

SUMMARY ON  
**ASSESSMENT OF  
FOREIGN AID EFFECTIVENESS:  
SOURCES, USES AND DEVELOPMENT**

*Dilli Raj Khanal, PhD*

## **INTRODUCTION AND CONTEXT**

After the Second World War there were realizations globally on the need to promote socio-economic development and improve living standards of people in the newly liberated countries from colonial rule as well as other independent poor and underdeveloped countries. The right to aid principle was also being advanced in parallel. Accordingly, besides bilateral, multilateral institutions such as the UN system and Bretton Wood Institutions started to provide developmental aid to the developing and poor countries in an expanded way. Noticeably, when a system of support through aid was initiated at that time, it was presumed that aid besides being additive to the domestic saving as a prerequisite to boost investment will also be instrumental for higher productivity and returns in the economies of aid recipient countries. On the same ground, there were high expectations from the aid in the aid recipient countries.

Along with advancement of a system of aid to the poor countries, a steady rise in aid has taken place in Nepal since the first aid inflow in 1951 in a more systematic way. The need to promote socio-economic development at a faster pace along with sweeping political changes overtime was raising high expectations of the people which impelled for larger aid mobilization in the country. A number of other interlinked factors contributed to this as well. First, Nepal has tried to update aid or development cooperation policy in line with commitments made in the global aid effectiveness agenda. Similarly, as one of the LDCs as categorized in 1971, Nepal has also received priority to receive aid in general and concessional aid in particular from the development partners. Likewise, Nepal is one of the unique countries which have readily accepted the aid conditionality in prescribed form. Nepal has also constantly shown its commitment to implement the agenda set at the UN and other global forums. Nepal's strategic location has also helped for the increased aid inflow to the country.

It was expected that aid being both catalyst and complementary will play a critical role in Nepal's rapid development and prosperity of the country. However, the performance of the economy in different critical areas largely shows a very poor scenario amidst continued expansion in the level of foreign aid. Though relatively satisfactory progresses in health, education and consumption poverty are noticeable, in the areas of growth and its pattern, social services quality, employment, income poverty and income inequality including gender inequality the performance has been highly disappointing. Lately, along with backlog effect of COVID-19, the economy is facing the problem of stagflation which if persists for long will intensify growth, unemployment, poverty and inequality problems further with marked rise in vulnerability of the poor and deprived. This may perpetuate very high inter-provincial socio-economic inequalities further. As such, Nepal may lag far behind towards achieving the SDGs. Though the aid dependency has reduced considerably in recent years, mounting debt outstanding and debt servicing problems has been added by the slowdown in revenue mobilization along with a looming recessionary threat posing as added risk of rise in external aid dependency again. This raises the question on the effectiveness of aid in Nepal.

Indeed, the effectiveness of aid has been a big global problem. Amidst continued aid inflow, many developing countries had faced crisis in both domestic and external fronts beginning from the 1980s. During that time, an impression was created that the aid receiving country's state led inward looking and protectionist policies were mainly responsible for the poor performance or crisis. On the same logic and citing the successes of the East Asian countries, the World Bank and the IMF jointly developed and implemented Structural Adjustment Program (SAP) in the 1980s which contained liberalization as a precondition for aid. The Enhanced Structural Adjustment Facility (ESAF) of the IMF and the Washington Consensus of both the World Bank and IMF followed this in the early and mid-1990s respectively. These had more draconian aid conditions for pushing countries to embark on the path to market fundamentalism. However, such strong conditional programs or agendas imposed grounded mainly on technical reasoning's by undermining the pre-existing structural and institutional constraints including a poor and misguided governance system in the poor and developing countries contributed very little to improve or adversely affected the socio-economic conditions in most of these countries. At the same time, the micromanagement of national economies by the multilateral institutions, lost country ownership and economic sovereignty became a major bone of contention. Consequently, discontent rose markedly across the globe.

Against this backdrop, the Poverty Reduction Strategy Paper (PRSP) was evolved 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. Though program wise its focus was on poverty, social development and governance, it further pushed market fundamentalism via aid conditions. As such, it was criticized widely by terming it as an augmented Washington Consensus. Largely, the PRSP also, unlike its apparent focus, contributed very little or had an adverse effect to the economies and people of the poor and developing countries. It is noticeable that Nepal has implemented all SAP and other conditional programs.

As such, the debate on the underlying reasons for the poor outcomes of the aid continued. Many research findings concluded that due to predominant influence, interest or often control of the donors, the outcome or impact of the aid has been poor or adverse. Consequently, unlike the customary practice of blaming recipient countries for the poor aid performance, the need for mutual responsibility gradually emerged. The Rome Declaration on Aid Harmonization in 2003 followed by the Paris Declaration on Aid Effectiveness in 2005 was outcome of this. As well known, Aid Effectiveness agenda of 2005 laid out five principles which included country ownership, donor alignment, harmonization of procedures and information sharing, managing for and measuring of results and mutual accountability between donors and aid recipient countries. Accordingly, a new beginning of regular review of aid effectiveness grounded on these 5 criteria was initiated. In view of poor outcomes of the Paris Aid Effectiveness agenda a new Accra Agenda for Action was agreed in 2008 for meeting Paris targets. Inclusive participation, delivery of results and capacity development were the major agenda for actions. Again, the Fourth High-Level Forum on Aid Effectiveness held in Busan in late 2011 reaffirmed 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. Importantly, it laid down the international standard on the principles of effective aid and good development. The main principles agreed on in the forum included country leadership and ownership of development strategies, a focus on results that matter to the poor in developing countries, inclusive partnerships among development actors based on mutual trust, and transparency and accountability to one another. Apparently, these agendas tried to shift the major gamut of aid system to a greater extent.

Thereafter, 2030 Agenda for Sustainable Development was adopted in 2015 which, inter alia, necessitated a bigger shift in the development paradigm for accomplishing 17 goals and 169 targets by 2030. Among them, the Sustainable Development Goal 17 stresses the need to strengthen the means of implementation and revitalizing the Global Partnership for Sustainable Development. Similarly, SDGs 13 urges action to combat climate change and its impact having larger implications on climate finance. As an offshoot, the Paris Climate agreement 2015 on climate change can be regarded to be a landmark agreement on the most serious challenge of 21st Century which has committed to limit the global temperature rise to 1.5°C above pre-industrial level. Such a target involves huge resources in the form of climate finance in which the loss and damage cost is estimated to be \$116–435 billion in 2020 and \$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. In principle it is an issue associated with climate justice that has been campaigned by civil society organizations and justice seeking individuals of the globe since long. This has brought the justice dimension to the forefront under the aid effectiveness agenda.

A progress review presented in the 2022 Effective Development Co-operation Summit of the Global Partnership states that the weaknesses of the Busan meeting has been such that it did not result in a agreement on a clear framework to monitor aid effectiveness commitments. After stocktaking, it says that amidst more challenges there is a need of collective action for country-led, result-oriented, inclusive, and transparent aid system. It reiterates the need for future decision-making around such four effectiveness principles and strengthening progress towards the Sustainable Development Goals (SDGs).

It is, however, ironical 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 the current development policies and operational approaches of international development partners are hardly consistent with the broad scope of the 2030 Agenda. Added to this, the developed countries have not fulfilled their commitments on climate finance made back in 2009. In 2009 they had committed to release \$100 billion per year by 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 the COP28 towards creating loss and damage fund and making it operational in two years. 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 besides influencing the policies of the multilateral agencies, opposite to their commitments. Indeed, in the aftermath of COVID-19 pandemic and Ukraine war, there is a rapid rise in finance divide between the developed and developing countries. Now the debt crisis in the developing and poor countries poses a big resource gap problem for the SDGs amidst no tangible progress on debt relief agenda. More precisely, neither the commitments made under aid effectiveness agenda are being fulfilled by the development partners nor are the perpetuated systemic problems of dominant global order changing for a fairer and more inclusive world system. This is a real challenge of today.

Amidst such less favorable developments and or environment, it is noticeable that Nepal has been continuously involved in the processes of formulating and implementing the 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 per global commitments as well as internal priorities and pressures, various initiatives and steps have been taken in Nepal aimed at enhancing aid effectiveness. The publication of development corporation reports regularly on the status of aid is a part of such initiatives. Importantly, to make the aid policy compatible with the global commitments Nepal has updated its development cooperation policy in regular 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 formal aid policy, some specific new initiatives were also taken long back. Among them, one was creation of Nepal Aid Group in 1976. Similarly, in 2000 a system of Nepal Portfolio Performance Review (NPPR) was also initiated.

Against such backgrounds, the present study based on more recent developments in Nepal and globally tries to assess the aid effectiveness agenda by, among others, linking aid with some direct and proxy parameters associated with main ingredients of aid effectiveness principles. The climate finance agenda has also been covered to some extent. While doing so a closer review of the past and ongoing aid and development cooperation policies has been made to gauge the linkages between the aid policies and aid effectiveness. Analyses of the actual trends in aid by type and sources as well as examination of the changing role and contribution of aid in funding government budget are part of the study. Based on the overall assessment, the way forward from the standpoint of enhancing aid effectiveness has been presented at the end of the study. The study is based on government published secondary data sources. It has used both qualitative and quantitative study approach with focus on trend or comparative analysis. Inability to cover aid through the private sector and undertake field visits for the testimony of selected aid funded projects is the major limitations of the study.

## MAJOR FINDINGS

After the first aid policy 2002, improved and changed policies in the form of development cooperation policy and international development cooperation policy were brought in 2014 and 2019 respectively. A noticeable thing is that in all three policies in general and two later policies in particular attempts were made to make them consistent with global aid effectiveness agenda to the larger extent. As such they have focused on country ownership, aid alignment with country's development priority, better results, mutual accountability and inclusiveness. Prevention of aid fragmentation, preferences to budgetary support and need of abiding by country system are the other priorities of these policies. In such policies, climate change has also been covered indicating the need of, among others, climate funds for climate related programs. Some reflections 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 policy, more so in the later policies. Both have committed to transform Nepal from the LDC category to developing one. Some added indications on the SDGs are found in the development cooperation policy of 2019. Both of them have committed to enhance self-reliance development through among others better utilization of aid. Added features of these are their focus 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 fully 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 to improve the transparent and accountable system in them. To clarify the aid mobilization authority under the federal system, the policy of 2019 clearly states that such a role fully lies with the federal government and adds some processes through which sub-national government could obtain aid through the federal government.

Though the coverage of issues and commitments to bring reforms and changes in critical aid related areas including outlining of the responsibilities of the development partners from the aid effectiveness standpoint are positive steps in the aid policies, serious gaps are apparent in the policy of 2019 as well. First, the major shortcomings of the policy as in the past or more so in the changed internal political context amidst commitments to graduate in three years and moving up to the middle-income category by 2030 is that the kind of major shift in the policy direction and corresponding expected support from the development partners had to be incorporated in the policy these are not there. As an offshoot, enhancement of aid effectiveness is expected without bold reforms in the structural, institutional and governance related front. Aid alignment is simply referred to development plans which encompass through serious flaws and lapses. How mutual accountability system will be enhanced is not clearly spelt out. Instead of outlining how the federal system will be used to bring about the required transformation in the economy with the support of development partners, the policies are contradictory to the spirit of federal governance system has further tightened the grip of the federal government on the sub-national developments with respect to mobilization and utilization of development cooperation. The kind of new policy thrust on mobilizing development cooperation through INGOs as per the aid effectiveness global agenda was needed is 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.

The second and major finding of the study amidst major policy and implementation gaps is that there is hardly any strong linkage between the aid policies and aid effectiveness agenda as revealed by the comparative analysis of trends between the aid and some selected direct and proxy indices.

## **GAPS AND DEFICIENCIES**

Largely, serious gaps and deficiencies in the entire aid system are revealed by such a comparative analysis. For instance,

- 1.** 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.
- 2.** Despite a positive contribution of aid to induce government investment, no strong relationship between the government investment and growth is noticed. This means that despite aid contributing to augment social and physical infrastructure development, among others, it has no strong impact on the growth. 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 as well and thereby overall growth. The worsening climate crisis also might have nullified the strong positive outcomes.
- 3.** 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. The compounded problem is that along with the increased dominant share of multilateral donors in total aid inflow, the share of grants has reduced drastically.
- 4.** Similarly, despite repeated focus and priority on reducing aid fragmentation no significant improvement is noticed which raises questions on the diversion of aid toward priority areas. It also complicates the accountability of aid.
- 5.** Still, no major shift from project aid to budgetary support is found despite high policy priority to this. More worrying is that the share of SWAp funding has decreased in recent years. With no major compositional changes in aid modality, the critical issues of ownership, aid alignment with national development priorities and utilization of aid more efficiently have remained largely unresolved. Though a compositional change is not a panacea if internal aid management is not significantly improved, such a change is a pre-requisite for preventing escape tactics of governments and forcing them for major internal reforms.
- 6.** 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 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 the private sector has the capacity and can come forward.
- 7.** As an offshoot of the above, another foremost problem is that the larger chunk of aid is still spent directly without including it 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 a larger chunk is spent directly by the development partners. This 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. This means that despite a system of regular joint Portfolio Performance Review meetings being a positive development, major core issues of aid effectiveness are still undermined. The bigger problem of releasing the compensation is one of the best examples of this.



- 8.** Inclusiveness has been one of the priority areas for 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 is operational. The reluctance to provide authority to sub-national governments in mobilizing aid as per bestowed authorities additionally corroborates this.
- 9.** It is noticeable that, amidst serious lapses among development partners in fulfilling the aid commitments including climate financing, the internal systemic problems rooted in the fiscal and budgetary management have compounded aid effectiveness problems 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. 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 the equity and sustainable issues of the budget principles are prioritized at the practical level. In fiscal balancing rules also following neo-liberal orthodoxy some shallow type approaches are followed in which fiscal balance is maintained at the cost of capital expenditure, the critical source of, 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.
- 10.** Despite such a worsening budgetary situation posing a threat of a bigger crisis, no attention is given to address deepening resource allocation and operational efficiency problems having economy-wide worse effects including a very adverse effect on aid effectiveness as already pointed out. Now there are added symptoms of further rise in budgetary deficit due to poor performance in the revenue mobilization which for last many years was providing enough space to expand unproductive expenses recklessly.
- 11.** 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, still there are 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 plans set national priorities become questionable with, among others, room to manipulations. The MTEF now has been converted into a ritualistic document.
- 12.** As an offshoot of ritual or customary practices inherent in the MTEF, the operational efficiency and effectiveness in implementation have been worse which, among others, are closely associated with budgetary and public expenditure management. There is predominance of sick projects and programs in the capital budget which are major sources of resource drains and hence they derail the expected outcomes. One of the compounded problems is the off budgetary liability the government accumulated massively since last several years because 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 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 that also about 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 shallow fiscal balance and fiscal stability approach as indicated above, an asymmetrical tendency in the execution of current and capital budget is perpetuating since long. In recent years, the situation has further worsened. For instance, in the fiscal year 2021/22, the actual capital expenditure compared to the estimates reduced to 57.23 percent. Added to such a tendency, the financing component

has started outstripping the level of capital expenditure owing to the fast growth in debt servicing liability and increased government resource liability of the public enterprises.

- 13.** A weak and customary monitoring system accompanied by very ineffective oversight institutions including parliamentary committees added by no proper role to the civil society organizations has contributed to worsening the situation. All these are making the budget predictability and credibility a big problem. In such a system or practices, the probability of worsening aid effectiveness increases further.

Third, though INGOs have played important role in the 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, 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 the credibility problem. All these derailing the very objectives have limited the effectiveness of their support.

Fourth, still the data base system is poor. This is equally so in the area of foreign aid. For instance, 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 are found. This apart from constraining to assess how debt servicing liability compared to the returns is manifesting overtime creates problems in bringing overall effectiveness on foreign aided projects. This also prevents strengthening transparency and mutual accountability, which is key to improving the performance in foreign aided projects and programs.

Fifth, deepening climate crisis is adding more challenges as Nepal is the fourth vulnerable country in climate change. The melting of glaciers in Himalayas poses a big threat of intensifying climate crisis further. Despite this, Nepal has received low global attention and priority on climate finance. More worrisome is that after graduation the limited climate funds in Nepal also may be discontinued.

Thus, the findings entail that together with malfunctioning in several critical areas the ongoing business as usual practices will hardly enable to enhance aid effectiveness, cope with climate crisis and overcome the looming economic crisis that Nepal is facing today.

## **MAJOR WAYS FORWARD**

Grounded on the above findings, the following major way forward with some better options are presented in the study. The foremost and 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 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 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 monitoring framework making 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 progress on the SDGs especially focusing on low-income countries like Nepal which are lagging far behind in a way to accomplish SDGs in stipulated time due to both external and internal reasons. In such a framework climate financing also has to be made an integral part of it. Along with operationalization of loss and damage fund in the near future such an integrated framework becomes even more essential. Such a monitoring framework if made operational and effective may help to identify the goals where countries like Nepal 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 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.** 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, priority should be given to budgetary support followed by enlarging their contribution to SWAp in which sector coverage should also be extended. In case of project funding, their support should be 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 grant in which financing should be guided by the principle of climate justice led resilient development. As such, a review of 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's resilient development is embedded in it which in turn will enable justify the financing claims.
- d.** As a part of mutual responsibility, it is urgently necessary that the ratio of disbursement is drastically increased. 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 systems are introduced and strengthened for enhancing aid effectiveness. This will enable us to reduce aid tying practices as well to a greater extent. As an offshoot, more sincere and extra concerted joint efforts have to 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's Public Financial Management (PFM) and procurement systems, among others.
- e.** 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 must 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 strengthen inclusiveness in aid.
- f.** All aid mobilized by INGOs should also come through the treasury and they should also be obligated to abide by the aid effectiveness criteria. The coordinating and monitoring capacity of the Social Welfare Council has to be further strengthened.
- g.** Notwithstanding the need to reduce external aid dependency sooner than later, at the moment there is urgency for 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 loan, there is a need of high priority to mobilize grants by identifying the reasons for sharp reduction in grants 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 rapid rise in external debt outstanding and servicing liability, there is also a danger of interest hike in the ODA in the post-graduation period. So, priority has to be given to mobilizing grants, at the same time giving due attention that it comes without violating the aid effectiveness principles which largely has been customary.


- h.** The continued practice of imposing conditions by the donors, ignoring pre-existing structural bottlenecks, vulnerabilities and institutional constraints must be stopped by leaving the governments to decide internally in a judicious way which is essential for internalizing the policy ownership and making the national government accountable.
- i.** 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 get feedback on raising the effectiveness of aid. Such mechanisms could be formed at the provincial and local levels.
- j.** Along with 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 ensure marked improvement in the performance of the economy in a more sustainable way. For this, revamping of the planning system is also a prerequisite.
- k.** 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 overall MTEF. In such frameworks, input, output, outcome and impact criteria have to be the integral part for ensuring a much more robust framework.
- l.** To be consistent with systemic reforms in the planning and MTEF, revamping of budgetary system will be necessary through, among others, introducing performance-based system by replacing the expenditure system at all three levels. A responsive and accountable system has to be there 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 must be transformed in a way that 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 through transferring resources to the public enterprises without justified criteria has to be stopped. Parallely, major overhauling of the implementation system with focus on operational efficiency will be needed. For this all institutions involved in the implementation have to be made fully accountable.
- m.** The Financial Procedure and Financial Accountability Rule 2019 has to be further revised to prevent its misuse through 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 there in which transfers before 7 months and the last months of 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 well, knowing the executive power solely rests with the Council of Ministers.
- n.** Parallely, major restructuring of the revenue system is needed to reverse more recent decelerating trend in revenue and prevent adverse effects on development programs including effect on counterpart funds. To compensate for the likely adverse effect after graduation also, such a necessity is further pronounced. 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 into untaxed businesses


and other incomes. In the process, simultaneous focus on formalizing the economy will be required. While doing so, concerted efforts with sincerity to check the parallel economy has to be there. 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 a need to make the tax system highly progressive to address the mounting gap between the haves and have nots. For this, apart from protecting the poor from a higher incidence of highly regressive VAT, the income tax has to be made more progressive. Now the time has come to introduce a highly progressive wealth tax. It is also necessary that the public sector asset management system is substantially improved that could help better utilization of public sector resources in a sustainable way and generate resources for the government markedly.

- o.** 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 us to consider mounting structural problems in resource allocations efficiencies and the 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 comparative advantages and has 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 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 productive areas. The economic policies should also pay more attention to attracting FDI inflows including inflows from Non-residential Nepalese (NRN) in priority areas for overcoming the larger resource gaps problems. These, in turn, will help reduce aid dependency as well.
- p.** In recent years debt crisis is looming in Nepal. Therefore, Nepal apart from devolving a strategy to reduce the loan dependency in the long run, from a near term point of view pressure must 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 such a facility exclusively to the low-income countries like Nepal.
- q.** There is a need of creating economy-wide strong data base system in which data on climate change-based loss and damages, project and program wise detailed information etc. should be readily available which 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.
- r.** 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 the 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 could be like a zero-sum game. The institutional and technical capacity enhancement at the three levels of government should be a part and parcel of such governance transformation.
- s.** Parallely, there is a need of strengthening the oversight and watchdog institutions by among others, increasing the role of non-governmental organizations including civil society organizations for enhancing a participatory, transparent, accountable and responsive system.

**COUNTRY OFFICE**

 Apsara Marga, Lazimpat  
Ward No. 3, Kathmandu, Nepal

 P.O. Box. 6257

 Tel.: +977(0)1 400 2177

 Email: [mail.nepal@actionaid.org](mailto:mail.nepal@actionaid.org)

