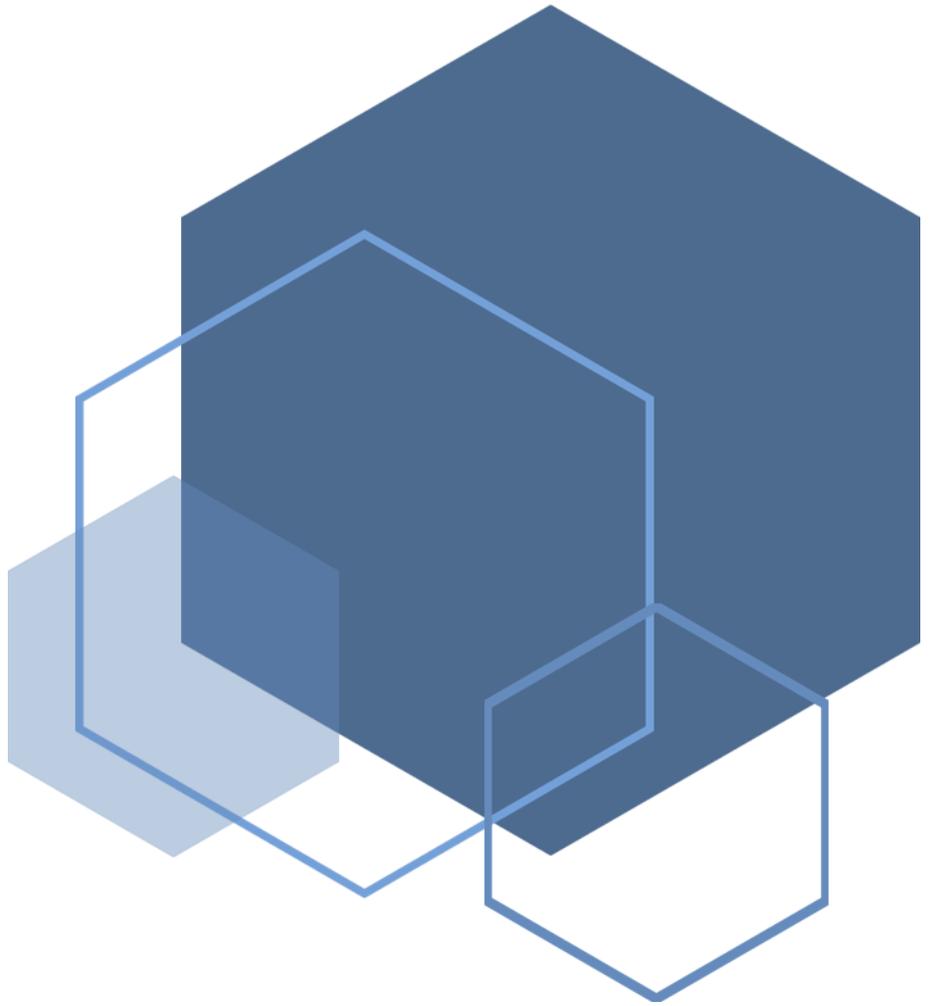


**PROCEEDINGS  
REPORT**



**CONSIDERING THE EFFECTIVENESS OF  
FOREIGN AID: GLOBAL TRENDS,  
CHALLENGES AND IMPLICATIONS FOR  
NEPAL**

PRESENTED BY PIERRE JACQUET—GLOBAL DEVELOPMENT NETWORK  
ORGANIZED BY INTERNATIONAL ECONOMIC COOPERATION COORDINATION  
DIVISION (IECCD), MINISTRY OF FINANCE (MOF)

JULY 27, 2018



## OPENING REMARKS

**DR. RAM PRASAD MAINALI, UNDER SECRETARY,  
IECCD, MOF**

In his opening remarks, Dr. Ram Prasad Mainali thanked UNDP, DFID and NEF for their support and collaboration on the seminar, and highlighted the fact that Nepal is at an important juncture in its history and journey towards development. He emphasized that the path the country takes in the coming years—and the pace at which development continues—will depend a great deal on how the broad reform agenda is concretely translated into public policies, and how successful the country is in mobilizing and managing different forms of finance in support of the Government’s policy priorities.

Foreign aid is a critical part of the financing landscape in Nepal. The country must therefore continually strive to improve the effectiveness of foreign aid that is available. The global landscape of development finance is changing rapidly and it is imperative that Nepal stays on top of these trends and adjusts its internal processes accordingly. Against this backdrop, Mr. Pierre Jacquet’s invaluable insights on global trends in aid effectiveness and implications for Nepal will be an asset to the country’s development strategy and its efforts at improving aid effectiveness.



## KEYNOTE LECTURE

MR. PIERRE JACQUET, GLOBAL DEVELOPMENT NETWORK

### OVERVIEW

The lecture began with an inspection of the origins of foreign aid, with an emphasis on its historically defined as opposed to intentionally designed features, which has strong implications for its nature and measurement. It is well recognized that aid strategy has evolved over time by accumulating political, strategic and moral ideals and is now used to facilitate collective action and accomplish global objectives, such as climate change, by bringing together both donor and recipient countries.

In this context, the lecture explored ways to better rationalize foreign aid policy and highlighted that well governed countries are in a better position to absorb foreign aid than poorly governed nations. The lecture also examined whether foreign aid is indeed ineffective as many proclaim it to be. It identified the positive impact of project aid on local communities and further inspected the sustainability of such projects. This was further explored through an examination of the concept of development, which underscored the need to adopt a broad view of the development process, including but not limited to reduction of extreme poverty. Particular emphasis was given to the importance of country ownership—one of the crucial principles of aid effectiveness identified by the 2005 Paris Declaration on Aid Effectiveness.

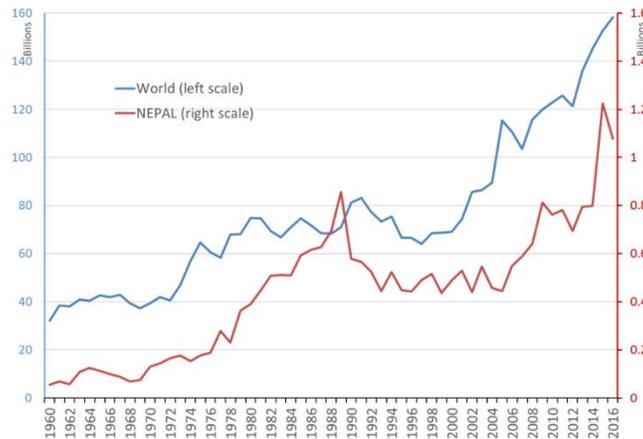
The lecture explored how to recognize, define and build country ownership of development policies and the potential role of foreign aid in this process. It stressed on the need to formulate strategies that leverage the benefits that aid brings to a recipient country and eliminate dependency that it may create in the long run. The lecture concluded by highlighting mutually beneficial policy designs for foreign aid.

## DEVELOPMENT ASSISTANCE: RECENT TRENDS AND ISSUES

The lecture began with Mr. Jacquet recapitulating evidence derived from global trends and statistics in order to link his own research with that in the academic literature in the field of aid economics. A comparison with global trends suggests that foreign aid received by Nepal has followed a similar trajectory to that of the rest of the world (Figure 1). The line in blue represents the total aid received by all countries in the world since the 1960s, and the line in red represents aid received by Nepal in the same period.

He further emphasized that measuring aid effectiveness can be challenging due to its complex nature, which demands a critical approach to measurement. He highlighted that his lecture would focus on six aspects of aid effectiveness: aid and growth, changing objectives of aid throughout the years, micro-macro paradox, aid and development, aid and governance, and the need for aid to be effective.

Figure 1. Net Aid Received in Constant 2013 dollars (billions)



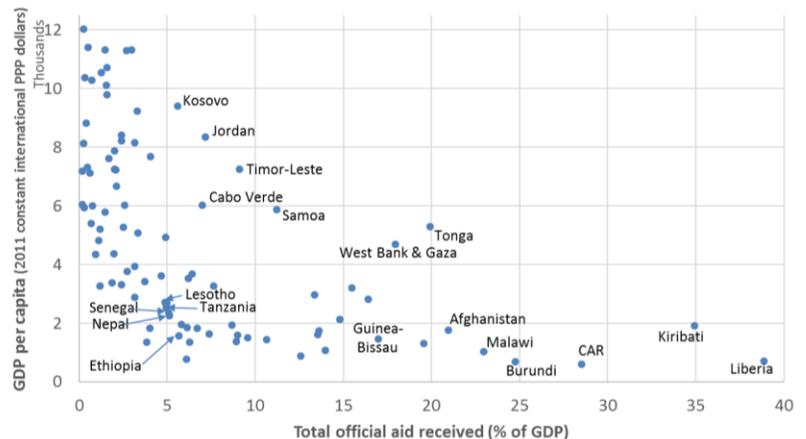
### I. GROWTH

The first area of focus was on the relationship between aid and growth. Figure 2 presents total official aid received as a percentage of GDP against GDP per capita. The graph reveals a negative correlation between the two variables. The findings suggest that contrary to the popular belief that aid drives economic growth, aid is at best a part of the development story and not the driver of economic growth.

In the context of Nepal, a significant portion of aid received is used to finance public expenditure, about 30% in 2016, making the country financially dependent on aid. The ultimate objective of foreign aid should be to make itself redundant. Therefore, the challenge for Nepal now is to manage between the good that aid brings to the country and the dependency it creates. Managing that process so that the contribution of donors is channeled through consistent and deliberate national strategies of development, and is sustainable in the long-term is key for aid effectiveness and also poses a significant challenge for the country.

Nepal is in a unique position as it depends largely on remittances for foreign exchange access. While aid is a public and centralized resource, remittances are decentralized and private. More than 80% of remittances received in Nepal are consumed and do not add long-term value to the economy. The government should look for ways to create incentives in order to channel remittances towards investment. In fact, interaction between aid and remittances could assist this process. Aid can be used to facilitate remittances by allowing lower cost of transaction between people. There are possibilities to think of creative ways to incentivize private individuals and households to invest more in the economy. But, doing so will require innovative approaches.

Figure 2. Aid and GDP per capita 2016 (Low income and Lower middle income countries)



## II. OBJECTIVES OF FOREIGN AID: SUCCESS AND CUMULATIVE TRENDS

Mr. Jacquet then outlined a brief history of aid from a global perspective, establishing that aid has served different purposes at different times in recent history. This was highlighted as an important factor to keep in mind before looking into detail at the question of aid effectiveness. Mr. Jacquet also highlighted that aid is a complex public policy that has evolved by responding to different objectives as presented below:

### **Aid in support of political and strategic interests (1960s)**

Following the periods of the cold war and decolonization in the 1960s, aid was used as a political instrument to attain strategic interests of donors. This was followed by an episode of aid fatigue during which aid did not achieve any significant results.

### **Aid as a moral obligation of the North to the South (1970s)**

By the 1970s, the idea of international world order had emerged which induced a sense of moral obligation among rich nations to transfer aid from the North towards the South.

### **Aid as an incentive to improve policies and undertake structural reforms (1980s)**

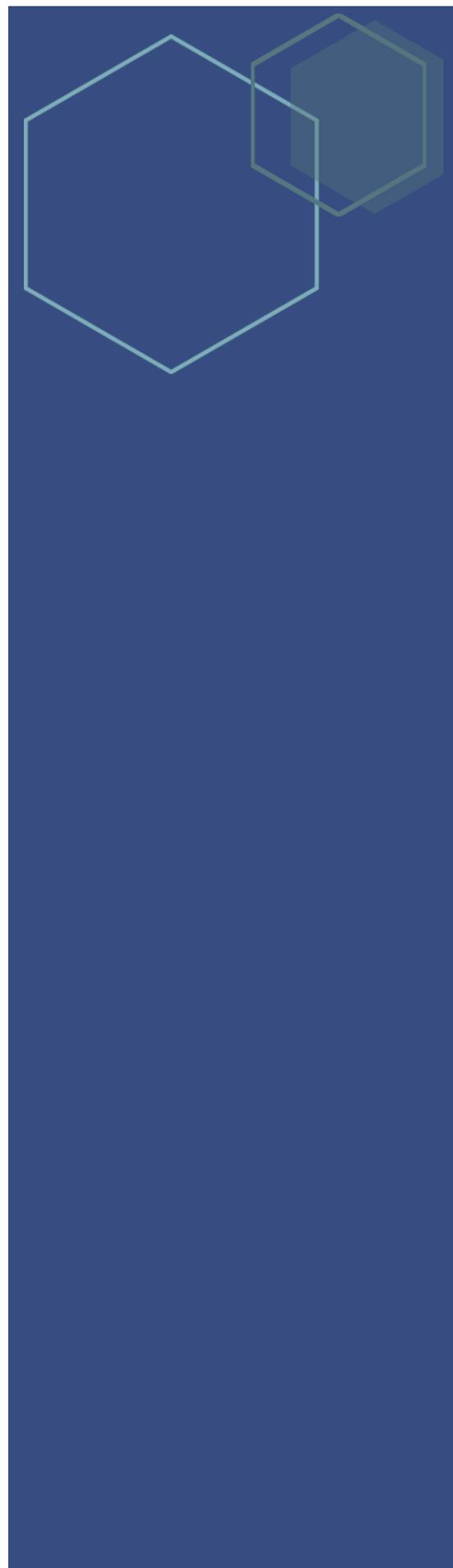
Following the debt crisis and fall of the Berlin Wall in the late 1980s and 1990s a more technocratic nature of foreign aid policy emerged which took away some of the political ingredients for foreign aid. Instead, it was used to undertake structural reforms in target nations.

### **Aid as an instrument to reach specific, quantitative objectives (post 2000s)**

Post 9/11, there was again a political motivation for aid. The issue of security was further compounded by a change in attitude towards migration in developed countries. Donor countries then used aid as a way to stabilize the process of migration and counter security threats. It was also used as a tool to reduce extreme poverty.

### **Aid as the cement of global collective action (present)**

Lately, aid has evolved as a way to encourage collective action on issues of global public goods such as climate change. The Sustainable Development Goals (SDGs) are also driven by this idea in which both developed and developing countries collectively participate to accomplish global objectives. Recognizing aid as a political instrument is crucial for recipient countries to make the best use of aid. Aid has long been used as a technical instrument to reduce global poverty. However, aid is and has always been a political instrument, not only a technical one. It is a verifiable truth that aid is increasingly used to pursue donor interests, as it is their taxpayers' hard-earned money. Therefore, instead of looking at aid from a parochial perspective, recipient countries should recognize the political aspect of aid and make the best of it. Furthermore, aid should be viewed as a contract between the donor and the recipient, where donor countries provide aid in exchange for stability in recipient countries.





### III. MICRO-MACRO PARADOX

The third approach used to understand the relevance of aid effectiveness is to look at the contradiction in that exists between micro and macro-economic impacts of aid. Most independent evaluations conducted in aid recipient countries demonstrate a high rate of success of donor funded projects. Project aid is systematically evaluated and most evaluations show that there is a local, positive impact on livelihoods and poverty reduction. However, no macro-economic impact has been observed as a result of the accumulation of these micro-results, leading to a micro-macro paradox.

Micro-impacts are often related to one single project or donor whereas macro-impacts are generated by all donors in a cumulative manner over time. However, economic growth is not merely the accumulation of sectoral results. In fact, it is a sustained and dynamic process that builds upon the productivity from all sectors of the economy.

### IV. SUSTAINABLE RESULTS

Against this backdrop, Mr. Jacquet underscored another important approach to measure aid effectiveness – development. He emphasized that measuring development or economic growth using basic indicators can be misleading. Development is a complex process which involves interaction between different sectors. However, there is no recipe for development and no amount of foreign aid can drive the desired economic growth. Therefore, the recipe for development has to be engineered locally. **What makes growth last overtime is not the accumulation of factors but the quality of factors that are accumulated. It's not the amount of resources a country is endowed with that matters but the country's capability to effectively mobilize them that makes a difference.** Hence, Nepal will have to endorse its development strategy in a way that its local capital is central to the process. In fact, sustainable development is not a luxury enforced by developed countries, instead, it is a natural way to think about the development process.

According to the World Bank, the world poverty headcount declined from 42% in 1981 to 11% in 2013. Similarly, Nepal has largely succeeded in its fight against extreme poverty, where the poverty headcount declined from 75% in 1984 to 15% in 2010. In this regard, it is hard to conclude that aid has been ineffective in poverty reduction. However, it does not necessarily provide a correct picture of the development process due to two main reasons. First, measurement of poverty is narrow and has not been adjusted for local situations and second, development is not only about eliminating extreme poverty but involves various factors such as reducing inequality and ensuring freedom of expression. Hence, there is a need to remodel the **concept of aid linked to development via poverty reduction strategy.**

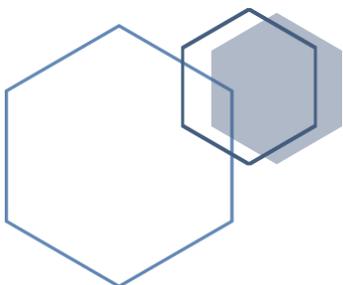
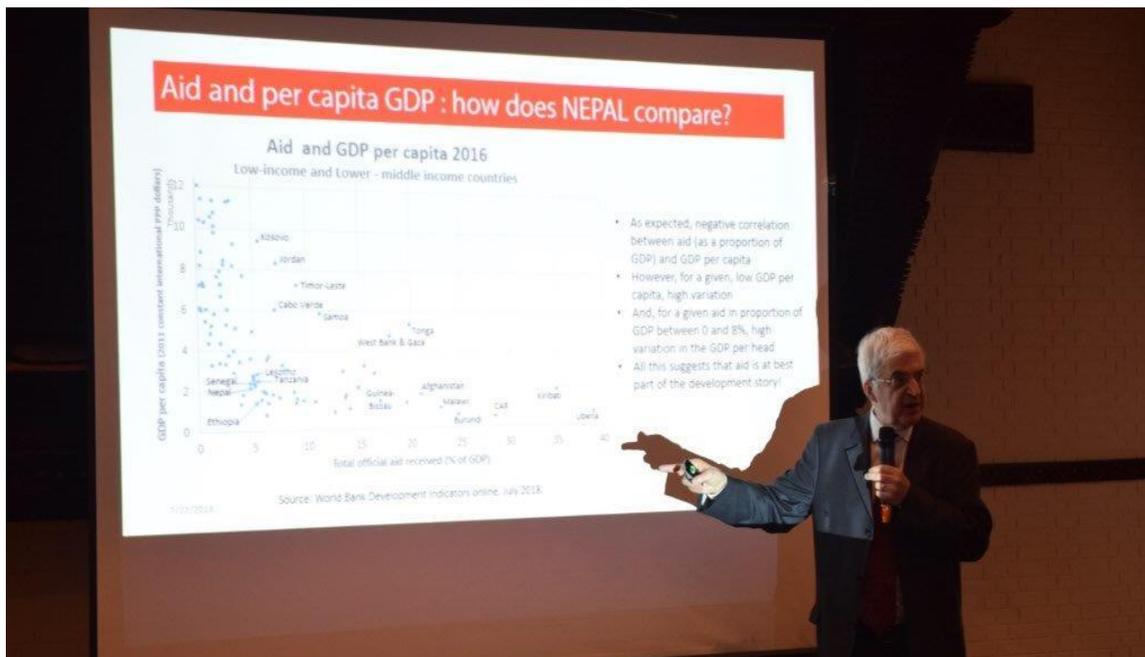
**Disbursement of aid** can have numerous implications for a developing economy. First, aid is capable of financing projects that have direct implications in improving the livelihoods of individuals. Second, obtaining and managing aid may increase the cost of transaction and, as a result, lead to 'relative price effects' which can then displace the private sector from making investments. It may also divert public resources. Third, in case a recipient nation does not have an integrated development plan, aid can lead to opening up of new pet projects, consequently leading to adoption of haphazard model of development strategy. Fourth, aid may result in the release of development oriented fungible public resources in the developing countries. Fifth, aid can create acute dependency, moral hazard and weaken incentives for reform and good governance. Moreover, at times it may also validate poor governance. Finally, supply of foreign aid can lead to a phenomenon known as Dutch Disease. This results in inflationary prices of domestic wages and goods and as a result penalizes export competitiveness.

## V. AID AND GOVERNANCE

Mr. Jacquet continued the lecture by highlighting the implications of aid and its impact on governance. Aid is effective in countries that are well governed. The great paradox is the case that well-governed nations do not usually seek aid. It is weak governments and countries in the early stages of development that want and seek aid as a way to assist and expedite development. Often, aid is mismanaged because of weak governance in such nations.

The book *Violence and Social Order*, by Douglas North, explores the integration of issues of violence into a larger social and historic framework and argues that modernized nations ultimately make the transition from a closed access social order to an open access social order in order to foster political and economic competition. In a closed access social order, an elite group captures the rents through violence and redistributes it through various processes that do not qualify as “good governance”. An open access is a social order where the rents are accrued through a competitive process (democracy and elections; market economy). Development is ultimately the movement from a closed access social order to an open access social order. While no country is fully operating in an open access social order today, it is interesting that the few countries with good governance have largely transitioned to ultimately lean towards an open access social order. Through these observations, it can perhaps be concluded that well-governed countries lean towards an open access social order and are ultimately better at effectively managing their resources.

Bad governance is not a pathology that can be cured by foreign aid or by importing governance characteristics from developed countries into systems not ready to absorb them. The various aspects of the social order – economic, political, social, and institutional – must be in place. It must also be understood that aid has a way to be effective even in institutions where governance is poor. Good governance is a part of the transition process and a larger part of the dynamics of development. Moreover, good governance is not a prerequisite for development but is a pathway that leads to the process of development.

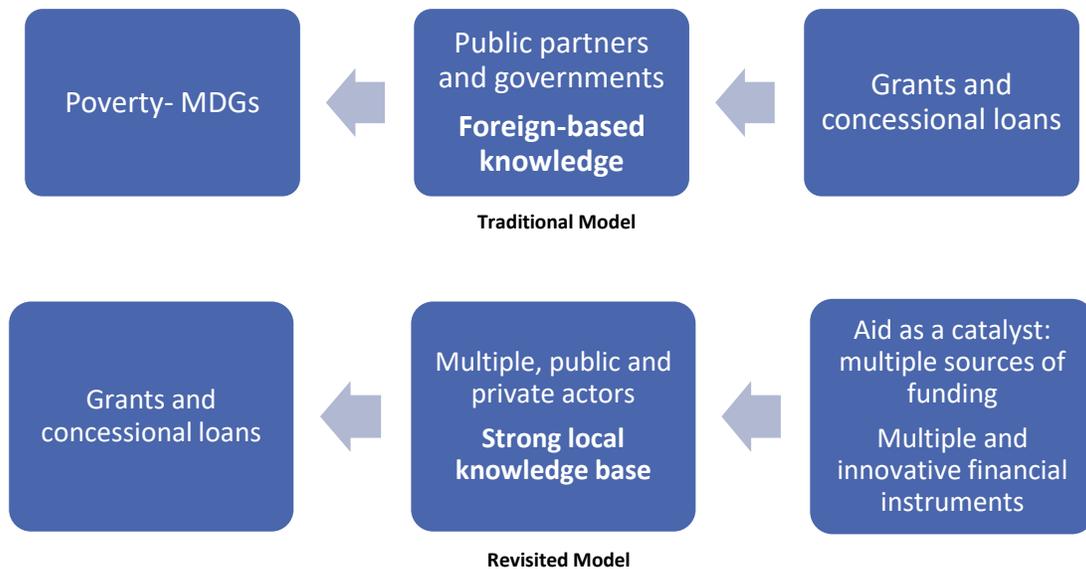


## VI. SHOULD AID ACTUALLY BE EFFECTIVE?

In conclusion, Mr Jacquet addressed the question of whether aid needs to be effective. He concluded that the objective of aid largely affects how effective it is. Distributive justice sees aid as a social transfer from rich countries to poor countries and as an incipient component of global social policy in the governance of globalization. Effectiveness becomes secondary with redistribution as the primary objective under a moral perspective. Corrective justice, on the other hand, looks at aid as a tool to correct basic imbalances and inequalities. Aid becomes a mechanism to compensate for various handicaps and aims to promote catching-up, and effectiveness is a crucial objective. Therefore, aid effectiveness depends on the kind of aid and the process of aid disbursement that is being carried out.

In 2016, the Second High-Level Meeting of the Global Partnership for Effective Development Cooperation (GPEDC) in Kenya identified key points that, if embraced, can make aid more effective. Nations should stress ownership, results, inclusive partnerships, transparency and accountability for aid to be more effective. This should be a collaborative effort of both the recipient nations and the donors. Donors often prefer to use knowledge from the best universities when it comes to aid implementation. They fear that recipient countries lack the best resources, and end up snatching away opportunities to build and hone their capacity. However, the best universities don't always produce the best resources applicable in developing nations. Therefore, donors should make efforts so that developing nations build their own capacity and become capable to be able to implement aid and development strategies independently. Building capacity should be seen as part of development. Recipient countries, such as Nepal, should be able to overcome this problem and actually be able to build capacity for ownership. The importance of local knowledge production and research as keys to promoting ownership (including ownership of foreign-produced knowledge) and balanced discussions with donors are essential to building capacity.

Figure 3. Evolution of Aid over time



In closing, Mr. Jacquet pointed out that the traditional model of aid, in which the instruments used such as grants and loans were provided to public partners and governments and supported by input of foreign knowledge, has many loopholes. These conventional techniques can be made better and thus, must evolve. A more dense and revisited model in which aid is no longer seen as a transfer, but as a catalyst to development must be embraced. Aid should be mobilized through a mix of private and public resources in collaboration with locals. A sustainable development model can only be built with a development process that is inclusive - in which private parties, social stakeholders and the government work together in thinking about development. Furthermore, aid is complex. It is multifaceted and has many objectives, all of which may not always benefit the recipient nation. Thus, it must be understood and absorbed as it is—something temporary. Nations should mobilize aid while working towards sustainable development. Donor and recipient nations must come together to better structure aid so that it benefits the world for the better.



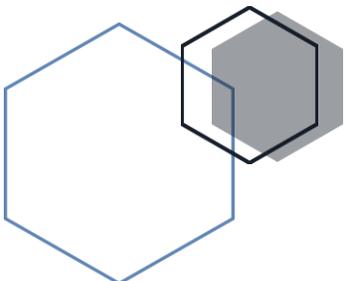
## DISCUSSION

### MR. SHREEKRISHNA NEPAL, JOINT SECRETARY, IECCD, MOF

The open floor discussion saw questions that revolved around the issue of aid mobilization, capacity building and domestic resource mobilization, specifically in the Nepali context. Participants were interested in how an LDC like Nepal could position itself better to be able to effectively absorb aid. Participants also discussed the possibility of increasing donor and recipient ownership and accountability, and how balanced roles could be reinstated among all stakeholders thereby all party interests could be addressed on an equitable basis so that the country's prosperity is at the forefront. There was also a discourse on how aid could be better mobilized in light of the country's transition to a federal structure.

Mr. Jacquet agreed that Nepali stakeholders, both public and private, have to come together for the country's prosperity and stressed that the government of Nepal should pursue a politically, socially and economically driven development vision that is a product of a collaborative effort from all stakeholders. Implementing federalism was presented as a window of opportunity. Mr. Jacquet stressed that bilateral discussions should be at the forefront of negotiating aid terms so that the recipient country's interests are not side-lined. Capacity building along with ownership was highlighted as crucial during negotiations. He stressed that countries like Nepal should leverage aid terms to be able to better mobilize domestic resources to build capacity for their long-term growth.

Mr. Jacquet also stressed that one of the major ways through which aid can improve governance is transparency. Widespread awareness about transit payments invites accountability. This, in turn, invites an informed civic society, and an informed country. This reduces the chances of aid ineffectiveness. Nepal should promote transparency.





## CLOSING REMARKS

**MR. SHREEKRISHNA NEPAL, JOINT SECRETARY, IECCD, MOF**

In his concluding remarks, Joint Secretary Mr. Shreekrishna Nepal thanked Mr. Jacquet for bringing in new dimensions of foreign aid and touching upon the aspects of social justice as an important instrument in effectively mobilizing foreign aid. Blended finance is the future and as a Least Developed Country, Nepal can leverage public-private partnership in order to expedite development. For that matter, MoF/IECCD is looking at ways to use foreign aid catalytically to leverage and blend with other types of finance. Specifically, MoF/IECCD is analysing ways to explore options in order to combine foreign aid with private sector finance (concessional but also non-concessional commercial loans) for big-budget projects. In this connection, as of now, Nepal's debt-to-GDP ratio is low so there is space to take on more debt. This is an avenue that the country can definitely delve into, to be able to tap into the changing architecture of international aid.