Inclusive participation, delivery of results and capacity development were the major agendas added. More say was accorded to the aid recipient countries in the development processes through wider participation in development policy formulation. Strong

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[26] He compares 10 agenda under WC with ten agenda under the PRSP which are 1) corporate governance, 2) anti-corruption, 3) flexible labor markets, 4) adherence to WTO disciplines, 5) adherence to international financial codes and standards, 6) prudent capital account opening, 7) non-intermediate exchange rate regimes, 8) independent central bank/inflation targeting, 9) social safety nets, and 10) targeted poverty reduction. No changes in the policies laid down in the Washington Consensus and simply addition of these led to term augmented Washington Consensus.

[27] Rodrik 2004.

[28] An exhaustive review on the PRSP on those lines can be found in Khanal et al 2008.

[29] A thorough assessment on the aid motive is found in Foreign Aid as Foreign Policy Tool. See for details. https://doi.org/10.1093/acrefore/9780190228637.013.332

[30] A review can be found in Khanal et al 2008 and Khanal 2011 with specific reference to Nepal.

leadership on aid co-ordination and more use of country systems for aid delivery were also included with priority in the action plan[31].

Again, the Fourth High-Level Forum on Aid Effectiveness held in Busan in late 2011 reaffirming the commitments made in Paris and Accra. In this, a new Global Partnership adding emerging donors and private sectors was agreed upon for Effective Development Cooperation. An important contribution of this forum is that it laid down the international standard on the principles of effective aid and good development. Main principles agreed in the forum included: a. Country leadership and ownership of development strategies, b. A focus on results that matter to the poor in developing countries, c. Inclusive partnerships among development actors based on mutual trust, and d. Transparency and accountability to one another.

Thereafter, the 2030 Agenda for Sustainable Development was adopted in 2015 which, inter alia, necessitating a bigger shift in the development paradigm for accomplishing 17 goals and 169 targets by 2023. Among them, the Sustainable Development Goal 17 stresses on the need to strengthen the means of implementation and revitalizing the Global Partnership for Sustainable Development. It recognizes multi-stakeholder partnerships as important vehicles for mobilizing and sharing knowledge, expertise, technologies and financial resources to support in achieving the sustainable development goals in all countries, particularly developing countries. As such, the goals not only underscore the need of more partnerships and support to the poor and other developing countries for accomplishing the ambitious goals in stipulated time but also to shift the partnership and financial support accordingly. The 2030 Agenda recognizes that its goals cannot be realized by Official Development Assistance (ODA) alone. In this respect, the third international UN Conference on Financing for Development convened in Addis Ababa had emphasized on the need for all relevant actors to invest in the new agenda, through blended finance, which combines concessional public finance with non-concessional private finance and expertise from the public and private sector. Similarly, the SDGs 13 urges action to combat climate change and its impact having larger implications on climate finance.

Notably, the Paris Climate agreement 2015 on climate change, which is regarded to be a landmark agreement on the most serious challenge of 21st Century has committed to limit the global temperature rise to 1.5°C above pre-industrial level. The UN Intergovernmental Panel on Climate Change says more candidly that limiting global warming to around 1.5°C requires global greenhouse gas emissions to peak before 2025 at the latest and be reduced by 43 percent by 2030. Such targets involve huge resources in the form of climate finance. The Standing Committee on Finance in 2020 estimated that the total climate finance needs of developing countries would range anywhere between $5.8 trillion a year to $11.5 trillion a year. Estimates of mitigation spending needs were estimated to be between $2.2 to $5.3 trillion added by adaptation costs of $ 70 billion annually. These figures were estimated to reach $ 140-300 billion in 2030 and $ 280-500 billion by 2050. More distinctly, the loss and damage cost were estimated to be $116–435 billion in 2020 and rising to $290–580 billion in 2030. Amidst commitments through agreements coupled with mounting pressure, another landmark agreement was made at COP27 in Sharm el-Sheikh, Egypt by agreeing to create a Loss and Damage Fund and operationalize it within two years to support to the vulnerable countries that are hit hard by floods, droughts and other climate disasters. Thus, for the first time by accepting the climate crisis primarily the byproduct of the developed and some emerging countries it was agreed to compensate the highly affected countries. In principle it is an issue associated with climate justice which has been campaigned by civil society organizations and individuals advocating for justice since long. This has brought the justice dimension to the forefront under the aid effectiveness agenda. It should also be noted that when climate justice is advocated at the global level, it has to be based on internally assessed, among others, loss and damage to the economy and vulnerable people due to climate change. Inter alia, it also necessitates the internalization of climate justice resilient development dimension in policies, plans and programs which is often overlooked.

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[31] See for some details https://www.oecd.org/dac/effectiveness/parisdeclarationandaccraagendaforaction.htm

It is, however, irony that neither the past commitments made on aid effectiveness agenda including commitments by the developed countries to raise aid up to 0.7 percent of GDP have been fulfilled nor have the current development policies and operational approaches of international development partners been consistent with the broad scope of the 2030 Agenda. As such, the most important commitment to national ownership and priority to sustainable solutions benefiting current and future generations is yet to be realized. Instead, often unilateral decisions are taken by some developed countries along with influencing the policies of the multilateral agencies, opposite to their commitments. Some recent examples corroborate this. In the aftermath of COVID-19 pandemic and Ukraine war, as indicated by the 2022 Financing for Sustainable Development Report (FSDR) of the UN[32], there is a rapid rise in finance divide between the developed and developing countries with drastic reduction in the ability of many developing countries to respond to shocks and invest in the recovery of their economies. The unilateral decisions of the developed countries have played a decisive role in it. For instance, in the wake of the COVID-19 pandemic, developed countries financed massive fiscal response packages (almost 18 percent of GDP) at very low interest rates, backstopped by their central banks through quantitative easing. Developing countries, on the other hand, were constrained by their limited fiscal space and capacity to embark on large scale deficit financing. Developed countries did not feel the need to support developing countries as a part of their international commitment. As a result, the poorest countries were forced to cut spending in areas such as education and infrastructure, contributing to a more protracted crisis[33]. Consequently, there was excess liquidity in their economies with big pressures on the prices. Thereafter, a tight monetary policy of higher interest has been pursued by the US, and other developed countries unilaterally to cope with the inflationary pressures leading to outflow of capital from developing countries and massive rise in debt serving liability etc. These issues have compounded economic problems markedly[34]. This is a paradoxical situation from a larger aid perspective.

Added to this, the developed countries have not fulfilled their commitments on climate finance made back in 2009. In 2009 they had committed to provide $100 billion per year from 2020 to support developing countries in carrying out climate change related programs. This is yet to be materialized. Similarly, no progress has been made prior to COP27 towards creating loss and damage fund and making it operational in two years[35].

Amidst such tendencies and behaviors, debt distress has increasingly become a serious problem in developing countries with the threat of increased net outflows leading to widening financing gap of SDGs. At the same time, rising debt problem of the poor and other developing countries partly entails the possibility of poor outcomes of the investment in which the role of the foreign aid also comes to the forefront. Added to this, the average interest cost on external borrowing in the developing countries was three times higher than that of developed countries. In the low interest environment of the last decade, developed countries borrowed at an interest cost of an average of 1 percent. Least developed countries (LDCs), which have increasingly tapped international markets in recent years, borrowed at rates over 5 percent, with some countries paying over 8 percent. This has dragged up their average borrowing cost and translated into further narrow downing of fiscal space[36] with pressures on stiff conditions which led to external loans. Studies report that even during the period of Covid-19 pandemic, countries were forced to adopt strong austerity measures to qualify for concessionary aid[37]. Importantly, unless the debt outstanding issue which is now one of the top global agenda is not settled in near future, it may pose a bigger resource crunch problem which will further impede the development process with added adverse effect on accomplishing SDGs by 2030.

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[32] *UN 2022.*

[33] *For a critical review on how the Finance Divide is widening between the developed and developing countries see Spiegel and Schwank 2022*

[34] *How problems of the developing countries due to unilateral policy moves by the US having international reserve currency can be found in Khanal 2023.*

[35] *Some progress on this seem taking place at the COP8 in Doha.*

[36] *Ibid*

[37] *For details see ERODAD 2022.*

A progress review presented in the 2022 Effective Development Co-operation Summit of the Global Partnership also states that one of the weaknesses of the Busan meeting has been such that it did not result in an agreement on a clear framework to monitor aid effectiveness commitments. It also says that progress has been very slow in areas such as creating building blocks on public-private cooperation for development. Donors are increasingly using ODA to leverage private finance for investments. Of more serious concern is that the focus on the private sector has been driven by the motive of filling the financing gaps created by continuous shrinking of aid budgets. It further reports that the little progress made on reducing aid fragmentation and it is largely associated with coordination failures. Considering the overall progress on the development effectiveness of aid agenda, the 2022 Effective Development Co-operation Summit of the Global Partnership states that there are more challenges today and adds on the need of collective action for country-led, result-oriented, inclusive, and transparent aid system. It reiterates the need of future decision-making around such four effectiveness principles and strengthening progress towards the Sustainable Development Goals (SDGs). The Summit also has decided to launch a new monitoring framework.

The introduction of a more robust new monitoring framework could be a milestone towards more progress towards the four principles amidst new resolutions and initiatives at different levels toward that end. The major problem is that the agreed or committed norms are hardly followed and complied[38]. As already indicated, no or slow progress on climate finance is a classic example of this which entails that under the dominant global system the extent to which decisions or established rules are violated and undermined.

Due to a host of reasons, developed countries continue to fail to meet ODA commitments of 0.7 per cent of their GNI as already indicated above. In reality, they hardly allocate 0.15-0.20 per cent of GNI to the least developed countries (LDCs). On the other hand, contradictory to commitments on funding SDGs and climate finance, concessional finance terms have worsened at the aggregate level with LDCs receiving fewer grants. There are fears that with prolonging of the Ukraine war, the ODA could be reduced considerably by diverting more and more funds to the war unless alternative arrangements are made swiftly and more robustly.

It is noticeable that Nepal has continuously been involved in the processes of formulating and implementing aid effectiveness agenda, ranging from Paris Declaration on Aid Effectiveness to the Accra Agenda for Action and the Global Partnership for Effective Development Co-operation, among others. Nepal has also ratified the Paris Climate agenda and has been actively involved in climate negotiations in the global climate forums.

As a part of reviewing the aid effectiveness agenda, there is regular publication of development corporation report on the status of aid in Nepal. Similarly, to make the aid policy compatible with the global commitments Nepal updates its development cooperation policy regularly. The latest one was updated in 2019 where in enhancing aid effectiveness has been prioritized.

Strengthening ownership, focus on result-oriented projects and programs and gradual reduction in the aid dependency are some of the major policy focuses of the aid. For strengthening national ownership, SWAp arrangements in health and education have been introduced since long. Nepal has also launched Aid Management Information System (AMIS) in 2019. Both periodic plans and annual budget statements commit to the aid effectiveness agenda. A more participatory approach is claimed to be followed in the processes by involving stakeholders, civil society organizations and NGOs.

Despite various initiatives and steps including regularly updating the foreign aid policy and making commitments to abide by global aid effectiveness agenda which has been mutually agreed upon, various studies carried out and reports prepared in the context of Nepal in the past reveal that the overall performance of the aid has

[38] *See for a critical view on what is behind aid ineffectiveness? https://www.cairn.info/revue-reflets-et-perspectives-de-la-vie-economique-2016-2-page-61.htm&wt.src=pdf*

been less than satisfactory and, in many instances, disappointing. Studies point out that contradictory steps or measures and a non-responsive system ensuring fulfillment of the commitments by both national governments and donors have been mainly responsible for this.

A review of economic reform policies carried out under the SAP and other similar conditional programs shows that typically Nepal has been in the category of countries which have readily accepted all conditions that were laid down in them by forgetting about one's own set and prioritized national agenda. This was a period when special LDCs linked program of action was under implementation which focused on structural reforms and changes. This was also a period when Nepal had declared fulfilling basic needs of the people in 15 years to reach at the Asian Standard. These were fully undermined by both governments and donors. Consequently, along with a higher social cost of adjustment, the performance in critical areas such as growth, employment, poverty reduction, prices and external balances was highly unsatisfactory[39]. A book on Nepal's failed development indicates that foreign aid is also responsible for this[40].

A study carried out in 2008 by the IPRAD with the support of ActionAid Nepal to exclusively gauge the aid effectiveness under PRSP concludes that aid behavior before and after PRSP has hardly changed despite the changed focus. The study found that the attached conditions were even more stringent than the conditions laid down in SAP. The study has concluded that, despite focus on the social sector, poverty and governance issues after the introduction of PRSP, no major breakthrough in aid behavior including correction in economic policies to bring policy and program coherency considering structural impediments and non-responsive governance system took place. The study based on the quantitative analysis shows that no considerable positive impact on both growth and poverty reduction is visible due to the PRSP[41].

As indicated above also, indeed it is ironic that the donors' conditional programs are designed and implemented in a way that they hardly try to bring consistency with own set global agenda. If LDCs program of action as well as last Millennium Development Goals and ongoing SDGs are compared with the conditional programs, hardly any coherency is found. This is the real dilemma of aid. The crux of the problem of implementing aid effectiveness agenda set in 2005 and modified or changed subsequently have largely suffered due to this principal reason.

A study carried out in 2011 as feedback to the Busan meeting has concluded that in the areas of both ownership and accountability no perceptible progress has been made as per the commitments. Similarly, a book focused on development and donors concludes that combined with many internal factors aid has played little role in Nepal's development[42]. A book focused on aid, technology and development has concluded that aid has done some good, in only limited areas and has done worse in larger areas[43].

On the other hand, a recent study on the health sector with focus on the inclusion indicates that there is no civil society representation in the federal- level technical working groups and other coordination mechanisms. It also says that there is no framework to engage with non-governmental organizations (NGOs)/civil society organizations (CSOs). Besides indicating no harmonized reporting of indicators, it also points out that there is no oversight/visibility over private health providers including no arrangements to engage with private sector for cooperation[44]. The latest Development Cooperation Report 2021 of the government which is a part of regular updates since last many years also reveals that there are many weaknesses in the aid system[45].

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[39] *See for details see Khanal et al 2005.*

[40] *See Panday 1999.*

[41] *See Khanal et al 2008. Some studies describe at length that how aid has been a part of the failed development in Nepal.*

[42] *See Panday 2011.*

[43] *Gyawali et al 2018*

[44] *UNICEF 2022.*

[45] *MoF 2022.*

Thus, various studies together with latest Development Cooperation Report of 2021 on the one hand and overall socio-economic situation in the country added by looming bigger economic crisis on the other hand act as guide to indicate the need of a more comprehensive study on the development effectiveness of aid. There are many interlinked issues associated with lately agreed country-led, result-oriented, inclusive, and transparent aid system requiring a deeper analysis amidst weak or deteriorating performance of the Nepali economy. Therefore, first of all it is necessary to delineate whether effectiveness problems are rooted in internal or external factors or both which are also associated with ownership, alignment and harmonization issues. The aid fungibility issue is also partly associated with these. Similarly, from a policy standpoint review of sources of aid (distinguishing grant, loan, technical assistance and others, if any) is also equally important which in many instances is associated with aid conditions and aid tying practices. The latest thrust is that aid should be participatory and more inclusive for strengthening democratic processes, enhancing transparency and ensuring the benefits to the most deprived and excluded. This issue needs special consideration. Based on the experience so far, reluctance to comply with the mutual accountability has been a major problem. Above all, how conditional aid programs, periodic plans, program of actions, global development agenda such as MDGs and SDGs and aid effectiveness policies apparently having conflicting objectives are often implemented simultaneously is the most important issue from political economy perspectives which may have created ambiguities and uncertainties in many instances affecting the intended outcomes. In Nepal's context, all the major aid effectiveness issues associated with climate finance[46] are highly important as Nepal is ranked to be the 4th highly vulnerable country on the climate change in the world.

As such, while reviewing aid effectiveness policies and assessing the progress and outcomes multiple factors have to be taken into account. In doing so, a closer review of internal structural, institutional, governance and policy led impediments which are often ignored together with international political economy factors often compelling contradictory policy directions will also be necessary for finding out the principal reasons affecting the better outcomes of aid. Under the federal system, whether aid policy is consistent with the rights granted to the sub-national governments or not has also to be taken into account, which is important from the standpoint of participatory, inclusive perspectives, among others. As there are hardly seven years left to accomplish the SGDs including goal 13, it is pertinent to gauge the development effectiveness of aid including climate finance in the light of initiatives and progresses made in meeting the goals taking both enabling and constraining aid related factors into account.

1.3 OBJECTIVES OF THE STUDY

The overall aim of the study is to assess the development effectiveness of aid in Nepal taking changing global developments in this area into account. The specific objectives are

1.3.1 Review the overall trend and structure of aid by source and nature of at least last ten years and closely assess, if any, the changing pattern in the aftermath of launching of SDGs,

1.3.2 Review the aid effectiveness global agenda and its changing nature together with examination of Nepal's development cooperation policies in a comparative manner,

1.3.3 Assess to what extent the four principles of aid effectiveness have been implemented in Nepal and contributed to improve the development effectiveness of aid and thereafter identify the major internal and external factors constraining the effectiveness taking political economy factors into account,

[46] *In Nepal various initiatives in addressing climate change have been taken with focus on both adaptation and mitigation policies and programs. As a part of this, the new national climate policy has been implemented in 2019. Various climate funds have been mobilized since long. In 2021 Nepal adopted the Green, Resilience and Inclusive Development (GRID) approach with the support of the World Bank which focuses on climate resilient development as a part of recently prioritized global agenda. Moreover, climate financing and its effectiveness will be particularly critical and important in the coming days in Nepal amidst mounting climate led crisis with economy-wide pervasive adverse effect.*

1.3.4 Draw policy implications from the standpoint of enhancing development effectiveness in aid which at the same time could lead to gradual reduction in dependency on the aid.

1.4 METHODOLOGY AND DATA SOURCES

Both qualitative and quantitative methodological approaches have been followed in the study. Both national and international aid related documents and studies have been closely reviewed and assessed to find out the underlying reasons for the changes brought in aid effectiveness agenda and examine the extent of these implemented by the development partners and Nepal to full commitment responsibilities. While assessing, a brief review of periodic plans, conditional aid programs, LDCs directed program of actions and global agenda such as MDGs and SDGs have been made in the light of aid effectiveness to see the extent of coherency and likely ramification on aid effectiveness. Similarly, to gauge the aid effectiveness, some trend analysis following quantitative approach has been made in which the pattern in aid and growth, aid and saving, aid and revenue, aid and investment etc. have been examined. Similarly, some specific parameters associated with aid effectiveness have been closely examined in the alight of aid inflow in Nepal. For the study secondary data and information have been used.

1.5 STRUCTURE OF THE REPORT

After this introductory chapter next chapter is devoted to examining the overall trend and pattern of foreign aid in Nepal in a comparative way covering the longer period 1974/75 to 2020/21 and albeit short period 2010/11 to 2020/21 separately. The trends in both sources and type of aid have also been presented in this chapter. In the next third chapter a closer review of foreign aid/development cooperation policies of Nepal has been made in detail. This has been followed by an assessment on the effectiveness of aid for which various direct and proxy indices have been used and compared with the aid inflows in Nepal in the same chapter. The last chapter is devoted to present conclusions and way forward in brief.

1.6 LIMITATIONS OF THE STUDY

Different aid data sources have different numbers. For the study only government published data could be used without comparing with other sources including those of OECD. For the assessment of aid effectiveness, a more advanced robust quantitative technique would have been used. Added to this, donor funded selected project covering the project initiative agency, year of initiation and project appraisal details including total cost, expected return, debt serving schedule etc. would have been reviewed. Thereafter, as a testimony, a field visit would have been carried out to see the actual status of such projects. Given the time constraint and non-availability of required information and data readily, the study could not follow advanced technique and assess projects in detail. Similarly, due to lack of comprehensive data on aid channeled through the private sector could not be covered.

Chapter 2

Recent Trend and Pattern of Aid in Nepal: A Quick Review

Recent Trend and Pattern of Aid in Nepal: A Quick Review

Generally, after frequent ups and downs followed by sweeping changes in the state and political system as has happened in Nepal since 1951, drastic changes in the aid trend and pattern highly beneficial to the economy and people is expected. New developments at the global level associated with aid and development also entail the possibilities of such changes.

Below the trend and pattern of foreign aid is presented and analyzed focusing mainly the period 2010/11 to 2020/21[47]. While examining such a trend, major types of aid, major aid sources, aid modality, aid disbursement and mode of payment have been covered. The modes of payment comprising cash, reimbursements, direct payment and commodity support is also important and examined below. The aid mobilized and utilized through I/NGOs is separately discussed.

2.1 TREND IN AID BY TYPE AND SOURCE

Establishment of democracy in 1951 followed by introduction of budgetary system in 1952 and planned development initiatives in 1956 created certain bases of mobilizing aid in Nepal. After first inflow of aid in 1951, a continuous rise in the total volume of aid at current prices has taken place in Nepal with exceptions in some years. Though increasing trend shows stability in the aid inflow to some extent, it conceals many critical aspects of aid that are linked to need, quality and effectiveness.

Nepal has mobilized aid largely in the form of grant, loan, technical assistance and humanitarian aid. A closer assessment of the long-term trend of grant and loan shows that there has been wider fluctuation and changes in the composition of these components. From the sources side also, in the beginning bilateral aid was predominant but gradually multilateral aid became a major source. Likewise, some compositional changes in the aid modality are observed which to some extents have been influenced by the changed priority in modality over time partly affected by the internal push and external aid related global agenda. Among the modality of aid, project support is the major one. Under this, projects are initiated and developed by the line ministries and donors are approached and is negotiated through the Ministry of Finance for funding. Another is program support. In this modality, more than one agency is involved and hence it cannot be implemented as standalone projects. The next one is Sector Wide Approach (SWAp). This is a program-based approach and implemented by the government with the support of various donors or development partners. Next is the humanitarian aid, which is provided or utilized, for instance, to cope with natural disasters or other unanticipated happening.

Under the loans, Nepal receives mainly concessional loans from both bilateral and multilateral development partners. The government prioritizes utilization of loans in SWAp Projects, Pool funds, co-financing and physical infrastructure projects. There are also certain benchmarks to take loan. There is also the practice of taking in the form of other loans. Such loans with certain benchmarks are being used in hydropower, electricity transmission, highway bridges, strategic road networks, railways, airport construction and upgrades, dry ports, large scale irrigation projects and other large, prioritized projects. This policy does not allow taking commercial loans for the private and non-governmental sectors under the government guarantee.

Technical Assistance is also one of the important forms of aid in Nepal since the beginning of aid inflow in Nepal. TA is received in both individual and organizational level. It is further categorized into project preparatory technical

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[47] *For detailed analysis 2010/11 has been taken as a base fiscal year considering the long transition period after introduction of Interim Constitution in 2007 which commits sweeping changes in state governing system along with high priority on political, economic and social rights of the people in general and deprived socio-economic and geographical group in particular. The last fiscal year 2020/21 has been chosen considering the availability of actual dat. However, for a quick review on long term trend and comparison with latest one decade period 1974/75 to 2020/21 has been covered.*

assistance, standalone technical assistance for capacity development, and international and regional technical assistance. Under such categories numerous forms of support are obtained. Among them, one form is of national or international level consultants. Another form is external volunteers.

A close review of sources shows that in the 1960s, Japan was the largest donor to support infrastructure projects. Gradually, Japan also provided aid to the social sector. During the same period, countries such as India, China and the United States extended their support to roads, establishment of enterprises, health, education and integrated development. In the early 1970s, share of grant was higher but gradually projects and programs loan became dominant after increased funding by the Asian Development Bank (ADB) and the World Bank.

A quick review of the long-term aid inflow covering the period of 46 years (1974/75 to 2020/21) reveals that per year average growth rate was 14.7 percent with 11.1 and 17.5 percent growth in grant and loan respectively. This simply means that during the entire period under review, the rate of growth in loan has been faster than grant which indicates the possibility of rise in debt servicing liability at a faster pace overtime. If compared such a long-term trend with last one decade's (2010/11-2020/21) trend, such a possibility reinforces further. During the period 2010/11 to 2020/21, compared to negative growth in grant by 2.3 percent, the growth in loan has been very fast at an average rate of 30.5 percent per annum. The trend in grant is albeit puzzling as there have been more ups and downswings during these periods. For instance, in 1974/75, its share in total aid was about 73.1 percent. It went down sharply thereafter and reduced to 26.8 per cent by 1988/89. Interestingly, this was a period when LDCs plan of action for 1980s was being executed. This was also a period when the conditional SAP was also under implementation. Politically, the democratic movement was also picking up at that time with increased crisis to then autocratic regime.

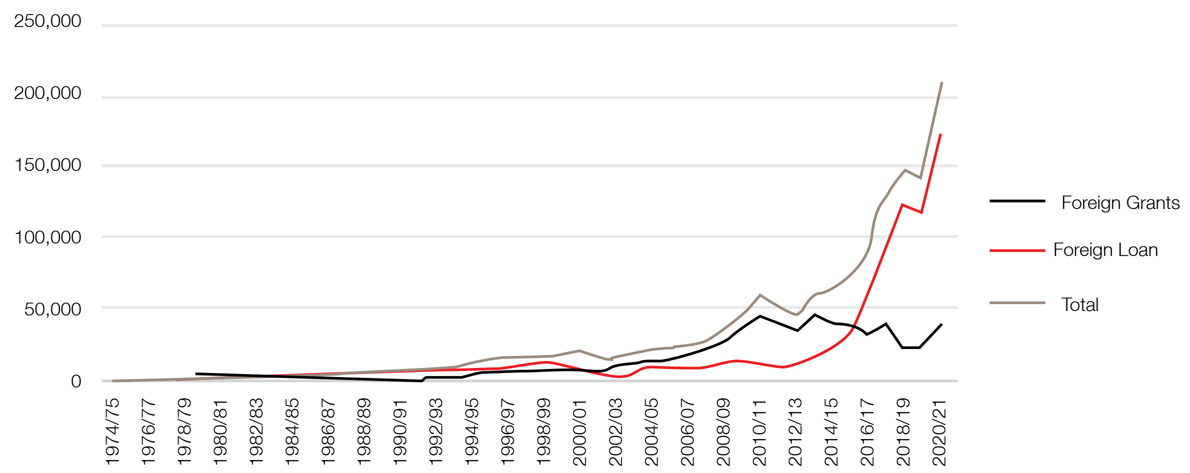
After the restoration of democracy in 1990, a sharp increase in grants took place. By 2002/03 its share reached 71.4 percent again. This was the fiscal year when introduction of PRSP took place in Nepal in which 10th plan was made compatible with the PRSP approach in which various conditional aid programs were included in it. It is noticeable that the PRSP was framed focusing on social development and poverty reduction despite further push to neo-liberal policy agenda simultaneously. Such a changed program priority paved the way for increased inflow of grant component. The increase in grant inflow compared to the loan continued and reached a climax in 2011/12 at 78.6 percent. Thereafter, the deceleration in the level of grant started markedly and its share reduced to 17.4 percent in 2020/21 in total. Worry is that if recent trends continue and do not reverse, grant component will be negligible and insignificant[48]. Highly fluctuating long-term trend with sharp reduction in grant in recent years is quite visible from the Graph 1 below. Aid covering the period 2010/11 to 2020/21 is also presented separately in the Graph 2 below for exhibiting clearer picture on the recent trend. It appears that some changed behavior of the donors in the aftermath of PRSP along with sweeping political changes, peace agreement focusing on durable peace and commitments in new Interim Constitution 2007 facilitated to some extent for increased inflow of grant. But after certain transition period, the extra concession that Nepal was enjoying through grant phased out. A global tendency of switching from bilateral to multilateral aid accompanied by Nepal's own initiatives or concurrence and priority to the sectors and areas where mobilization of loan has been much easier might have played a role for jumping toward loan at the expense of grant. It entails the possibility of aid source and aid priorities including aid modality playing decisive role in such a dramatic shift. In view of even in a grant dominance period economy performing poorly, such a bigger shift raises concern about the underlying factors contributing to this with an increased downside risk of better outcomes and sustainability of loan. One interesting aspect is that such a shift has taken place at the time of implementing the SDGs and the LDCs plan of action simultaneously.

It is obvious that with no debt servicing future liabilities, grants are preferred to loans. In a resource scares economy, it provides big opportunity to tap it in transforming the economy and strengthening the scope of sustaining development. However, if it is considered like a free lunch and misused recklessly, net gains would be

[48] See budget of fiscal year 2021/22 and 2022/23 (MOF, 2023).

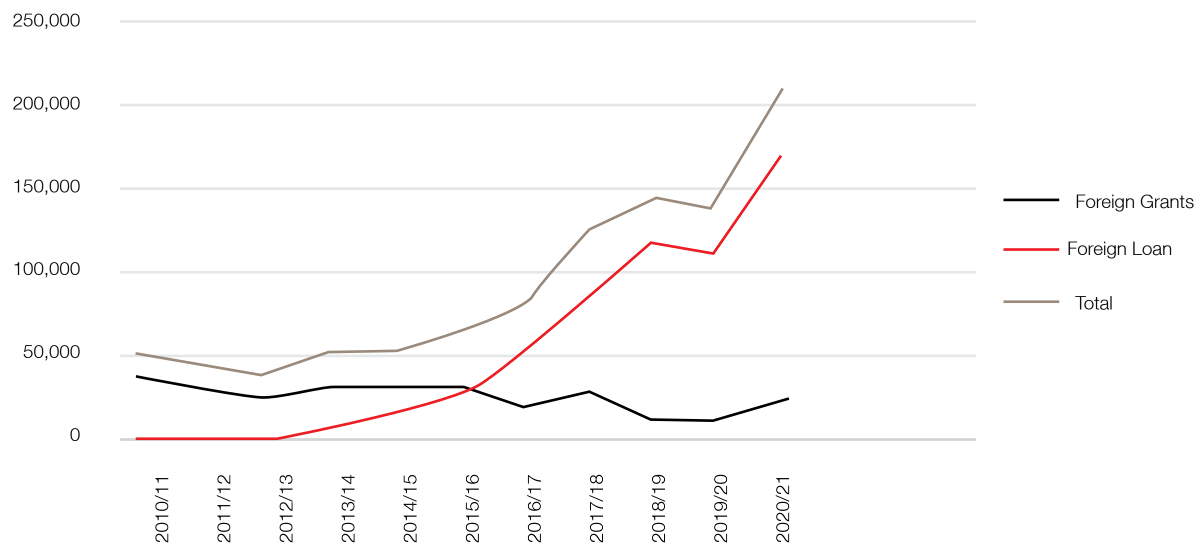
negligible leading to perpetuation in aid dependency, among others. Indeed, with the possibility of lesser efforts at internal resource mobilization, grant may lead to intensify the external dependency further. Country experiences additionally show that under grant strong terms and conditions are often imposed through which aid tying practices become rampant with predominant share of grant returning from where it has come. This means that ultimately the ownership, institutional capability and governance issues are highly critical to reap higher benefits from the grant as well.

Graph 2.1 Trend in Grant, Loan and Total Aid during 1974/75 to 2020/21



Source: Economic Survey of Various Years, Ministry of Finance

Graph 2.2 Trend in Grant, Loan and Total Aid during 2010/11 to 2020/21

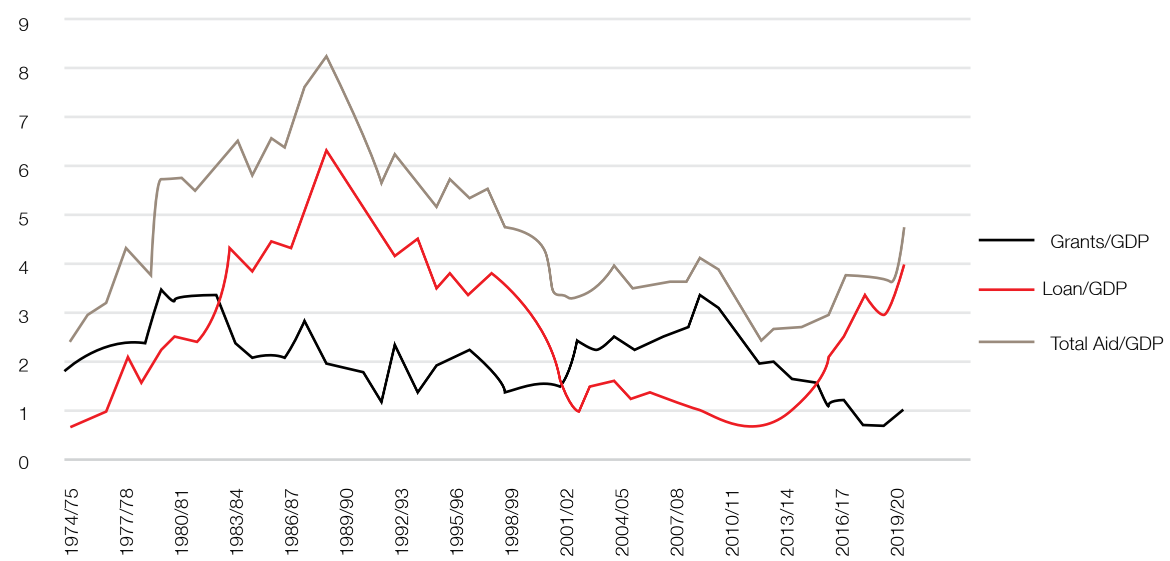


Source: Economic Survey of Various Years, Ministry of Finance

Besides corroborating the above phenomenon, the share of foreign aid in GDP gives some additional insights. In 1974/75 share of grant in GDP was 1.7 percent compared to loan's share at 0.63 percent. By 1979/80 both grant and loan's share in GDP increased sharply and reached 3.45 and 2.29 percent respectively. After one decade, there was not only dramatic shift from grant to loan as a share of GDP but also the rise in the share of loan was phenomenal. With grant at 1.88 percent of GDP in 1989/90, the share of loan in relation to GDP reached very high at 6.35 percent. In total, the share of aid in GDP reached as high as 8.23 percent. Such a ratio is the highest in Nepal's aid history. As already indicated, this was the terminal year of SAP which further corroborates that the loan program under the SAP was largely instrumental to raise share of loan vis a vis grant in Nepal. Thereafter, the ratio of grant in relation to GDP increased rapidly along with sharp decline in the share of loan leading to reduction in the overall share of aid in GDP. The major reasons have already been pointed out above. By 2009/10 share of grant in relation to GDP reached 3.23 percent against loan's share standing at 0.94 percent of GDP. Thereafter, a reverse trend manifested again with grant as a share of GDP reducing to 0.84 percent as opposed to loan jumping to 3.97 percent of GDP in 2020/21. Their combined share reached about 4.81 percent of GDP.

Thus, at a first glance, it is observed that there is a tendency of reduction in overall aid dependency in recent years compared to the trend during 1980s and 1990s. In recent years the contribution of internal revenue to the total government expenditure has increased steadily which could be considered as one of the reasons for such a reduction. However, it would be immature to derive such a conclusion affirmatively. First, the reduction as a share of GDP in recent years has largely been due to the sharp reduction in grant. Contrarily, share of loan in GDP is on the rise in recent years. Both sources of aid and aid modality give some explanation on the underlying reasons.

Graph 2.3 Share of Grant, Loan and Total Aid in GDP



Source: Economic Survey of Various Years, Ministry of Finance

Examining the source of aid, a drastic shift took place from bilateral to multiple sources. Under the multilateral institutions, UN, World Bank, ADB and IMF are the major aid sources. Among the bilateral donors, India, China, UK, Japan, USA, S Korea and Scandinavian countries are the major one. South-South cooperation is also slowly picking up as data reveal. According to the Development Cooperation Report 2010/11, out of the total aid disbursed in that fiscal year, almost 58 percent came from multilateral donors. About 36 percent of aid was given by the OECD-DAC bilateral donors and the rest 6 percent came from bilateral South-South cooperation partners. Among the donors, the top was the World Bank, the Asian Development Bank, the United Nations, the European Union and the Global Fund to fight AIDS, Tuberculosis and Malaria. Under the bilateral donors, United Kingdom, Japan, India, the United States and Norway were the five major countries[49]. As already indicated, this was the period when Nepal was passing through a political transition in which durable peace was the main agenda which contributed to acquire more grant (79.2 percent) than loan (20.8 loan) from both bilateral donors and multilateral donors.

A closer analysis of aid considering five-year intervals beginning from 2010/11 gives a clearer picture on type of aid, aid modality and mode of payment. Mode of payment is highly important from the standpoint of ownership, accountability and aid alignment perspectives. An analysis on the types of aid separating technical assistance for fiscal year 2010-11 shows that grants represented 57 percent, loans 24.3 percent and technical assistance (TA) 18.5 percent. Though in 2015/16 grants contribution was also highest in the total disbursement, it was lower than in 2010/11 at 49.64 percent. Loan constituted 34.89 percent and technical assistance at 15.47 percent respectively. By 2020/21, however, there was big shift from grant to loan. Out of the total ODA disbursed, the share of loan was 66.88 percent followed by grants at 21.49 percent and technical assistance at 11.39 percent respectively. There was also in-kind support at 0.24 percent in 2020/21. It is also noticeable that there has been a big fluctuation in technical assistance.

By source, the contribution of multilateral and bilateral donors was 58 and 42 percent respectively in 2015/16. Among the multilateral donors, higher disbursement was by the World Ban, the UN, the EU and IFAD respectively. There was some adverse effect on disbursement due to the devastating earthquake of 2015. Among the bilateral donors, contribution of the USAID was highest followed by the DFID, Japan, Switzerland and India in 2015/16. Out of the total disbursement, the top 10 contributed about 87.6 percent. In that top 5 multilateral donors disbursed about 57.1 percent of total disbursement and top 5 bilateral donors disbursed almost 30.5 percent.

In 220/21, ten development partners contributed approximately 93.25 percent of ODA. Multilateral development partners contributed 73.05 percent of all ODA. Major disbursing multilateral partners in FY 2020/21 were the World Bank, the Asian Development Bank, the European Union, the United Nations (UN) and GAVI, the Vaccine Alliance. Bilateral development partners contributed 26.95 percent of ODA. Major disbursing bilateral development partners were the United States of America, the United Kingdom, India, Japan and Germany.

A trend analysis was also made separating technical assistance from the grant and loan in US dollar. Tough it shows a slightly different trend partly due to the conversion factor[50], the pattern is broadly the same. As evident from the graph 2.4, unlike very fluctuating trend in grant and loan, the technical assistance shows a relatively more consistent pattern. As above, the disbursement of grant has reduced drastically in recent years.

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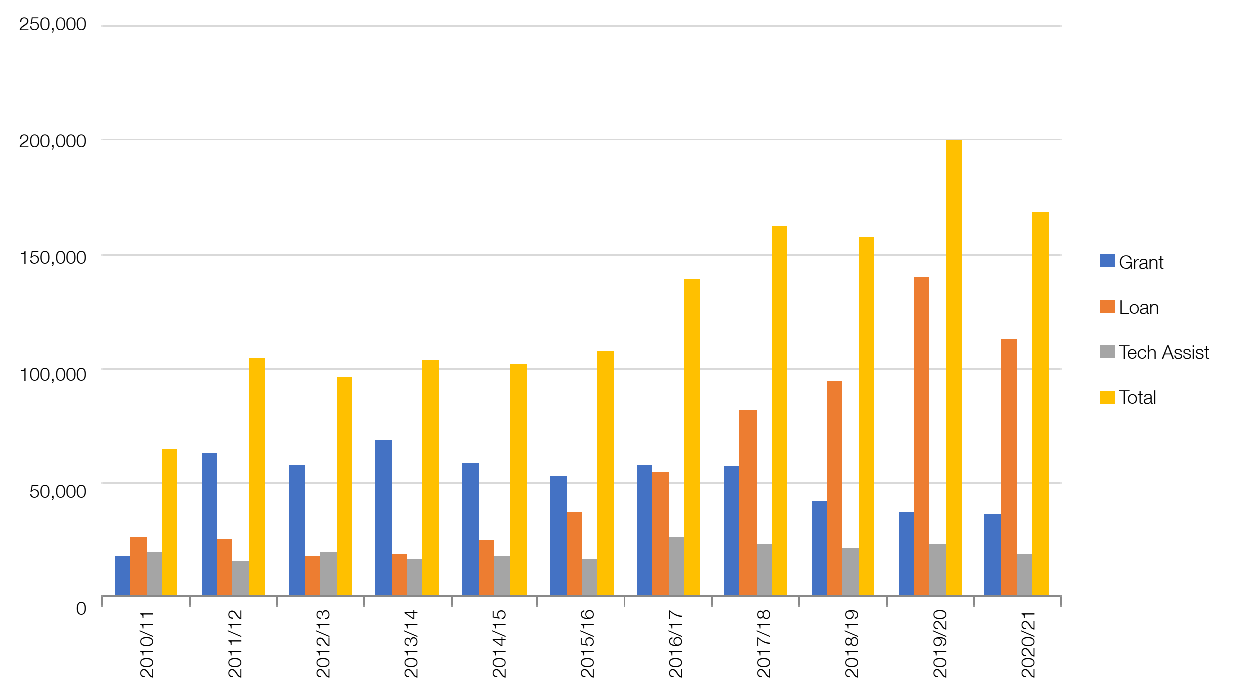
[49] MOF 2012.

[50] Often there is difference between the amount shown in the development cooperation report and aid data shown from the development partners needing to visit to bring convergence.

Graph 2.4 Foreign Aid Disbursement including Technical

In million US $

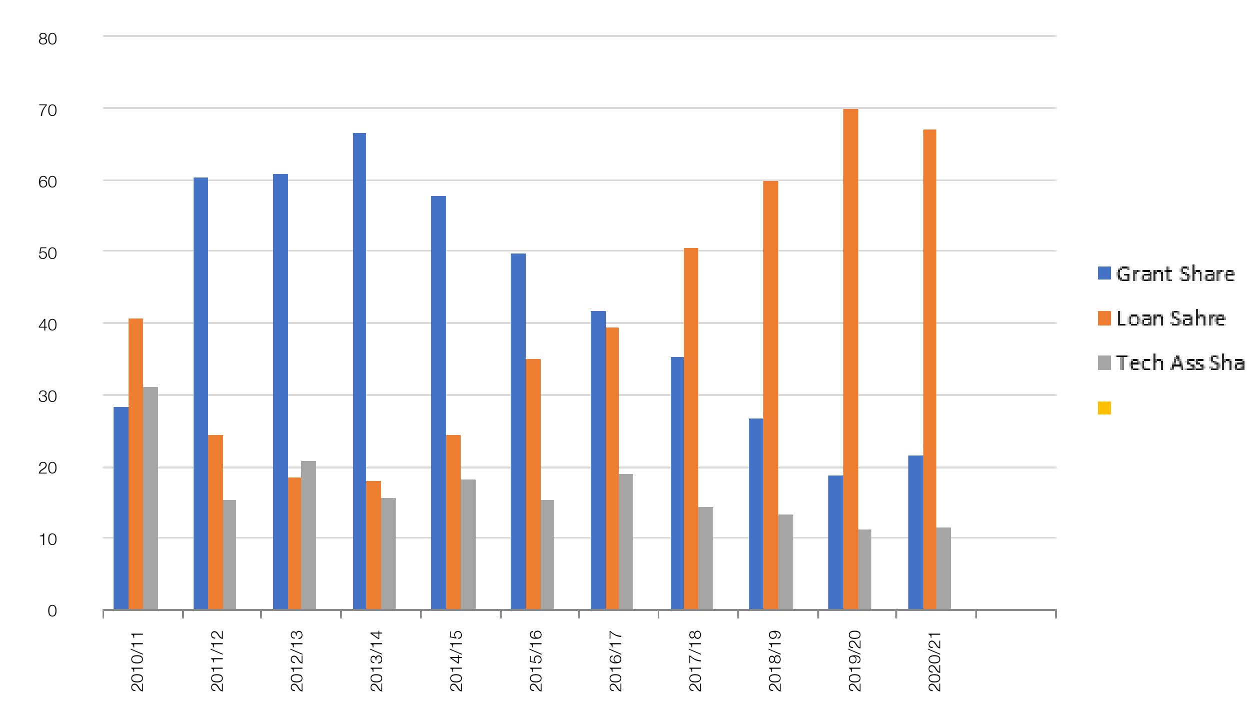


Source: Development Cooperation Reports (Various Years), MOF

A clearer picture emerges when the trend in the share of each component in total disbursement is looked into. As shown in the graph 2.5, the share of technical assistance was comparatively high in 2010/11 and remained relatively high until recently despite some decline over the years. Since the technical assistance largely has predominated by the direct funding, this has had some positive impact on mode of payment.

Graph 2.5 Share of Grant, Loan and Technical Assistance in Total Aid

(As per dollar disbursement)

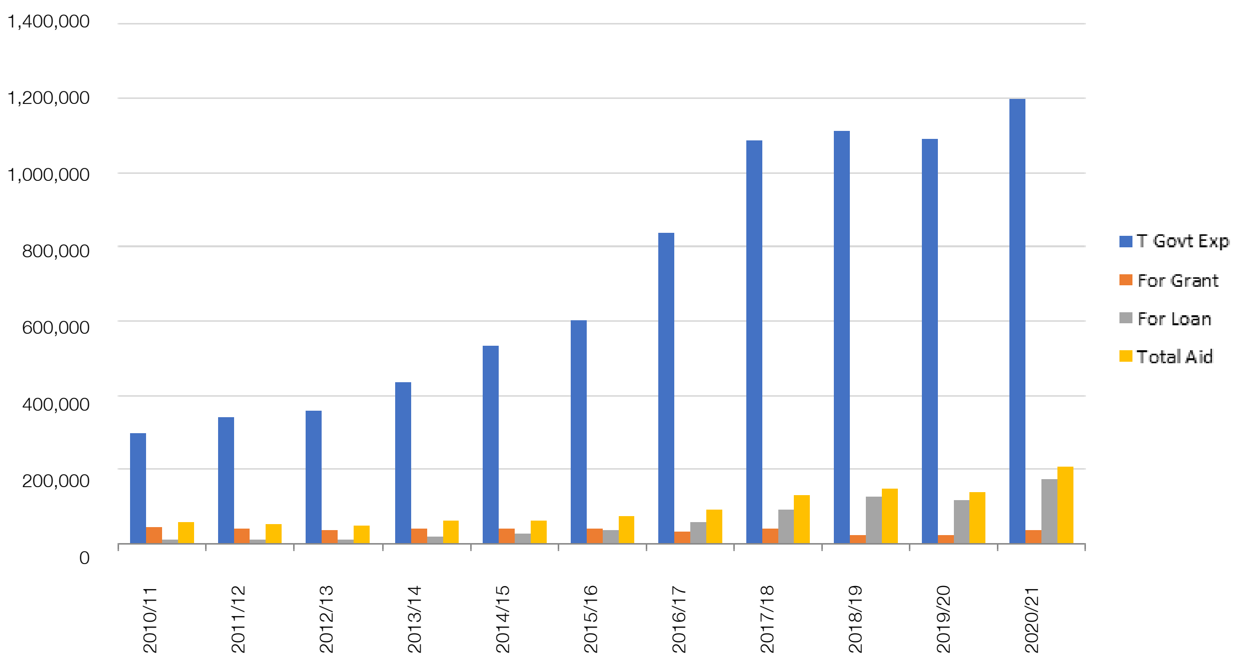


Source: Development Cooperation Reports (Various Years), MOF

2.2 AID AS A SOURCE OF FINANCING BUDGET

The foreign aid has been an important source of financing Nepal's socio-economic development programs as budget's funding sources reveal. As shown in the graph, there has been a continuous rise increase in the level of total aid along with fast rise in government total expenditure (graph 2.6). Similar to the pattern discussed above, grant as a source of government expenditure was higher compared to the loan during the period 2010/11 to 2015/16. Thereafter, the contribution of loan exceeded that of grant as a source of government expenditure. The share of loan has risen at a faster rate in recent years.

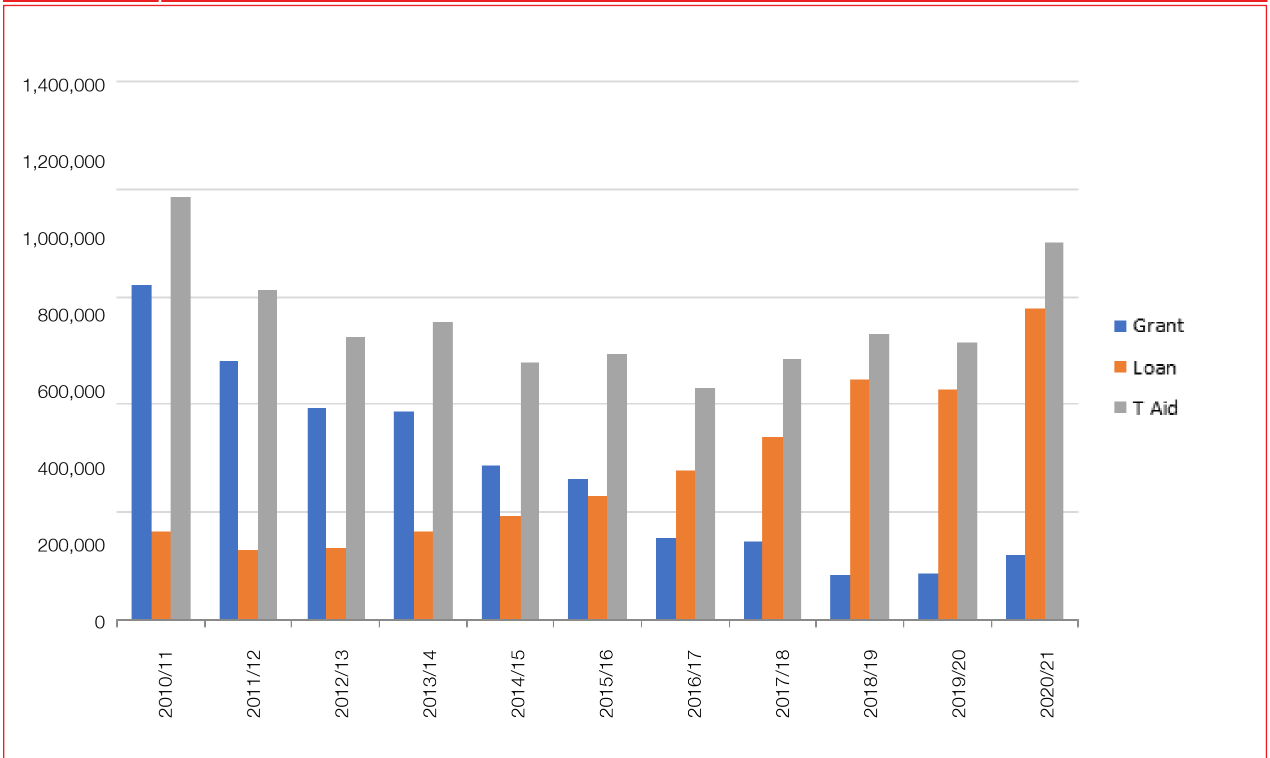
Graph 2.6 Trends in Grant, Loan and Total Aid Compared to Government Expenditure



Source: Economic Survey (various years), MOF

The changing contribution of grant and loan over the years can be assessed more closely when the contribution of foreign to funding the total government expenditure is examined. As shown in the graph 2.7, it is interesting to note that in 2010/11, for instance, the share of foreign aid in total government expenditure was closer to 20 percent which is highest of the period under review. Though after 2010/11 there was steady decline up to 2016/17 with the aid contribution reducing to just 10.7 percent as a share of total expenditure, the aid contribution has risen again thereafter and has reached 17.5 percent in 2020/21. Within the composition of aid, the share of grant in total expenditure was more than 15 per cent in 2010/11. Its contribution gradually reduced and came down to 2.2 percent in 2019/20 and albeit increased in 2020/21 at 3 percent. Accordingly, the contribution of loan changed overtime with its share in total expenditure rising markedly in recent years. For instance, in 2020/21 its share in total expenditure reached 14.5 percent. Thus, unlike the commitments of enhancing self-reliance development and reducing the aid dependency made through aid or development cooperation policies and other government statements, there is not only resurge in the aid dependency but also the share of loan has increased conspicuously. Generally, along with increased inflow in aid, a reduction in aid dependency is expected in the long run on the assumption of accelerated growth and development. Why this has not happened is a matter of further investigation.

Graph 2.7 Share of Grant and Loan in total Government Expenditure



Source: Economic Survey (various years), MOF

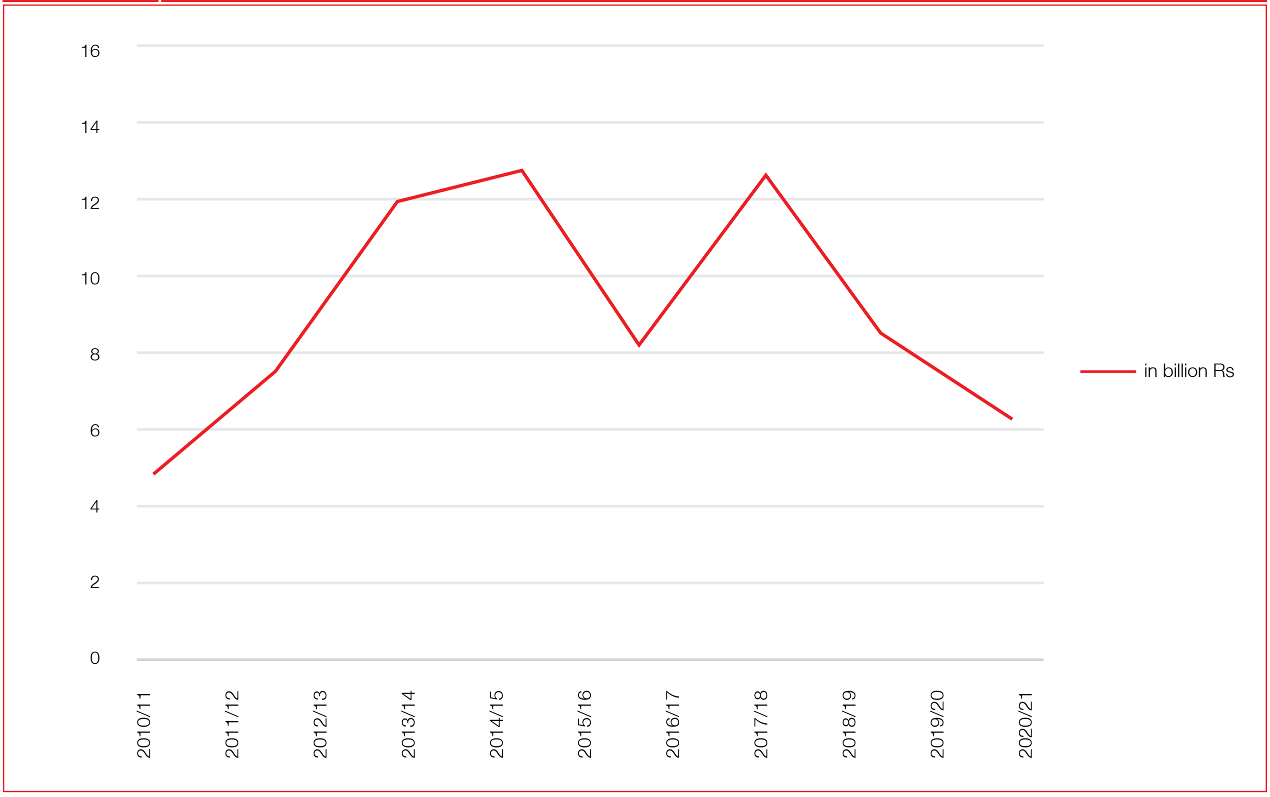
2.3 TRENDS IN AID THROUGH INGO

The IGOs play important role on Nepal's development as they focus on grass root development and give priority on enhancing quality of people's life and promoting human development. In Nepal, a phenomenal rise in Non-Governmental Organizations (NGOs) has taken place in Nepal since the 1990s. INGOs in Nepal enjoy autonomy in the implementation of the project/program and receive resources directly from bilateral/multilateral aid agencies and international organizations.

The contribution of INGOs has increased overtime though with wider fluctuations. In 2014-15 INGP contribution was US$ 116.89 million which went up to US$ 168.39 million in 2015/16. In 2020/21, their contribution albeit declined compared to the level of 2015/16 and reduced to US$ 160.21 million.

Leprosy Mission Nepal, World Vision International, United Mission to Nepal, Good Neighbors International Nepal, Mercy Corps, World Wildlife Fund, Inc., Ne-pal Program, Lutheran World Federation, CARE Nepal, International Nepal Fellowship and Heifer International Nepal are ten prominent INGOs working in Nepal whose total support was highest in 2016/17 at Rs 14.1 billion. This was followed by Rs 13.9 billion in 2018/19. In 2020/21 their contribution decreased sharply and reduced to Rs 6.6 billion. The fluctuating trend shows that during the time of big shocks and natural calamities, the contribution of most of these INGOs increased markedly (graph 2.8).

Graph 2.8 Contribution of Ten Large INGOs during 2013/14 to 2020/21 in Billion Rs



Source: Development Cooperation Reports (Various Years), MOF

The Social Welfare Council (SWC) is the coordinating and supervising government institution of all I/NGOs in Nepal. The MOF coordinates the development cooperation fund mobilized through the INGOs.

Chapter 3

A Review of Foreign Aid/Development Cooperation Policies and Their Effectiveness

A Review of Foreign Aid/Development Cooperation Policies and Their Effectiveness

In Nepal aid policy was first announced in 2002 despite periodic plans, budgets and other government policy statements outlining such a policy since a long time. Since 2002 aid policy has been improved and modified in 2014 and 2019 in the form of development cooperation policy and international development cooperation policy respectively. Noticeably, unlike the bigger political changes in 2006 followed by Interim Constitution 2007 making sweeping changes in political, economic and social system necessitating swift alteration in the aid policy developed in the different environment, the new development policy was introduced only in 2014. It is also clear that in-between Aid Effectiveness agenda was adopted globally with follow up commitments in 2008 and 2011 to make the aid agenda more effective. Similarly, prior to the changes in the international development cooperation policy in 2019, a new federal constitution was introduced in 2015 along with the adaptation of the SDS in the same year. Despite such historical developments, the revision in development cooperation policy was made with four years lapses in 2019 only. Thus, at a first glance, less priority on timely reforms and changes are noticed. It is also noticeable that after COVID-19 many new developmental challenges have emerged and manifested.

Below, a short review of the legal and constitutional provision of foreign aid is made. This is followed by a brief examination of aid/development cooperation policies taking both national and international developments into account. In the last section, an assessment of aid effectiveness has been made employing various direct and other proxy measures. The INGO related policies and trends in their contribution have been separately reviewed in brief.

3.1 LEGAL AND CONSTITUTIONAL PROVISION

From the perspectives of regulating and directing the foreign loan, the Loans and Guarantee Act was introduced for the first time in 1958 in Nepal. It also had a clause provisioning the guarantee on any form of loan from multilateral and bilateral agencies alike. Under the federal system many of these clauses have been obsolete and questionable.

From the aid policy standpoint, the Constitution of 2015 is highly important. It authorizes the Federal Government to take a lead in mobilizing foreign aid from multilateral/bilateral donors as well as I/NGOs[51]. Similarly, as stated in the Constitution 2015, all foreign aids flowing to Nepal will have to be transparent and be aligned with the national interest and priorities. At the same time, it has to be reflected in the national budget. The Constitution also states that sub-national governments have to take consent from the Federal government to obtain foreign aid including grants and assistance from donors. As such, the sub-national governments (both provincial and local governments) are prevented from taking aid directly. Such a clause is still debatable[52] as it requires first mobilization of aid by the federal government to be distributed to the sub-national governments presumably to fill the resource gap.

[51] Article 59(6) and schedule 5(5) of the Constitution.

[52] Apparently, it contradicts with the spirit of Federal system. Instead, certain norms or conditions and limitations could have been provisioned to maintain fiscal rules and discipline.

3.2 REVIEW OF AID/DEVELOPMENT COOPERATION POLICIES

Prior to the introduction of first aid policy in 2002, numbers of initiatives were taken in different time periods with the aim of mobilizing and diverting aid to the priority areas for better utilization and outcomes. In this respect, creation of Nepal Aid Group by the World Bank in 1976 can be regarded to be an important step. This was formed to organize aid group meetings annually. In such meetings donors used to be invited to pledge their commitments voluntarily on the volume, nature, and areas in which they intend to offer. In the meetings, there was also a system of reviewing the progress on the disbursement of aid. That to some extent helped to avoid uncertainties in predicting the aid which in turn gave certain maneuvering space in finding out possible sources of plan outlays and annual budgets.

As a next important step, a system of Nepal Portfolio Performance Review (NPPR) meeting was initiated in 2000 to be organized by the Ministry of Finance and participated by donors on a voluntary basis which is being continued today also. Various bottlenecks and related issues associated with implementation of donor funded development programs are reviewed in such meetings. This platform is also used to monitor the joint progress on key aid effectiveness agenda set under Busan Partnership for Effective Development Cooperation.

A certain breakthrough took place in 2002 with the introduction of first foreign aid policy in Nepal[53]. It tried to replace the issue-based ad-hoc nature of decisions on aid. Through such a policy initiative, the beginning of formulating a comprehensive aid policy was started in which attempts were made to tailor it with the development priorities set, for instance, in the periodic plans and annual budgets. It was brought out at a time when the implementation of Brussels Plan of Action (2001-10) for LDCs had been already starte[54]. Similarly, PRSP (i.e., 10th Plan) was in the process of implementation when the aid policy was introduced.

The first aid policy 2002 had given foremost priority on ensuring the compatibility and convergence of foreign-aided development activities with nationally determined development priorities and improving the quality and effectiveness and efficiency of foreign aid for reducing poverty through enabling higher rates of economic growth with distributional equity. Institutionally, improvement in the linkages with civil society organizations and the private sector was also committed in the aid policy. Need of establishing complementarities between aid and other economic policies was also recognized in it for utilizing aid more effectively as it was assumed that such complementarities would help to address issues such as governance, gender, and the environment, among others, simultaneously. It was also perceived as a means of enhancing equal partnership between Nepal and donor institutions in the spirit of development partnership. As a part of aid modality, higher priority was given on the budgetary support. The infrastructure development including energy, transport, tourism, science and technology, agriculture, irrigation, and forestry including the environment, human resource and social development, education, health and population were outlined as the priority areas of aid with presumption that focus on the activities in those sectors would help to alleviate poverty, promote employment and develop backward regions. Policy also made commitments to make the inflow of foreign aid consistent with, and reinforcing, economic reform programs. Fixation of predetermined criteria for selecting the priority projects was also committed in the policy.

Policy also recognizing the problem of compartmentalization and fragmentation in aid, promised to follow a more holistic and integrated approach in the design of projects and programs as it was anticipated that such a holistic approach would help to address cross-cutting issues such as poverty, gender, environment, governance, and

[53] *For details see MOF 2002.*

[54] *See UN 2001.*

management. Some of the ways for better return of concessional loan highlighted in the policy include (i) utilizing foreign loan assistance in projects and infrastructure development promising (ii) analyzing the various implications of each new loan before accepting it, (iii) focusing loan assistance on areas that help generate private sector activities and promote external sector transactions which in turn could enhance the foreign exchange earnings capability, (iv) exploring ways of reducing the loan liability of the government by protecting against exchange rate fluctuations.

Aid policy also noted that project and program components would be more appropriate for grant financing than concessional financing in countries like Nepal. Areas such as project design, institutional and capacity building, technical backstopping, and project monitoring and reviewing were identified the areas where technical assistance will be preferred.

Maintenance of financial disciple was another area of policy focus in which transparent reporting, internationally recognized accounting, monitoring and auditing practices were committed. As such, need of transparency in fund transfers through INGOs/NGOs, reflection of all financial sources in the annual budget and improvement in donors' procedures in negotiations in line with contemporary laws of the country were emphasized by the policy.

Another feature of it was its stress on enhancing the quality of aid. Accordingly, apart from focus on transparency and accountability, strengthening of aid coordination, better identification, selection and design of projects/programs, creation of Foreign Aid Management Information System and promotion to the institutional effectiveness has been promised. Prudent resource allocation and management procedures, joint programming approach through effective project planning and implementation as well as improvement in project evaluation, supervision and monitoring including encouragement to a "Common Pool" with emphasis on co-financing arrangements have been recognized as the important components of increasing aid quality and its effectiveness. Toward that end, adaptation of basket-funding approach, strengthening of financial management, improving procurement and disbursements have been recognized to be equally crucial.

One of the positive aspects of it is that it by recognizing the multiple problems, ranging from the problem of aid alignment to country's development priority, aid modality to quality and effectiveness of aid, proposes various measures to be pursued by the government and donors individually or jointly. However, the major problem of it is that it oversimplified or generalized the problems in said areas. It by overlooking the social cost of SAPs, very adverse socio-economic implications of conditional programs and serious deficiencies in the adjustment package especially from the LDC's perspectives, committed to intensify such an economic reform which was synonymous to market fundamentalism. Added to this, the highhandedness, strong terms, political and economic interest involved in the aid were overlooked. More broadly, the aid policy was not brought out by recognizing the serious deficiencies in the entire aid system which was being exposed widely worldwide at that time. At the same time, serious problems in the institutional and governance fronts together with systemic deficiencies in the planning and budgetary system were hardly recognized as few policy changes proposed were largely grounded on business-as-usual premises. Noticeably, it was a period when social contradiction in society was mounting fueled by perpetuation in the deprivation of larger section of society. In such a situation also, the kind of priority on strengthening the participatory process through the involvement of civil society and other stakeholders had to be given was not there. Taken together, even with many deficiencies, the kind of poverty and governance focus that was apparent in the PRSP (i.e., 10th Plan) was not there in the aid policy. Similar deficiency is found when the aid policy is compared with the LDCs program of action which gives high priority to the structural reforms led poverty reduction, at the same time underlying the need of more generous and expanded support by the donors to the LDCs.

After 12 years of first aid policy, a new Development Cooperation Policy 14 was introduced. The policy came after major changes that took place in Nepal domestically along with continued major new developments globally in the issues associated with aid effectiveness. Internally after the historic political change of 2006, an Interim Constitution was brought out in 2007 in which sweeping changes in the political, economic and social system were promised. In that the focus was on deepening of inclusive democracy through federal system of governance, ensuring of economic and social rights of the people and strengthening of equity-based growth and development. Importantly, it was prior to the promulgation of the New Constitution prepared by the Constituent Assembly after many years of political wrangling and indecisiveness. Externally, it was after the Paris Declaration 2005, the Accra Agenda for Action 2008 and the Busan Commitment 2011. The development cooperation policy to some extent had tried to accommodate many commitments made internally and as well as externally. As such, there were some departures from the policy of 2002.

The main objectives laid down in the Development Cooperation Policy of 2014 were getting development support and achieving development goals as stated in the periodic development plans, transforming Nepal from status of LDC status to developing country, bringing development effectiveness and building a self-reliant economy.

Broad strategies outlined to accomplish the above objectives were mobilization of external resources and their effective utilization. Gradual reduction in aid dependency was also a part of the strategy stated in the development cooperation policy. Again, aid mobilization had to be in line with the national policy and priority of achieving a broad-based, inclusive, and sustainable economic growth, generating employment, reducing poverty, and yielding maximum returns. Accordingly, the focus was laid on increasing investments in areas such as infrastructure development including hydropower and roads, agricultural modernization, tourism, industry and trade. Aid strategy also focused on ensuring sustainability of the achievements made so far in social development, Human Development Index and Millennium Development Goals. It also stressed mobilizing resources required for post 2015 sustainable development agenda. For achieving rapid economic growth, a conducive environment for private investment, trade in productive sectors and effective utilization of development cooperation was repeatedly emphasized. References of Paris Declaration, the Accra Agenda for Action, the Busan Commitment, and the Mexico High Level Meeting were made from the standpoint of channeling of development cooperation and ensuring of development cooperation. The strategy also indicated the need of development cooperation's contribution to National capacity development and the transfer of knowledge and technology. Strategy also committed to utilize development cooperation through the use of country system in a transparent way. Introducing a minimum threshold of development cooperation to reduce aid fragmentation and high transaction costs was also a part of the overall strategy. Utilization of development cooperation was also conceived as a contributor to the increase in the internal revenue, building a self-sustained economy, strengthening aid management platform, enhancing transparency of development cooperation and disseminating aid information to the wider public.

In the areas of aid modality, general budgetary support was stated to be the first preferred aid priority. Second preferred aid was sector budget support. Standalone project was the third priority but it had to be aligned with the National Plan. Setting up of a pool fund for small-sized standalone projects was also part of the aid modality for minimizing transaction costs and shortening the implementation delays. Largely, principle of aid alignment with the country system, untied aid, and comparative advantages were to be pursued. Policy of mobilizing international aid funds for education, health, and climate change were also given priority. In the areas of climate change, grants were preferred over loan.

Rural infrastructure, social sector including health, education, drinking water, sanitation, human development and agriculture sectors were noted as priority areas of grants. Similarly, grant assistance of less than US$ 5 million except for the Sector Wide Approach Program (SWAp), Pool Fund, climate change, sustainable development grant, small grant for community development, small grant for rural infrastructure development, co-financial arrangements, humanitarian assistance, technical assistance, and capacity development were to be disallowed. On the other hand, concessional loan was to be utilized in sectors such as physical infrastructure (hydropower, roads and bridges, irrigation, airports, railway, dry port and urban infrastructure development), agriculture and tourism for higher growth, employment generation and earning of foreign currency. A policy of disallowing below US$ 10 million per standalone project was also announced with exception to the sectors such as higher knowledge and technology besides projects that fall under Sector Wide Approach (SWAp), Pool Fund, and Co-financing model. Arrangements of debt servicing in local currency to the extent possible, and use of necessary monetary instruments to manage the foreign currency exchange risk was also part of the policy announcement. Discouragement to the tied loan through procurement of goods and services was noted in the policy. It also announces that suppliers' credit will not be used. However, room for additional windows of aid mobilization through Export Import Bank (EXIM Bank) of various countries was kept open keeping conditions that such loans will not be permitted below US$ 20 million per project/program. Technical assistance on a selective basis was pushed by the policy especially for country's capacity development noting differentiation between the individual level assistance (like skills, knowledge, innovation, entrepreneurship) and organizational level assistance (like system, procedure and technology). Development partners were encouraged to pool technical assistance fund in the Technical Assistance Pool Fund. It also gave priority to the humanitarian aid, South-South cooperation and partnership with the private sector.

The policy also duly recognizes the role of civil society and National/International Non-Governmental Organization in social and human development. It encouraged such organizations to development assistance directly from bilateral/multilateral aid agencies and international organizations. Policy, at the same time, indicated the need of accountability and transparency while mobilizing development cooperation by them. Similarly, all national/international non-governmental organizations (N/INGOs) providing development assistance were instructed to register with the Social Welfare Council (SWC). Project Analysis and Facilitation Committee under the Ministry of Women, Children, and Social Welfare was also proposed as an inter-ministerial coordination mechanism to provide recommendation for the approval of programs mobilized by N/INGOs. It also stressed on the need of their programs aligning with Nepal's national development and sectoral priorities. Attachment of action plan with measurable results, deadline, and exit plan by the N/INGO has also been made mandatory. Similarly, coordination with the concerned agency at the Centre and local level was also made mandatory.

The policy had also encouraged development partners to make direct investment in projects under turn-key basis in which priority was given on medium and large-scale projects such as hydropower development, transmission line, highway construction, strategic road network, bridges, railway, airports, large irrigation, dry port, and special economic zones. Such projects were also required to be part of the budgetary system including the Aid Management Platform (AMP).

An added feature of the policy was that it gave priority to the implementation side for which various institutional and coordination mechanisms were proposed. These mechanisms were entrusted with the responsibility of monitoring, among others. First, a Development Cooperation Policy Implementation Committee chaired by the finance minister was proposed. Continuity to the Nepal Development Forum was emphasized. Similarly, the need of Local Development Partners Meeting at the interval of four months were highlighted. This mechanism served as a platform for regular dialogue and coordination between the government and the development partners working at the local level. The policy also stressed on the need of organizing Nepal Portfolio Performance Review meeting once a year. Similarly, continuity to the Joint Sectoral Review meetings between the government and development partners for sectoral planning, policy and program implementation, and coordination were emphasized. Likewise, a Joint Local Level Review to review the development programs implemented by local agencies to be coordinated by District Development Committee (DDC) was also proposed.

Another feature of the policy was such that it had pointed out certain responsibilities of Development Partners which included alignment of development cooperation with national development plan and priority, assistance without conditionality to the extent possible, reporting all kinds of aid information to the Aid Management

Platform (AMP) well in advance to ensure aid predictability, help preventing aid fragmentation for reducing transaction costs, expand Sector Wide Approaches (SWAp) to other sectors and give priority to mobilize development cooperation through Nepal's National Budgetary system.

Similarly, through the policy certain commitment towards development cooperation effectiveness was made by the government which included a. due importance to inclusive growth, aid transparency, south-south cooperation, engagement of the civil society, gender equality, climate change, disaster mitigation, and the best results; b. adopting the policy of good governance and zero tolerance against corruption; c. implement programs for institutional reform and capacity development of the entities of the Government of Nepal and its associated institutions directly involved in infrastructure building; d. participate in the global partnership for and monitoring of effectiveness of the development cooperation; e. initiate programs to minimize possible fiduciary risks and improving public financial management system; f. reducing project's transaction cost and maintaining sustainability through enhancing national capacity; g. implementing recommendations of the second Public Expenditure and Financial Accountability (PEFA) evaluation report; h. simplifying the procedure of public service delivery and improving the quality of expenditure; i. ensures public access to aid information available in the Aid Management Platform (AMP), in order to enhance transparency and accountability.

Thus, compared to the policy 2002, it was relatively more comprehensive as it attempted to address perpetuated or emerging problems of aid effectiveness associated with both domestic as well as international factors. It took into account of the changed development priority set in the aftermath of big political change in Nepal apart from trying to internalize the commitments made in the international forums by the development partners and aid recipient countries jointly. The development trust and priority on achieving a broad-based, inclusive, and sustainable economic growth, generating employment, reducing poverty, and yielding maximum returns included in the policy were largely the outcome of this. At a time when the policy was introduced, the thirteenth plan was under implementation which had focused more on poverty reduction and improvement in the living standards of people in a way that they could feel or realize. In the detailed strategy such priories were included. This was also a time when Istanbul Plan of Action (2011-2020) was under implementation which had stressed on enhancing productive capacity development, addressing pre-existing or emerging vulnerabilities and reducing poverty through domestic resources and ODA mobilization, external debt restructuring, FDI and remittances inflows. Good governance was conceived as prerequisite to all these. All in all, graduation was the foremost priority accorded in the LDC action plan. In both development cooperation policy and thirteenth plan also, Nepal had committed to graduate by 2022. Similarly, prevention of aid trying practices, inflows and procurement system within Nepal's budgetary and financial management system were also added priorities which were essential. A more accountable and transparent system in the aid inflows and utilization processes as well as strengthening of monitoring schemes at different level and time intervals as a part of ensuring mutual accountability were also needed policy thrust. Nepal's preferences in aid modality were also focused which were critical to enhance domestic ownership and align aid with national development priorities to a greater extent. Similarly, needed thrust on the involvement and role of civil society and the private sector was there. The role of the NGOs/INGOs was also duly recognized.

Apparently, these were some of the positive aspects of the development cooperation policy 2014. However, there were number of serious weaknesses or deficiencies in it. First and foremost is that despite such sweeping changes in the political system followed by commitments to bring about a breakthrough in the socioeconomic development processes and outcomes, how the major pre-existing structural impediments preventing the unleash of development forces and tapping the used country's resource potentials will be addressed in the changed political milieu was simply overlooked. As an offshoot, instead of specifying policies more concretely compared to the failed policies of 2002 repetition of many were made there. Despite knowing that due to, among others, lack of coherency among objectives, specific targets, strategies, policies, programs and implementation mechanism, plans rarely accomplished the goals was hardly recognized as the aid alignment was simply linked to the plans. This provided enough maneuvering room for both donors and the government. In view of budgets largely influenced by the MTEF containing many resources drain type of projects and programs at the time when the policy was framed, simple linkages without qualification undermined the ground reality. Had there been a system picking up most viable projects from the project bank, in that case only internally driven priority could be realized as per the repeated trust and direction of the policy. But this was not the case and hence by implication many policies ultimately boiled down to the rhetoric's. More surprising aspect of the policy was such that it recommended donors to make direct investment in a turn-key basis which itself contradicted the principle of national ownership and aid alignment with the national priorities. As an offshoot, NGOs/INGOs were also encouraged by the policy to mobilize resources directly from the donors. On other aid effectiveness related issues, though there were references, the kind of assertiveness was needed was not there amidst very poor compliance on the part of many donors. The proposed coordination mechanism and monitoring schemes at different levels without strong policy for improved compliance as per the findings entail this. Similarly, the kind of strong commitments to involve civil society and other stake holders in the policy making and outcome evaluation processes was essential that was not there. Mere formalities were repeated in the policy. As an offshoot, policies transforming governance system as prerequisites to implement cooperation policy was not there despite strong commitments in the LDC plan of action, among others. It is also surprising that in the policy the responsibility of donors and some form of commitments on the part of the government were additionally included which by implication is that the policies proposed were grounded on weak built-in government institutional system and poor bases with poor level of confidence.

After 2014, a new International Development Cooperation Policy was announced in 2019 by the first elected federal government which came into power after massive people's mandate. At that time, after a long vacuum the local governments were functional apart from sub-national governments at the province level. Noticeably, this was a period when along with implementation of the new constitution, SDGs was also under execution. The 15th plan formulation was also in the completion phase. Interestingly, as indicated, the aid policy was mainly driven by the aspiration of the people reflected in the long terms vision of "Prosperous Nepal, Happy Nepali" set by the first elected government.

It should also be noted that this was a year when devastating COVID-19 had brought serious humanitarian, livelihood and economic crisis.

The major goals set by the policy include mobilizing resources required to graduate from Least Developed Country status within the coming three years, graduating to middle-income country status while achieving the Sustainable Development Goals (SDGs) by 2030 and enhancing national capacity through transparent and results-oriented mobilization of international development cooperation so as to gradually reduce aid dependency. Thus, except SGDs related, the other two goals are broadly similar to the one set in the 2014 policy.

The priorities set for mobilizing development cooperation are broader and more comprehensive. With first priority on physical infrastructure followed by education, health, drinking water and sanitation, the policy also gives priority to enhancing national production and productivity. Other priorities included are employment generation and poverty alleviation, development of science and technology and transfer, environmental protection, climate change and disaster management.

Major strategies incorporated in the policy include mobilization of development cooperation for achieving high economic growth, increasing production and productivity, creating wider employment opportunities, promoting export-oriented production by increasing domestic production and substituting imports for moving towards correcting trade imbalances and developing a self-reliant economy. Policy also stresses that such strategies have to be guided by the aim of balanced development of all regions, classes and communities which has been the trust of constitution. Similar to the previous policies, cooperation policy has pursued a strategy that mobilizing of development cooperation is aligned with the national budget system and also focuses on transparency in the process through strengthened Aid Management Information System (AMIS).

As per the strategies, policy thrust has been on aligning development cooperation with national priorities and needs. In the areas of modality, similar priorities have been repeated. One additional feature is that mobilization of development cooperation has been linked to the needs and priorities of the sub-national governments as well. Some added attempts have been made to introduce minimizing transaction costs and promoting innovation and sustainability criteria while using the modality. As in the case of 2014, development partners have been encouraged to set up a pool fund for small-sized stand-alone projects in order to minimize transaction costs and avoid delays in implementation in which priority has been given to transfer these funds mainly to the provinces and local levels. Policy also expects humanitarian assistance; including rescue and relief materials, food assistance, and medicines or medical equipment for disaster management form the development partners. Policy has repeated the preference for untied aid apart from urging on the need of all types of aid coming through national budgetary system.

Sectors directly contributing to environmental protection and climate change, sustainable development, rural infrastructure development, social sector development, modernization and development of agriculture, health, education, drinking water, sanitation, poverty alleviation and human development have been given priority for grant assistance. On the other hand, concessional loans are to be utilized in sectors such as physical infrastructure (hydropower, solar and renewal energy, roads and bridges, irrigation, airports, railways, dry ports and urban infrastructure development), agriculture and tourism infrastructure contributing to high economic growth, areas contributing to skills development and job creation, and the areas contributing to the earning of foreign currency through export capacity enhancement as per the policy. Policy also conditions that concessional loans above US$ 10 million per project only will be accepted except in case of pooled funds and co-financing mechanisms. Adaptation of untied procurement process has also been emphasized.

Provision to accept development cooperation for high priority infrastructure projects with complex and advanced technical specifications under Engineering, Procurement, Construction and Finance (EPCF) arrangements has also been included in the policy which is an additional policy approach. It also allows, similar to the past policies, additional loan windows, other than the concessional loan window, for implementing projects of national need and priority. Under this window, loans are allowed from the Export-Import Banks (EXIM Banks) of bilateral Development Partners and other agencies providing project finance to invest in areas such as hydropower generation and transmission, highways and bridges, railways, airports, dry ports, urban infrastructure and any other areas of national need and priority. Policy, for the first time, opens the space for mobilizing commercial loans for mega projects of national priority that have commercial viability with a high financial rate of return. On technical assistance, repetition of past policies has been made. It also adds that the Inter-governmental Joint Economic Commission will be used to explore the potential areas for economic partnerships bilaterally as well as multilaterally. Similarly, South-South and Triangular Cooperation and partnership with the Private Sector particularly through Public-Private Partnership (PPP) have also received priority in the policy. Blended financing has also been encouraged by the policy.

The institutional mechanism for coordination and progress monitoring by the government separately or jointly with the development partners at different levels proposed are almost the same as in the policy of 214. In the same way, it says that programs implemented by the INGOs at the Local level are to be coordinated and monitored by the relevant District Coordination Committees.

Some specific policies related to the use of development cooperation by the sub-national governments have been included in the Policy 2019. It states that the Ministry of Finance will conclude and send financing agreements to the province for implementation in the case of foreign grants and technical assistance. Similar arrangements are laid down there with respect to projects to be implemented at the Local level. The amount of such foreign grants mobilized through the budget system will be conditional grant according to the policy. As stated in the policy, in case of loan, subsidiary loan agreement with the amount of the foreign loan, interest rate and conditions of payment are to be provided to the province and local level where the programs are to be implemented. The sub-national governments are also advised to prepare an integrated project bank after identifying feasible projects which then have to be forwarded with due process to the Ministry of Finance for further action or approval.

A Province level mechanism comprised of Nepali representatives from governmental as well as from non-governmental sectors is proposed to review the development projects and programs that include international development cooperation and are implemented by the Provincial government. Similarly, the District Coordination Committee is entrusted with the responsibility of monitoring and reviewing the international development cooperation-funded projects and programs implemented by the Local levels.

Similar to the Development Cooperation Policy 2014, the responsibility of development partners has been included in it also. Among others, policy expects aligning of international development cooperation and projects/programs with the national development plan and priority, providing of all types of aid information in advance to the Aid Management Information System (AMIS) for ensuring aid predictability and supporting to address aid fragmentation by the development partners. It has focused on the need of implementing programs in alignment with Nepal's national systems and organizational structures under the leadership of the Government agencies so as to enhance, among others, local capacity and sense of ownership.

Similarly, some specific commitments on behalf of the government have been made which include government's due importance to national needs and priorities, universal norms of human rights, democracy, rule of law, inclusive development, good governance, zero tolerance of corruption, aid transparency, and good results. In a way the government tried to convey the message that government is serious to address the issues that are associated with deepening democracy, improving governance system and accelerating development as per country's needs and priorities. Toward that end it has committed, among others, to carry out institutional reform and capacity development programs and collaborate with global partnership in the implementation, monitoring and evaluation. It has further committed to reduce project transaction costs and maintain sustainability through enhancing national capacity. It has also committed to simplifying the public service delivery procedures and improve the quality of expenditure besides disseminating the information available in the Aid Management Information System (AMIS) for better transparency and accountability. It also says that every two years evaluation of the policy will be made.

Thus, along with some ambitious goals, the policy, positively, has come forward with certain new policy directions and development priorities in the changed context. As an offshoot, some commitments to carry out reforms and changes in different areas have been made for raising aid effectiveness and better outcomes. Some expected positive steps from the development partners as per the international commitments have also been laid down in the policy which also can be regarded to be the positive side of the policy. However, the major shortcomings as in the past or more so in the changed internal political context amidst commitments to graduate in three years and ensure Nepal moving up to the middle-income category by 2030 along with accomplishing SDGs as stipulated is that the kind of major shift in the policy direction accompanied by bold reforms in the policy, structural and institutional fronts were needed that are missing to a greater extent. For instance, the sustainable and non-reversible graduation requires that unlike structural changes, genuine transformational discourse of development had to be pushed in which the paramount priority would have been on moving from low labor productivity to higher productivity areas and sectors. To sustain that process, it was necessary to ensure through policy reforms that productive capacity of the economy is enhanced through more equitable and qualitative human development. Grounded on such milestones and clear-cut strategic routes, more specific policies and action plans directed to accomplish critical targets of SDGs could have been spelt out and included. Within such a specified framework, the support of the development partners would have been sought to fulfill the resource gap. This could have helped to strengthen national ownership and augment aid alignment with national priorities in an effective way. For enhancing mutual accountability, more drastic reforms in the areas of coordination and monitoring would also have been proposed. Instead, as in the earlier policy, responsibility of the development partners and commitment of the government have been included in an ex-post manner with implicit confession that the proposed policies in many stated areas have been hardly backed by the concrete measures as pre-requisites to ensure the successes of the proposed policies. As experience entails, it is noticeable that unless some bold policy measures are proposed with assertiveness in consistent with international commitments, aid effectiveness agenda can mainly be a propaganda tool with no major improvements in outcomes or returns. In these, entire how federal system will be used to bring about transformation in a new way would have been clearly stated in the policy set in a completely different system. Instead, contradictory to the spirit of federal governance system, federal government through the policy has further tightened the grip on the sub-national developments with respect to mobilization and utilization of development cooperation. Such a shift could only have helped to build up more inclusive and participatory process in the development with positive impact on strengthening national ownership among others. The kind of new policy thrust on mobilizing development cooperation through INGOs as per the aid effectiveness global agenda are also lacking in the policy. At the same time, despite promises to review development cooperation policy in two years, still such a process is awaited despite changed domestic and external environment in the aftermath of COVID-19 added by mounting environmental and climate crisis in recent years.

3.3 BRIEF REVIEW OF INGO POLICY

Both the development cooperation policy of 2014 and international development cooperation policy of 2019 have outlined the policies associated with the INGOs. As per these policies, INGOs are required to mobilize development assistance directly from the bilateral/multilateral aid agencies and international organizations. They emphasize the need of accountability and transparency for raising development cooperation effectiveness. At the same time, the INGOs are required to register with the Social Welfare Council (SWC). The need of a prior approval from the SWC to mobilize development cooperation is also conditioned in them. As stated, the approval has to be based on the recommendation of the Project Analysis and Facilitation Committee under the Ministry of Women, Children, and Social Welfare. It is also stated that project activities implemented through the INGOs should align with Nepal's national development and sectoral priorities. Action Plan with measurable results, deadline, and exit plan has also been made mandatory while submitting the program. INGOs have also been instructed to follow the Participatory Plan Preparation Procedures under the leadership of the concerned local agency while selecting the project for implementation. Similarly, they are required to coordinate with the concerned sectoral Ministry while implementing central level projects. While implementing district and village level projects they have to coordinate with the district-level sectoral office, District Development Committee (DDC), and the Municipality or the Village Development Committee (VDC). The regulatory agencies are also obligated to prepare a digital mapping of projects where they are operating. The policies have also set the limits of administrative expenses up to 20 percent for any project to be undertaken or funded by the INGOs. Apart from compulsorily making the income and expenditure of the project's public, a third-party audit of the activities, a public hearing and a social audit at the project area once a year have been made mandatory to the INGOs.

Though the policies have tried to make the wider coverage to make the INGO supported aid program transparent, accountable and effective, policies granting direct funding through the development partners and other organizations undermine the interlinked issues associated with aid effectiveness to a greater extent. The weaker roles of the SWC amidst weak institutional and technical capacity have perpetuated such problems.

In such backgrounds, the most important yardstick to judge the effectiveness of development cooperation is the assessment of the related key parameters. The next section below is devoted to this.

3.4 FOREIGN AID AND ITS EFFECTIVENESS

For examining the aid effectiveness, some indirect and other proxy measures have been employed[55]. For such a purpose, long term growth in GDP and foreign aid, trend in domestic saving, government investment and foreign aid, pattern in aid commitment and disbursement, mode of payment, pattern of aid fragmentation, phenomenon of debt outstanding and debt servicing liabilities and budgetary management system as well as practices have been closely assessed.

3.4.1 Foreign Aid, Domestic Saving, Government Investment and Growth

As already indicated, the foreign aid is justified on the presumption that it will have unyielding contribution to the growth, development and wellbeing of the people of low-income countries like Nepal through direct and indirect channels. As an offshoot, it is also presumed that, with additional spill over economy-wide positive effect, aid leads to reduced external dependency and enhance self-reliant development overtime. Because of such conjectures working poorly or adversely for many years, the agenda of aid effectiveness has been to the fore in recent years. Accordingly, it is quite natural to expect better outcomes in line with the above presumptions.

As such, one of the presumed channels and sequencing from macro perspectives is that aid besides directly contributing to augment investment in aid recipient countries also adds to the domestic saving to boost investment further leading to higher growth and development. Below on the similar assumption, the linkages between foreign aid and domestic saving, government investment and growth are analyzed through plotted graphs based on the long time series data (1974/75 to 2020/21).

One of the premises of the role of the aid has been such that aid rather than playing substituting role plays an additive role in a country's domestic saving. Understandably, if aid substitutes domestic saving, then it becomes like a zero-sum game without addition to the domestic saving to be used in the expansion of investment. Viewing from this angle and closely examining the rate of growth in domestic saving and foreign aid in real terms, with some exceptions in few years no strong negative trend between the two is observed especially in more recent years (Graph 3.1). This means that there is not much substituting effect on domestic saving amidst steady expansion in aid. However, it is also noticeable that there is no significant inducement to the overall domestic saving through stimulus to the private saving.

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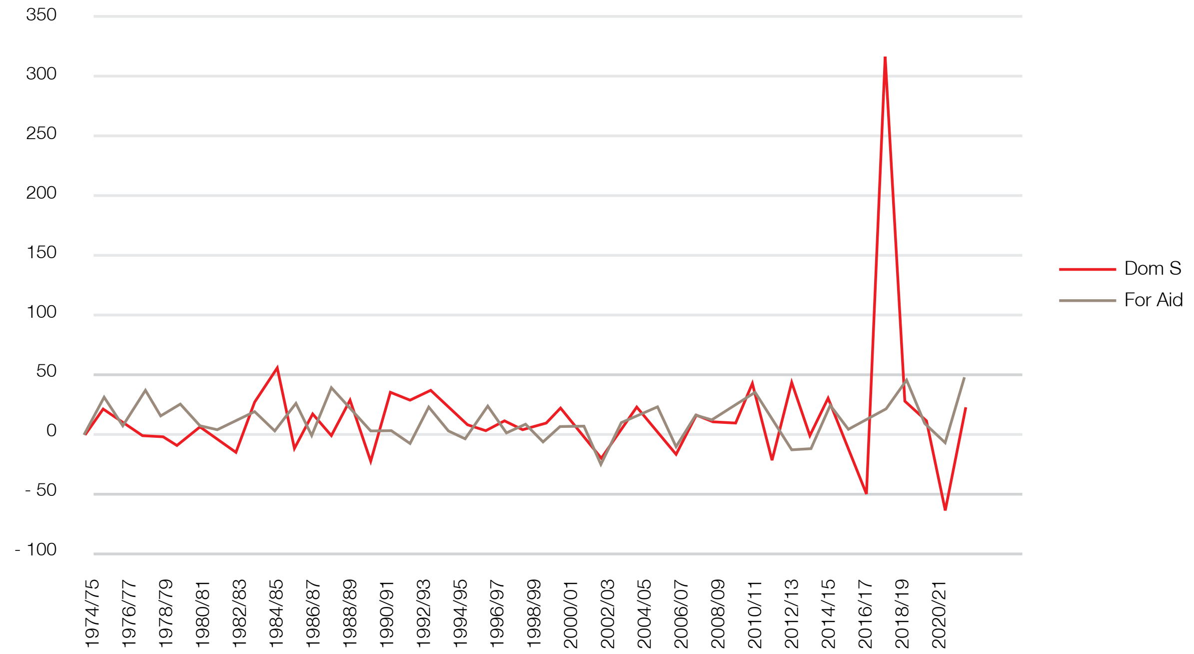
[55] Various indirect and proxy measures employed here are only indicative and such an assessment has its certain limitations. Examination of selected aid funded projects more exhaustively covering processes and means adopted to select and implement the projects linking with targets set during the project appraisal phase and actual outcomes or return after the completion of the project taking aid conditions, nature of the project as a part aid modality, procurement system, mode of payment, debt servicing liabilities etc into account would have been more appropriate. This could not be possible due to non-availability of such data readily amidst time constraint.

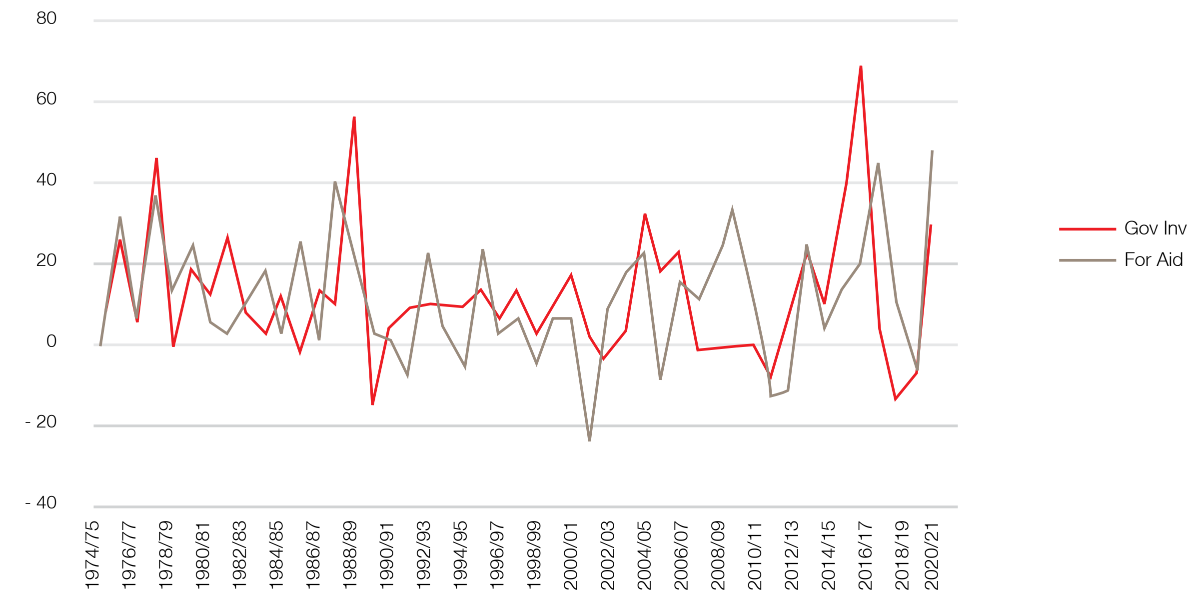
Graph 3.1 Growth in Foreign Aid and Domestic Saving



Source: Economic Survey (Various Years), MOF.

With not much negative effect on domestic saving, it is generally expected a positive role of foreign aid in heightening government investment further. A comparison of growth in foreign aid with the growth in government investment shows that despite fluctuations in both, the fluctuating pattern especially in some turning points depicts that there is some symmetrical phenomenon (Graph 3.2). This means that foreign aid has played a positive role in expanding the level of government investment. This is on the expected line. Now the basic question is whether that has contributed to the growth and more so in a sustainable manner.

Graph 3.2 Foreign Aid and Government Investment

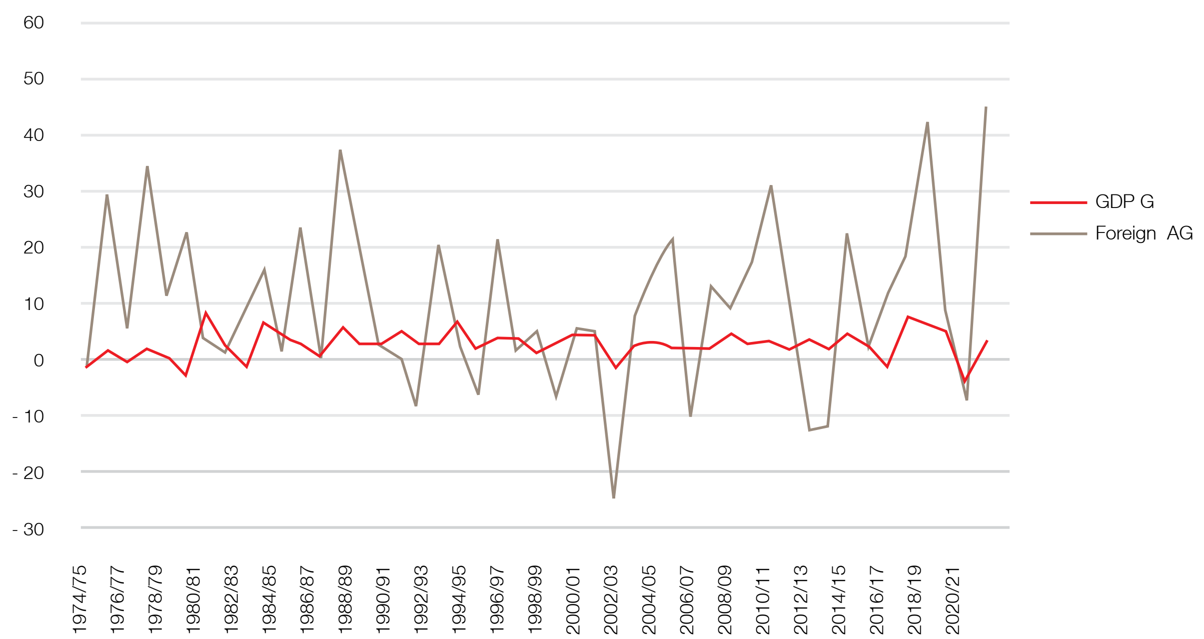


Source: Economic Survey (Various Years), MOF

For examining the correlation between the aid and growth, a graph has been plotted below (Graph 3.3) using growth in aid and GDP covering the period of 1974/75 to 2020/21. As is well known, one of the main principles of the aid effectiveness is the expected high returns and hence many of other reform agenda connected with aid effectiveness are supposed to be closely associated with the outcome or return parameters. As a proxy, not level but the growth has been considered mainly to see whether or not there is any similar pattern overtime between the two. As the trend indicates, there is no similar stable pattern in aid and growth despite some positive correlation between aid and government investment. This raises questions about the sincerity and efficacy of implementing aid effectiveness agenda popularized especially since 2005.

Though the fluctuation in aid is much wider than the fluctuation in GDP growth, there is no strong predictable pattern between the two. As well known, as a result of dominant role of the agricultural sector coupled with poor performance of the dynamic and strategically important sectors such as manufacturing and others, the fluctuation in GDP has taken place[56]. This means, had there been transformation in the economy rather than simple structural change amidst stagnating or declining trend in the production sectors like agriculture and manufacturing and limited contribution of sectors like energy, tourism and construction having competitive strength and higher spillover effects, more qualitative and sustainable growth pattern would have manifested overtime. This partly entails that foreign aid despite boosting government investment and contributing to augment infrastructure development including energy development and expand health and education services etc., contributed very little to drive the economy toward sustainable path to higher growth and development[57]. By implication it is also clear that foreign aid played a limited role in boosting private investment in the most productive areas. The bigger oscillation in the growth of aid realization indicates the possibility of less than expected reforms in critical aspects of aid effectiveness agenda despite such focus in development cooperation policies, among others.

Graph 3.3 Foreign Aid and Growth



Source: Economic Survey (Various Years), MOF

[56] *Noticeably, larger negative growth effect in some years is due to devastating earthquake and COVID-19 effect.*

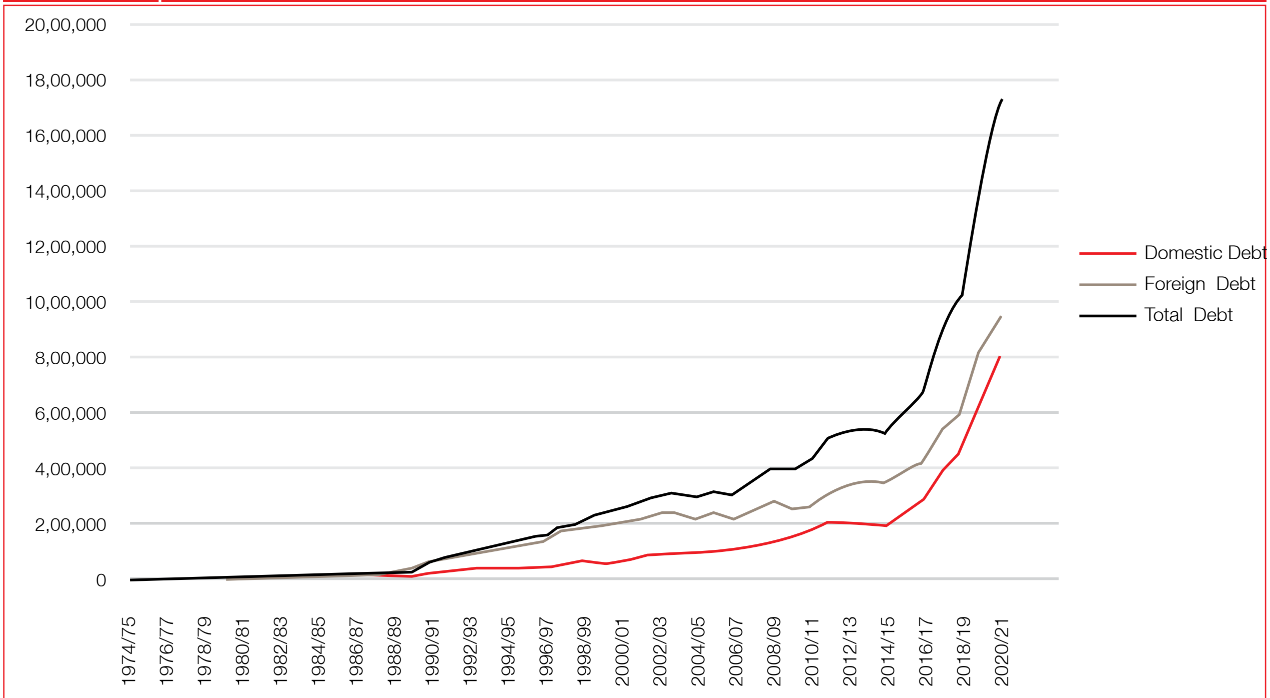
[57] *Probably low priority on environment and climate finance with immense losses and damages due to climate effect also contributed to the poor linkages. Though with the implication of GDIR approach some added focus has been given, the concrete outcomes are awaited. At the same time, the predominance of loan under the GRID raises questions on such financing modality, especially so associated with climate related finance as for this grant is preferred principally.*

3.4.2 Aid, Debt Outstanding and Debt Services

The continuous inflow in foreign loans not only raises the foreign debt outstanding of the country overtime markedly but it also augments total debt servicing liability overtime massively. However, it is expected that after certain phases of intensive development with high growth, a tendency of declining in the growth of external debt will take place leading to a steady decline in the external debt dependency with corresponding decline in the debt serving liability. On similar grounds, Nepal's aid or development cooperation policies while recognizing the importance of aid have committed to reduce external dependency and enhance self–reliant development. Below a long term as well as more recent trends in debt outstanding debt serving liability has been presented.

As shown in the graph 3.4, the total debt was negligible up to the early 1980s. Thereafter, there was picking up in both internal and external debt, with albeit fast rise in external loan components. Thus, along with the implementation of SAP, the rise in both augmented as the graph indicates. Noticeably, in recent years, there has been sharp jump in both internal and external debts, more so since 2014/15. Though albeit ambitious budgets and the need of reconstruction after devastating earthquake were instrumental for such a rise, after some time intervals there would have been some slowdown in the debt expansion. Apparently, an opposite tendency is visualized.

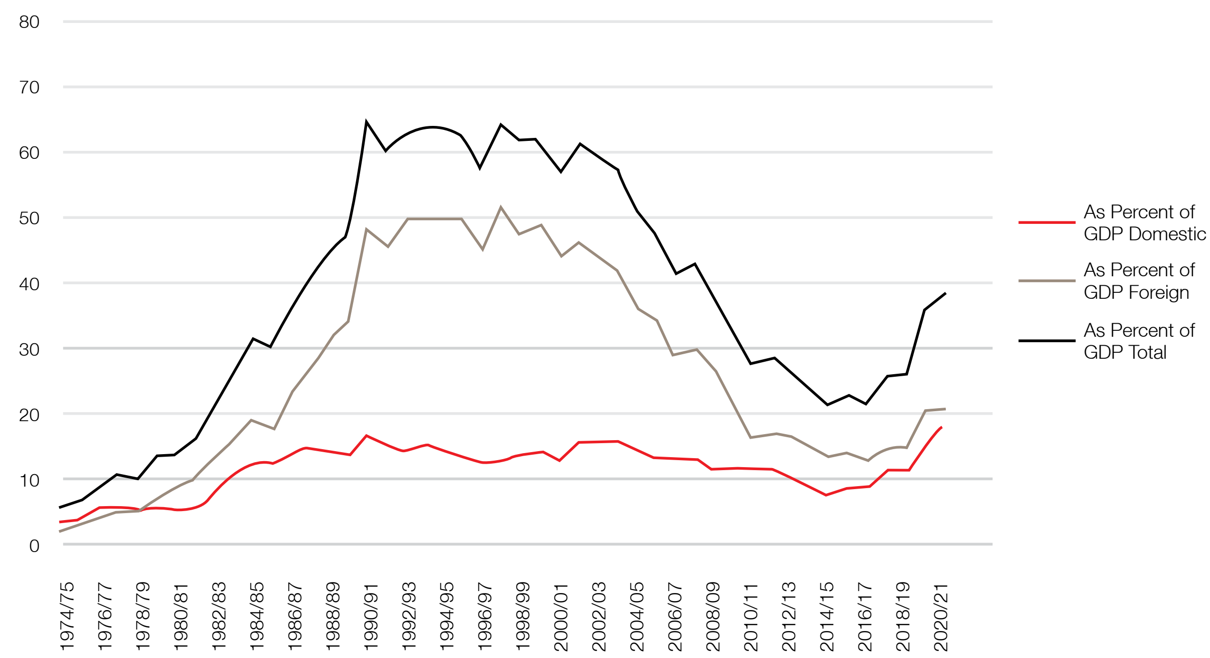
Graph 3.4 Domestic, Foreign and Total Debt Outstanding



Source: Economic Survey (Various Years), MOF

A clearer reason is ascertained when the trends in internal and external debt to GDP ratio is examined (graph 3.5). As shown in graph 3.5, after the fast rise in external loan as a share of GDP up to 1989/90, a decline in the share began and manifested up to the mid-2010s. This was a period when the share of grant had picked up, at the same time some debt relief policies were adopted by some donors. Added by a debt restraining policy of the government, there was clear cut downward slope in the debt to GDP ratio. The trend completely changed thereafter. In the last four to five years a sharp jump in external debt to GDP ratio has taken place, leading to such a ratio exceeding 20 percent. During the same period, the rise in the ratio of internal debt to GDP ratio has been equally fast. As a result, the total debt to GDP ratio has surpassed 40 percent. This simply means that the rise in debt compared to the expansion in economic activities represented by country's GDP has been very fast. This may lead to a debt trap situation unless such a phenomenon manifests further. This is most likely unless overall growth performance outstrips the rise in the country's debt. In a way, this corroborates the earlier finding that, among others, no close association between the aid and growth is apparent. More strikingly, this may have further pressure of development financing due to corresponding fast rise in debt serving liability.

Graph 3.5 Debt Outstanding-Domestic and External as a share of GDP

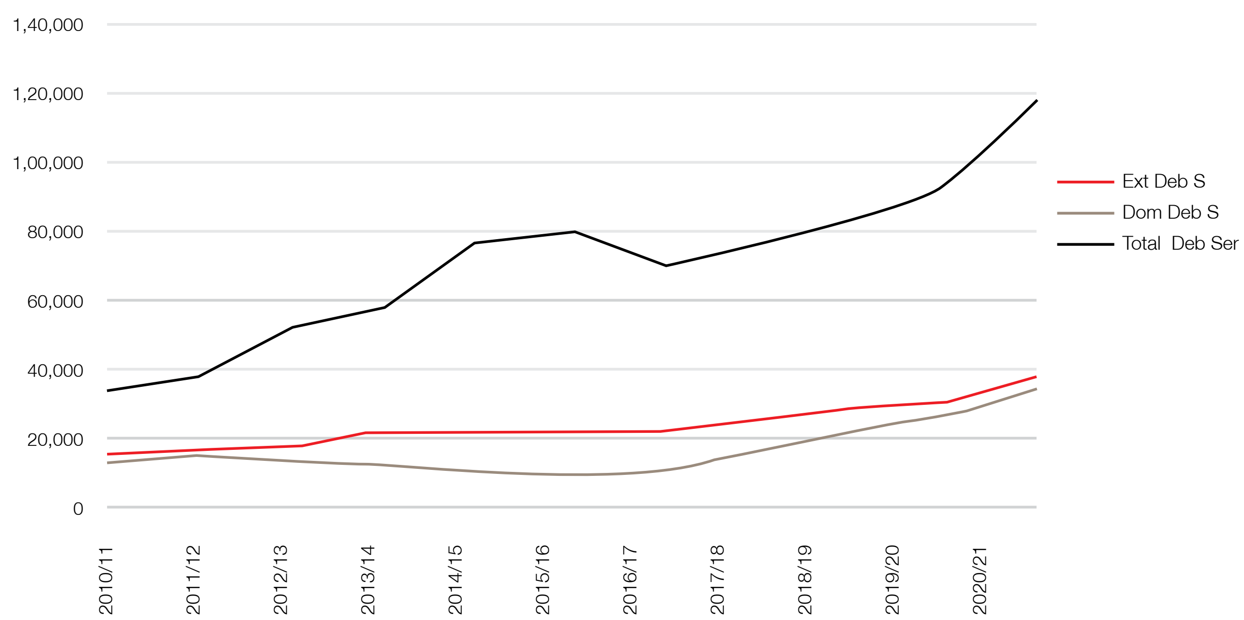


Source: Economic Survey (Various Years), MOF

To assess such a likely effect, two separate graphs are presented below; one shows the debt serving liability of external and internal debt separately (graph 3.6) and other shows the ratio of debt serving to GDP and ration of debt servicing to total revenue (3.7) for the period 2010/11 to 2020/21. As the graph 3.6 indicates, with some slow growth up to 2016/17, the debt servicing of external debt started rising at a faster rate. With closer to the maturity of past loans and continued appreciation of the dollar, there is an additional threat of further jump in debt serving liability in the years to come. Equally worrying is the rise in the level of internal debt servicing liability which also may jump in the coming years further as the interest charges on internal loan is much higher.

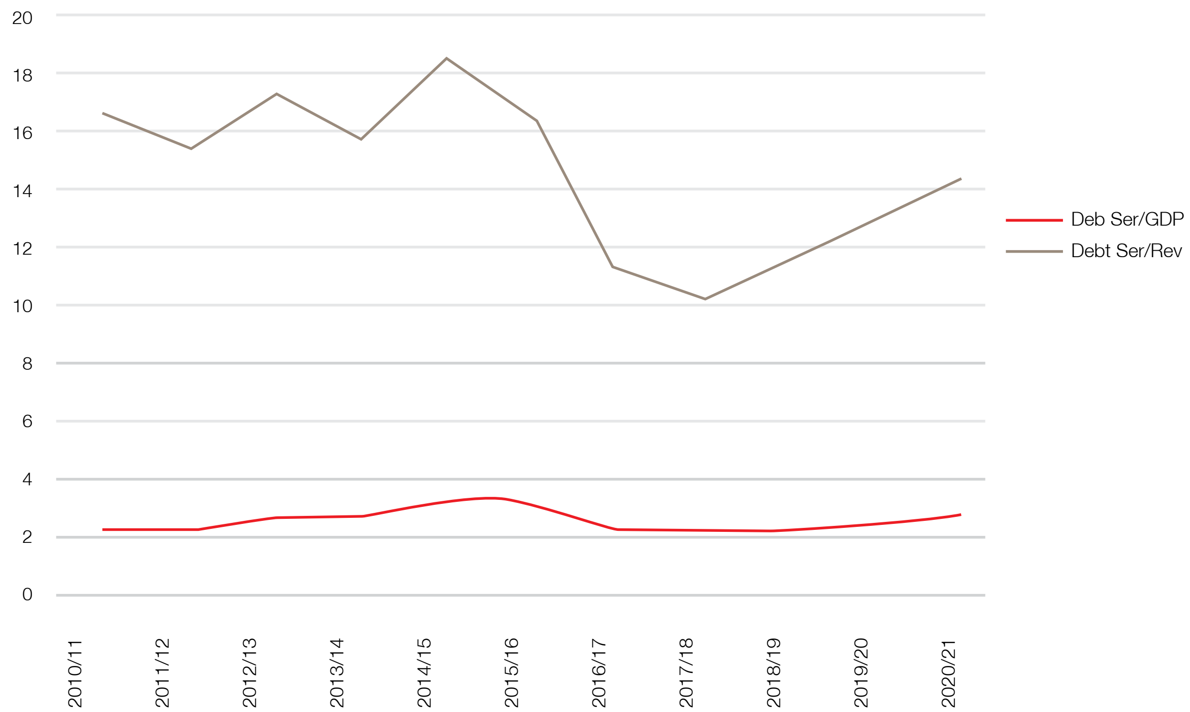
Along with such a rising debt servicing level, both internal and external, debt servicing as a share of GDP has started going up at a faster rate in recent years. After reducing to 2 percent of GDP for some years, there is a further upward trend in more recent years. Correspondingly, debt serving as a share of government revenue has reached above 14 percent after continuous decline for many years. Similarly, the external debt servicing liability as a share of revenue was about 7.7 percent of revenue in 2010/11. Such a ratio steadily declined for some years. It has again started going up since 2018/19 and has reached 4.5 in 2020/21. Though, so far, the total debt serving has not been that high, it is picking up at a faster rate recently. With growing resource gap for funding the SDGs in a situation of tremendous lag in meeting many critical targets, the challenges emanating from resource gaps bound to compound amidst larger revenue share to be absorbed by the debt serving.

Graph 3.6 Total, External and Domestic Debt Servicing Trend (2010/11-2020/21)



Source: Economic Survey (Various Years), MOF

Graph 3.7 Total Debt Servicing as a Share of GDP and Revenue



Source: Economic Survey (Various Years), MOF

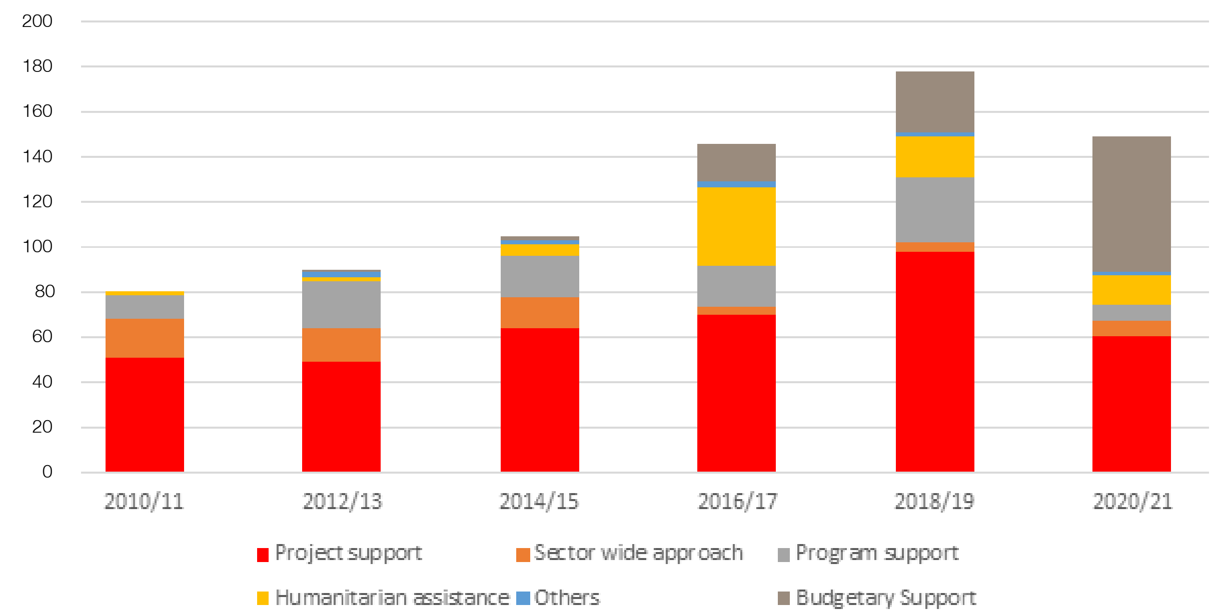
3.4.3 A REVIEW OF PROGRESSES ON SOME SPECIFIC AID EFFECTIVENESS AGENDA

3.4.3.1 Aid Modality

From ownership, alignment of aid with national development priorities and utilization more smoothly with limited hindrances or delays in the processes, composition of the aid modality is crucial. This is the reason for first priority given to the budgetary support by the aid or development cooperation policies as it provides much more leeway to the government to allocate or divert aid to the areas which are being prioritized and are regarded to be most needy. Similarly, SWAp is also considered to be more appropriate from ownership, better and timely aid use practices. On similar grounds, the project aid has been given the least priority.

To examine whether the changes in aid modality has taken place as per the policy trust, a graph was plotted covering major aid modalities that are in practice in Nepal (Graph 3.8). However, as the graph shows, though some changes have taken place in the aid modality, these are neither in the expected line nor are predictable. The share of project aid has continuously increased during the period under review except in the fiscal year 2002/21. This largely can be attributed to the rise in the COVID-19 related budgetary support. More worrying is that the share of SWAp has reduced dramatically in recent years which are major concerns as under this most of the resources have been disbursed to the health and education sectors. A sharp increase in humanitarian aid is noticed in 2015/16 and 2020/21, as expected due to devastating earthquake of 2015 and COVID-19 respectively. Importantly, no perceptible changes in the aid modality are found, contradictory to the development cooperation policy priority and aid effectiveness agenda.

Graph 3.8 Aid Disbursement by Modality *NPR in billion*



Source: Development Cooperation Reports (Various Years), MOF.

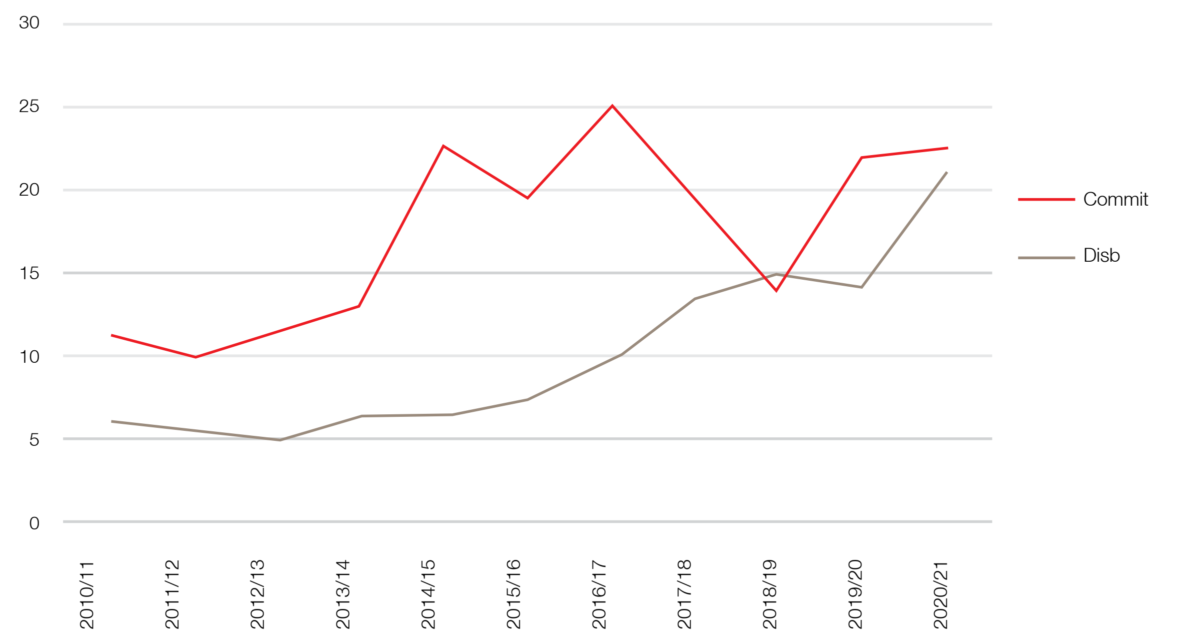
It should also be added that in addition to prioritizations of aid modality as per aid or development cooperation policies, it is equally indispensable that internally institutional and governance system is very strong in which project and program selection are grounded on strong viable or needy criteria and simultaneously implemented in an effective manner. If not, the outcome or performance will not be in the expected line or = could be worse. As growth and other indicators presented reveal, such a problem is quite serious in Nepal. This means that Nepal is now passing through highly quandary or delicate situation.

3.4.3.2 Aid Commitment and Disbursement

One of the most critical indicators of the improvement in the entire aid system is the narrowing gap or convergence between the aid commitments and disbursements overtime. It not only simply entails the strengths and weaknesses of the system followed to select particular projects and programs but more importantly portrays how the entire budgetary and public expenditure management including financial management system is carried out in a responsive manner. As a priory, it is also associated with the MTEF and its robustness which, inter alia, is associated with the extent of adopting input, output, outcome and potential impact criteria. Equally important is the changing behavior and role of the development partners.

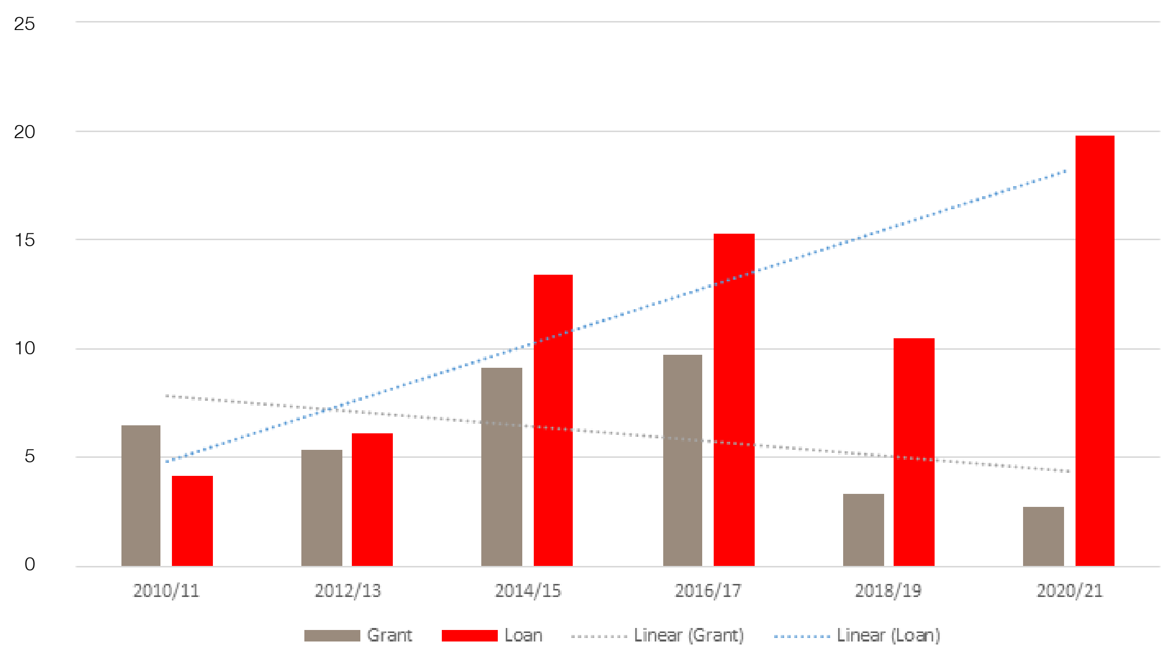
From the graph 3.9 below, number of unique patterns is observed. First, there has been a highly fluctuating tendency in both commitments and disbursement during most of the period under review. In that a typical and more unpredictable trend is observed. A continuous rise in commitments with some fluctuations took place after 2010/11 and reached the peak in 2016/17 amidst very low rate of disbursement. Then after a sharp fall in commitments together with marginal improvements in disbursement occurred leading to convergence between the two in 2018/19. Thereafter, a modest increase in both commitment and disbursement has taken place with persistence of gaps between the two. If commitments (graph 3.10) and disbursements (graph 3.11) are looked into by source, albeit a different pattern is observed. Under the commitment, the share of grant was high compared to the loan up to 2014/15. But thereafter, the loan overtook the grant despite grant commitment also rising steadily up to 2017/17. But after that, a sharp fall in grant commitment occurred leading to total commitments so far not catching up to the level of 2016/17. Under the disbursement, the share of grant was high up to 2014/15. Thereafter, there was marked increase in loan compared to the grant.

Graph 3.9 Trends in Aid Commitments and Disbursements (2010/11-2020/21)



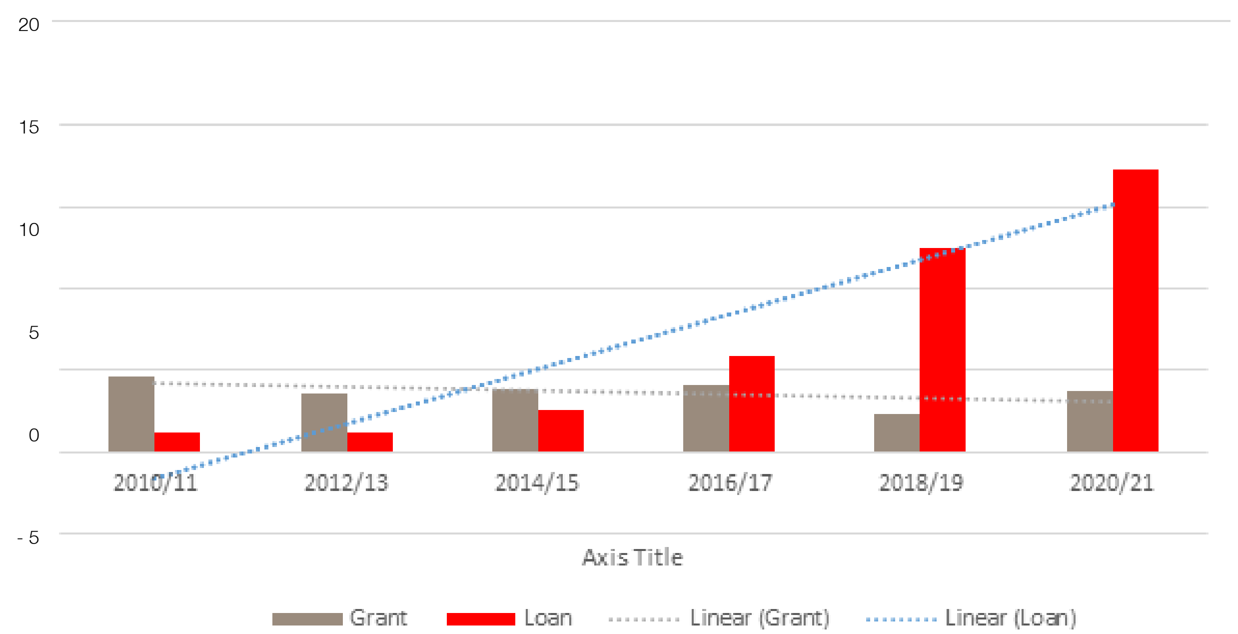
Source: Economic Survey (Various Years), MOF

Graph 3.10 Aid Commitment by Source *NPR in billion*



Source: Economic Survey (Various Years), MOF

Graph 3.11 Foreign Aid Disbursement by Source *NPR in billion*

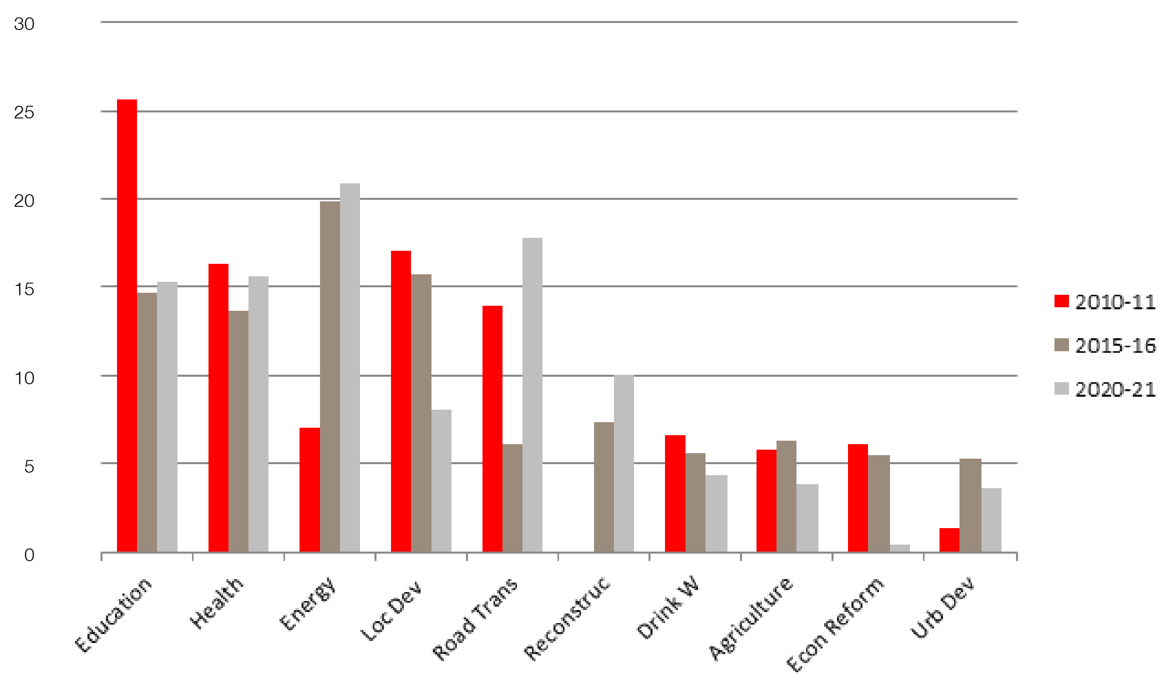


Economic Survey (Various Years), MOF

The large gap in commitments and disbursement has had an impact on the sectoral disbursement of the ODA. As shown in the graph, there is no stable pattern among the six major sectors. At the same time, the sectoral disbursement is neither consistent with the priority set in the development cooperation policy nor it is compatible with the SDGs. In recent years, the highest disbursement has been in the energy sector[58] followed by the transport sector. The education sector which received highest priority at more than 25 percent in 2010/11 received low priority subsequently though there is some increment in 2020/21 compared to the low share of below 15 percent. The agriculture sector has also received low priority. Climate financing also has received very low priority. Broadly, the disbursement shows that there has been no balancing approach in terms of production, infrastructure and services sectors amidst little attention toward promoting sustainable development.

[58] *From the standpoint of harnessing abundant resources having competitive strength with big potentials of contributing to energy transition, the priority to the energy sector may be justified. But to fulfill the SDG's more balancing approach is needed including ensuring of increased access of such energy to the common people. At the same time, areas where private sector including small investors may come forward, some complementary approach may be needed to divert the resources where resource gap is larger.*

Graph 3.12 Share of ODA Disbursement in Major Sectors



Source: Development Cooperation Reports (Various Years), MOF.

More broadly, the highly fluctuating and unpredictable pattern of both commitment and disbursement accompanied by no firm principle in fixing the sector priority reveals disturbing phenomenon. First, amidst the role of aid still remaining crucial, the entire budgetary system has been encompassed through a trust deficit syndrome. Similarly, as an offshoot of the first, the mismatch between the two makes the prioritized resource allocations decisions and setting of targets at both sector and project or program level through the budget and annual programs almost redundant. As such, it entails that the policy reforms proposed and committed in relation to aid have largely been ineffective towards translating them into achievements. In the aftermath of sweeping political change with long instability and transition, certain problems in the disbursement are understandable. But in the post 2015 period with elected governments in the power accompanied by very ambitious economic agenda put forward by all major political forces, why performance has been so poor is a matter of concern from aid effectiveness standpoint. As an offshoot, there is merely any consistency between the disbursement of ODA in different sectors and the priorities set in the development cooperation policies and SDGs. As obvious, together with larger commitment and disbursement gap, this may have negative impact on both the speed of development and accomplishment of the SDGs as per stipulated time amidst still backlog effect of the COVID-19. The low priority of the climate finance is a matter of great concern. It is also obvious that the continued low disbursement will have cumulative effect on commitments too at a time when resource crunch has emerged a big problem with a threat of increased retardation in development.

3.4.3.3 Trend in Aid Fragmentation

As well known, larger aid fragmentation would have detrimental impact on ownership, aid alignment, accountability, aid management and better outcomes. For these reasons, addressing aid fragmentation has been one of the top priorities of the aid or development cooperation policy. However, no major improvement in controlling aid fragmentation has taken place so far. In 2010/11, for instance, technical assistance was the most fragmented. With a total of 258 projects, on average each donor was engaged in 9 different sectors. This means that donors were not focusing on those sectors and areas where they had comparative advantages. The Herfindahl index for donor portfolios was estimated below 0.3 for almost two thirds of donors. Similarly in 2015/16, ODA was highly scattered and fragmented. Despite the number of foreign aided projects coming down to 369 in 2015/16, the total ODA was distributed across 212 grant projects, 145 TA projects and 49 loan projects. In 2020/21 also, ODA was highly fragmented. There were over 362 ongoing projects with an average of 22 development partners engaging with 24 counterpart agencies. It is reported that in 2020/21 an implementing agency carried out an average of 15.73 projects and a development partner was engaged in an average of 16.45 projects. The UN group was involved in a maximum of 90 projects, followed by USAID with 50 projects; the EU with 45 projects; the ADB and Germany with 30 projects each; the World Bank with 29 projects; Switzerland with 21 projects, and the UK with 18 projects. Of the total projects, 315 projects were supported by 8 development partners, with the remaining 47 projects supported by 14 development partners. As such, 8 development partners were involved in 87 percent of total projects and 14 development partners were involved in 13 percent of projects[59]. Thus, aid fragmentation has persistently remained one of the major problems. This corroborates that aid is highly driven or influenced by the donors. Importantly, along with the implementation of SDGs a big shift in the nature and priority of aid was expected. But this could not be materialized[60].

3.4.3.4 System of Aid Inflow, Procurement, Auditing, Mode of Payment and Monitoring System

The system of aid inflow, procurement, auditing, mode of payment and monitoring system are critical from the standpoint of enhancing domestic ownership, strengthening mutual accountability and ensuring overall improvements in the performance of aid. These are the areas where Nepal in support with development partners has continuously committed to improve the situation remarkably.

Despite such commitments, one of the foremost problems in Nepal is the system or practices in which larger chuck of aid is spent directly without including in the system of budget which is termed as off-budget practices. One of the added problems is that despite inclusion in the budget, a larger chuck is spent directly by the development partners. For instance, in 2010/11, only 54 percent of total aid was channeled through the national treasury. Out of the remaining, 16 percent of the disbursements despite being on-budget were not channeled through the treasury. The remaining large chunk of 30 percent was disbursed directly which comprised of, among others, technical assistance or other project related payments including projects delivered through civil society and the private sector.

Though there was some improvement in 2015/16, no breakthrough could take place. Of the total ODA disbursed in 2015/16, about 63 percent of foreign aid was disbursed through on budget projects and as high as 37 percent was disbursed through off-budget projects.

Apparently, some further improvements are seen in 2021/21 as out of the total ODA, 84.3 percent was on-budget and only 15.7 percent was off budget. However, out of the ODA on-budget of 84.3 percent, only 66.6 percent was mobilized through the government's treasury system. The remaining 33.4 percent of on-budget disbursement was channelized through outside the treasury system. Thus, despite some reduction in the off budget in recent years, the direct payment outside the treasury has continuously remained extremely high. This simply means that a major chunk of aid neither comes within the orbit of Nepal's procurement system nor it is audited[61]. Though a system of regular Portfolio Performance Review jointly is a positive development since last many years from the standpoint of strengthening, among others, mutual accountability, the progress has been

[59] *For details see MOF 2022.*

[60] *For details see MoF 2012, 2016 and 2022.*

[61] *For instance the 60th Auditor General Report for the fiscal year 2021/22 points out that out of the total disbursed loan; almost 22 percent was out of the audit system. See AGR 2023.*

slow or disappointing as many related indicators corroborate. Taken together, there is still a serious problem from ownership, aid alignment, complying with national audit system, ensuring better monitoring and mutual accountability point of view, the core issues from the aid effectiveness standpoint.

3.4.3.5 System of Inclusiveness in Aid

One of the strong focuses after Susan meeting is that it should be inclusive through devolving a system in which civil society organizations and private sector are involved in the aid selection, execution and monitoring processes. Though in the development cooperation policies such an emphasis is there, no built-in system is yet to be developed and strengthened. As already indicated, a recent study focused on the health sector indicates that there is no framework to engage with non-governmental organizations (NGOs)/civil society organizations (CSOs). It also adds besides no harmonized reporting of indicators, it also points out that there is no oversight/visibility over private health providers including no arrangements to engage with private sector for cooperation[62]. One of the better added approaches could be to involve the sub-national governments as per their responsibilities laid down in the constitution in the selection and implementation of the provincial and local level projects and programs through which more inclusive approach could be ascertained. As noted above, the tendency seems to be in the opposite direction.

3.4.3.6 Foreign Aid and Fiscal and Budgetary Management

Along with compliance from the development partners as per their commitment, the effectiveness of aid hinges on the fiscal and budgetary management practices to a greater extent. As is clear most of the policies and programs including aid policies and programs evolved or pursued have to be embedded in or passed through the fiscal and budgetary system. At the same time, Nepal has accepted and implemented the SAP and other aid linked conditional programs apart from accepting the policy recommendations regularly made by the IMF and other multilateral donor agencies that are, among others, associated with fiscals and budgetary management.

In general, the fiscal and budgetary management is associated with such a system that could ensure that resources are allocated and spent in an efficiently and effective way for better delivery, outcomes and returns. Traditionally, the major trust has been on three aspects, viz, financial stability, resource allocation efficiency and operational proficiency. While the financial stability is associated with fiscal discipline, the allocation efficiency is regarded to be crucial for qualitative economic growth and equity. Operational efficiency is linked to efficient and effective use of resources in a time bound manner. These three principles, thus, are associated with fiscal discipline (expenditure control), allocation of resources consistent with policy priorities (strategic allocation) and efficient operational management at the project and program level. It should also be added that with climate crisis and SDGs under implementation, the sustainable and equity dimensions have also become highly important. Needless to add, in the federal system of governance, the spatial dimension from resource allocation, operational efficiency and equity point of view is crucial. As a part of fiscal rule, parallel effort has to be on resource mobilization to enhance the revenue elasticity with added care on boosting private investment and strengthening tax justice system. Larger effort on resource mobilization is essential to earmark the counterpart funds for foreign aided projects apart from the need of gradual reduction overtime in external dependency on aid.

In order to accomplish such a management system, various rules and regulations have been prepared and implemented. Various revenue and tax rules are under implementation with more and more reliance now on VAT. There is also focus on income tax for changing tax structure and raising the tax elasticity. On the expenditure side, certain norms and benchmarks have been established broadly following the international practices to the low-income countries like Nepal for ensuring fiscal balance or fiscal stability. Moreover, the NRB act limits the internal borrowing as a part of deficit financing. Similarly, aimed at better and efficient allocation of resources, the

[62] *UNICEF 2022.*

Medium-Term Expenditure Framework (MTEF) has been in practice since the beginning of the 10th Plan (2002-2007) which is also aimed at bringing the coherency between the periodic plans and annual budgets through a system of projecting resources and expenditures for three years in a rolling way every fiscal year. Thus, it through advanced projections tries to ensure that fiscal balance is maintained by the budget. Noticeably, such a framework was developed and recommended by the IMF and the World Bank jointly as a part of conditional PRSP program. Importantly, the MTEF has to be based on a framework in which the indicators related to input, output, outcome and likely impact of projects and programs has to be taken into account for assessing in a priory the resource allocation efficiency and potential returns. Now the MTEF is mandatory to the sub-national governments as well.

As a part of new initiatives under the federal system of governance, various acts, rules, regulations and working procedures have been either newly enforced or revised in such a process. The Local Government Operation Act, 2017, National Natural Resource and Fiscal Commission Act, 2017 and Inter-governmental Fiscal Management Act, 2017 are under implementation. The Financial Procedure and Financial Accountability Rule introduced in 2019 is regarded to be one of the milestones of fiscal rules and budgetary management. Similarly, for making the procurement process of large projects systematic and result oriented, the criteria related to multi-year contract, 2020 has been brought into implementation. Noticeably, there have been frequent revisions in the Public Procurement regulations aimed at improving the operational efficiency of projects and programs. For selection and implementation of strategic projects with priority, a separate treatment is there to the National Pride projects. Now the transformative projects have been added to the priority lists[63]. For overall improvements, the Line Ministry Budget Information System (LMBIS), Province- level Budget Information System (PLMBIS), Single Account Treasury System (TSA), Public Assets Management System (PPMS) and Sub- National Treasury Regulatory Application (Sutra) are under implementations. More than ninety percent of government transactions are done through electronic fund transfer system (EFT)[64]. The introduction of Project Bank system since the beginning of the 15th Plan has been a major step to introduce project screening process in the selection of projects for preventing the ado and poor project selection processes that undermine the principle of better public expenditure management system. Apart from a system of monitoring and evaluation of the projects and programs in a time bound manner, there are parallel oversight constitutional bodies and other organizations which are responsible to monitor that how expenses are made by various wings of the government in different projects and programs. Equally importantly, Nepal is now implementing the Second Phase of Public Financial Management Reform program as a part of reforming the budgetary management system in general and financial management system in particular.

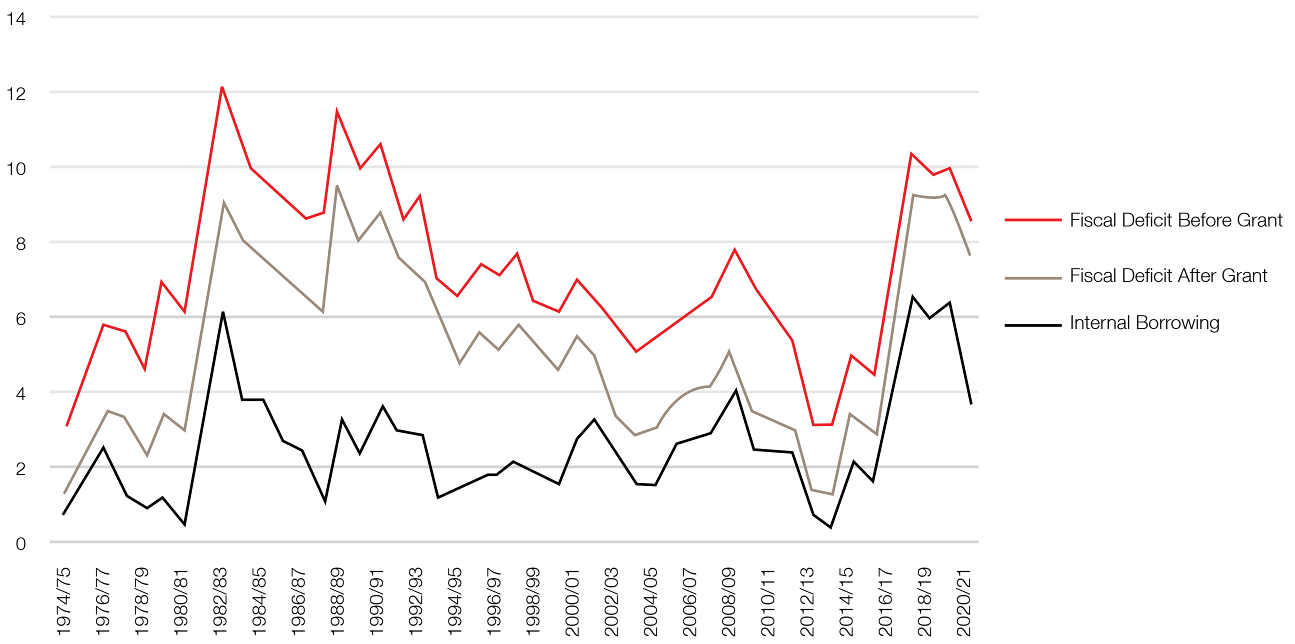
Notwithstanding such initiatives, the major problem is that the foremost focus has been given on fiscal balance and macroeconomic stability without looking into the composition of the expenditure and allocation efficiency issues[65]. From the graph below some interesting phenomenon is observed. After the 1980s there were improvements in fiscal and budgetary deficits prior to the 2014/15 though at the cost of capital expenditure or compromises on the quality dimension. But in 2014/15 and thereafter a sharp jump in the ratio of internal borrowing to GDP took place though with some fluctuations and reached similar to the ration of early 1980s. This was the period when Nepal was compelled to introduce economic stabilization and the SAP. Though in 2019/20 and 2020/21 some improvement has been there, this was partly due to worsened capital budget implementation. Now there are again symptoms of rising deficit due to poor performance on the revenue front. This means that now the threat of not only rise in budgetary deficit has increased but also the likelihood of poor performance in the capital budget has augmented further amidst no improvement in the resource allocation efficiency and budgetary management. As is discussed below, this is one of the bigger challenges Nepal faces at the moment amidst cosmetic approach followed without realizing the gravity of the problem.

[63] See 15th Plan (NPC 2019).

[64] Various recent initiatives are highlighted in the 15th Plan (NPC, 2019) and Economic Survey of this fiscal year 2021/22 (MoF, 2022).

[65] The equity and sustainable dimension are yet to be explicitly laid down expect following some tinkering approaches.

Graph 3.13 Fiscal and Budgetary Deficits as a Share of GDP



Source: Economic Surveys (Various Years), MOF.

One of the principle means of enhancing the resource allocation efficiencies is regarded to the MTEF which desolately has been converted into a ritualistic document. For instance, all expenses under either current or capital expenditure are treated as projects/programs and subsequently bifurcated into P1 and P2 categories. Interestingly, P1 are the first priority projects and programs which absorb almost 90 percent of the total budget outlay. This means, the allocations are not input and output/outcome driven but they are essentially expenditure driven. This is evident from the fact that even in the post new constitution implementation period, no intra and inter sectoral restructuring under the MTEF has taken place. Though as per the commitments or need to expedite the implementation of projects and programs from a strategic point of view the separation of projects and programs in the form of function-wise strategic allocation, SDGs, gender based, environment related, national pride and transformative may be justified, the irony is that such a strategic grouping has hardly been based on restructuring principles as per the basic rules embedded in the MTEF except some shifting or addition of new projects each year under pride projects category through largely a political decision making process rather than through prudent strategic yardsticks. This also means that despite a shift in priorities in the successive aid policies, no subsequent initiatives have been made through MTEF which influences the budget to a greater extent. The portfolio review meetings that take place regularly hardly take these issues seriously, undermining the allocation efficiency as a pre-requisite to enhance effectiveness in aid.

As an offshoot of ritual or customary practices inherent in the MTEF, the predominance of sick projects and programs has been a major problem as these constitute the major resource drains and are derailing the expected outcomes from the reform's initiatives. For instance, a study examining the contract management of government implemented road construction projects found that almost 68.76 percent of the contracted-out projects were neither completed nor extended by the concerned authorities by completely violating the procurement rules. A similar tendency was found in other sectors also[66]. Another study by the same constitutional body devoted to identifying the sick contracts found that out of the 1848 sick contracts with equivalent of Rs. 118.01 billion, as many as 1032 contracts crossing

[66] *See CIAA 2019 for details.*

the completion deadline were neither terminated nor were extended[67]. This exemplifies the disarray in the contract management /procurement system which has converted into a major systemic problem. Such a disorder is further corroborated by the recent government decision. At almost the end of the fiscal year 2021/22, the government extended the construction contracts of more than 3000 projects whose contract deadline was about to expire by the end of the fiscal year. Similar practices have been repeated in 2022/23 also.

One of the compounding problems is that with the popularization of multi-year contract practices in Nepal, a system was institutionalized in Nepal under which various ministries through such a window used to prepare lists of new projects/programs to be forwarded for written resource assurance from the Ministry of Finance. Then, after obtaining a resource assurance letter from the Ministry of Finance, the new listed projects were contracted out despite no budgetary provision in that particular year. Though some of such projects used to be included in the next year's budget, most of them contracted out without budgetary arrangement had led to accumulating billions of contractual liabilities to the government. Even awarding Ministries had no updated information on the extent of their added payment liability to the contractor[68]. It is was also contributing to perpetuating the systemic muddle.

Needless to repeat, due to predominant expenditure centric approach and lack of commitment and sincerity to embark on the path to performance budgeting system[69] the allocation efficiency criteria are yet to be the basis of budget formulation which may help to overcome many of the systemic deficiencies. More worrying phenomenon in recent years is that during the mid-year review of the budget, a system of downsizing the expenditure as well as revenue targets has been most common without following a democratic process. Thus, the democratic parliamentary process including a system of check and balance is violated or broken. It is not limited to this. A system of transferring budget has also become most common. In 20020/21, for instance, out of the total audited budget, the total transfer was as much as 40.5 percent[70]. This again was in addition to off budgetary practices[71]. This means that transfer of budget throughout the year, large spending or resource assurance commitments outside the budget and abrupt reduction in the budget allocation in different heads in the mid-year budgetary review not only violates the budgetary rules but also fully undermines the physical and other targets set in the budget. All these are making the budget predictability and credibility a major issue. In such a system or practices, the probability of worsening aid effectiveness increases further.

As a part of structural or systemic problems, there is a phenomenal rise in the current expenditure with negligible growth in the capital expenditure with capital expenditure increasingly becoming insignificant compared to the current expenditure. The added problem is that, apart from phenomenal rise in current expenditure compared to capital expenditure partly driven by shallow fiscal balance and fiscal stability approach as indicated above, an asymmetrical tendency in the execution of current and capital expenditure is perpetuating since long. The current expenditure is spent almost to the level that is made in the budget proposal whereas in the case of capital expenditure the actual spending is in the neighborhood 73 to 75 percent[72]. In recent years, the situation has further worsened. For instance, in the fiscal year 2021/22, the actual capital expenditure compared to the estimates has reduced to 57.23 percent[73]. Added to such a tendency, now the financing component has started exceeding the level of capital expenditure due to the fast growth in debt servicing liability and increased government resource liability of the public enterprises.

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[67] See CIAA 2020 for details.

[68] Such a problem was indicated in the Auditor General's Report of 2018 and 2019. The white paper of the government in 2019 claimed that such an accumulated liability of the government outside the budget has reached around Rs 800 billion. It has been reported that such a liability outside budget is about Rs 500 billion in Ministry of Physical Planning alone.

[69] Though generally program budgeting is suggested before adaptation of performance budgeting system, the deepening systemic crisis in the budgetary system entails on such a necessity. At the same time, a zero based budgetary system can be an added component of such a system.

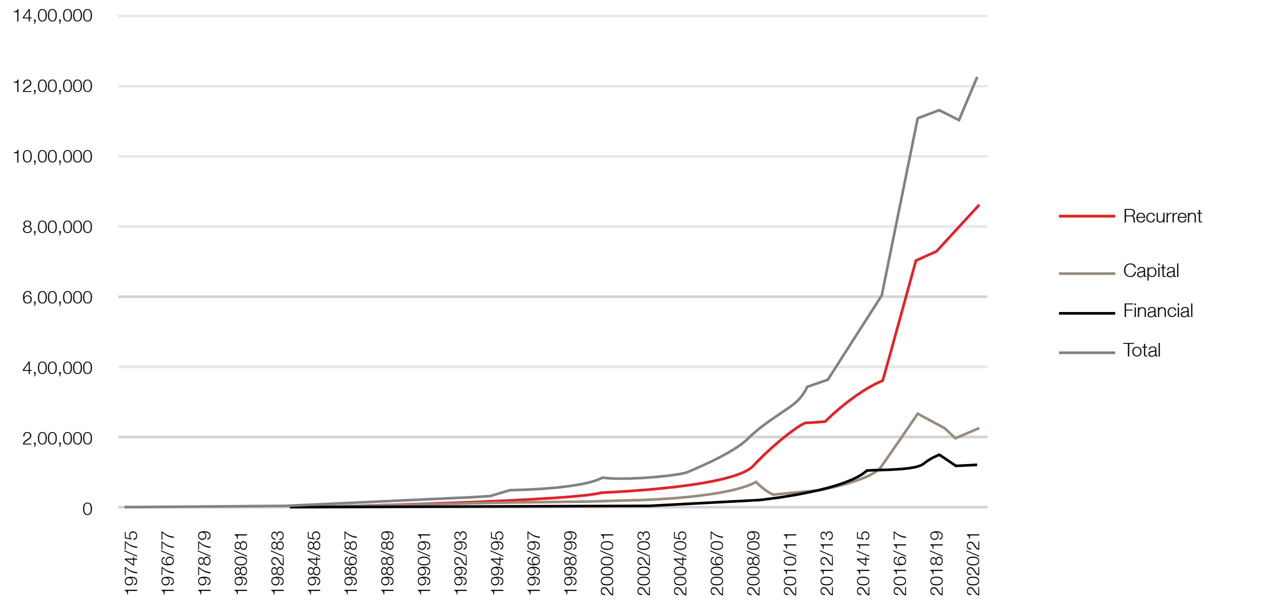
[70] See AGR 2022 in which the details of the transfers in the fiscal year 2020/21 are given. It shows that a big chunk was transferred in the last of month of the fiscal year 2020/21. The situation might have worsened in the last fiscal year 2021/22 as the information furnished by the FCGO reveal.

[71] The off budgetary practices are two types. One, as discussed above, is through multiyear contract window and another and equally common is a regular type driven by political influence or politics of appeasement to serve certain interest.

[72] For a recent trend analysis see WB 2021.

[73] See daily revenue and expenditure reporting of the FCGO (July 17 2022).

Graph 3.14 Trends in Recurrent, Capital and Financing Expenditure 1974/75 to 2020/21



Source: Economic Surveys (Various Years), MOF.

More concerning from the operational efficiency and budgetary management point of view is that out of the total capital expenditure a large chunk is spent in the last months of the fiscal year in general and last seven days of the last month in particular. The Auditor General's Report 2021 shows that out of the total budget around 23.37 percent was spent in the last month of the fiscal year 2020/21 and in that about 6 percent was spent in the last week itself. The situation has further worsened in the fiscal year 2021/22. In this fiscal year, about 36 percent of the capital budget was spent in the last month i.e., June/July. As such, expenses are made in such projects, programs and activities where fast spending is possible. For this, one of the means employed is the transfer from the unspent heads. This brings mismatches between budget allocations in various programs and actual expenses leading to misallocation and mismanagement of resources. It makes the prioritization and fixation of targets in the budget redundant. It also thoroughly compromises on the quality, poses a threat to durability and sustainability, a big problem[74]. The overall situation is not encouraging even in projects that the government is proud of as indicated by the Auditor General's Report of 2021. All these additionally prove that there are serious systemic problems in fiscal and budgetary management having an adverse effect on aid effectiveness.

3.5 EFFECTIVENESS OF INGO SUPPORTED PROGRAMS

The INGOs are playing important role in Nepal in the areas of disaster relief, human rights, education, health, and poverty alleviation, among others. Instant relief and rehabilitation of the people badly affected by the earthquake of 2015 is one of the memorable works done by the INGOs. During COVID-19 the role and support of the INGOs has also been equally vital. Many of the INGOs are working in remote and backward areas and are helping to construct roads, schools, and health facilities etc. They also undertake training and capacity development programs at the local level. Uplifting of marginalized people is one of their focused areas. They have also played a key role in supporting local organizations to carry out development activities in the backward areas. Now their programs are largely guided by the SDGs. They also take account of Aid Effectiveness agenda to some extent. Often their advocacy in restoring fairness and equity in the global aid system has been a positive contribution to be beneficial to the low-income countries like Nepal.

Notwithstanding their contribution, still there is an average trust deficit for INGOs. In many instances direct funding without channeling through government treasury and lack of transparency has continued the credibility gap. There have been procurement related issues. The sustainability of INGO funded programs has also been a matter of debate and discussion. Often political motives of some INGOs create controversy in societies. All these have limited the overall effectiveness of their programs despite constructive contribution by some INGOs in critical sectors and areas.

[74] Coincidently, in the last month of the fiscal year the rainy season intensifies and hence roads and other construction works carried in hat month becomes just like water in the sand.

Chapter 4

Conclusions and Way Forward

Conclusions and Way Forward

4.1 CONCLUSIONS

1. After inflow of international aid for the first time in 1951, a continuous expansion in aid has taken place in Nepal over the years despite fluctuations and exceptions in some years. Nepal's efforts to mobilize aid is aimed at overcoming underdevelopment and accelerating the tempo of socio-economic development as well as commitments of the global community to support poor countries like Nepal for such purposes contributed to this. Sweeping political changes over time and the rising expectations of the people equally played a vital role in this. Noticeably, the increased inflow of aid for such a crucial role was expected on the premises that aid being additive to the domestic saving and fulfilling larger investment gap will spur, among others, growth and productivity leading to enhanced self-reliant development overtime. Such positive outcomes were anticipated on the presumption that both development partners and aid recipient countries like Nepal will play very constructive role towards better utilization of aid for maximizing returns. But by the early 1980s, many poor countries like Nepal were on the verge of economic crisis as a result of a deeper foreign exchange crisis amidst larger the BOP deficit coupled with a rise in deprivation, poverty and unemployment as well as slowdown in growth. Thus, in contrast to the expectations, aid miserably failed to accomplish the intended objectives due to the donor's aid behavior as well as internal political economic factors added by undermining of pre-existing structural and institutional barriers.

2. As a part of exploring policy alternatives aimed at better outcomes including those of aid, the IMF and the World Bank, citing the successes of export oriented liberal and marked friendly East Asian countries, came up with SAP, a conditional aid program. Nepal since has implemented all subsequent conditional aid programs including both ESAF and PRSP. Many elements of the WC were also implemented. Through these efforts, Nepal was pushed to embark on the path to market fundamentalism. Also, as a result deregulation, dismantling of highly protection polices, limiting the budgetary deficit, strengthening of economic stabilization, and opening of economy were conditioned. Though these helped to ensure continuous rise in aid inflow with support to social, economic, and infrastructural development programs, a focus on technical aspects without political economy considerations added by very adverse initial conditions including pre-existing structural and institutional impediments led to a worsening in the economic conditions. With the SAP etc. there was a phenomenal rise in debt, inflation, BOP deficit and poverty amidst a very high social cost of adjustment. Across the globe, including Nepal, donor's micromanagement of the economy and loss of economic sovereignty became a major area of concern. Interestingly, this was a period when LDC action plan was under also under implementation in Nepal which in contrast to the SAP had focused on transforming the economy through addressing structural bottlenecks and vulnerabilities. Interestingly, the need of complementing each other was hardly recognized. Though with mounting resentment, more poverty focused conditional aid programs in the form of PRSP were implemented from the beginning of 21st Century across the globe including Nepal. The irony was that widely criticized policies of market fundamentalism were kept intact in regard to aid conditions.

3. Consequently, unlike the customary of blaming recipient countries for the poor aid performance, the need for mutual responsibility of development partners and aid recipient countries was gradually recognized. The Paris Declaration on Aid Effectiveness in 2005, Accra Agenda for Action 2008 and the Fourth High-Level Forum on Aid Effectiveness 2011 were an outcome of it. The 2030 Agenda for Sustainable Development and the Paris Agreement on climate action underscores the need of mobilization of aid and climate finance

massively to accomplish the SDGs and meet the emissions reduction targets. The Development Co-operation Summit 2022 of the Global Partnership reiterated on the need of collective actions for a country-led, result-oriented, inclusive, and transparent aid system. Notwithstanding such positive developments, there are still serious lapses in the aid system from the standpoint of better returns and effectiveness globally as various research and country case studies reveal. The major problem is that the agreed or committed specific agenda and norms are hardly followed and complied with. Still no effective monitoring system is in place which can help in identifying the major gaps and suggest areas where prompt actions and follow up in the true spirit of aid effectiveness would be required. Above all, the current development policies and operational approaches of international development partners are hardly consistent with the broad scope of the 2030 Agenda, its commitment to national ownership and its focus on sustainable solutions benefitting current and future generations. Lack of sincerity in fulfilling the commitments made on climate finance is a major area of concern amidst mounting climate crisis in countries like Nepal that are suffering immensely despite having a very negligible role in generating greenhouse gas emissions. Despite climate resilient development priority in recent years, the agenda has not been properly operationalized through aid. Importantly, the agenda of climate justice though being critical from Nepal and other poor country's perspectives has deliberately been undermined.

4. It is noticeable that Nepal has been continuously involved in the processes of formulating and implementing the aid effectiveness agenda, ranging from the Paris Declaration on Aid Effectiveness to the Accra Agenda for Action and the Global Partnership for Effective Development Co-operation, among others. The publication of development cooperation reports regularly on the status of aid is a part of these processes. Similarly, to make the aid policy compatible with the global commitments Nepal updates its development cooperation policy in certain time intervals. Formally, Nepal introduced aid policy for the first time in 2002 despite plans, budgets and government's policy statements outlining government's policy on foreign aid since the inception of budgetary and planning system. The Aid policy of 2002 was replaced by the development cooperation policy in 2014. This was again replaced by the international development cooperation policy in 2019. Prior to it, some specific new initiatives were also taken. Among them, one was the creation of the Nepal Aid Group in 1976. Similarly, in 2000 a system of Nepal Portfolio Performance Review (NPPR) was also initiated.

5. Largely, all three policies in general and two later policies in particular have tried to bring consistency on the global aid effectiveness agenda in which country ownership, aid alignment with the country's development priority, better results, mutual accountability, and inclusiveness have been given priority. Prevention of aid fragmentation, preferences to budgetary support and need to abide to the country system has been the focus of all these policies. Some reflection of sweeping political change of 2006 and subsequent drastic steps taken in state, political, economic, and social system is found in both 2014 and 2019's development cooperation policy, more so in the later policy. Both have committed to transform Nepal from LDC category to developing one. Some added indications on the SDGs are found in the development cooperation policy of 2019. Both have committed to enhance self-reliance development through among others better utilization of aid. Added features of these are the priority on monitoring and accountability system for which various institutional mechanisms at different levels with the involvement of development partners and government agencies have been proposed. They also recognize the role of civil society and private sector in the implementation of the aid policy. Similarly, all policies dully recognize the important role of INGOs in Nepal's development from grass roots and at the same time stress on the need of inflows through country's treasury and budgetary system in which added focus has been given on better transparent and accountable system within them. Another important feature of the development cooperation policy of 2014 and 2019 is that they have laid down specific responsibilities of the development partners in a way that they feel obligated to comply with the stated policies associated with them. Typically, these policies have also added extra commitments on the part of the

government to convey the message to donors that the government is serious regarding bringing reforms in the areas where there are possible gaps in the implementation of the stated polices. Under such commitments, the enhancing of institutional capacity to strengthen aid management has been outlined. To clarify the aid mobilization authority under the federal system, the development cooperation policy of 2019 broadly in line with the constitution states that such a role fully lies with the federal government and adds processes through which sub-national government which allows the obtaining of aid through the federal government. Typically, the development cooperation policy of 2014 also invites direct lending from the development partners on a turn-key basis. In such policies, climate change has also been covered indicating the need of climate funds for climate related programs. Added to this, in 2021, the GRID approach has been adopted with focus on climate resilient development.

6. With concerted efforts through different means including that of policy inducement, Nepal has been able mobilize all major forms of aid including grant, loan, technical assistance, and humanitarian aid. Nepal has also mobilized aid through INGOs considerably. A closer assessment of the long-term trend of grant and loan shows that in the beginning grant was predominant and then it was replaced by the loan. The loan component increased more rapidly after implementation of the SAP which was further exacerbated by the shift from bilateral to multilateral later aid. One noticeable thing is that after the restoration of democracy in 1990 followed by PRSP and major political changes accompanied by, among others, priority on strengthening durable peace led to rapid increase in the grant again. But after 2011/12, the deceleration in the level of grant augmented there is now a fear of the share being quite negligible in the coming years. Amidst a sharp rise in the debt outstanding and debt servicing liability coupled by both the weakening of revenue performance and a worsening of overall economic performance, it presents as a matter of added concern.

7. The concern further rises when aid effectiveness is gauged based on various direct and proxy indicators. For this, besides examining the relationship between aid and long-term growth in domestic saving, government investment and GDP as well as debt outstanding and debt servicing liabilities, some specific indicators such as aid modality, pattern in aid commitment and disbursement, system of aid inflow, procurement, auditing, mode of payment and monitoring system, pattern of aid fragmentation, inclusiveness and fiscal as well as budgetary management system were assessed. Largely, all these reveal that still there are serious gaps and deficiencies in the entire aid system, constraining enhancement of aid effectiveness to a greater extent.

8. The long-term trends in the growth of aid and domestic saving show that there is no significant inducement to domestic saving through which private saving could be encouraged though no strong substitution effect is apparent. At the same time, despite positive contribution of aid to induce government investment, no strong causal relationship between the government investment and growth is noticed. This is a major area of concern. This corroborates the findings of many studies that the government investment boosted through aid has not been properly channelized toward productive areas with quick and high returns which through spillover effects could have boosted, among others, private investment, and thereby overall growth. The poor growth performance amidst increased inflow of aid in general and loan in particular is further verified when the fast acceleration in debt outstanding in relation to GDP and rising debt serving liability is compared, more so in recent years with increased maturity of past loans. Despite repeated focus and priority on reducing aid fragmentation, no significant improvement is noticed which raises questions on the diversion of aid towards priority areas. It also complicates the accountability of aid. Still, no major shift from project aid to budgetary support is found despite high policy priority to this. More worrisome is that the share of SWAp funding has decreased in recent years. Thus, with no major compositional changes in aid modality, the critical issues of ownership, aid alignment with national development priorities, and utilization of aid with more efficiency have remained largely unresolved. Though a compositional change is not a panacea if internal aid management

is not significantly improved, such a change would a pre-requisite for preventing the escaping tactics of the government and would force them towards major internal reforms.

9. An equally worrisome phenomenon observed based on the data is that with minor exceptions there is no major improvement in narrowing the gap between aid commitment and disbursement amidst high fluctuations in both by aid type. The large gap in commitments and disbursement has had an impact on the sectoral disbursement of the ODA. At the same time, it is found that the sectoral disbursement is neither consistent with the priority set in the development cooperation policy nor is it compatible with the SDGs. In recent years, the highest disbursement has been in the energy sector followed by the transport sector. The education sector which received the highest priority at more than 25 percent in 2010/11 received low priority subsequently though there is some increment in 2020/21. The agriculture sector has also received low priority. The disbursement shows that there has been no balancing approach in the development of production, infrastructure, and services sectors and also, no proper attention has been given to sustainable development. At the same time, less care has been given to aid priority in sectors where private sector has the capacity and can come forward. As an offshoot, another foremost problem is that the larger chunk of aid is still spent directly without being included in the country's budgetary system. Though there is some incremental improvement in this, an added problem is that despite inclusion in the budget again another large chunk is spent directly by the development partners. Besides undermining national ownership, internal procurement, payment, and auditing system bypasses the mutual accountability principle of aid effectiveness to a greater extent. As such, the predominance of aid tying practices remains strong. Thus, the above findings clearly entail that despite a system of regular joint Portfolio Performance Review meetings being a positive development, major core issues of aid effectiveness are still undermined.

10. Inclusiveness has been one of the priority areas since a long time in which the focus is on strengthening of active participation of civil society organizations and the private sector. But despite such a policy focus, no built-in system exists as both studies and experiences entail. The reluctance to provide authorities to sub-national governments as per bestowed authorities provided to them additionally corroborates to this.

11. It is noticeable that, amidst serious lapses among development partners in fulfilling the aid commitments including climate financing, the systemic problems rooted in the fiscal and budgetary management have compounded the problems of aid effectiveness to a greater extent. As is clear, most of the policies and programs including aid policies and programs evolved or pursued must be embedded in or passed through the fiscal and budgetary system. In general, both the fiscal and budgetary management associated with such a system could ensure, that resources are allocated and spent in an efficiently and effective way for better delivery, outcomes and returns. Therefore, financial stability, resource allocation efficiency and operational proficiency are regarded to be the cornerstone of rapid development and transformation of an economy. Today the equity and sustainability dimensions have emerged to be highly important.

12. The major problem of the budget system is that the foremost focus is given on fiscal balance and macroeconomic stability undermining the deepening systemic problems in resource allocations and operational efficiencies. Hardly are the equity and sustainable issues of the budget principles prioritized at the practical level. Also, in fiscal balancing rules which follow neo-liberal orthodoxy, some shallow type approaches are followed which results in the qualitative dimension being largely ignored. In other words, the fiscal balance is fixed with priority while determining the resource position for a particular year's budget without checking the nature and composition of current and other unwanted expenditures contributing to a phenomenal rise in the size of the budget in an unsustainable way. This simply means that fiscal balance is maintained at the cost of capital expenditure, the critical source of which among others, enhancing productive

capacity of the economy. Ironically, in recent years, even such a shallow fiscal balancing principle has been violated for primarily financing burgeoning current and other non-productive expenses.

13. Despite such a worsening budgetary situation posing a threat of bigger crisis, no attention is given to address deepening resource allocation and operational efficiency problems having a worsening economy-wide effect including a very adverse effect on aid effectiveness as already pointed out. Now there are added symptoms of a further rise in budgetary deficit due to poor performance in the revenue mobilization which for the last many years was providing enough space to expand unproductive expenses recklessly.

14. One of the principle means of enhancing the resource allocation efficiencies is regarded as the MTEF which is again supposed to be linked to the periodic plans. However, there are still many deficiencies in the planning system affecting MTEF and budgets markedly. A closer analysis shows that there is no coherency among objectives, overall and sectoral targets, strategies, working policies, programs, and envisaged implementation mechanism in the periodic plans. As such, commitments to align aid with periodic plan set national priorities become questionable with, among others, rooms to manipulations.

15. The MTEF was supposed to be based on input, output, outcome, and impact-based analysis so that program selection and sector priority fixed could ensure resource allocation efficiency and high returns. But today it has been converted into a ritualistic document. Some examples corroborate this. First of all, strangely, all expenses under either current or capital expenditure are treated as projects/programs and subsequently it has been bifurcated into P1 and P2 categories. More objectionably, almost 90 percent of the total budget is earmarked under the P1 category. This means, even in the post new constitution implementation period, no intra and inter sectoral restructuring under the MTEF has taken place. As per the commitments or the need to expedite the implementation of projects and programs from a strategic point of view, the separation of projects and programs in the form of function-wise strategic allocation, SDGs, Gender based, environment related, national pride and transformative may be justified. The irony is that such a strategic grouping has hardly been based on restructuring principles as per the basic rules embedded in the MTEF. This excludes some exception such as that of the shifting or addition of new projects each year under the pride projects category through largely political decision-making processes rather than through prudent strategic yardsticks. Though the establishment of a project bank is a positive move, the budgetary practices reveal no improvement in the project selection and priority determination. Thus, despite a shift in priorities in the successive aid policies, no subsequent initiatives have been there through MTEF which influences the budget to a greater extent. The portfolio review meetings that take place regularly hardly take these issues seriously, undermining the allocation efficiency as a pre-requisite to enhance effectiveness in aid.

16. As an offshoot of ritual or customary practices inherent in the MTEF, the operational efficiency has been worse, which is among others, closely associated with the governance system. There is predominance of sick projects and programs in the capital budget which are major sources of resources drains and hence they derail the expected outcomes. One of the compounded problems is the off budgetary liability to the government accumulated massively since the last several years as a result of a system of resource assurance to the sector ministries by the Finance Ministry based on the list of projects submitted and not covered in the budget. This is a kind of financial anarchism. An equally worrying phenomenon in recent years is that in the time of the mid-year review of the budget, a system of downsizing the expenditure as well as revenue targets is made. Such a practice violates the democratic parliamentary process including a system of check and balance. It is not limited to this. A system of transferring budget has also become most common. In 2020/21,

for instance, out of the total audited budget, the total transfer was as much as 40.5 percent. This again was in addition to off budgetary practices. Likewise, out of the total budget, around 23.37 percent was spent in the last month of the fiscal year 2020/21 and in there to, 6 percent was spent in the last week itself, violating the accountability rules of 2020. The situation has further worsened in the fiscal year 2021/22. The added problem is that, apart from phenomenal rise in current expenditure compared to capital expenditure partly driven by the shallow fiscal balance and fiscal stability approach as indicated above, an asymmetrical tendency in the execution of current and capital budget has been perpetuating since long. The current expenditure has been spent almost to the level that it is made in the budget proposals whereas in the case of capital expenditure the actual average spending has remained in the neighborhood of 73 to 75 percent for last many years. In recent years, the situation has only further worsened. For instance, in the fiscal year 2021/22, the actual capital expenditure compared to the estimates has reduced to 57.23 percent. Added to such a tendency, the financing component has started outstripping the level of capital expenditure as a result of fast growth in debt servicing liability and an increased government resource liability of the public enterprises. A weak and customary monitoring system accompanied by very ineffective oversight institutions including parliamentary committees added by a lack of a proper role to the civil society organizations has contributed to such a worsening situation. All these factors are making budget predictability and credibility a big problem. In such a system or practices, the probability of worsening aid effectiveness increases further.

17. INGOs have played an important role in mobilization aid and financial support accompanied by contribution to augment grass root development, uplifting marginalized people of backward and remote areas, providing relief to the people suffering from big shocks including natural calamities although there are still trust deficits. Largely, mobilization and use of funds outside the budget system and a poor transparent and accountable system have contributed to this. Often, some INGOs over-politicize certain issues and attempt to intervene. The weak institutional and technical capacity of the SWC and its politicization has also augmented credibility problems. All of these factors have equally contributed to derailing the very objectives leading to limiting the effectiveness of their support.

18. The database system is poor in the areas of foreign aid. For instance, there were no readily available data on the profile of foreign aided projects to compare the actual cost, including debt serving obligation and returns with the various components envisaged in the project appraisal. This, apart from the constraint to assess how debt servicing liability compares to the returns in manifesting overtime, creates problems in bringing overall effectiveness on foreign aided projects. This also prevents strengthening transparency and mutual accountability which is key for improving the performance in foreign aided projects and programs.

19. In regard to the multitude of deeper problems of today, the global environment for aid is highly unfavorable. In the post COVID-19 period, there has been a larger financial divide between the developed and developing countries. Similarly, the tight monetary policy of the developed countries added to by the Ukraine war leading to an intensifying geopolitical conflict, fueling prices of food and petroleum products, and the threat of the diversion of more resources towards war has further enhanced such a possibility. On the other hand, Nepal faces the challenges of a smooth graduation from the LDC by 2026 in a nonreversible and sustainable way and accomplishing the SDGs in the stipulated time amidst lagging far behind in number of critical fronts. The deepening climate crisis is compounding problems further. Thus, together with malfunctioning in a number of critical areas, the ongoing business as usual practices will hardly enable to cope with multiple challenges including looming deeper economic crisis that Nepal is facing today.

4.2 WAY FORWARD

1. The foremost and most critical aspect of aid effectiveness is that there should be a strong built-in system in which both the donors and aid recipient countries comply with as per the commitments made at the joint global forums. In this respect, initiatives made in the aftermath of 2022 Effective Development Cooperation Summit of the Global Partnership, to introduce a monitoring framework and to assess the progresses on development cooperation including aid effectiveness agenda regularly at different levels, must be made more robust and effective by ensuring that it is not converted into a ritualistic framework. The development of the monitoring framework for the aid effectiveness agenda (i.e., country-led, result-oriented, inclusive, and transparent) as a basis of evaluation should be closely and more robustly linked with the progresses on the SDGs especially focusing on low-income countries like Nepal which are lagging far behind. This must be pursued which aims to accomplish the SDGs in a stipulated time due to both external and internal reasons. In such a framework climate financing must also be made an integral part. It also should include operationalization of loss and damage fund in the near future as an integrated framework becomes even more essential. Such a monitoring framework if made operational and effective may help to identify the goals in the cases of countries like Nepal who are lagging far behind. This will pave the way to assess the potential resource gap and take new initiatives with the support of the development partners to mobilize additional resources beyond the ongoing commitments. Along with concerted efforts at different levels with a more active role assumed by Nepal in this process, there are some specific areas where more immediate initiatives and actions by the development partners in cooperation with the government of Nepal will be needed which include:

a. First of all, it is necessary that the development partners strictly abide by the principle of country ownership and aid alignment with the development priorities of Nepal.

b. As an offshoot of the above, the first priority should be given to the budgetary support followed by enlarging their contribution to SWAp in which sector coverage should also be extended. In case of project funding also, their support should be directed to the projects which have completed project selection and scrutiny processes through the project bank. As an integral part of these, they should abide by the internal financial management rules including procurement rules. The practice of funding projects outside the budget and making direct payment of many projects included in the budget must be stopped. At the same time, the principle of mutual responsibility must be strictly followed in lieu of fulfilling the formalities through information sharing and participating in portfolio review meetings. It is also equally essential that support provided by the Embassies pass through due budgetary processes in a transparent manner.

c. It is also necessary that as a part of fulfilling the commitments on climate finance, development partners should give high priority on grants in which financing should be guided by the principle of climate justice led resilient development. As such, a review of the GRID funding predominated by loan has to be reviewed. More broadly, on the part of the government, the demand for climate financing should be based on a robust framework in which the climate justice resilient development is embedded in it which in turn will enable to justice the financing claims.

d. As a part of mutual responsibility, it is of urgent necessity that the ratio of disbursement be drastically increased. Abnormally, the larger gap between the commitment and disbursement has had many distortion types and other adverse economy-wide spillover effects. In this context, it is necessary to establish a more functional mutual accountability mechanism in which the joint performance frameworks based on the development targets, including more tangible transparency system are introduced and strengthened for enhancing aid effectiveness. This will enable the reduction of aid tying practices to a greater extent. As an offshoot, more sincere and extra concerted joint efforts must be made to strengthen aid coordination, ensure aid predictability, prevent fragmentation of aid and stop direct implementation of projects and programs outside the budget. It is necessary that development partners abide by the country Public Financial Management (PFM) and procurement systems, among others.

2. As a part of strengthening the federal system, improving inclusiveness, expanding their outreach, and benefitting the people, the present practice of preventing the sub-national governments from their direct involvement in mobilizing the aid has to be reviewed and corrected. Based on the overall authority and expenditure responsibility laid down in the constitution, they should be authorized to do so with an effective coordinating role by the federal government. This will help in building a strong mechanism to promote democratic ownership, better align and harmonize the aid with the needs of the people at the grass root level. This will also strengthen inclusiveness in aid.

3. All aid mobilized by INGOs should also come through the treasury and they should be obligated to abide by the aid effectiveness criteria. The monitoring framework should be broadly the same as that of the global framework in which the basic ingredients of aid effectiveness criteria are embedded. Though this will automatically enhance the role of the MOF, the project scrutiny, coordinating and monitoring capacity of the Social Welfare Council has to be further strengthened. The ambiguity often arising pertaining to the coordinating role of the provincial and local governments on the programs implemented by the INGOs working in these respective areas have to be clarified and resolved.

4. Notwithstanding the need to reduce external aid dependency sooner than later, currently there is an urgency of a larger mobilization of aid to meet the huge resource gap for accomplishing the SDGs by 2030 and mitigate the climate crisis. However, it is necessary that instead of a tendency of switching to loans, there is a need of high priority to mobilize grants by identifying the reasons for the sharp reduction in grant in recent years. Similarly, there is also need of mobilizing FDI in a larger way to the areas from where the country could get maximum advantages. Amidst the rapid rise in external debt outstanding and servicing liability, there is also a danger of an interest hike in the ODA in the post-graduation period. So, priority has to be given on mobilizing grants, at the same time giving due attention with the condition that it comes without violating the aid effectiveness principles which largely has been the customary.

5. The continued practice of imposing conditions by the donors ignoring pre-existing structural bottlenecks, vulnerabilities and institutional constraints has to be stopped by leaving the governments to decide internally in a judicious way is the essentials for internalizing the policy ownership and making the national governments accountable.

6. It is also necessary that the role of the civil society organizations and the private sector is enhanced. A joint mechanism involving government, civil society organization and private sector representatives has to be established to set the aid priorities and more importantly to monitor the progress and receive feedback on raising the effectiveness of aid. Such mechanisms could be formed at the provincial and local levels.

7. It is clear that, along with the development partners complying with the aid effectiveness principles, overhauling of fiscal and budgetary management system is a prerequisite for effectiveness in aid and climate financing and thereby fostering a marked improvement in the performance of the economy in a more sustainable way. For this, revamping of the planning system is also a prerequisite in which apart from strengthening the technical and institutional capacity of organizations involved in the planning wings at different levels, a more robust planning system has to be introduced. In this the main focus has to be given

on ensuring that there is consistency among goals, targets, strategies, policies, sector priorities and resource allocations in programs/projects. In the modern planning system effective implementation mechanism and monitoring and evaluation have to be envisaged making these as an integral part of the planning. Such a system has to be strengthened at the sub-national government level also. For better guidance, the MTEF and annual budgets and also enhance the reliability as well as credibility of the planning as it also acts as a prerequisite. Importantly, there is a need to adopt a more forward-looking transformational approach in the planning to ensure progressive structural transformation in the economy in which resources are moved from low to high productivity sectors and sub-sectors. In such a transformational discourse, a considerable breakthrough in reducing rising developmental imbalances among the provinces must be made taking both historical and contemporary factors into account.

8. As an offshoot of the above, an overhauling of MTEF is a prerequisite to, among others, guide the required reforms in fiscal and budgetary management system. Preparation and institutionalization of medium-term fiscal, budgetary and performance frameworks should be made as the bases of the overall MTEF. In such frameworks, input, output, outcome, and impact criteria have to be an integral part to ensure a much more robust framework. If followed strictly, this will ensure efficiency in resource allocation in which projects and programs which have been acting as resource drains for decades will require dropping, once for all. Likewise, it will help follow a more qualitative approach in fixing fiscal balance targets. The preparation of a medium-term performance framework will particularly compel to move not only towards a performance based budgetary system but also to institutionalize a built-in performance-based criteria in the evaluation and monitoring of the projects and programs to be helpful to overcome from the deep rooted institutional and structural problems. Such a major shift has to take place at the sub-federal level along with a strong focus on strengthening their institutional and technical capacity.

9. To be consistent with systemic reforms in the planning and MTEF, revamping of budgetary system will be necessary through, among others, the introduction of a performance-based system by replacement of the expenditure system at all three levels. A responsive and accountable system has to be present in all institutions that are associated with budget preparation and implementation. In such a process, restructuring and strengthening of institutional capacity with focus on technical capacity enhancement is a must. In such a way, the budget has to be transformed in a way that it besides signifying comprehensiveness, realism and predictability ensures that in a certain time interval the share of the capital expenditure surpasses markedly the current expenditure at the actual level. For this, a massive reduction in the current expenditure predominated by unproductive, wasteful and resource drain type expenses have to be made through bold steps. As a part of this, the resource drain taking place due to the transfer of resources to the public enterprises without justified criteria has to be stopped. In parallel, a major overhauling of the implementation system with a focus on operational efficiency will be needed. For this all the institutions involved in the implementation have to be made fully accountable as already pointed out. As an offshoot, along with a robust monthly working and action plan of each and every project and program in which the procurement plan will have to be developed. A performance-based monitoring system has to be introduced which through built-in indicators will make the implementation system accountable. This will increase the absorptive capacity of the capital budget, massively leading to, among others, a significant raise in the aid disbursement. In this context, the Financial Procedure and Financial Accountability Rule 2019 has to be further revised to prevent its misuse of loopholes and manipulations. It should candidly include a clause which prevents off-budgetary and resource assurance practices. Similarly, more stringent clauses to prevent fund transfers from one head to another should be put into place in which transfers before 7 months and the last month of the fiscal year is made illegal. The time has come to introduce accountability rules for ministers separately. The drama of contracts between the PM and Ministers and

Ministers and Secretaries associated with executing projects/programs has to be stopped as it is a well-known fact that the executive power solely rests with the Council of Ministers.

10. In parallel, a major restructuring of the revenue system is needed to reverse the more recent decelerating trend in revenue and prevent an adverse effect on development programs including its effect on counterpart funds. Such a necessity is further pronounced which compensates for the likely adverse effect after graduation. The priority has to be given to reducing excessive dependency on international trade-based revenue by expanding internal revenue bases. For this, at first the base of the direct tax has to be increased substantially by tapping the untaxed business and other incomes. In the process, a simultaneous focus on formalizing the economy will be required. While doing so, concerted efforts with sincerity to check the parallel economy is required. The policy corruption that is mushrooming in the name of changing tax rules and providing concessions etc. has to be stopped through strong countervailing measures. Similarly, there is need of making the tax system highly progressive to address mounting gap between the haves and have nots. For this, apart from protecting the poor from the higher incidence of highly regressive VAT, the income tax has to be made more progressive. It is also high time that the introduction of highly progressive wealth tax is put into effect. It is also necessary that public sector asset management system is substantially improved so that it may better markedly help the utilization of public sector resources in a sustainable way and generate resources for the government.

11. As a part of overall fiscal and budgetary management, the macroeconomic policy framework rooted in neo-liberalism that primarily focuses, among others, on pro-cyclical fiscal balance must be replaced by counter cyclical fiscal rules to prevent misguided balancing rules. This will compel the government to consider mounting structural problems in resource allocations efficiencies and public expenditure management system. More broadly, the economic policies should create a more favorable environment to the private sector to invest in areas where Nepal has had both comparative advantages and very high future potentials. In this process, priority has to be given to small and medium enterprises. Amidst the banking sector lending at a par with the total GDP of the country now, major changes in the banking and financial policy aimed at massive restructuring of banking sector lending will be essential to ensure that bank deposits are primarily diverted to the productive areas. The economic policies should also pay more attention to attracting FDI inflows including inflows from Non-residential Nepalese (NRN) in priority areas to overcome the larger resource gaps problems. These, in turn, will help reduce aid dependency as well.

12. In recent years the debt crisis is looming in Nepal. It is noticeable that debt distress in poor countries has received global attention. But progress on resolving the debt problem inhibiting development is still disappointing. It should be noted that the measures adopted by the G20, namely the Debt Service Suspension Initiative (DSSI), which expired at the end of 2021, and the G20 Common Framework for Debt Treatments beyond the DSSI have not only been highly inadequate and insufficient but also such initiatives give less priority on debt reliefs issues. Therefore, Nepal apart from devolving a strategy of reducing loan dependency in the long run, from near term point of view pressures, have to be built in a coordinated way for debt reliefs for low-income countries like Nepal. Similarly, there is a need of pressuring for SDR extension with facilities directed exclusively for low-income countries like Nepal.

13. There is a need of the creation of an economy-wide strong data base system in which data on climate change-based loss and damages, project and program wise detailed information etc. as a readily available system could be helpful to strengthen climate justice based planning and budgetary system. A more detailed information on foreign aided project in such a data base will be equally helpful to find out the gaps and improve the performance of the foreign aided projects considerably besides facilitating regular assessment on the debt sustainability issue from the project level.

14. A massive transformation of the governance system at all three levels is a must for enhancing overall transparency and accountability, curbing corruption, checking state and market captured practices, containing crony capitalism, strengthening rule of law, and improving the delivery system efficiently and effectively. Without bold governance transformation, whatever initiatives are made in aid related fronts and others it could be just like a zero-sum game. The institutional and technical capacity enhancement at three levels of government should be part and parcel of such governance transformation.

15. In parallel, there is a need of strengthening oversight and watchdog institutions, among others, through increasing the role of non-governmental organizations including civil society organization. For enhancing participatory, transparent, accountable and responsive system, this is essential.

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