

Eyeing for External Resources: Wants and Ways

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Abstract

External resources have shaped the making and breaking of the nations. In the past, the rulers dominated the source or provider of external resources while in the present days, the rulers (political leaders) are under the domination of resource providers (be it a government, agency or company). In the period following World War II, the United States rose to prominence politically and economically. The 21st century is seeing the rise of China. This study deals with the methods and practices relating to foreign aid and investments that have evolved and looks into their hold on Nepal. The study shows that the availability of external resources started with a goodwill approach. However, over time it has moved onto the sphere of influence of the resource providers while the governance failure has made the country more and more dependent on external resources failing to adopt safeguard measures.

Keywords: Foreign aid, foreign direct investment, donor, economy, development

Introduction

There is mixed evidence of foreign aid contributing to development. If it is used for consumption instead of investment it would not contribute to economic growth as shown by the studies (Griffin, 1970), (Boon, 1996). Aid needs to be appropriately tuned up. Otherwise, uncontrolled foreign aid will be counter-productive creating a space for corruption while failing to deliver results with limited percolation to the poor or the targeted population. In many instances, the aid inflows have perpetuated corrupt behavior, as bureaucrats and ruling elites take it as a means of generating revenue and a source of employment for their coterie that makes them more powerful while deteriorating the quality of governance (Sharma, 2013). Studies also showed that aid is effective only in the presence of a sound economic policy, as the evidence does not show the link between openness and aid effectiveness and democratic regime and aid effectiveness in the case of Nepal (Adhikary, 2024).

A benchmark was even set in the 1970s by the United Nations that the donor country should provide aid to the tune of 0.7% of its Gross National Income (GNI) (Clemens, 2007). But so far only five countries (Denmark, Netherlands, Norway, Sweden

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and Luxembourg) have done so while other donors are still behind. Following the establishment of the United Nations Development Programme was established by the UN General Assembly in 1965, provide multilateral aid got started with the establishment of IMF, World Bank Group, and other regional financial institutions like the African Development Bank, Asian Development Bank etc. while Asian Infrastructure Investment Bank was the latest to join in 2016 (Smolaga, 2017). While the UN mobilizes funds from the members to provide humanitarian and development support in the form of grants to needy countries, other multi-lateral agencies extend loans and/or invest in equity of the project or undertaking company while part of the initial appraisal could be in the form of grants.

Method of Study

This study is based on secondary information drawn from manuscripts, published studies, and Nepal government budgets and economic surveys. The information has been processed and analyzed to look at aid or investment purposiveness as well as intendedness.

Review of Literature

The benevolence of providing aid, so to say foreign aid from the recipient's perspective got started from strategic perception on the part of the provider.

- a) Earliest form (military assistance): Prussia in the 18th century provided military assistance to its allies which is attributed in essence as foreign aid (Brittanica, 2024).
- b) Modern form (economic support): The US doled out a package known as the Marshall Plan to rehabilitate the economies of WWII ruined 17 European countries. With the US and USSR rivalry turning into the Cold War, developing and keeping allies got strategically instrumented with providing of aid. Other countries also followed suit (McKinlay, 1977).

Further, in the 20th century following the end of WWII the rich countries, apart from bilateral support in the form of grants or loans, initiated establishing multi-lateral institutions to help out the resource requirement of needy countries on eligibility grounds. Besides, the private sector emerged helping to enrich itself by way of off-shore investment or FDI and sharing the richness by way of charity directly or through trust or charity organizations.

- a) Bilateral assistance: This constitutes aid given by a government directly to the government of another country or a local NGO therein for the sake of political stability (on the strength of humanitarian and developmental effects) strategically aiming at the protection of allies and thereby upholding common interest. The US initiated it through Truman's Four Point Program of 1949 which provisioned economic assistance to independent low-income countries (McKinlay, 1977).

Multilateral assistance: As an international bank for reconstruction and development, the World Bank started operations in 1946. Its first loan was provided to France in 1947 and Chile became the first non-European country to receive a loan amounting to USD 13.5 million in 1948 for hydroelectric power generation. Apart from monetary, the Bank also initiated technical assistance and has also included NGOs as aid recipients. Its affiliate organization the International Financial Corporation (IFC), established in 1956, also lends out and makes equity investments in private enterprises (International Finance Cooperation, 2024)

Offshore investment: ‘The current international corporate tax regime for taxing the business proceeds of firms operates arbitrarily. As a result, multinational business decisions are distorted by tax considerations’ (de Wilde, 2015). When the advantages are higher than the home country and it is legally doable such investments are made to get additional benefits. This is happening as many countries to attract foreign investors offer tax incentives as such offshore investment takes place in tax havens.

Foreign Direct Investment (FDI): When an entity based in one country purchases in another country of asset (land and building) or equity of an ongoing or new company, it constitutes FDI that provides a total or shared ownership in a business. It is an inorganic investment if it is buying a company and is called organic if it constitutes an expansion of operations of an existing business in the target country (Hayes, 2023).

External Resources to Nepal

Foreign Aid

Nepal was a self-contained nation in isolation till 1950 with people in subsistence while ruling Rana families were in enrichment. This was due to pocketing more of the state coffer that went less to the people. The state coffer was constrained by providing land as ‘*birta*’ to the family members and conduction of trade sans income-tax i.e. for the state: exports of resources (woods from the jungle and people from the hills), and imports conducted in collusion with businessmen (who were locals mostly Newars). After 1951, when the state needed extensive resources for fostering development the state coffer was in a pitiable state. The 1951 budget broadcast over Radio Nepal (as there was no legislature) indicated NPR 30 million as revenue and NPR 52 million as expenditure with a deficit of NPR 22 million (Basnet, 2023). In such a situation Nepal looked towards foreign aid as a possible option since prominent nations had already started offering aid and multilateral agencies also started their operations in developing continues to meet their resources gap.

NGOs like the Ford Foundation and United Mission to Nepal were quick to dole

out resources. Nepal joined the Colombo Plan in 1952 which was started to assist the developing countries of Asia and the Pacific region in their economic and social development (Micinski, 2017). Most importantly, aids were received from two far-off Cold War poles which had started aid diplomacy to turn the uncommitted nations into allies. They considered Nepal, which was just out of isolation, of strategic importance that it should not be grabbed by other political hegemony. The US with which Nepal established diplomatic relations in 1947, initiated its aid providing NPR 22,000 under an agreement signed on January 23, 1951. The US went on to provide aid that helped develop roads, establish telephone exchange, eliminate malaria from Tarai and enable growth in agriculture during the 1950s. The aid flow surged in the 1960s, when US President Dwight Eisenhower pledged USD 15 million to King Mahendra in April 1960 for the sake of Nepal's development (Adhikary, 2024).

Following the establishment of diplomatic relations in 1956, the Soviet Union also initiated its assistance in 1959 which covered the development of physical and industrial infrastructure that contributed to building roads and hospitals, plus the establishment of power generation and manufacturing plants (cigarette, agri-tools, sugar, rosin and turpentine, etc.) (Ministry of Foreign Affairs, 2024). Neighboring countries India and China also wanted to maintain good relations because of Nepal's strategic importance and their desire to create a sphere of influence. Upon the establishment of diplomatic relations in 1955, China started providing aid to Nepal. Aid assistance from China helped develop roads and airports, manufacturing industries and conference halls (Ministry of Foreign Affairs, 2024). After becoming independent from the British Raj, India signed a peace and friendship treaty with Nepal in 1950. While it assisted in democratic change in 1951 with the signing of the Delhi Compromise, the aid assistance started in 1954 by setting up the Indian Aid Mission which remained till 1966 as it helped develop roads, industrial estates, etc. (Adhikary, 2024).

Other bilateral donors joined later. The foremost was Israel with which diplomatic relations were forged in 1960. Nepal then stood as the only country to recognize Israel from this part of Asia, and Israel assisted in the development of cooperatives and townships (Bharatpur at Chitwan in particular) and machinery of transport (Poudel, 2020). Pakistan, after establishing diplomatic relations in 1962, connected an air link with Nepal and offered free trade access with transport facilities through the port of Chittagong (which was part of the then East Pakistan) (Nepal, 2022). Despite the formal diplomatic relations forged in 1923, the United Kingdom was a little late to come out to aid Nepal by initiating fellowships in the early 1950s and providing volunteers since 1964. The grant aid got started much later. Japan started

providing aid to Nepal in 1969, even though diplomatic relations were established in 1956. The aid started with commodity loans and technical cooperation while a year later grant aid got started. Japan's support has covered health, education, transportation as well as irrigation and power facilities (Shrestha, 2016). Other countries including France, Australia, Korea, and others joined later in providing aid to Nepal.

Meanwhile, Nepal was able to get assistance from multilateral donors comprised the World Bank Group, Asian Development Bank, etc. The shift came when the Nepali economy faced hardships in the 1970's. On the whole, by the end of the 1980s, aid flowed into Nepal from 11 UN agencies, 7 multilateral agencies, 8 private agencies and 17 countries (Shrestha, 2022).

The dependency on foreign grants for development was almost total till the mid-1960s and got lowered with domestic contribution on the rise. Another shift was seen from 1970 onward with major funding coming from multilateral agencies as compared to bilateral donors with an overall shift occurring from grants to loans:

- Loan share in aid: from under 4 percent between 1965-70 to more than 25 percent by 1985-88
- Aid dependence: as a percentage of GNP increased from under 8 percent to almost 13 percent between 1984 and 1987
- Debt service: as a percentage of GDP increased from less than 0.1 percent in 1974-75 to almost 1 percent in 1987-88
- Outstanding debt: increased from NPR 346 million to almost NPR 21 billion between 1984 and 1987

The contribution of aid continued to increase to 22% in 1990. As per the World Bank, official development assistance to Nepal was USD 8.2 million in 1960 which increased to USD 369 million in 2003 and then fell to USD 177 million in 2004. As per government data, total foreign aid committed in fiscal year (FY) 2003 was USD 555 million, with 63.3 percent in grants and 36.7 percent in loans which fell to USD 320 million in FY 2004 with 37.7 percent in grants and 62.3 percent in loans (Goossenaerts, 2013).

Donors were attaching conditions and wanted to execute the funded projects by themselves after 1990. The Foreign Aid Policy was formulated in 2002, but the flow was disrupted following King Gyanendra's takeover of the rein on February 1, 2005. Following the pluralistic transition in 2006, the aid was resumed. Upon the promulgation of the constitution in 2015, the state of foreign aid in terms of commitment and utilization indicates that grants increased in 2016/17 onward but

utilization of aid decreased significantly over the years as observed from the table below:

NPR million

FY	Approved foreign grant	Utilized foreign grant	Approved foreign loan	Utilized foreign loan
2014/15	91603	38286	134216	25616
2015/16	79204	39544	116395	33228
2016/17	97676	40819	152569	59022
2017/18	84904	39319	117094	92233
2018/19	33429	22899	104826	124372
2019/20	30105	19191	189777	149462
2020/21	27386	26791	197984	107538

Source: Economic Surveys, Ministry of Finance, Nepal

Aid Effectiveness

The government of Nepal stepped up in aid transparency in 2013 setting up its Aid Management Platform (AMP) for public view which put specific sub-nationally geocoded information on more than 600 development projects. The World Bank specified a country assistance strategy in 1998 and introduced a systematic country diagnostic report in 2018 which suggested following differential strategy calling for a) inclusivity in public organizations, b) private sector investment increase of employment creation, c) human capital development, d) utilization of national resources, e) capacity development to deal with national calamities, and f) utilization of migrant workers. It required improvement in budget implementation, transparency and accountability, and using resources to reduce poverty (Adhikary, 2024).

Foreign Direct Investment

In terms of appropriateness and quick progression, Foreign Direct Investment (FDI) is considered better than foreign aid.

To attract FDI, Nepal organized a ministerial conference in 1982 and an Investment Promotion Meeting (IPM) in 1984. While these were encouraging, the IPM held again in 1992 loosened further the foreign investment restrictions. Both options, the parent company creating a subsidiary firm and purchasing an existing one or setting up a new one, are available in Nepal. The 2021 Nepal Rastra Bank (NRB) bylaw on

FDI and Loan Management has provisioned a direct route for offshore investment companies (but not the offshore PE companies) not requiring further approval from NRB or other authorities once the permission from the Department of Industries is obtained. However, in case of investment exceeding NPR 5 million, permissions are required in every stage of investment, divestment, and return of sale proceeds, thus resulting in increased cost and time for decision-making while the process remains to be digitized. Double taxation at exit is not as yet removed which stands at 25% in Nepal on any gains from the sale of investments or even a change of ownership by 50% or more within three years (Pandey, 2021).

There has been hardly an incremental shot of foreign direct investment into Nepal (as it depends on the conditions prevalent in the country) as against the comparative conditions in China and India which did attract foreign investment right through 1990 to the present day. It amounted to NPR 1.27 billion in 1990, NPR 9.03 billion in 1996, and stood at NPR 2.74 billion annual average over 2001-2011. The approved FDI was at its peak during the mid-1990s and thereafter declined due to the Maoist insurgency. In terms of actual receipt, it is considerably low as confirmed by the NRB which reached 2.5% in 2011, that is much lower than Maldives 72.4%, India 6.4%, Pakistan 5.3% and Bangladesh 4%, but better than Sri Lanka (2.1%), Bhutan (2.1%) and Afghanistan (2%) in South Asia (NRB, 2022). According to UNCTAD's data, South Asia witnessed a robust growth of 23% in 2011 and has made incremental showing thereafter. In 2017, out of a world total of USD 1746 billion for 192 countries, China alone secured 133 billion, India 44.5 billion while Nepal could secure only USD 100 million. The FDI afterward does not show an encouraging trend despite Nepal holding another IPM in 2019 owing to clumsy political governance, poor aid effectiveness and business environment. The withholding factors apart from the political instability and resultant policy and legal uncertainty are the poor state of infrastructure and the militancy of trade unions (Adhikary, 2024).

Amidst the policies and the operative framework that simply encouraged trade and financial investment in quick-yielding areas for ensuring nominal margins with large benefits going outside the country, there occurred an unprecedented rise in external dependency. This constrained harnessing of resources within the country and enhancing competitiveness in a way to raise the internal productive capacity of the economy which could generate productive employment in the domestic economy simultaneously. In the absence of this, an exodus of hundreds of workforces daily got underway with almost no possibility of immediate domestic employment generation under business as usual. Around 400,000 enter into the job market every year most of which go to foreign countries as the Nepali economy has failed to absorb them (Adhikary, 2024).

In short, Nepal could not promote exports and attract foreign investment as Nepal failed in infrastructure development causing problems in supplies. Besides, Nepal has faced transit problems being landlocked.

Changing Situation of Accessing External Resources

The state of globalization that heralded in 1990s has changed a little bit swinging to protectionism upon the West wanting to control the upswing of China which it is considering a threat to its security. In this situation, the trends that are appearing concerning external resources indicate the following:

- a. Multilateralism is getting distorted and alliance-centric is getting pivotal which has affected even relief from epidemic/pandemic and climatic catastrophes,
- b. Bilateral assistance is still played on from the donor's perspective as a proportion of aid is intended to address its strategic interest which could be political dominion or hegemonic influence
- c. Control over investment or security of investment is a priority.
- d. In the case of normality what is still on is that passing out funds is subject to business-ability: either a loan that requires a good credit score or an investment that requires a standing on continuity (not halted by regulative off-swing and labor outbursts) and competitiveness (better than the alternative locations).

With regard to Nepal, the aid availability lurked around the following:

- a) US: In the aftermath of 9/11, it got concerned about the growing Maoist activities in Nepal. In this period, the US aid to Nepal was concentrated on increasing the state's capacity to prevent Nepal from becoming a failed state. It has however limited presence. Upon the restructuring of the state between 2006 and 2015, the MCC framework was rolled in which was a case of limited homework by the political leadership in Nepal.
- b) India: Its aid to Nepal covers a wide array of sectors. It is keen to maintain its influence by providing aid from the political to the socio-economic domain. Recently, the government of Nepal and the government of India signed an agreement that allows the Indian side to provide financial aid to projects and institutions in Nepal up to NPR 200 million from the existing 50 million (The Kathmandu Post, 2024).
- c) China: The aid consideration of China was seen primarily due to its concern in Tibet. In the past, China could not influence the political standing of Nepal due to difficulty with border infrastructure. However, over period the state formation has changed in Nepal. China how has built up infrastructure in Tibet and beyond. It seems now keen to help Nepal develop its road infrastructure under its BRI program.

d) Other countries: Lately Russia seems to be interested in Nepal but not much has progressed, while Japan and South Korea are regular aid providers and the UK is continuing aid friendship.

With respect to Nepal being an investment-friendly place (to attract FDI), two bottlenecks still persist:

- a) Nepal lacks its strategic drive towards building resource based economic growth. As such the market connectivity and technological swing remain out of question while the economic health remains afloat by aid and remittance from Nepalis working outside the country. Still, the resource constraint is so much that the government every year is asking for aid for budgetary support.
- b) Instability in Nepali politics has continued. Besides, the decision of one government does not get continuity when another takes over. This makes long-term investment focus out of the question.

Discussion

The external resources do help the developing countries to speed up economic progression but it all depends on its modality. At times, it might become a source of promoting corruption. With respect to foreign aid, what needs to be avoided is:

- a) Asking for budgetary support which is just reflective of the government's ineffectiveness to stay put its survival within the limits of financial capability, and
- b) accepting aid with donors' mindset of pursuing their interest in the disguise of helping out. This would mean doing away with (i) doling out millions in charity support by foreign countries and (ii) providing funds to politicians on an individual basis in any pretext. Both of these are tantamount to making the individual or the group serve the interest of the donor which, in other words, constitutes external state-induced corruption for political dominion. Apart from avoiding these, what needs to be done is to articulate an aid acceptability strategic framework to make it specific to programmatic support on results orientation within limits of resource use efficiency order.

In so doing what matters is the imperative of counterpart funding by the recipient country which would be in the order of 10-20% at minimum. But most importantly a country should rise to the level which does not wait for donors' approval but starts on its own while asking donors to contribute for the sake of completion of the project. This would lead to timely completion of the project within the original investment needs thus achieving the expected resource use efficiency.

What matters with investments is the state of doing business at the basic level, but that alone is not sufficient to attract sufficient inflow. Political orderliness that leads to stable government is required and the way economic progression is eyed

on the conditions of competitiveness that need to be strengthened are critical for investment decisions. Furthermore, investors would still toil with the question of what extra mileage they would get by investing in Nepal as against investing in China or another South-Asian country, India in particular. Nepal as a market or resource base would be one thing, but market or resource base outside Nepal would be entirely another thing. The situations in the past such as investors coming in for readymade garments production hubs that disappeared with the end of the multi-fiber agreement and the Colgate or Ever-ready setting up plants that were closed with the labor trouble do provide learning points (Giri, 2021). How Bangladesh could expand the readymade garments in terms of industrial operation (third country market, technology and raw material but with cheap labor that cannot go on strike in this industry as the political leaders supporting it) also provides a learning point.

Conclusion

In order to eye external resources, Nepal's political leadership needs to decide whether to accept the premise of goodwill or be willing to fall into the donor's domination. As such it has to a) formulate strategic conditions for foreign aid acceptability which is not possible if the political mindset is extractive, and b) operational framework for foreign investments. Concerning the latter, it has to pitch a business favorability comparative to investment-seeking competing countries which is not possible sans political stability and regulative orderliness. The absence of it would mean foreign aid for falling into others' spheres of influence while foreign investments would shy away from venturing into the country.

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