



ISSUE BRIEF
INFRA.DIP #2

TALKING INFRASTRUCTURE

THE ROLE OF AID IN NEPAL'S INFRASTRUCTURE DEVELOPMENT

In partnership with



Introduction

Foreign aid has been a key source of funding for infrastructure development in Nepal. As early as 1953, Nepal received aid from India to upgrade the Tribhuvan International Airport (then called the Gauchar Airport) and the first highway connecting Kathmandu to the Terai and the Indian state of Bihar. [1] Since then, Nepal has received significant bilateral aid for developing infrastructure. India remains a major provider of financial support for projects such as airports, power plants, and roads.

China and Japan are two other major donors to Nepal. China's assistance started in the early 1960s with the construction of the Araniko Highway that connected Kathmandu to its northern border with China. Other Chinese-assisted infrastructure projects included the trolley bus system and the ring road around Kathmandu. Meanwhile, Japan has supported critical infrastructure such as the Kulekhani Reservoir Hydropower Project and the Kathmandu-Bhaktapur Road. Other countries such as the United States, the United Kingdom, and Germany, among many others, have also helped Nepal develop its energy, communication, and transportation sectors.

Among multilaterals, the World Bank and the Asian Development Bank are the biggest providers of aid to Nepal. These two institutions began assisting Nepal in the late 1960s, with the former offering credit to a telecommunications project and the latter to an air transport project as their first major investment. The two have since been at the forefront of financing Nepal's infrastructure with each committing around USD 300–500 million annually. They also account for nearly half of the total foreign aid received by Nepal, [2] most of which have been for infrastructure-related projects. Another multilateral institution that recently entered Nepal is the Asian Infrastructure Investment Bank, which has started investing in Nepal's energy sector.

The nature of foreign aid in Nepal has evolved over the years. Aid today constitutes a lower proportion of Nepal's budget, especially compared to remittance from labor migration and tax revenue. Also, in the past aid mostly came in the form of grants, whereas now loans (albeit concessional) make up the bulk of the aid package. [3] These changes, along with the shifting politics of foreign aid, indicate that it is about time Nepal rethought its strategy for aid and infrastructure. To discuss these issues, the Society of Economic Journalists-Nepal (SEJON) and Policy Entrepreneurs Incorporated (PEI) hosted a public event on 19 April 2021, as part of their *Talking Infrastructure* discussion series. Participants included representatives from the government, private sector and media. Many of them had long experience working with bilateral and multilateral institutions in developing infrastructure in Nepal. In this issue brief, we present the salient points raised during the discussion.

Main Barriers to Effective Aid Mobilization

Low absorptive capacity: Although the amount of aid committed to Nepal has increased over time, the country's low absorptive capacity has prevented it from harnessing available opportunities. Due to poor planning, procurement and management, as well as delays in implementation, projects have a tough time achieving their targeted outcomes. [4]

Lack of project readiness: Despite Nepal's massive infrastructure deficit, the government has very few shovel-ready projects for potential donors to take up. According to Mr. Shree Krishna Nepal, Joint Secretary at the Ministry of Finance, the lack of project readiness with clearly defined outcomes and benefits is a major reason why Nepal fails to attract funds. This unpreparedness can be attributed to a lack of a clear vision of development, the lack of ownership and accountability among political leaders, and low technical capacity of the bureaucracy.

[1] Mihaly, E. B. *Foreign Aid and Politics in Nepal: A Case Study* (London, Oxford University Press, 1965), p. 45

[2] This data does not include the bilateral aid from India and China.

[3] Bishta I. and S. Ghimire. 2020. National Budget 2020/21: An Analytical Review. Nepal Economic Forum.

[4] For more details on challenges to project development, see Issue Brief, *Infra.Dip#1*



Limited capacity to negotiate: A couple of factors limit Nepal's ability to ensure that the terms of project negotiations are in its favor. First, as most government agencies work in silos, the projects are often not designed to maximize their potential. According to Mr. Shiva Raj Adhikari, Professor of Economics at Tribhuvan University, "The government has no robust plans for infrastructure, each project is carried out in isolation, and the government is often unable to show the full impact of the project. All these things affect the level of commitment from donors." Second, frequent transfers of government officials prevent them from being involved in a particular project for a long time. This leads to a loss of institutional memory and officials negotiating with limited understanding of the overall project.

Inadequate donor coordination: The lack of coordination among donors poses a challenge to aid effectiveness in Nepal. [5] The government is trying to improve aid coordination. Towards that end, in 2019 it brought out the International Development Policy, which seeks to align aid with national needs and priorities, as well as to ensure that the Nepali government and the development partners are accountable to each other and to their respective taxpayers. [6] The government has also established the Aid Management Information System, an online portal designed to provide transparent and accurate data on foreign aid disbursement. [7]

Recommendations

Invest in institutional capacity: To increase aid effectiveness, it is necessary to strengthen the capacity of the bureaucracy for project implementation and monitoring. The government should make sustained efforts towards establishing an adequately trained workforce and mechanisms for ensuring accountability and transparency at all levels. These can result in the formulation of good policies, enhance implementation and produce the desired results. It can also build greater trust between the government and donors and make the aid system more efficient. For example, after the government implemented a strong auditing process, donors stopped insisting on a parallel audit, thus preventing duplication.

Streamline technical assistance: Given the lack of capacity within the country, Nepal needs technical assistance to improve project implementation. If properly designed and administered, technical assistance programs can be effective channels for transferring knowledge, skills and technology to Nepal. However, there are severe limitations in the way these programs are currently being administered. The government needs to formulate a clear policy to ensure that technical assistance is aligned with its priorities.

Think beyond aid: Aid is an important source of financing for Nepal's infrastructure. However, given Nepal's huge infrastructure deficit, aid is not going to suffice and Nepal will need to consider alternative sources of financing, including the private sector. First and foremost, Nepal should optimize aid by blending it with commercial finance. This will increase both resource allocation and aid efficiency. According to Mr. Sri Krishna Nepal, Joint Secretary at the Ministry of Finance, such financing models are necessary for risk sharing and for increasing the government's financial viability. Another option is to attract foreign direct investment into the country. On this front, the Nepali government has been largely unsuccessful because it hasn't been able to create a favorable investment climate in the country. An investment-friendly environment includes effective taxation and repatriation policies. According to Ms. Bhawani Rana, the immediate past president of the Federation of Nepalese Chamber of Commerce and Industries, "The repatriation process in Nepal is confusing and time-consuming, as investors have to go through a lengthy bureaucratic process to get their profit. If Nepal is to attract foreign investors, we need to make the entire investment process more investor friendly."

[5] Bhattarai, B. P. The Effectiveness of Foreign Aid: A Case Study of Nepal.

[6] Ministry of Finance. 2019. International Development Cooperation Policy, 2019.

[7] Ministry of Finance. Aid Management Information System for Nepal.



The Society of Economic Journalists-Nepal (SEJON) is an umbrella organization of the professional journalists working to disseminate facts and figures in the economic, business and financial sectors of Nepal.

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Policy Entrepreneurs Incorporated (PEI) is a Nepal-based development company engaged in examining public problems, assessing policy alternatives, and identifying policy solutions in areas of natural resource management, governance, and economic growth.

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