STUDY OF TREND AND PATTERN OF PUBLIC EXPENDITURE ON IMPORT

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By

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LETTER OF RECOMMENDATION

The thesis entitle **"STUDY OF TREND AND PATTERN OF PUBLIC EXPENDITURE ON IMPORT"** has been prepared by **Bhuwan Kumar Koirala** under my supervision. I hereby recommend this thesis for the examination by the Thesis Committee as a partial fulfilment of the requirements for the Degree for MASTER OF ARTS in ECONOMICS.

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Thesis Supervisor

Date: May, 2013

APPROVAL LETTER

The Thesis **"STUDY OF TREND AND PATTERN OF PUBLIC EXPENDITURE ON IMPORT"** submitted by Mr. Bhuwan Koirala to the Central Department of Economics, Faculty of Humanities and social science, Tribhuvan University, in partial fulfillment of the requirement for the Degree of MASTER OF ARTS in ECONOMICS has been found satisfactory in scope and quality. Therefore, we accept this thesis as a part of the said degree.

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Despite my almost care and efforts, I bear the full responsibility for any errors and discrepancies that might have occurred in this study report.

Bhuwan Kumar Koirala

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LIST OF ACRONYMS

LDCs	:	Least Developed Countries
DCs	:	Developed Countries
RE	:	Regular Expenditure
TE	:	Total Expenditure
DE	:	Development Expenditure
GDP	:	Gross Domestic Product
FY	:	Fiscal Year
TDE	:	Total Development Expenditure
IDS	:	Integrated Development System
CEDA	:	Centre for Economic Development and Administration.
CEDECON	:	Central Department of Economics
FDI	:	Foreign Direct Investment
GDP	:	Gross Domestic Product
GNI	:	Gross National Income
GNP	:	Gross National Product
GN	:	Government of Nepal
IMF	:	International Monetary Fund
MoF	:	Ministry of Finance
NRB	:	Nepal Rastra Bank
NPC	:	National Planning Commission
PCI	:	Per Capita Income
SAFTA	:	South Asian Free Trade Area
SAARC	:	South Asian Association for Regional Cooperation
WTO	:	World Trade Organization
CBS	:	Central Beauro of Statistic

CHAPTER I
INTRODUCTION

1.1 Background of the Study

Nepal is one of the least developed countries in the world where 25.2 percent of the population is below the poverty line (NLSS, 2012). Consequently, living standard of the people is worsening every year, though large amount of money is being spent from government and non-government organization to uplift the living standard of the people. This situation mainly occurs due to the slow growth of Gross Domestic Product (GDP) as compared to the rate of inflation. However, the process of economic development of a country is highly a complex phenomenon. It is influenced by political, social and cultural factors. Therefore economic analysis provides only partial explanation of this process.

Public expenditure is one of the instruments through which governments influence economic activities. Public expenditure refers to the expenses made by the public authorities' i.e. central government and other local bodies to carter the demand of the people. It is for protecting the citizens and for promoting their economic and social welfare. *Goode* states public expenditure as a means to carry out essential functions of administrating justice and providing national defense and to supply certain additional goods and services that are advantageous to a great society but that would not be supplied by private enterprises because doing so would not be profitable. (*Goode, 1983*)

Public expenditure is the instrument that influences most of the economic activities. It is most important instrument of fiscal policy and has to play significant role to achieve higher rate of growth, higher rate of employment, higher rate of per capita income and equitable distribution of income in the society. In developing countries, the government invariably assumes a development role. In recent years, the stabilization role has been one of the prominent roles.

The government spending of expenditure is of two types, namely regular and development expenditure (current and capital expenditure). The capital/development expenditure is the spending of government in the developmental programs, which

ultimately generates the income but the current/regular expenditure is mostly consumable expenditure. The government can make the private sectors active in the income generation activities.

Economic development is possible by participation of both private and public sectors. Private sector investors are found to be quite negligible mostly in developing countries. The small numbers of investors always try to invest only in those areas where there is higher rate of profit in the short term. But private investors of developing countries are not interested for creating infrastructures. Public expenditure is only responsible factor in the underdeveloped countries, where the base infrastructure for economic development has not been created. Economic development demands cooperation from both public and private sectors. Private cooperation for economic development comes later on.

Public expenditure may have direct and indirect impact on development. Public expenditure on industry and commerce may directly aggregate the economic development. Indirectly, it can help in the economic development by its suitable policies and co-operation with private participants by providing the transportation, communication, health, education and other social welfare programs in the economy. The growing popularity of planning and budgeting in the developing as well as developed countries has given importance to public expenditure. It promotes the pace of economic development.

The main sources of public expenditures are revenue through taxation. Tax collection of the government is two types, direct tax and indirect tax. Foreign aid and foreign loan are other resources of government revenue. In the poor and middle income countries, they play an important role in the economic development. This helps to fulfill the lack of resources of the economy to invest in the large project and this investment is indirectly used as consumption. However, no country can program its development path on the basis of an assumption that such external inflows can be sustained forever. Domestic resources are necessary even in the short-run because transfers or loan available from external sources have their values intact only if the additionally in resource availability it's maintained. (*IDS, 1987*)

Public expenditure is an instrument of state policy. The maintenance of civilian machinery of government providing law and order, justice, and defense of the realm have been its time honored objectives. Important in the well-being of citizens, development of the infrastructure and the promotion of structure change and development in the economy as the objective of the government expenditure policies are of recent origin. Today, debate is joined to the extent to which the state should directly participate in production of goods and services. Nevertheless, it is seen to be continuing to play a prominent role in the area of development and structural change. This has been achieved through the instrument of public loans, subsidies where appropriate, direct investment in enterprises deemed transport communication, utilities, and education and health services as part of infrastructure to sustain development. (*Sharma, 1999*)

In Nepal, the planning system was started since 1956. From the very beginning of planned development, public expenditure policies have been mainly guided by the objectives of accelerating economic growth, better allocation of resources, achieving equitable distribution of income and maintaining price stability. However, the outcomes have not been realized as expected. Therefore, the government of developing countries like Nepal, by increasing their expenditure on economic development and capital formation are making valuable contribution towards increasing income and opportunity of employment in the country. Thus, public expenditure in the developing countries plays a vital role to raise the level of income and employment.

1.2 Statement of the problem

Since 1956, Nepal has started planning process of economics development. But the basic issue of the country has remained the same. Nepal is one of the least developed and agro based country. The government has given more emphasis in the agriculture but the output obtained is not satisfactory. There is large degree of hidden unemployment in the agriculture sector. Private sector in developing countries heisted to invest in areas where returns on capital are not fast. Our economy is dependent on other country's economy and hence imports lots of consumable goods in spite of investing in the new industry. The striking reason for this can be political instability. So the peace has been most concerning issue these days. Irrigation, transportation,

communication, electricity, safe drinking water and local development etc are the insufficient in nation.

- Especially in the sector of government budgetary pattern, there is increasing trend of public expenditure than the government revenue as well as domestic product. It is serious problem of resource gap.
- There is increasing reliance on foreign aid for development expenditure. As the outstanding debt increases, the repayment also increases every year. It brings adverse effect in the economy. Above all, in a situation of low growth rate of economy, growing mass poverty and unemployment, such a review and assessment may enable to mark out the appropriate public expenditure programs that need to be developed and implemented in the prevailing condition of Nepal.
- There is large degree of hidden unemployment in the agriculture sector. Private sector in developing countries heisted to invest in areas where returns on capital are not fast. Our economy is dependent on other country's economy and hence imports lots of consumable goods in spite of investing in the new industry.

1.3 Objectives of the study

The general objectives of the study are to analyze the trend and pattern of public expenditure on import is as follows:

1) To present the trend and pattern of public expenditure in Nepal.
2) To analyze the relationship between public expenditure and total import.
3) To examine the impact of the public expenditure on import in Nepal.

1.4 Significance of the study

Nepal is rich in natural resources. It is still poor and underdeveloped as well as under vicious circle of poverty. In modern era, planning is taken as the main instruments for economic development. Various objectives and policy are made during the planning for the economic and social development. To achieve the objectives, public debt is necessary due to low level of tax payable capacity of the people, firms and institutions mostly in developing countries. Wants and needs are increasing and resources are limited, in such situation, public debt is common and reliable sources for resource mobilization. Similarly, to break the vicious circle of poverty and to improve social

condition of the people, there is greater need of public debt or government borrowing. So, government borrowing has been necessary for developing countries like Nepal.

1.5 Limitations of the Study

This study has following limitations:

1) This study is confined to analyze the growth, pattern and trend of public expenditure. The trend and pattern of government revenue is not analyzed in detail.
2) The study covers a period of 23 years (1987/88 to 2010/11). No comparative study will be done with the period prior to 1987/88.
3) Time and Financial constraint.

1.6 Organization of the study

There are seven chapters in the study and each chapter is further divided into various subsections. The first chapter is introductory portion which gives a general overview of the whole study.

The second chapter is devoted to the review of literature and describe theoretical concept of government expenditure. And, all reviews of literatures are made both in the national and international level as far as possible.

The methodology consist the third chapter that provides information regarding the types and sources of data used in the study. The chapter also presents the hypothesis that are to be tested and the procedure adapted to analyzed data and test hypothesis. Various statistical models and estimation methods to be used are the core of the chapter.

The fourth chapter relates our subject of the study with the scenario of Nepal. The trend and pattern of public expenditure in Nepal are analyzed in this chapter.

The fifth chapter describes the responsible factors for increasing public expenditure.

The empirical analysis to see the relationship between public expenditure and import are concluding in the chapter six. And the last chapter carries conclusion of the study and the recommendations that may be helpful in formulating policies. Bibliography is presented after the last chapter.

CHAPTER II
LITERATURE REVIEW

2.1 Introduction

Public expenditure refers to the expenses made by the public authorities i.e. State Government, Central Bodies and Local Bodies to satisfy the common wants of the public which they cannot satisfy individually. It is for protecting the citizens and/or for promoting their economic and social welfare.

Public expenditure has emerged greater importance modern times for two reasons. Firstly, the economic activities of the state have increased manifold. Secondly, the nature and volume of public expenditure have important effect on production, distribution and the general level of economic activities. Therefore, it is the need of the hour that state should participate in almost every field and the government is responsible even for small matter. Prof. Musgrave advocated that 'Public expenditure should be forced to deal with many day-to day activities like re-allocation of resources, redistribution activities, stabilizing activities and commercial activities'. (*Lekhi, 1995*).

Government spending is founded out of taxes on the income earned by households and/or borrowing on financial markets. It is determined politically, that is government spending influences real GDP but real GDP does not necessarily influence government spending. In this sense, government spending is autonomous of real GDP. Government spending is a political not a strictly economic decision. Technically, most government classifies it into two parts as current expenditure and capital expenditure (Goode, 1983).

In case of literature review of government expenditure, find out the both positive and negative perception towards government expenditure. Government expenditure is not the new and knee concept for the student of economics. It has been discussed, included and expressed by the economists from the beginning of 19^{th} century. The classical, Keynesian, post Keynesian and modern economist have different attitude towards government expenditure which discussed under this chapter.

2.2 Theoretical Review

2.2.1 Classical View on Public Expenditure

The classical economists paid a very little attention to public expenditure as there was no sound classification of the expenditure by central government, state government and local government. Basically, the functions of the government were restricted to justice, police and arms. From the rigid point of view, the government should make least inference in the general activity. The government is the only agent to keep political organization intact.

The classical economists were basically concerned with the activities of the individuals. Individuals lead to the welfare of the society and the policy of Laissez fair in the economy. The classical economists believed in the existence of the full employment in the economy. The classical economists had strong belief that if the resources are already employed there is no need of interference by the government. The classical economists argued that the large amount of government expenditure was wasteful and that the private personal could use resources better. Keeping the balanced budget is one of the notions of them. In a situation of full employment, if the government increases its expenditure without increasing the revenues, this will lead to inflationary rise in price. The budget deficit signifies as increases in the demand for resources on the part of the government without the private sector being willing to release the resources. Thus, in classical theory every budget deficit is inflationary.

The classical thought is that the borrowed expenditure should use only for productive purpose. If it is necessary for the state to borrow, then this borrowing must be confided to the financing of productive enterprises. Otherwise, borrowing will mean withdrawal of resources from their more productive uses in the private sector (Goode, 1983).

To increase in public expenditure, it is necessary to increase in taxation. For this purpose, the government should tax the consumption of the people but not saving, for a tax on saving will reduce the rate of capital formation in the economy. In short classical economist had no faith in the government activities (Lekhi, 1995).

Adam Smith approved government action in those activities where private action is either impossible or socially harmful and where government action promotes social welfare.

The third and last duty of the sovereign or commonwealth is that of erecting and maintaining those public institutions and those public works cannot be expected that any individual or small number of individual should erect or maintain.

According to Froyen (2003), classical economists mistrusted government and stressed the harmony of individual and national interest when the market was left unfettered by government regulations, except those necessary to see that the market remained competitive.

2.2.2 Keynesian view on public expenditure

J.M Keynes (1936) brought the field of public finance as the main stream of economic from the periphery of classical economists. The classical concept of full employment of capitalist economy was dismantling in 1930s when western world felt an unprecedented depression. Keynes came with a new concept of expansion of public expenditure programs to revive the economy from depression. Keynes justified the role of public expenditure in achieving full employment and pushing up the rate of economic growth (Hicks, 1955).

Keynesian contributions have influenced economics in more than one sphere and broadly examined in terms of economic theory, as policy prescriptions to deal with unemployment and as a philosophy that believed in government intervention for managing the economy to minimize unemployment. Keynes pointed out that the fundamental cause of the depression was the lack of spending. The decision to save in the household sector did not necessarily lead to a decision to invest and the government therefore had to step up its expenditures in order to 'Prime to Pump' of the economy. It was recognized that public borrowing absorbed private saving, but such borrowing contributed to greater economic activity, while money retained in the private sector would have more likely contributed to greater unemployment than to increase private investment.

Keynes challenged the classical view that private enterprises economy automatically ensures full employment. On the other hand, Keynes said that employment depends on effective demand and there is no guarantee that there will always be adequate effective demand to generate full employment. Unemployment arises because of the deficiency of demand.

If there are unemployed resources, there is no special virtue in keeping the budget small and balanced. When resources are unemployed, it is the duty of the state to increase effective demand by increasing its expenditure, far from being an evil, a budget deficit during a depression help to raise the level of employment and output. Similarly, when resources are unemployed, it is no longer true that the use of resources by the government is unproductive and inflationary. Therefore, there is no special virtue in not resorting to borrowing form finance for an increase in government expenditure. Similarly, during demand deficiency period it is no good taxing consumption, it is better to tax saving rather than consumption, as we want to raise the level of demand, not to reduce it.

2.2.3 Pigou Approach

The use of the ability to pay theory is the determination of the optimum level of public expenditure has received most comprehensive treatment in the hand of Pigou. Singh explains Pigou's view as that goods and services which are provided by government departments and can be sold for fees so arranged as to cover cost of production pose no problem. The amount of resources that should be devoted to this purpose is determined automatically by the public demand. Nevertheless, fees can cover neither bulk of non- transfer expenditure of government such defense, civil administration and so forth nor transfer expenditure. Hence, there is no automatic machinery to determine how far expenditure shall be carried, and some other method has been employed.

The optimum amount of government expenditure is determined at point at which the satisfaction obtained from last rupee spent is equal to the satisfaction lost in respect to the last rupee called upon by government service, Piogu states that condition when government expenditure would be larger: First, the greater is the aggregate income of the community, the larger will be the optimum amount of government expenditure is.

Second, under the circumstance where new opportunities for expenditure through government are opened up with no corresponding opportunities for the private expenditure, balance between marginal benefit of expenditure and marginal disutility of revenue will be struck at a higher point. Third, given aggregate income and population, greater the concentration of income in the hands of a few rich persons, higher the optimum level of public expenditure. It is because tax scheme can be framed as to rise given revenue with lower marginal sacrifice.

2.2.4 Wagner's law of Expanding State Activity

Adolph Wagner formulated a law of expanding state activity and pointed out the growing importance of government activity and expenditure as an inevitable feature of progressive state. Wagner hypothesized a functional relationship between industrialization and public sector activity. The proposition of the expending state activity is generally interoperated as rising share of public sector in relation to national income. This law seeks to establish that there is a kind of functional relationship between the rate of growth of an economy and the relative growth of its public expenditure.

According to Wagner, the basis causes of the relative growth of government expenditure, is 'social progress'. This factor require, in additional to the provision of law and order, government participation in the production of economic goods, including the provision of certain 'social products' like communication and education. As real per capita income grows, investment in these 'social products' tends to increase which helps to push up the magnitude of government expenditure. As the economy is continuously expanding government expenditure will also tend to continuously expanding.

2.2.5 Peacock- Wiseman Hypothesis

Peacock and Jack Wiseman hypothesis states that the time pattern of public spending trends and highlights the fact that the increase in public expenditure does not follow any smooth and continuous trends but increase in public expenditure occurred in step-like manner. At times, some social or other disturbance takes place, creating a need for increased public expenditure which the existing public revenue cannot meet. In Peacock and Jack Wiseman words, ‘An increasing tolerance level of taxation

following periods of national economic crisis paves the road enlarged public sector." However the approach of the hypothesis is made of three separate concepts:

A) Displacement effect

B) Inspection effect

C) Concentration effect

A) Displacement Effect

Using empirical data for the British economy from 1890 to 1955, showed during the time of war and other social crisis, new higher budgetary levels displaces the existing lower tax and expenditure levels. After the social crisis has ended the newly emerged level of tax tolerance makes the society willing to support a higher level of public expenditure since the society realizes that capable of carrying a heavier tax burden than it previously had. In this way the public expenditure and revenue get stabilized at a new level and still another disturbance occurs to cause a displacement effect. This displacement effect does not require the new higher growth of expenditures should continue with the same expenditure pattern that was created by the social disturbance.

B) Inspection Effect

In the time of crisis, method of raising revenue formerly through intolerable become possible and acceptance of new tax level remains even in the disturbance has disappeared. At the same time, social upheaval improves new and continuing obligations on the government both as the aftermath of functions assumed in war time was a result of social state. War often forces the attention of government and people to the problems of which they were formerly less conscious.

C) Concentration Effect

When the crisis or disturbance is over, the central government enters into many new economic activities and expands previous activities. This causes the increasing role of public sector. In this process, the role of central governments' activities enlarges in proportion to the total public sector activities. This effect has termed as inspection effect, which indicates the trend of declining role of local level within the public sector.

2.2.6 Colin Clark Critical Limit Hypothesis

This theory deals that when the share of the government sector exceeds 25 percent of the total economic activity of the country, inflation occurs even under balances budget. To support this contention, Clark argues that when the governments share of the aggregate economic activity reaches the critical limit of 25 percent ,the income earns are so affected by reduced incentives that their productivity suffers. On the other hand, demand effects of the government financing become quite strong even if the budget remains balanced. All told, inflation results from this maladjustment between demand and supply. The basis effect of Clark's hypothesis is its reliance on the institutional framework of the economy. The choice of define figure, 25 percent, as the critical limit. It would have been more acceptable to assert that in a market economy. Increasing state activity leads to mounting inflationary pressure. As it is, quite a few countries have crossed the 25 percent limit without confronting significant inflationary pressure. Moreover, whether or not government's budgetary activities would leads to inflation also depends upon the manner in which public expenditure is incurred.

2.2.7 Productivity Lag Hypothesis

The Productivity Lag Hypothesis was developed by W.J. Baumol. Sometimes it is also called ‘Baumol’s disease’ (Baumol, 1967). This hypothesis is based on productivity differential of private and public sector. To stabilize the economy when the economy is not automatically stabilized, expansion in public sector is made. While distinguishing progressive and non progressive sectors in the economy, Baumol maintains that to keep the same output level in the non-productive public sector labor input has to be increased tremendously. As a result, public sector expansion takes place at the cost of private sector. It follows that productivity gains are less likely to be experienced in the public sector than in private sector. Hence, there will be inherently greater labor intensity in the public sector compared with private sector. Baumol has given two causes that create ‘Productivity Lag’.

A) Technical barriers opposing innovation in the public sector are higher than in the private sector and
B) ‘Institutional barriers are greater in public sector in comparison to the private sector.

2.2.8 Stanley Please Hypothesis

Stanley Please Hypothesis deals with the cause and sources of increasing government expenditure in Least Developed Countries (LDCs) with its effectiveness and overall impact on economy. According to Stanley Please public expenditure especially for consumption is driven by available resources rather than the other way around. The question is, is increasing government saving by taxation is reality or mirage? Conclusion is, if government increase the tax, theoretically increases in national saving. But increasing in tax rate that implies to spend more: such expenditure is not only increased in investment but also increased in government consumption. So, that increase in national saving is mirage by the taxation. So, Please effect is relevant in developing countries. Stanley suggested some policies in expenditure management.

A) Government should be more rational and more self disciplined in determining public expenditure policy.
B) Expenditure on current activities and alternative uses of revenue should be calculated. Spending on education and health is taken as both current expenditure and capital expenditure as it provided benefit to the country after a lag of many years.
C) In case of foreign loan, the productivity that it yields and the liability that the country has to pay later should be calculated and has to be used in beneficial project.

2.3 Review of Empirical Studies

2.3.1 Introduction

There are many research papers, articles and reports on public expenditure with various conclusions. Different researchers come up with their own findings on the trend, impact and achievement of public expenditure. Some research papers and thesis are concerned with developing economy where as some are concerned with industrial economy. In this regard, it is advisable to review some of the relevant literature both by the international and by the national researchers.

2.3.2 International Context

Taylor (1961) discussed the significance of public expenditure stressed that the expansion of government had often been characterized a movement in the direction of socialism that government obviously tended to socialize through public expenditure. It helped to correct the disorder that had created by cyclical fluctuation, which mostly appeared during the depression. Taylor opined that with the expansion of government activities the objective of strengthening capitalism has been far more evident than the intent to socialize the economy.

United Nation Publication (1979) examined the Patterns of Government Expenditure on Social Services in developing countries, developed market economies and centrally planned economies in the 1970s. The available data on public expenditure for education, health, social security and welfare, and housing are analyzed, and the salient factors and policies shaping the evolving patterns of expenditure are reviewed. Patterns of government expenditure on social services in the developing countries and the policies they reflect tended to add fresh emphasis to the need for considering the provision of social services as part of the integrated process of raising levels of well-being.

Tait and Heller (1982) provided a comparable framework for comparison of a both functional and economic expenditure pattern of having similar economic and demographic position. It further provided an implicit technological norm for predicting the economic characteristics of a country's expenditure pattern based on its choice of priorities for functional expenditure.

Heller, Hemming and Kohnert (1986) examined the impact of prospective demographic trends on the level and structure of social expenditure by the governments of the seven major industrial countries through the year 2025. It attempted to place these demographic factors in perspective with the other factors likely to influence the growth of social expenditure. It also reviewed the key policy issues likely to emerge, both at an aggregate and sectoral level and the types of policies countries have initiated in trying to cope with the effects of these demographic trends.

The World Bank (1988) studied on the Role of Public Finance in Development in 1988. One aspect of sound public finance is the prudent of fiscal deficit. Among other things, this means extending public expenditure to those areas in which the public sector can act efficiently. It also means raising the necessary revenues in ways that distort prices as little as possible. The report has underlined some general conclusion on the public spending in developing and industrial countries.

A) In most developing countries, the share of central government spending in gross national product (GNP) remains below that of the industrial countries. Central government spending as a percentage of GNP is higher in low and middle income countries than in the industrial countries.
B) In developing countries the public sector tends to play a greater role as an investor than in industrial countries. The developing countries tend to need more investment in infrastructure than the industrial countries and the government investment bound to play a larger role in the infrastructure development.
C) In most developing countries states owned enterprises (SOEs) account for important share of both of total public spending and of gross domestic product (GDP).
D) State and local government appear in general to have smaller role in the developing countries than in industrial world. Historically, the growth of public revenue kept pace with that of public spending, but during the past decades, expenditures have tended to grow more rapidly than resources.

Walle and Nead (1995) concerned with the objective: public spending should promote equity by improving the distribution of economic welfare. It has asked: is the redistributive aim being met by current spending practices? What room is there for improvement? The study aimed to bring together some of the best recent research on these questions. Approaches to measuring public spending impacts have used regression analysis on micro data sets to measures the consumer's willingness to pay for services or to quantify impacts on other measures of individual well being. This study brought together recent policy-oriented research on public spending and poverty in developing and transition economies.

Hagen (2005) concerned with the political economy of the budgeting processes and discussed the implications of incomplete contracts of voters with politicians. In view

of these incomplete contracts, politicians can use targeted public policies to ensure their confirmation in office. Because there was a disconnect between those who bear the burden of financing and those who benefit from such policies, such an environment has generated the potential for excessive levels of spending, taxation and borrowing- as is commonly observed in developing countries.

Matthew (2005) concerned with introducing incentives for fiscal prudence in developing countries through the budgeting process. Matthew observed that, some governments have shown interest in reforms aimed at establishing a result- oriented budgeting approach. The emphasis on results or performance in the budgeting process has reflected a belief that public sector accountability should focus on what government does with the money it spends, rather than simply how it controls such expenditure.

2.4 Review in context of Nepal

Singh (1977) studied the expenditure pattern of Nepal government during the period of 1956\57 to 1976\77. Singh found that Nepal government budget show that between 1956\57 and 1962\63 (except 1961\62) revenue was not sufficient to meet even regular expenditure. Since 1963\64, there has been enough to meet development expenditure. Both regular and development expenditure had been rising fast. According to Singh, investment in the public sector, establishment of regional growth centers and decentralization of administration in a number of areas, maintenance expenditure, social service expenditure, increase in salary and debt servicing explain for the growth of Nepal government expenditure.

Integrated Development System (IDS, 1987) has reported that the government expenditure has grown rapidly relative to the country's gross domestic product. IDS found that a major feature of government expenditure in Nepal was the dominance of current expenditure over capital expenditure. In the absence of effective countervailing forces, the former was expending at the expense of the latter.

Khanal (1988) examined and analyzed the growth, pattern and impact of public expenditure on the basis of time series data of Nepal over the period of 1965 to 1981. He has analyzed public expenditure has increased by 8.42 percent. Khanal has found that regular, development, public consumption and public investment expenditure has

increased by 8.66, 8.59, 8.88 and 9.08 percent respectively. Thus trend highlights the fact that consumption type of expenditure have also expanded at a faster rate. Simple growth rate analysis indicates that social services comprising mainly education and health tend to increase at faster rate than other services like economic administrative defense etc. During the period under consideration, the pattern of public expenditure that major expansion has taken place only after the 1970.

Rana (1988) has analyzed the fiscal system of Nepal during the period 1964\65 to 1986\87. With the study, Rana has concluded that there has been constant increasing trend in revenue and expenditure. The trend of increasing in regular and development expenditure have excessively upon foreign aids. The amount of deficit has increased rapidly because of a rapid increase in the volume of regular and development expenditures. During the period under review, regular expenditure has increased from Rs. 117.94 millions to Rs. 4307.10 millions in 1986\87. Similarly, development expenditure has also increased from Rs. 239.91 millions to Rs. 8745.5 millions in 1986\87. Total expenditure taken together has increased. Consequently, a rapid increase in the volume of deficit has been recorded amount into RS. 157.51 millions in 1964\65 to Rs. 7177.5 millions in 1964\65.

Lohani (1993) examined and analyzed the trend of public expenditure, government revenue and problem of resource mobilization. Lohani has concluded that the public sector is draining the private saving towards unproductive regular expenses instead of canalizing it towards productive investment in the study period of 1974\75 to 1990\91. In spite of a tremendous increase in the size the public sector, it has failed to generate surplus requires to finance generate and sustain the process of economic development. Lohani has argued that both macro and sectoral planning have been found to be weak due to the absence of exact cost benefit analysis and program budgeting. Three decade of planning have failed to substantiate a long term perspective plans with a view to maintain consistency among macro and sectoral physical targets on the one hand and ensure necessary to the sectoral programs on the other hand.

Basyal (1994) has carried out a research about growth of development expenditure of the Nepal in different plans periods and resources of financing it. Basyal has underscored the dominance of foreign capital in Nepal's plan financing. During the

fifth (1976\80), the sixth (1981\85) and the seventh (1986\90) plan periods, foreign grants and loans financed the total development expenditure of the extent of 47.3 percent, 48.1 percent, and 59.5 percent respectively. This has clarified as upward trend in the reliance on foreign resources and, consequently, downward share of the revenue surplus in the meeting the development expenditure.

Upreti (1996) has studied government expenditure pattern in Nepal covering the period of 17 years (from 1975 to 1992) using the simple regression analysis method and graphical analysis. Upreti has concluded that the growth of public expenditure in Nepal has taken place rapidly than the growth of GDP of the country. The growth rate of regular expenditure was almost equal to the growth of development expenditure implying that the consumption type of expenditure has also expanded rapidly. Upreti has pointed out that the major chunk of regular expenditure has been gone to loan repayment and interest services indicating the dominance of foreign aid in the Nepalese economy. The trend of allocation of development expenditure has presented the situation that the large percent of development expenditure has gone to economic services, communication, transportation and electricity.

Khadka (1998) has made a remarkable study during the period of 1974\75 to 1994\95. The study has estimated the regression model using cross sectional data. The double log transformation model has been used in the study. During the period under consideration, the size of public expenditure has found to be extremely increasing. It has been observed that the internal revenue has mainly helped to increase recurrent and consumption type of expenditures. Khadka has found the high dependence of development expenditure on external sources. The dependence of foreign aid adversely affects the growth rate of the economy through the sustainable increase in the capital output ratio. In the study period, the foreign aid covered 48.5 percent development expenditure and 31.6 percent of total expenditure on average. Khadka has also pointed out the weakness in both macro and sectoral planning due to the absence of regional cost benefits analysis and program budgeting. The donor agencies have predominantly influenced in determining the sectoral programs.

Sharma (1999) has began has study specified the importance of budget and analyzed the trend of public expenditures for the decade of the 1980s and first half

of 1990; Sharma has found that the regular or non- planned expenditure increased faster than development expenditure during the review period, on the other, large amount of money from development budget was spent on non developmental activities due to not being clear in the concept of regular and development expenditure. These facts helped to minimize the pace of development of the country. Sharma also has presented the various conceptual ambiguities in classifying the budget. Sharma has viewed the expenditure growth in the light of the need to provide efficient public administration and an essential security infrastructure to properly managed development activities and regular services while ensuring stability in the country.

Upereti (2002) emphasized on the performance of public expenditure of Nepalese economy and also assisted in the preparation to develop further policies to reform fiscal weakness. For testing the performance of public expenditure t- test and F - test have been used. In the both tests he found that there is no significance difference between budgeted and actual public expenditure in practice, even if variation exists. Uperati has found both demand and supply side factors contributing to the rapid growth of public expenditure in Nepal. He has explained that public revenue is growing slower than expenditure leading to the widening research gap. This gap is further extended by the weakness of government towards strong commitment, clear vision and sufficient assessment necessary to choose programs and to allocate budget for them in Nepal. This increases the share of foreign aid in development expenditure to bridge the resource gap.

Pyakuryal (2004) has presented that Nepalese economy has lost its productive capital and sustained growth due to the government expenditure and revenue pattern. Pyakuryal found that ratio of regular expenditure of GDP in FY 1996\97 was 8.6 percent but increased to 11.5 percent in 2001\02 on the other hand he found that ratio of development expenditure was decrease with 9.5 to 7.5 percent during the same period, so, Pyakuryal recommended the explanatory fiscal policy is better that contract nary fiscal policy in war time.

Thapa (2004) has made a remarkable study during the period of 1980\81 to 2001\02. Thapa has analyzed public expenditure growth through both supply and demand oriented factors such as targeted income, internal revenue and foreign aid

in order to reveal the likely impact on country's long –term development. He found that the volume of development expenditure is increasing rapidly, in FY 1980\81, total expenditure was Rs. 4092.3 million and in FY 2001\02 it reached Rs. 80072.3 million. Imports also increased from RS. 4428.2 million In FY 1980\81 to Rs. 106731.3 million in FY 2001\02. Nepal's export and import are 60 percent with India and 40 percent with the rest of the world. Imports of most industrial equipment are brought from India. This relationship depicts trade deficit in the economy.

Raut (2005) has made a remarkable study during the period of 1990\91 to 2002\03. Raut has concluded that slow pace of revenue collection compared to expenditure growth in creating fiscal imbalance for which nation has to depend on foreign assistance. Due to the tendency of declining foreign grants and increasing foreign loans, the debt burden of Nepal has been increasing with almost one-third of the regular expenditure allocated for the debt service.

Karna (2007) emphasized on the performance of public expenditure of Nepalese economy. According to Karna, Nepal has completed more than fifty years of its budgetary history. This period is not sufficient to change the poor economic condition of this country but this period would be very significant to lead the economy into the progressive path of economic development. Though Nepal embarked on economic development very late, only in the 1950s and since the considerable public resources development with not worthy progress has been initiated in many years. Government spending on an average is high. Nevertheless, there is considerable evidence that a large amount of these resources has been misspent, which led the incidence poverty around 31 percent particularly in the rural areas where 85.80 percent of people live. In addition to poor use of public resources, Nepal has also been unable to implement a policy framework conductive to high level of economic growth. Although a brief period of economic reform led to a significant acceleration of the economic growth to about 5.6 percent in the early 1990s and since then the growth rate has decelerated to 3.9 percent in the mid-to–late 90s, 2.8 percent in Fiscal Year (FY) 1998\99, -0.6 percent in FY 2002\03, 3.4 percent in FY 2003\04 and 2.4 percent in FY 2004\05.

CHAPTER III
RESEARCH METHODOLOGY

3.1 Introduction

Research Methodology is the way to solve systematically about the research problem. It helps to analyze, examine and interpret various aspects of research works. The research methodology is followed to achieve the basic objective and goals of this research work. This includes; research design, data collection procedures, and tools used.

3.2 Research Design

This chapter presents how and which method the researcher to explain the data has used by using various statistical tools. In this study different techniques have been employed to achieve the above stated objectives. Such techniques are regression analysis, tabular, graphical and descriptive analysis.

3.2.1 Descriptive Analysis

The presentation of trend and pattern of public expenditure is the starting point of the study. Trend and pattern are presented using simple mathematical tools like average percentage. The available data have been reclassified, regrouped and analyzed in order to make them useful in examining the objective of the study. To understand and the information easily, there is used of tabulation of data and its graphical presentation, where necessary.

3.2.2 Empirical Analysis

Various statistical and econometric tools have been developed and utilized to establish the linkage between public expenditure and import. Variables used in the models are defined in the chapter. Regression Analysis method is the basis of estimating statistical econometric models. Different statistical methods of different tests like t-test, F-test, R2–test are employed to identify the significance of the result.

3.3 Nature and Sources of Data

This study is based on secondary data. Secondary data is collected from the various publications of Central Bureau of Statistics, Nepal Rastra Bank, Economic Survey and Ministry of Finance and other relevant publications.

3.4 Definition of Variables Used

Regular Expenditure (RE)

The regular expenditure is recurring types and consumption expenditure, it includes various consumption. The main functional components are general administration, social services, economic services, defence, loan and interest payment and miscellaneous.

Development Expenditure (DE)

Development expenditure are those expenditure which are appropriate and designed to add the productive capacity or the capital stock of the economy, which could raise the level of living of the people expressed in indices of health, food consumption and nutrition, education, employment and condition of works, housing, social security's, clothing, and recreation.

Total Expenditure (TE)

Total expenditure includes that sum of development expenditure and regular expenditure.

Gross Domestic Product (GDP)

GDP includes all those goods and services that have been produced within a country within a year. GDP at market price has used in the study.

Total Revenue (TR)

Total revenue includes both tax and non-tax revenue. Thus, it is the total revenue of the government collected during the year.

Foreign Aid (FA)

Foreign aid is any type of capital inflow or other assistance given to a country, which would not generally have been provided by natural market forces. In this study, the term foreign aid means all types of assistance given to Nepal by foreign nations and agencies.

3.5 Presentation and Data Analysis

Quantitative as well as qualitative methods have been employed for the purpose of data analysis. However, uses of quantitative tools have been employed widely. Tabulation and graphical presentation of data are made to make the information visible as well as understandable easily. Use of quantitative tools has been seen as the best method for the data analysis and also to reach conclusion. Different statistical tools for both estimation and test have been employed as demanded by the objectives, which are specified above. In general, following models of analysis are used.

3.5.1 Regression Analysis

Regression analysis is statistical technique, which deals with the relationship between variables. The main objectives of this model are to predict or estimate the value of variable corresponding to a given value of another variable. Thus regression analysis shows how the variables are related.

To analyze the trend and structure of linear regression equation has been used as:

$Y_{TE} = \alpha + \beta X$ …… (I) $0 \leq \beta \leq 1$

$Y_{RE} = \alpha + \beta X$ …….. (II) $0 \leq \beta \leq 1$

$Y_{DE} = \alpha + \beta X$ …… (III) $0 \leq \beta \leq 1$

Where,

Y_{TE} = Total Expenditure

Y_{RE} = Regular Expenditure

Y_{DE} = Development Expenditure

X = Total Government Expenditure is independent variable

Y = Total Import is dependent variable

β = Regression coefficient which is also known as slope of the regression line. It indicates the amount of change in the value of the dependent variable for a unit change in the independent variable.

$\propto$ = Constant, representing the Y intercepts. The intercept specifies the value of the dependent variable when the independent variable has a value of zero. But this term has practical meaning only if a zero value for the independent variable is possible.

In this study, for simple regression equation GDP is used as dependent variable and total government expenditure, regular expenditure and development expenditure are independent variable. This is due to the expansion of the government expenditure caused by different factors. Among them, the GDP of the country is one which reflects the economic situation and capacity of the country and life standard of the people also.

To examine the linear relationship of the variables or the level of significance and goodness fit in the regression analysis, following statistical measures are used to check the reliability of the analysis.

3.5.2 Coefficient of Multiple Determination (R^2)

Coefficient of multiple determinations explains how good is the fit of the estimated regression line to the sample observations of Y and X. therefore, it is the measurement of the dispersion of observation around the regression line.

R^2 is taken as a measure of goodness of fit as it shows the percentage of total variation of the dependent variable that can be explained by the independent variables of the multiple determinations. The higher the dispersion of the observations from the regression plane, higher the total variation. In other words, closer the observation to the line, the better the goodness of fit, i.e. the better explanation of the variations of Y by the change in the explanatory variables (Aryal, 2002)

The value of R^2 ranges from 0 to 1. If the value of R^2 approaches to 1, the regression plane thus estimated is a good fit and if it approaches to 0, it implies the bad fit. It is because increasing R^2 means explaining more of the total variation by regression plane.

Adjusted Coefficient of Multiple Determination (Adj. R^2)

The value of numerator in R^2 increase with the addition of new explanatory variable that finally affect the presentation of the result and decision made based on R^2 (Aryal, 2002). So, the adjusted R^2 is calculated to overcome this problem.

$$\text{Adj. } R^2 = 1 - \frac{\text{unexpected variation / d.f. for unexpected}}{\text{Total Variation / d.f. for total variation}}$$

$$= 1 - \sum e^2 / n - k$$

Where, n = number of observations, k = number of parameter, and d.f. = degree of freedom.

3.5.3 Test of significance of parameters

It is applied for judging the statistical reliability of the estimates of the regression coefficients. Gujarati defines test of significance is a procedure by which sample result are used to verify the truth or falsify of a null hypothesis (Gujarati, 2004). In order to test the hypotheses, following tests are performed:

t-test

Hypothesis testing or test of significance is different for large and small sample cases. In practice, most of the statistician conclude that a large samples is that which exceed 30 samples units (i.e. n >30). For small sample (i.e. n <30), t-test is applied.

The computed t-test is compared with the tabulated value of a certain level of significance for a given degree of freedom. If calculated value is grater then tabulated value, the null hypothesis is rejected inferring that estimated coefficient is significantly different from zero. It is defined by:

$$t = \frac{\hat{\beta}_i}{S.E.(\hat{\beta}_i)}$$

Where, $S.E.(\hat{\beta}_i)$ = Standard error of $\hat{\beta}_i$

$$= \sqrt{Var(\hat{\beta}_i)}$$

The t statistics has N-k degree of freedom.

N= No. of observation,

k = No. of parameters in the regression.

3.5.4 F-test

This is used to examine the overall significance of the model. It is also a test of significance of R^2. It is also known as the variance ratio test and is mostly used in context of analysis of variance. The value of F must lie between 0 to ∞ .

It is calculated by the following formula.

$$F = \frac{R^2 / K - 1}{\left(1 - R^2\right) / N - K}$$

Where, R^2 = coefficient of determination

K = numbers of parameters and

N = numbers of observation in the sample.

There is direct relationship between F and R^2. The larger the value of R^2, greater the F value. In the limit, where $R^2 = 1$, then F is infinite. The calculated F-variance ratio is compared with the tabulated value at specific level of significance with $V_1 = (k-1)$ and $V_2 = (N-k)$ degree of freedom. The same rule rejecting and accepting the hypothesis are applicable as in the case of t-test.

CHAPTER IV
TRENDS AND PATTERN OF PUBLIC EXPENDITURE IN NEPAL

4.1 Introduction

Budget, a financial statement of the government, comprises expenditure and revenues. It is both economic and political document. Budget is a mirror to look in development activities to be undertaken by the government, which sets a framework for policy formation and implementation. A good budget document contains: (I) overall development policy, (II) size and composition of revenue and expenditure and policy, (III) size and composition of external and internal borrowings and policy, and (IV) actual of previous year, revised estimates of next fiscal year.

Tenth plan (NPC, 2002) has reviewed the ninth plan, during the plan period, the government expenditure of Rs.2784680 million over the targeted expenditure of Rs 3372900 million at the constant price of 1996\97, created the expenditure gap of 17.4 percent. During the ninth period plan, there has been annual average increase of 9.3 percent in the regular expenditure. The share of regular side in total expenditure of the plan was estimated to be 43.8 percent, which has actually increased by 9.6 percentage over the estimation amounting. This substantial increase in regular expenditure has been due to the increase in the salary and previous of civil servants and rise in security related expenditure especially in the last years of plan.

The history of national budget announcement isn't very old in Nepal. The necessity of national budget in Nepal was realized after the establishment of democracy in the country in 1951 and first budget was introduced in 1952. But the budget presented by the Finance Minister of the first elected government in FY 1958/59 is considered as the first scientific budget of Nepal. Due to the increasing pressure for development, first development plan was launched in 1956. The regular budget was meant for meeting the administrative expenditure and development budget was meant for covering annual development activities of the government.

The main components of budget are government expenditure and government revenues. The expenditure is classified into: (I) object classification, (II) functional classification and (III) economic classification. The object classification includes expenditure on personal compensation and benefits, travel and transportation of persons and things, equipment, grant, subsidies and contributions, insurance claims and indemnities, and reimbursable items. Functional classification is comprised of expenditure on general public services and economic services. The general public services include expenditure on defense, education, health, social security's and welfare, housing and community amenities, and other community and social services. And economic services consist of expenditure on agriculture, mining, manufacturing, electricity, roads, water transport, railway, communications, and interest on public debt and so on. Economic classification consists of current expenditures and capital expenditures. The current expenditure include expenditures on goods and services such as wages and salaries, other purchases of goods, interest payments, subsidies and other current transfers. And capital expenditures assimilate acquisition of new and existing fixed capital assets, purchase of stocks/inventories, purchases of land and intangible assets, and capital transfers, and net lending including net acquisition on equities.

4.2 Trends of Public Expenditure

The public expenditure has been increasing during the study period. This is because the increasing trend of the expending activities and sector of the government. The growing government expenditure indicates both short term and long term effect in the economy. To increase in government expenditure, public consumption and public investment creates additional demand for goods and services in the through the multiplier effect and thereby increases in aggregate output. The demand pressure of the public services is increasing due to increasing level of money income and population growth and its subsequent impact on the density of population and urbanization. As the population growth rate is very high in Nepal, this augmented the problem of providing educational, health and other services. Government sector is compelled to make larger investment in infrastructure and other industrial development opportunities.

Similarly, supply factor has also increased in government expenditure. The massive investment in the social and economic overheads has been made contiguously to increase productive capacity of the economy. The economy is influenced either by increasing the skill in organizational capacity or by increasing the capital stock in the economy.

Table: 4.1

Trends of Public Expenditure

Rs in million (at current prices)

Fiscal Year	Regular Expenditure (RE)	Development Expenditure (DE)	Principle Repayment (PR)	Total Expenditure (TE)	Percentage Share in TE of			
					RE	DE	PR	TE
1987/88	4622.1	9428.0	-	14050.1	32.9	67.1	-	100
1988/89	5676.5	12328.7	-	18005.2	31.5	68.5	-	100
1989/90	6672.2	12997.5	-	19669.7	33.9	66.1	-	100
1990/91	7574.1	15979.5	-	23553.6	32.2	67.8	-	100
1991/92	9905.4	16512.8	-	26418.2	37.5	62.5	-	100
1992/93	11484.1	19413.6	-	30897.7	37.2	62.8	-	100
1993/94	12409.2	21188.2	-	33597.4	36.9	63.1	-	100
1994/95	19265.1	19794.9	-	39060.0	49.3	50.7	-	100
1995/96	21561.9	24980.5	-	46542.4	46.3	53.7	-	100
1996/97	24181.1	26542.6	-	50723.7	47.7	52.3	-	100
1997/98	27174.4	28943.9	-	56118.3	48.4	51.6	-	100
1998/99	31047.7	28531.3	-	59579.0	52.1	47.9	-	100
1999/00	34523.3	31749.2	-	66272.5	52.1	47.9	-	100
2000/01	42769.2	37065.9	-	79835.1	53.6	46.4	-	100
2001/02	48590.0	31482.2	-	80072.2	60.7	39.3	-	100
2002/03	54973.0	29033.0	-	84006.1	65.4	34.6	-	100
2003/04*	55552.1	23095.6	10794.9	89442.6	62.2	25.8	12.0	100
2004/05	61686.4	27340.7	13533.3	102560.5	60.1	26.7	13.2	100
2005/06	67017.8	29606.6	14264.8	110889.2	60.4	26.8	12.8	100
2006/07	77122.4	39729.9	16752.3	133604.6	57.8	29.7	12.5	100
2007/08	91446.9	53516.1	16386.9	161349.9	56.7	33.2	10.1	100
2008/09	127738.9	73089.0	18834.1	219662.0	56.9	32.6	9.6.	100
2009/10	151019.1	90237.7	18432.3	259689.1	57.4	33.3	11.3	100
2010/11	170295.4	107847.5	17220.5	295363.4	57.7	36.5	5.8	100

Source: Economic Survey 2011/12

Total expenditure heads till FY 2002/03 were classified as regular and development expenditure. Since FY 2003/04, such expenditure has been classified as recurrent, capital, and principal repayment expenditure. After FY 2003/04, the expenditure on

heads and sub-heads has been presented by reclassifying as recurrent, capital and principle repayment.

Table 4.1 reflects the amount of regular, development and total expenditure during the study period. In 1987/88, the total expenditure was only Rs. 14050.1 million that mounted up to Rs. 23553.6 million in 1990/91 similarly it goes up to Rs. 79835.1 in 2000/01 and in the fiscal year 2010/11 it reaches Rs170295.4 million of which 57.7 percent was current expenditure, 36.5 percent was capital expenditure and 5.8 percent was expenses against principal repayment. This clearly depicts the steady and increasing trend of public expenditure in Nepal. Public expenditure trend is going up before and after the restoration of democracy and republic too. Table 4.1 also tells about the percentage share of regular and development expenditure in the total expenditure. The percentage distribution gives clear idea of the very structure of the public expenditure. In fiscal year 1987/88, the percentage share of regular expenditure to total expenditure was 32.9, which were 32.2 in 1990/91. However small fluctuations is seen in the share of regular expenditure to total expenditure, the average overall share during 1987-1997 was around 42.2 percent of total expenditure. Hence, during the early 10 years period under consideration, the average overall share of development expenditure was 58.1 percent.

Nevertheless, in the second half of the study period, the picture is reversed. The overall pattern shows decreasing development expenditure and increasing regular expenditure. That is, more resources have been devoted for recurrent expenses rather for accumulation of capital. In FY 1987/88, the share of regular expenditure to total expenditure was 32.9 percent, which reaches up to 57.7 percent in FY 2010/11 while the development expenditure has decreased from share of 67.1 to 36.5 percent during the same period. It is from the FY 1998/99 the regular expenditure started raising then the development expenditure.

In FY 2002/03, development expenditure decreased by 7.8 percent against that of FY 2001/02 totaling of 29033 million. In the ratio of regular and development expenditure, tendency of regular expenditure rise through FY 2002/03. In terms of ratios, regular expenditure and development expenditure were 60.7 percent and 39.3 percent respectively in FY 2001/02. In FY 2002/03, regular expenditure ratio

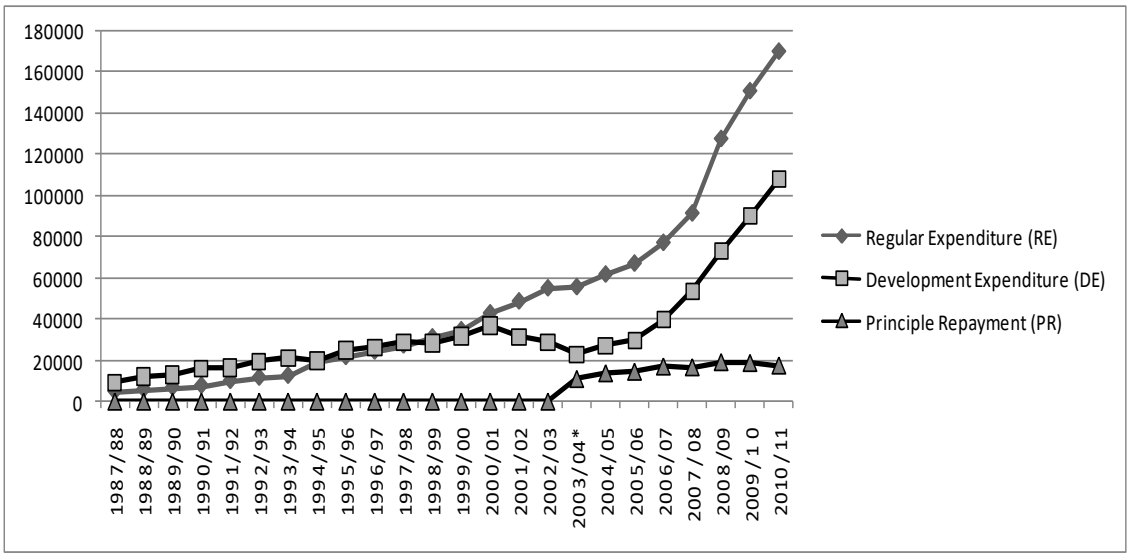
increased to 65.4 percent while that of development expenditure increased to 34.6 percent.

From FY 2003/04 total expenditure had been classified into three groups; i.e. recurrent, capital and principle repayment expenditure. In FY 2003/04, recurrent was of Rs. 55552.1 million. In FY 2010/11, recurrent expenditure increased by 12.8 percent compared to the previous fiscal year**.** In FY 2003/04 capital expenditure was Rs. 23095.6 million. In the last study period, FY 2010/11, capital expenditure is increased by 36.5 percent against that of FY 2009/10. And, from FY 2003/04 principle repayment expenditure has been reclassified separately and its share was Rs. 10794.9 million in total expenditure. In FY 2010/11, principle repayment expenditure decreased by 2.9 percent compared to the FY 2010/11**.** In FY2010/11, recurrent expenditure, capital expenditure and principle repayment expenditure were 57.7percent, 36.5 percent and 5.8 percent respectively.

Figure 1 is drawn based on table 4.1. Figure 1 clearly shows the steady and constant increasing trend of public expenditure. Before 1998/99, the share of development expenditure was greater than regular expenditure in total expenditure. Nevertheless, after then regular expenditure exceeds development expenditure. Table 4.1 and figure 1 lead to several important aspects of Nepalese public expenditure structure. Both, regular and development expenditure have encroached the economy in a steady and constant manner.

Figure: 1

Trends of Total, Regular and Development Expenditure



Khanal states that the growing public expenditure indicates both short term and long term effect in the economy. Firstly, it is general view that an increase in public expenditure creates additional demands for goods and services in the economy through multiplier effects and thereby induces a rise in aggregate output. The first round effect occurs in those industries that directly supply their products to the government. The subsequent effect occurs when those suppliers place order in other industries for intermediate goods. Besides, there is also multiplier effect through demand linkage. The increased output helps to increase the factor income in the respective industries that cause a rise in private consumption. The strength of public expenditure effect depends on the sector in which the expenditure is made and nature and strength of inter-industry linkage of those sectors. Secondly, massive investment made on machinery, equipment and construction works helps to accelerate the long term development by reducing the supply bottlenecks in the economy (Khanal, 1988).

Development expenditure has increased faster than regular expenditure up to 1990's. However, from 1990 to 2010, regular expenditure has increased more that development expenditure. Regular expenditure has been increasing at a higher pace mainly due to the responsibility of maintaining low and order, salary -hike and debt servicing obligation. Dept servicing is the fastest growing expenditure and now forms the single largest head of regular expenditure. In order to meet the minimum needs of

food, clothing, health, education, drinking water, transport, communication and other services, the rate of growth in development expenditure should increase both in absolute as well as relative terms. However, the growth of development expenditure remained lower than regular expenditure because of weak implementation of development projects resulting from political instability and lack of commitment. This indicates that public expenditure is rising faster than resource mobilization resulting in expanded government borrowing to match such expenditure. As much of the government expenditure is used for non-commercial purposes, and even commercial financing has not generated a surplus for the government, borrowing-led expenditure growths forebode a budgetary crisis.

To have a clear picture, an attempt is made to compare total expenditure, regular expenditure and development expenditure with respect to country's Gross Domestic Product.

Table: 4.2

Share of Regular, Development and Total Expenditure in GDP

Rs. in million (at current prices)

Fiscal Year	Gross Domestic Product (GDP)	Percentage share in GDP of		
		Regular Expenditure(RE)	Development Expenditure(DE)	Total Expenditure(TE)
1987/88	73170	6.3	12.9	19.2
1988/89	85831	6.6	14.4	21.0
1989/90	99702	6.7	13.0	19.7
1990/91	116127	6.5	13.8	20.3
1991/92	144933	6.8	11.4	18.2
1992/93	165350	6.9	11.7	18.7
1993/94	191596	6.5	11.1	17.5
1994/95	209974	9.2	9.4	18.6
1995/96	239388	9.0	10.4	19.4
1996/97	269570	9.0	9.8	18.4
1997/98	289798	9.4	10.0	19.4
1998/99	330018	9.4	8.6	18.1
1999/2000	366251	9.4	8.7	18.1
2000/01*	425454	10.0	8.8	18.7
2001/02	444052	10.9	7.1	18.0
2002/03	473546	11.6	6.1	17.7
2003/04	517993	10.7	4.4	17.2
2004/05	566579	10.8	4.8	18.1
2005/06	630301	10.6	4.7	17.6
2006/07	696989	11.1	5.7	19.2
2007/08	781262	11.7	6.8	20.6
2008/09	815658	11.8	6.9	21.4
2009/10	988053	12.5	7.5	23.1
2010/11	1171905	**14.1**	**12.2**	**25.2**

Source: Economic Survey 20109/11

* Real GDP, from FY 2000/01 to FY 2011/12, have been considered as the base year 2000/01.

In table 4.2, all information has been expressed as percentage of GDP at current price. Table 4.2 shows that government expenditure is growing rapidly to the country's gross domestic product. In 1987/88, the share of government expenditure in GDP was only 19.2 percent. In 2010/11, this share has increase to 25.2 percent. From 1987/88 to 1997/98, the share of development expenditure in GDP is greater than regular expenditure. Then, from 2000/01, the share of regular expenditure in GDP is going upward that of development expenditure. That is, in the second part of the study, the expenditure on regular services to GDP ratio is going up every year. In FY 2009/10, the share of development expenditure in GDP was only 14.1 percent against 12.2 percent of regular expenditure.

4.3 Pattern of Public Expenditure

4.3.1 Pattern of Regular expenditure

This category is in the nature of consumption expenditure and therefore includes recurring type of expenditures. Regular expenditure consists of various components. The main functional components of regular expenditure are constitutional bodies (CB), general administration (GA), revenue administration (RA), economic administration and planning (EAP), judicial administration (JA), foreign service (FS), defense (D), social service (SS), economic service (ES), loan and investment (LI), loan repayment/ interest payments (LRI),and miscellaneous (M) includes traveling expenditure of dignitaries and government dignitaries, pension, allowances and gratuity, hospitality, emergency help, donation and prizes, compensation, miscellaneous and contingency.

The table 4.3 shows the composition of regular expenditure on different heads. These categories have been divided into different sub categories, which are not mentioned in the table 4.3, the parenthesis in the table indicates percentage share of different heads to total regular expenditure.

Among regular expenditure's components, the highest percent share to the regular expenditure is of loan payment and interest and followed by social service, defense, general administration and miscellaneous services respectively. Loan payment and interest claims at an annual average of 24.0 percent of total regular expenditure incurred within the period. Next component with substantial amount is the

expenditure on social service, which is of annual average of 23.4 percent to regular expenditure. Defense and general administration have annual average 15.4 percent and 12.4 percent respectively to the regular expenditure. Miscellaneous claims for 10.6 percent to the total regular expenditure. the expenditure on loan and investment, economic administration, justice administration and revenue administration accounts for small share in the total regular expenditure, in the fiscal year 2010/11, regular expenditure on Social Service is Rs. 70541.7 million while that of economic administration and planning is of Rs. 1379.7 million, judicial administration of Rs. 1125.5 million and revenue administration of Rs. 1875.2 million. Allocation on economic service is quite lower that other categories. Expenditure on miscellaneous heading on the other hand has remarkable bearing on the total regular expenditure.

While dividing the study into two halves for analyzing the percentage share of its components to regular expenditure, a quite similar picture is observed. Before and after the restoration democracy, the annual percentage share to regular expenditure was the highest for loan payment and interest .Before the restoration of democracy, the second highest annual average percentage share to regular expenditure was defense while after the restoration period it was social service**.** During the period of 1987-97, the annual average percentage share of loan payment and interest was 36.7 percent. Loan payment and interest reduced in last 10 years of study period. Social service, which claims for the second highest share in 1987-1997, was 17.5 percent. It increases to 23.4 percent in the period of 1987-2008. Nevertheless, defense increased from 14.8 percent (1987-1997) to 17.0 percent (1997-2008). Regular expenditure in FY 2010/11 is higher by 12.8 percent compared to FY 2009/10. Debt servicing obligations decreased by 2.2 percent and occupied 6.9 percent of the total expenditure while social service occupied 38.3 percent, economic service occupied 10.1 percent and miscellaneous category 12.8 percent of expenditure in the review period. Under the functional headings of regular expenditure, 15.2 percent was spent on general administration, 11.5 percent on defense, and rest on the other**.** In FY 2007/08, defense expenditure rose by 5.0 percent, social service rose by 13.1 percent, economic service 19.2 percent, Foreign Service rose by 31.2 percent and miscellaneous category 47.8 percent of expenditure against those of FY 2008/09 while, in FY 2010/11 revenue administration decreased by 8.4 percent and economic administration and planning decreased by 45 percent against those of 2009/10.

The table 4.3 highlights some important aspects. The highest share of loan repayment and interest payment shows that size of resources which is devoted for the maintenance of public enterprises. These public institutions have been suffering heavy losses every year adding extra burden to the government.

Table - 4.3

Regular Expenditure under Different Head

Rs in million

Fiscal Year	CB	GA	RA	EAP	JA	FS	D	SS	ES	LRI	M	Total
1987/88	80.6 -1.7	701.3 -15.2	101.1 -2.2	38.2 -0.8	71 -1.5	106.9 -2.3	768.3 -16.6	562 -12.2	289.6 -6.3	1441.6 -31.3	4615.5 -10	4622.1
1988/89	91.2 -1.6	845.1 -14.9	111.2 -2	41.7 -0.7	79.5 -1.4	150.8 -2.7	898.7 -15.8	634.9 -11.2	351.4 -6.2	1720.7 -30.3	751.2 -13.3	5676.4
1989/90	103.6 -1.6	963.4 -14.4	124.4 -1.9	47.8 -0.7	88 -1.3	152.1 -2.3	1027.2 -15.4	716.1 -10.7	423.8 -6.4	2279.2 -34.2	746.6 -11.2	6672.2
1990/91	191.2 -2.5	1180.4 -15.6	124.8 -1.6	48.4 -0.6	84.2 -1.1	183.4 -2.4	1151.4 -15.2	724.6 -9.8	347.8 -4.9	2407.4 -31.8	1085.7 -14.3	7574.3
1991/92	282.7 -2.8	1534.3 -15.5	137.5 -1.8	59.4 -0.6	112 -1.1	230 -2.3	1489 -15	999 -10.1	548.7 -5.5	3797.1 -38.3	679.7 -6.8	9905.4
1992/93	169.7 -1.5	1816.5 -15.8	191.4 -1.7	68.4 -0.6	146.4 (1.47)	310.1 (2.7)	1723.6 (15.0)	1269.3 -11.5	586.1 (5.10)	4560.5 -39.7	632.1 -5.6	11484.1
1993/94	204.4 -1.6	1900.5 -15.3	194.9 -1.6	78.4 -0.6	149.5 (1.2)	329.6 (2.7)	1877.4 (15.1)	1352.8 -10.9	605.3 (4.9)	4855.1 -39.1	861.3. -6.9	12409.2
1994/95	214.8 -1.1	2119.8 -11	222.5 -1.2	86.4 -0.4	163.7 (0.8)	376.7 (2.0)	2001.3 (10.4)	4441.6 -23.1	1353.9 (7.0)	6083.3 -31.6	2200.7 -11.4	19264.9
1995/96	234.9 -1.1	2509.7 -11.6	252.5 -1.2	97.4 -0.4	191.4 (0.9)	385 -1.8	2126.4 (9.9)	5375 -25	1533.5 (7.11)	6715.4 -31.1	2140.8 -9.9	21561.9
1996/97	471 -1.2	2842.3 -11.7	261.7 -1.1	101.7 -0.4	222.7 (0.9)	440.4 (1.8)	2357.6 (9.7)	5909.1 -24.4	1738.2 (7.2)	7527.2 -31.1	2309.3 -9.5	24181.1
1997/98	353.5 -1.3	3158.8 -11.6	288.9 -1.1	112.5 -0.4	247.6 (0.9)	482.1 (1.9)	2582.8 (9.5)	6993.3 -25.7	1889 . 9 (6.9)	7682.8 -28.3	3382.2 -12.4	27174.4
1998/99	384.2 -1.2	3615.6 -11.6	314.9 -1	122 -0.4	275.7 -0.9	607.4 -2	2994.8 -9.6	7376.9 -23.8	2167.9 -7	8723 -28.1	4450.2 -14.3	31047.7
1999/00	431.5 -1.2	4070.4 -11.8	339.2 -1	130.7 -0.4	276 -0.8	672.6 -1.9	3482.1 -10.1	8327.9 -24.1	2224.8 -6.4	10032.8 -29.1	4496.1 -13	34523.3
2000/01	438.5 -1	6258.4 -14.6	384.1 -0.9	185.1 -0.4	317.5 -0.7	600.3 -1.4	3813.4 -8.9	10882.2 -25.4	1631.1 (3.8)	10338.4 -24.3	7860.5 -18.4	42769.5
2001/02	569.5 -1.2	7728 -15.9	477.1 -1	202.5 -0.4	437 -0.9	672.3 -1.4	5859.8 -12.1	13350.5 -27.5	1905.1 -3.9	12205.2 -25.1	5170.4 -10.6	48590
2002/03	825.4 -1.5	7818.2 -14.2	479.9 -0.9	206.7 -0.4	437 -0.8	722.7 -1.3	7381.5 -13.4	13749 -25	2048.1 -3.7	16181.3 -29.4	5128.6 -9.3	54972.4
2003/04	397.7 -0.7	7325.3 -13.2	496.6 -0.9	269.6 -0.5	449 -0.8	710.2 -1.3	6629.6 -11.9	20808.5 -37.4	5512.8 -9.9	6543.9 -11.8	6408.9 -11.5	66347
2004/05	465.4 -0.7	8226.3 -13.3	540.8 -0.9	328.5 -0.5	504.8 -0.8	794.2 -1.3	8580.3 -13.9	23208.8 -37.6	7167.8 -11.6	6218 -10.1	5651.5 -9.2	75219.7
2005/06	634.7 -0.9	9269.3 -13.8	609.8 -0.9	330.7 -0.5	565.4 -0.8	826 -1.2	9706 -14.5	25382.6 -37.9	7529.8 -11.2	6158.7 -9.2	6006.8 -8.9	81282.6
2006/07	876.1 -1.1	11079 -14.4	1001.2 -1.3	663.3 -0.9	580.1 -0.7	846.8 -1.1	10128.9 -13.1	29497.6 -38.2	8384.8 -10.9	6164 -7.9	7900.5 -10.2	93874.7
2007/08	1642.9 -1.8	13941.7 -15.2	916.6 -1.0	361.7 -0.9	673.2 -0.7	1020.6 -1.1	10564.9 -11.5	35073.2 -38.3	9200.4 -10.1	6373.7 -6.9	11678 -12.8	107833.8
2008/09	1418.1 -1.7	16860.3 -16.3	1212.1 -1.2	380.2 -0.9	811.5 -0.8	1150.2 -1.2	16576.0 -11.7	47437.9 -39.1	12052.6 -11.1	8154.2 -7.1	21599.2 -13.2	15109.1
2009/10	1564.1 -1.7	19574.6 -16.5	1468.7 -1.3	502.7 -1.1	1051.3 -0.9	1379.2 -1.3	13748.4 -10.3	62394.7 -41.2	14929.3 -11.4	9981.3 -7.3	9877.3 -11.8	77327.8
2010/11	2408.9 -1.8	22209.0 -1.5	1875.2 -1.3	1379.7 -1.1	1125.5 -0.8	337.7 -1.2	17410.3 -11.6	70541.7 -38.1	17789.2 -11.3	12737.1 -7.0	12737.1 -12.3	160551.4

Source: Economic Survey 2010/11

Note: CA= constitutional Bodies, GA= General Administration, RA= Revenue Administration, EPA= Economic Administration and Planning, JA= Judicial Administration, FS= Foreign Services, D= Defense, SS= Social Services, LRI= Loan Repayment and Interest and M= Miscellaneous.

Figure in parenthesis indicates percentage share of heads to the regular expenditure.

* indicates the average percentage share during the period.

4.3.2 Pattern of Development Expenditure

In the initial stage of the development, government should play the strategic role in the public sector for sustaining growth. Literature strongly argues the necessity of expanding productive investment in an economy by the state in order to accelerate the process of capital formation as well as to increase and improve the quality of human capital. Development expenditure, as already been stated, is basically a capital expenditure. Development expenditure, like regular expenditure, is made of different components. The main constituent are constitutional body, general administration, economic administration and planning, economic services, social services, defense, communication and transportation, electricity, etc.

The evidence taken from simple percentage share of development expenditure categories generally verify above argument. Among economic, social and miscellaneous services, the highest percent share is of economic services followed by social services and miscellaneous services respectively. Economic services, which had the substantial share, it is because this category comprises sub- components which hold a substantial share of total development expenditure. Expenditure on economic services was Rs. 6751.7 millions in FY 1987/88, reaching a peak at Rs. 17900.2 millions in FY 1997/98 and then started declining. Social services expenditure shows ups and downs in different fiscal year. In some FY like 1993/94, 1998/99, its share to development expenditure is relatively less than the previous year. Nevertheless, the overall trend in social service is increasing. In FY 1987/88, the share of social services was only Rs. 2433.3 million while that of economic service was of Rs. 6751.7 million. However, in the last year of study under consideration, the share of social service boosted to Rs. 36495.2 million and that of economic service reached to 22142.7 million of total development expenditure. Expenditure incurred

under miscellaneous handing is also significant. Except the FY 1992/93, the amount allocated under this head is significantly higher than other categories like constitutional body, general administration and economic administration and planning.

Table 4.4

Development Expenditure under Different Heads

Rs. in million

Fiscal Year	Constitutional **B**ody	General Administration	Economic Administration and Planning	Social Service	Economic Service	Miscellaneous	Total Development Expenditure
1987/88	-	24.4 (0.3)	5.9 (0.1)	2433.3 (25.8)	6751.7 (71.6)	212.6 (2.3)	9427.9
1988/89	-	35.0 (0.3)	10.1 (0.1)	3309.2 (26.8)	8241.6 (66.8)	732.8 (5.9)	12328.7
1989/90	-	14.3 (0.1)	10.8 (0.1)	3973.2 (30.6)	8200.7 (63.1)	798.7 (6.1)	12997.7
1990/91	-	11.3 (0.1)	83.3 (0.5)	3560.3 (22.3)	11893.3 (74.4)	422.2 (2.6)	15979.4
1991/92	-	13.8 (0.1)	39.9 (0.2)	5040.3 (30.5)	11063.3 (67.0)	356.1 (2.2)	16512.8
1992/93	-	29.0 (0.1)	18.7 (0.1)	7245.5 (37.3)	12111.5 (62.4)	8.9 (0.0)	19413.6
1993/94	-	31.3 (0.1)	19.5 (0.1)	7104.1 (33.5)	13841.4 (65.3)	191.9 (0.9)	21188.2
1994/95	-	33.5 (0.2)	31.6 (0.2)	6224.8 (31.4)	12852.7 (64.9)	652.3 (3.3)	19794.9
1995/96	-	41.6 (0.2)	33.2 (0.1)	7612.7 (30.5)	16982.7 (68.0)	310.3 (1.2)	24980.5
1996/97	-	34.5 (0.1)	17.3 (0.1)	9281.3 (35.0)	17054.7 (64.3)	154.8 (0.6)	26542.6
1997/98	3.6 (0.0)	46.4 (0.2)	19.3 (0.1)	10323.5 (35.7)	17900.2 (61.8)	650.9 (2.2)	28943.9
1998/99	28.5 (0.1)	79.2 (0.3)	20.5 (0.1)	10265.5 (36.0)	17324.4 (60.4)	812.3 (2.9)	28531.3
1999/00	26.6 (0.1)	108.1 (0.3)	28.6 (0.1)	12406.2 (39.1)	18648.6 (58.7)	531.1 (1.7)	31749.2
2000/01	12.7 (0.0)	127.2 (0.3)	196.2 (0.5)	12872.7 (34.7)	21114.3 (57.0)	2742.8 (7.4)	37065.9
2001/02	11.9 (0.0)	838.0 (3.4)	7.0 (0.0)	7927.5 (32.0)	13562.5 (54.7)	2426.3 (9.8)	31482.2
2002/03	16.8 (0.0)	581.3 (2.6)	3.7 (0.0)	7050.9 (31.5)	12561.0 (50.3)	2142.4 (9.6)	29033.0
2003/04	36.8 (0.2)	578.1 (2.5)	(8.9 (0.0)	7135.2 (30.9)	13129.0 (56.8)	2207.1 (9.5)	23095.6
2004/05	37.7 (0.1)	883.1 (3.2)	24.2 (0.1)	7940.8 (29.1)	15394.9 (56.3)	3059.6 (11.2)	27340.7
2005/06	96.1 (0.3)	1181.7 (3.9)	20.3 (0.1)	10151.3 (34.3)	14797.1 (50.0)	1919.6 (6.5)	29606.6
2006/07	45.3 (0.1)	4512.7 (11.3)	26.2 (0.1)	15529.3 (39.1)	17938.6 (45.1)	1678.5 (4.2)	39729.9
2007/08	96.2 (0.2)	1773.6 (3.3)	79.8 (0.2)	20283.6 (37.9)	22142.7 (41.4)	9140.5 (17.1)	53516.1
2008/09	84.7 (0.2)	1781.7 (3.3)	47.2 (0.1)	34056.8	31999.9	3002.9	73089.0
2009/10	71.6 (0.2)	2006.6 (3.4)	86.8 (0.2)	36495.2	42968.0	3563.7	90237.7
2010/11	**105.9**	**1776.2**	**169.2**	**45591.1**	**45615.3**	**3322.1**	**108153.20**

Source: Economic Survey 2011/12

Table 4.4 highlights some special characteristics. In this economic and social service expenditures hold a large share on total development expenditure. The expenditure on the administrative reforms side such as spending on constitutional body, general administration and economic administrative and planning command some amount on development expenditure signifying the reforms process on the administrative side. These will contribute in realizing the efficient and good governance within the country. However, in all same time, the spending under the miscellaneous head leaves an open debate about the productivity of such spending.

Table 4.5

Total Development Expenditure and Respective Share of Sub-functional Group of Social Services

Rs. in million

Fiscal Year	Education (E)	Health (H)	Drinking Water (DW)	Local Development (LD)	Total Development Expenditure (TDE)	Percentage Share of TDE			
						E	H	DW	LD
1987/88	1226.8	385.2	236.3	442.7	9427.9	13.0	4.1	2.5	4.7
1988/89	1458.8	616.0	469.3	458.6	12328.9	11.8	5.0	3.8	3.7
1989/90	1479.8	393.8	617.4	454.1	12997.7	11.4	3.0	4.8	3.5
1990/91	1716.0	366.8	538.5	321.6	15979.4	10.7	2.3	3.4	2.0
1991/92	2395.2	507.2	1334.4	406.5	16512.8	14.5	3.1	8.1	2.5
1992/93	3465.0	600.2	1821.4	656.1	19413.6	17.8	3.1	9.4	3.4
1993/94	3822.1	560.5	1073.6	1006.9	21188.2	18.0	2.6	5.1	4.8
1994/95	1453.6	858.5	1102.2	2416.1	19794.9	7.3	4.3	5.6	12.2
1995/96	1791.0	915.5	1206.4	3345.3	24980.5	7.2	3.7	4.8	13.4
1996/97	2356.2	1621.2	1327.1	3622.9	26542.6	8.9	6.1	5.0	13.6
1997/98	2037.1	2076.1	1670.1	3678.8	28943.9	7.0	7.2	5.8	12.7
1998/99	1641.3	1677.2	1866.8	3968.7	28531.3	5.8	5.9	6.5	13.9
1999/00	2573.7	2126.7	2423.0	4136.7	31749.2	8.1	6.7	7.6	13.0
2000/01	2783.9	1972.4	2407.2	4626.2	37065.9	7.5	5.3	6.5	12.5
2001/02	1103.0	899.3	1418.0	3872.4	31482.2	4.4	3.6	5.7	15.6
2002/03	940.7	159.3	1665.9	4009.4	29033.0	4.2	0.7	7.5	17.9
2003/04	1003.4	142.2	2065.8	3538.8	23095.6	4.3	0.6	8.9	15.3
2004/05	1260.4	409.3	1440.0	4468.6	27340.7	4.6	1.5	5.3	16.3
2005/06	1609.6	948.2	1949.8	4682.4	29606.6	5.4	3.2	6.6	15.8
2006/07	1604.9	1185.5	3182.7	7671.6	39729.9	4.0	3.0	8.0	19.3
2007/08	2963.6	2437.7	3693.5	7885.3	53516.1	5.5	4.5	6.9	14.7
2008/09	3520.2	2677.4	5657.7	16826.1	73089.0	5.6	4.4	6.9	16.2
2009/10	3903.9	3170.7	5335.0	18846.5	90237.7	5.9	4.7	7.1	15.4
2010/11	6258.4	4566.0	4838.6	22178.3	108153.2	5.8	4.2	4.5	20.5
Average percentage share of TDE						***8.2***	***3.8***	***6.1***	***11.7***

Source: Economic Survey 2011/12

Table 4.5 takes into accounts only important of social service. In the social sector, local development had the highest growth rate, followed by education, drinking water and, health. Before FY 1994/95, highest share was of education in development expenditure. Though the education and health sectors had good growth performances in the 1990s and early of the 2000s, the current allocation to these sectors is considered low in relation to the needs of the country and also as compared with other developing countries.

There is an increasing trend in the education, health, drinking water and local development. In the FY 1987/88, expenditure under education was Rs. 1226.8 million which rose to Rs. 6258.4 million in FY 2010/11. Similarly, expenditure on health reaches to Rs. 4566.0 million in FY 2010/11 from Rs. 385.2 million of FY 1987/88. Likewise, expenditure on drinking water was Rs. 236.3 million in FY 1987/88 which rose to Rs. 4838.6 million in FY 2010/11. The highest increase is seen in the local development from Rs. 442.7 million in FY 1987/88 to amount Rs. 22178.3 million in FY 2010/11.

Table 4.5, while analyzing the average percentage share in 23 years study period of the selected components of social services to that of development expenditure, it is observed that the highest average percent share is of local development expenditure. The percentage share of local development in an average command 11.1 percent of the total development expenditure. During the same period, the average share of education was 8.6 percent, while that of health and drinking water was of 3.8 percent and 6.1 percent respectively.

Table 4.5 analyzes only four different important subcomponents; agriculture, irrigation, transportation and electricity of development expenditure and excluding other components have minor share. The absolute figure as well as the share of different sub categories that reflect major chunk of resources has gone to transportation sector, followed by electricity, irrigation and agriculture productivity. Under economic services, expenditure on agriculture increased by 2.6 percent, on irrigation decreased by 1 percent, on electricity decreased by 2.7 percent and on transportation decreased by 2.8 percent compared to those of previous fiscal year, while analyzing the average percentage share in 21 years study period of the selected components of economic services to that of development expenditure. It is observed

that the highest average percentage share is in transportation which takes average 15.8 percent of total development expenditure. The average share of electricity was 15.4 percent. Likewise, that of irrigation and agriculture was 10 percent and 6.5 percent respectively. The low spending on agriculture reveals the fact that government is not keen to implement the Agriculture Perspective plan, which is the master plan of the agriculture development of the country.

The pattern of development expenditure broadly confirms that the prime concern of public authorities has been expanding the expenditure on economic overhead. Besides transportation, electricity services have also increased tremendously in recent years. As a result, its share has been obtained to be higher even in comparison with education, agriculture, irrigation, health, drinking water and local development. For instance, the share of transportation for the entire period comes to as much as 16 percent, followed by electricity, irrigation and agriculture respectively.

Table No. 4.6

Total Development Expenditure and Respective share of Sub functional groups of Economic Services

Rs. in million

Fiscal Year (FY)	Agriculture (A)	Irrigation (I)	Transportation (T)	Electricity (E)	Development Expenditure (TDE)	Percentage share of TDE			
						A	I	T	E
1987/88	928.9	854.7	1214.6	1924.7	9427.9	9.9	9.1	12.9	20.4
1988/89	1016.2	1623.2	1857.2	2003.4	12328.7	8.2	13.2	15.1	16.2
1989/90	1183.5	1204.8	1590.1	2087.6	12997.7	9.1	9.3	12.2	16.1
1990/91	1534.6	1118.9	1979.5	1363.1	15979.4	9.6	7.0	12.4	8.5
1991/92	1276.0	2212.2	2381.0	1414.4	16512.8	7.7	13.4	14.4	8.6
1992/93	2077.2	2017.3	2844.0	2229.1	19413.6	10.7	10.4	14.6	11.5
1993/94	2300.3	3232.1	3363.2	2312.2	21188.2	10.9	15.3	15.6	10.9
1994/95	2639.4	2550.8	3010.6	1764.9	19794.9	13.3	12.9	15.2	8.9
1995/96	2224.0	2884.6	5968.5	2310.2	24980.5	8.9	11.5	23.9	9.2
1996/97	1889.6	2725.6	5305.2	4447.3	26542.6	7.1	10.5	20.0	16.8
1997/98	2144.3	2437.6	5619.9	4704.7	28943.9	7.4	8.4	19.4	16.3
1998/99	1926.3	2940.7	5111.3	4811.3	28531.3	6.8	10.3	17.9	16.9
1999/00	2089.5	3044.6	4695.4	5537.9	31749.2	6.6	9.6	14.8	17.4
2000/01	2329.5	3959.3	5354.9	6813.7	37065.9	6.3	10.7	14.4	18.4
2001/02	505.4	2913.5	4429.6	4317.9	31482.2	2.0	11.8	17.9	17.6
2002/03	187.0	1840.9	3664.9	3881.6	29033.0	0.8	8.2	16.4	17.4
2003/04	160.2	2070.9	3958.0	4746.2	23095.6	0.7	8.9	17.1	20.5
2004/05	217.5	1921.5	4149.6	7219.1	27340.7	0.8	7.0	15.2	26.4
2005/06	265.4	2462.7	4178.1	6256.4	29606.6	0.9	8.3	14.1	21.1
2006/07	1374.2	3012.6	6382.1	5450.0	39729.9	3.4	7.6	16.1	13.7
2007/08	3211.8	3605.1	7178.9	5847.6	53516.1	6.0	6.7	13.4	10.9
2008/09	556.9	5695.8	9893.7	6073.3	73089.0	6.1	6.9	13.6	11.1
2009/10	638.6	7974.6	17016.6	12503.4	90237.7	6.3	7.1	13.7	11.3
2010/11	1069.6	7352.0	20184.4	11291.2	108153.2	9.8	6.7	18.6	10.4

Source: Economic Survey 2011/12

In FY 2010/11 total expenditure under economic services head is 45.1 percent of the total development expenditure while social service shares 35.0 percent and rest of the category shared 19.9 percent (table 4.5 and 4.6). Under the assumption of infant private sector, domestic governmental set up justifies the need of large resources to be allocated under the social service and economic service. The real debate, however, should be the productivity of such spending under the different components of social and economic service. Hence, there is need to have inter sectoral comparison to guarantee the higher yield so that the society's major objective of poverty alleviation can be achieved with in the desired period.

Generally, the emerging picture revealed by functional components is that the government is likely to grow even at a faster rate not because of government's involvement in providing more social and economic services to the community but because of growing debt servicing of the government.

4.4 Growth of Public Expenditure

Trend and pattern of public expenditure, so far has been analyzed with the help of nominal values excluding permanent influences like population and prices. However, now an attempt is made to analyze the actual public expenditure growth in Nepal during the period under study in terms of real growth rates.

A simple approach of examining public expenditure growth is the comparison of its real growth rates with that of real national income registered during the period under examination. Growth rate of all Total, Regular and Development expenditures do not show any specific pattern rather are of random attribute. In some FY there are large upswing and in some FY there are large downswing in growth rate of all categories. Public expenditure in Nepal has grown faster than the national income.

The growth rate of total public expenditure on the FY 1988/89 is 28.1 percent that was the maximum growth rate whereas there was just 0.3 percent growth rate in the 2001/02. In FY 2009/10, the growth rate of public expenditure was 21.9 percent. Similarly, in the beginning of the study period regular expenditure's growth rate was 22.8 percent. It increased to ever highest growth rate in FY 1991/92 of 30.8 percent, which is substantially higher than the decade's average of 16.5 percent. In addition, in FY 1988/89, the growth rate of development expenditure was 30.8 percent whereas there were -20.4 percent, negative growth rates in FY 2003/04.

Table 4.7

Growth Rate of Regular, Development, Total Expenditure and GDP

Fiscal Year	Regular Expenditure(RE)	Development Expenditure(DE)	Total Expenditure(TE)	Gross Domestic Product (GDP)
1987/88	-	-	-	-
1988/89	22.8	30.8	28.1	17.3
1989/90	17.5	5.4	9.2	16.2
1990/91	13.5	22.9	19.7	16.5
1991/92	30.8	3.3	12.2	24.8
1992/93	15.9	17.6	16.9	14.1
1993/94	8.1	9.1	8.7	15.9
1994/95	55.2	-6.6	16.2	9.6
1995/96	11.9	26.2	19.1	14.0
1996/97	12.1	6.2	9.0	12.6
1997/98	12.4	9.0	10.6	7.5
1998/99	14.2	-1.4	6.2	13.9
1999/2000	11.2	11.3	11.2	11.0
2000/01	23.9	16.7	20.5	16.2
2001/02	13.6	-15.1	0.3	4.4
2002/03	13.1	-7.8	4.9	6.6
2003/04	1.1	-20.4	6.5	9.4
2004/05	11.0	18.4	14.7	9.4
2005/06	8.6	8.3	8.1	11.2
2006/07	15.1	34.2	20.5	10.6
2007/08	18.6	34.7	20.8	12.1
2008/09	19.4	34.9	21.8	12.4
2009/10	19.6	34.9	21.9	12.6
2010/11	14.1	9.2	25.2	12.8
Average	**16.6**	**12.3**	**14.4**	**12.7**

Source: Economic Survey 2011/12

The growth rate of total public expenditure on the FY 1988/89 is 28.1 percent that was the maximum growth rate whereas there was just 0.3 percent growth rate in the 2001/02**.** In FY 2010/11, the growth rate of public expenditure was 25.2 percent. Similarly, in the beginning of the study period regular expenditure's growth rate was

22.8 percent. It increased to ever highest growth rate in FY 1991/92 of 30.8 percent, which is substantially higher than the decade's average of 16.5 percent. In addition, in FY 1988/89, the growth rate of development expenditure was 30.8 percent whereas there were -20.4 percent, negative growth rates in FY 2003/04.

Distinguished feature of both total and regular expenditure from that of development expenditure is that they never achieves negative growth rate during the study period. On an average, total expenditure has increased by 11.9 percent against 16.5 percent increase in regular expenditure. The growth rate of development expenditure in the beginning of the study period was high but there was negative growth rate in the development expenditure in FY 1994/95, 1998/99, 2001/02, 2002/03. In FY 2010/11 there was 9.2 percent of growth rate in development expenditure which was the lower growth rate achieved during the period of analysis. The average growth rate of development expenditure is 12.7 percent.

The growth rate of GDP in FY 1988/89 was 17.3 percent, which was the highest during the study period. The average growth rate of GDP is 12.7 percent. The growth rates derived for the total expenditure, development expenditure, regular expenditure and gross domestic product of the country during the period 1987-2011 clarifies the proposition of expanding state activity. The average growth rate figure shows that the highest growth rate is of regular expenditure followed by total expenditure.

4.5 Sources of Public Expenditure

Developing country generally faces the problem of supply constraints due to the massive participation of government in development and welfare activities. Supply constraints can be judged in the terms of predominant agriculture sector, low monetization, low industrialization, structural and institutional rigidities, and low taxable capability of the people. Nevertheless, these constraints are continuously minimized as the process of development get momentum through the structural and intuitional changes in the economy (Khanal, 1988).

The sources of financing public expenditure are receipts; revenue and foreign grants, foreign loan and internal loan. An attempt is made to divide the sources of financing into three categories i.e. total revenue (tax revenue and non-tax revenue), foreign aid (foreign grants and aid), and internal loan (banking system and non-banking system).

Table 4.8

Sources of Financing Public Expenditure

Rs. in million

Fiscal Year (FY)	Total Revenue (TR)	Foreign Aid (FA)	Internal Burrowing (IB)	Percentage Share in Total Expenditure			FA as % of Development Expenditure
				TR	FA	IB	
1987/88	7350.4	5892.6	1130.0	52.3	41.9	8.0	62.5
1988/89	7776.9	7347.0	1330.0	43.2	40.8	7.4	59.6
1989/90	9287.5	7935.0	2150.0	47.2	40.3	10.9	61.1
1990/91	10729.9	8421.5	4552.0	45.6	35.8	9.3	52.7
1991/92	13512.7	8460.7	2078.0	51.1	32.0	7.9	51.2
1992/93	15418.4	10714.2	1620.0	49.0	32.7	5.2	55.2
1993/94	19580.8	11557.2	1820.0	58.3	34.4	5.4	54.5
1994/95	24575.2	11249.4	1900.0	62.9	28.8	4.9	56.8
1995/96	27893.1	14289.0	2200.0	59.9	30.7	4.7	57.2
1996/97	30373.5	15031.9	3000.0	59.9	29.6	5.9	56.6
1997/98	32937.9	16457.1	3400.0	58.7	29.3	6.1	56.9
1998/99	37251.0	16189.0	4710.0	62.5	27.2	7.9	56.7
1999/00	42893.8	17523.9	5500.0	64.7	26.4	8.3	55.2
2000/01	48893.6	18797.4	7000.0	61.2	23.5	8.8	50.7
2001/02	50445.5	14384.8	8000.0	63.0	18.0	10.0	45.7
2002/03	56229.8	15885.5	8880.0	66.9	18.9	10.6	54.7
2003/04	62331.0	18192.4	5607.8	69.7	21.1	6.3	81.9
2004/05	70122.7	23657.3	8939.1	68.4	23.1	8.7	86.5
2005/06	72282.0	22041.8	11834.2	65.2	19.9	10.7	74.4
2006/07	87712.2	25854.4	17892.3	65.6	19.4	13.4	65.1
2007/08	107622.5	29300.6	20496.4	66.7	18.2	12.7	54.7
2008/09	143474.5	26382.8	18417.1	66.9	18.4	12.6	56.7
2009/10	179945.8	38545.9	29914.0	67.2	18.6	12.8	58.9
2010/11	199818.7	45922.2	42515.8	67.7	16.1	14.3	43.1
Average Percentage Share (1987/88-2010/11				60.1	27.1	8.9	59.4

Source: Economic Survey 2010/11

Table 4.8 shows that during the period under review the contribution of total revenue, foreign aid and internal borrowing as the sources of financing of public expenditure.

In the 23 years period from 1987/88 to 2010/11, government revenue reported an increasing trend but with the fluctuating growth rate. During the period, the percentage share of total expenditure to the government revenue grew at an annual average of 57.8 percent with the highest share of 69.7 percent in FY 2004/05 and the lowest of 43.2 percent in FY 1998/99. In 1987/88, it was only Rs.7350.4 million, which is increased to Rs. 48893.6 million in FY 2000/01. In FY 2010/11 it reaches to highest amount as Rs. 199818.7 million. While the snail-pace growth of the economy is one major reason for low growth of revenue mobilization, the declaration in tax revenue especially customs revenue is the other. Foreign aid also shows increasing trend. However, there are some decline in the FY 1994/95, 1998/99 and 2001/02. The amount of foreign aid at the starting period of study was only Rs.5892.6 million, which reached to Rs. 45952.2 million in FY 2010/11. Similarly, there has been increasing trend in internal borrowing. In FY 1987/88, it was only Rs. 1130 million, which increased to Rs. 5500 million in FY 1999/2000, and in FY 2010/11, it increased higher as Rs. 42515.5million.

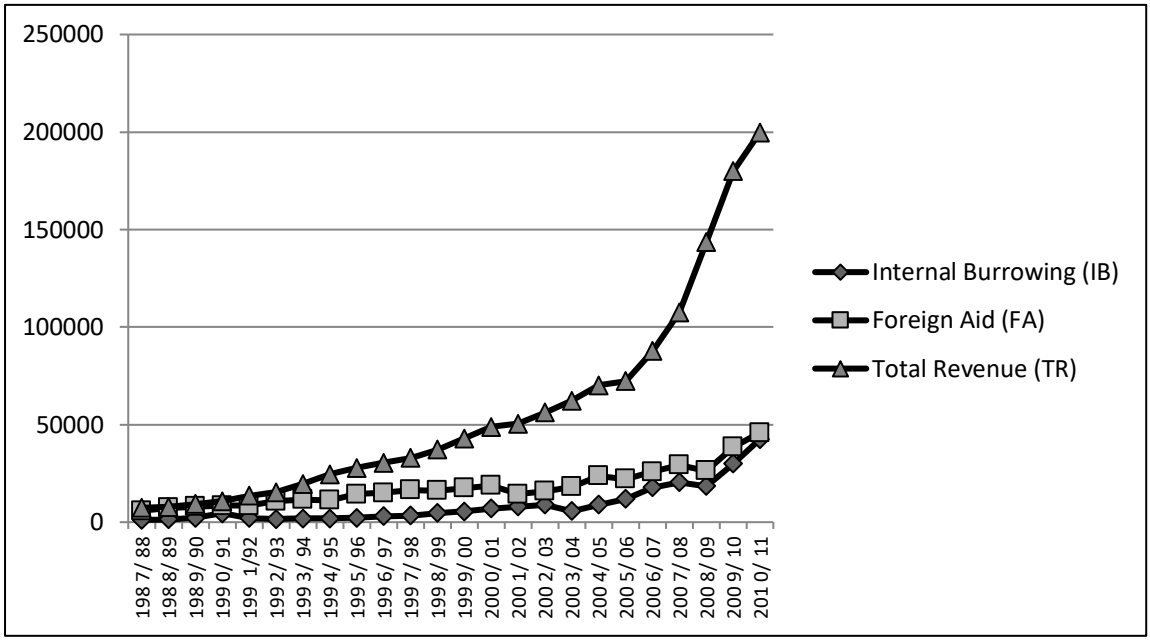
While examining the share of different sources of financing of total expenditure, it is observed that the total revenue is the major components among different sources of financing. In the period under consideration, it commands an average percentage share of 57.8 percent to the total expenditure. The share of foreign aid has gone as high as 41.9 percent in FY 1987/88, which in recent years fell down to 18.2 percent. There has some inconsistent share of internal borrowing to total expenditure. In FY 2006/07, it got as high as 13.4 percent, the highest in the study period under consideration. It is due to the large internal borrowing for continued low or even negative rates of economic growth. In FY 1995/96, it became 4.7 percent of total expenditure. Recently, it is seen that the share of internal borrowing is 12.7 percent of total expenditure.

Foreign aid as percentage of development expenditure is very high. In an average, foreign aid as percentage of development expenditure is 59.5 percent. This highlights that major portion of development expenditure has been financed by foreign aid. Thus, the analysis of data reveals that the expanding public sector size has been maintained either through the internal resource mobilization or through the increasing

inflow of foreign resources. Table 4.8 and figure 2 show the Sources of Financing Public Expenditure in Nepal.

Figure: 2

Sources of Financing Public Expenditure



CHAPTER V

PREVALING SITUATION OF RESOURCE GAP IN NEPAL

Nepal faces many problems with growing public expenditure. Public expenditure policy is the allocation of resources among competing ends. The decision of how much to invest there is the question of which sector to invest and which project should receive top priority. Government expenditure policies have very strong root in both micro as well as budgeting intensive cost benefit analysis in project selection, suitable help to change not only capital output ratio and employment structure but also to maintain the efficiency in resource allocation.

5.1 Resource Mobilization and Problems of Resource Gap

Resource mobilization is the main challenge in the economic development of the country. The internal resource play vital role in economic development of the country. Government collects the resources for different ways. The tax structure is major sources of revenue of the government. Government has imposed two types of tax like direct and indirect tax. In the present tax structure, the government revenue comes more than fifty percent from indirect tax. Tax policy has to be made a part of the instrument of the development goals.

Resource gap is defined as the difference between total expenditure and revenue. The problem of resource gap rising due to weak planning or sharp increase in unproductive recurring expenses, deficit financing has led to increase in economic in stability in many developing countries. The debate in 1960s and early 1970s was mainly confined to developing countries regarding the efficiency of monetary as well as fiscal policy in bringing economic stabilization. Though the debate is still continuing, how the focus is one the possibilities of crowding out of private resource in a situation of excessive dependence, on banking system in financing fiscal deficit, which is reflected of countries rate of growth and overall development (Chaudhary, 1976).

The next factor to be considered in the context of developing countries is that if the coefficient of government expenditure adjusts rapidly than revenue, it may have chain effect on prices and deficit financing (Heller, 1980).

Another problem that might be created by deficit financing is in trade and balance of payment by either generating excessive demand in the economy or export becoming costlier and costlier.

All these issues need careful consideration in a country like Nepal where the resources mobilization has been a major problem in financing growing expenditure. The problem has compounded as a result of low savings in the government in a situation where private saving is also comparatively low in comparison of neighboring countries like India and Sri Lanka. In India the share of domestic saving in GDP was more than 24 percent in the year 2003 where as 9.58 percent in the current year.

5.1.1 Trend of Resource Gap in Nepal

During 1960s, Nepalese economy faced little problem of resource gap. Later, resource gap also increased because of increasing share of the government activities i.e. ambitious plan in terms of financial resources and physical target, heavy government investment in the field of agriculture, industry, transport and communication, education and health and especially due to merge increase in fiscal efforts.

From 1970s onward resource gap has become a continuous phenomenon. Resource gap emphasize a condition where the amount of public expenditure become more than government resource. 'A principal saving is also regularly diverted to the government consumption. In addition, financing of public sector investment is increasingly more dependent upon external upon external sources' (IDS, 1987).

The resource mobilization has been a major problem in financing of growing government expenses. Since 1980s there has been a tremendous increment in the size of public expenditure. The development works have to be carried out by the government in the initial stages. An increase in public expenditure creates additional demand in the economy through multiplier effects and thereby includes as rise in aggregate output. The government resources have been concentrated more on expanding economic overhead in the form of transport power and communization which stimulate agriculture, industry and transport in the private sector.

The public expenditure is the main source of Gross National Investment and capital formation many studies have been attempted to examine the problem of resource gap and prospect of internal resource gap. The problems of resource gap have increased form one to another which has been recovered through massive inflow in external capital. Regular expenditure is fulfilled by internal resource whereas development expenditure is mostly dependent on external resources. If the resource gap in minimized through over dependence upon foreign loans, it can further create the problem of resource gap in the near future.

Table 5.1 shows that the trend of resource gap and the trend of government expenditure and total revenue. In every fiscal year the trend of total expenditure is greater than the revenue. In the FY 1987/88 the resource gap was Rs. 6699.9 million which increases to Rs. 95544.7 million in FY 2010/11. Here, trend of resource gap is fluctuating until the end of the study period.

Table 5.1

Trend of Resource Gap in Nepal

Rs. in million

Fiscal Year	Total Government Expenditure (TGE)	Total Government Revenue (TGR)	Resource Gap	$\frac{Resource\ gap}{GDP}$ x 100
1987/88	14050.1	7350.4	6699.7	9.16
1988/89	18005.2	7776.9	10228.3	11.92
1989/90	19669.7	9287.5	10382.2	10.41
1990/91	23553.6	10729.9	12823.7	11.04
1991/92	26418.2	13512.7	12905.5	8.90
1992/93	30897.7	15418.4	15749.3	9.52
1993/94	33597.4	49580.8	14016.6	7.32
1994/95	39060.0	24575.2	14484.8	6.90
1995/96	46542.4	27893.1	18649.3	7.79
1996/97	50723.7	30373.5	20350.2	7.55
1997/98	56118.3	32937.9	23180.4	8.01
1998/99	59579.0	37251.0	22328.0	6.77
1999/00	66272.5	42893.8	23378.7	6.38
2000/01	79835.1	48893.6	30941.5	7.27
2001/02	80072.2	50445.5	29626.7	6.67
2002/03	84006.1	56229.8	27776.2	5.87
2003/04	89442.6	62331.0	27111.6	5.23
2004/05	102560.4	70122.7	32437.7	5.73
2005/06	110889.2	72282.0	38607.2	6.12
2006/07	133604.6	87712.2	45892.4	6.58
2007/08	161349.9	107622.5	53727.4	6.88
2008/09	219662.0	143474.5	76187.5	9.34
2009/10	259689.1	179945.8	79743.3	8.07
2010/11	295363.4	199818.7	95544.7	8.12

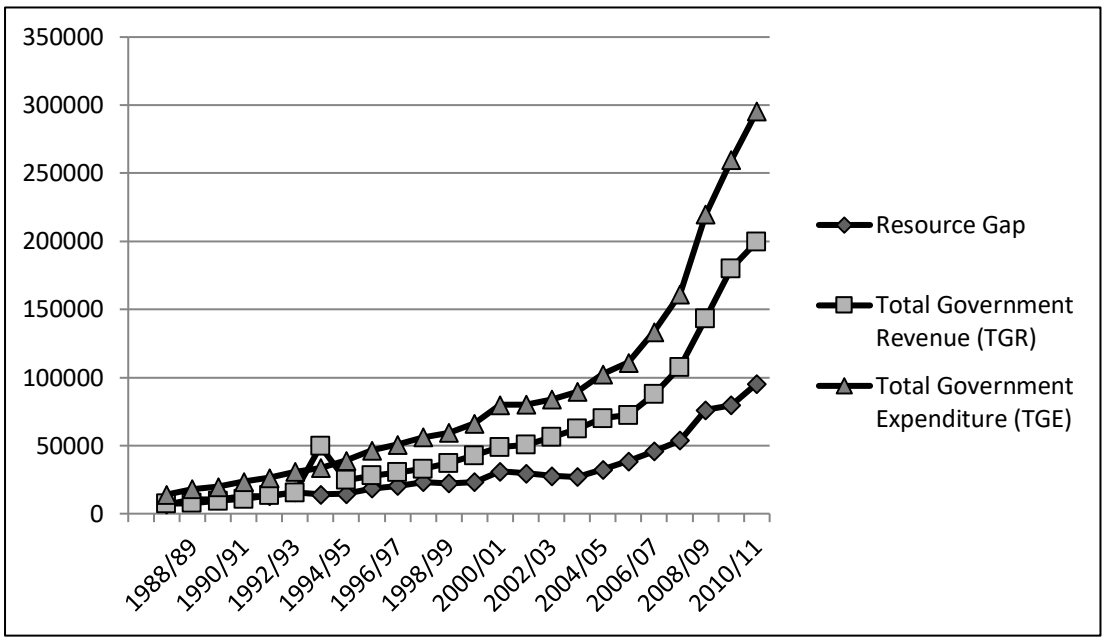
Source: Economic Survey 2011/12

Total government expenditure is Rs. 63154.7 million, total government revenue is 41201.0 million and the resource gap is Rs. 23395.1 million where total expenditure is greater than total revenue. As a result the resource gap is increasing and in order to fulfill this gap the government borrowing is increasing every year rapidly.

According to the table (5.1) average GDP between 1987/88 and 2010/11, the highest GDP during these periods is 11.92% and the lowest is 5.23%. Above all the table shows fluctuating condition of GDP.

Figure: 3

Trend of Resource Gap



5.2 Effects of Public Expenditure on GDP

In the developing countries like Nepal, private sector is not well developed. So, the public expenditure increases with its increasing activities. When market works perfectly, price mechanism will solve the basic economic problem of what, how and to whom to produce. Government intervention however does not necessarily provide a guarantee that society will benefit from such action. Government failure may be as common as market failure. Tight budgets, high cost of raising revenue and multiplicity of claims on the public purse indicate that government activity demonstrates its ability to add tangibly to the economy. Excepting the countries with low capability and few resources under take more complicated redistributive function such as providing social safety nets could be a tall order to fill. Improving government performance requires, among other things, sustained commitment of and political support from key government and societal players and realistic time frame to carry out appropriately sequenced reform take time. To oversee empirical study we have fitted the following regression equations.

CHAPTER VI
RELATIONSHIP BETWEEN PUBLIC EXPENDITURE AND IMPORT

6.1 Introduction

Being a government of developing economy, Nepal government has to do lot of developing activities. But resources in the hand of government are not sufficient. Government is facing various difficulties to gear up all the sectors simultaneously and to provide the budget too. On the other hand, in the Nepalese economy, private sector is not well developed. When market works perfectly, price mechanism solve the basic economic problem of what, whom and how to produce. However, government intervention does such action. Government failure may be as common as market failure. The government must complete her primarily duties and must spent for regular expenditure like general administration, defense, health, education and constitutional bodies. On the other hand, there is a strong challenge to gear up the sustainable economic growth. For this government has to invest huge amount in the income generation sectors and to carry out development works. Incremental changes are better than no changes, but far-reaching institutional reform takes time. The increment in government expenditure enhances aggregate demand. This aggregate demand can be met either from domestic production or from import. When import increases then the consequences of trade deficit also increase.

An import is any good or services brought in from one country to another country in a legitimate fashion, typically for use in trade. Import goods and services are provided to domestic costumers by foreign producers. An import in the receiving country is an export to the sending country. Import of goods normally requires involvement of all costumers' authority. Trade balance is dependent upon the import and export of the country. A country has demanded for an import when domestic quantity demanded exceed domestic quantity supplied or when the price of the good or services on the world market is less than the price on the domestic market. A country's trade deficit is also dependent on the import. A trade deficit occurs when imports are relative to exports. Imports are impacted principally by a country's income and its productivities

resources. A high trade deficit is caused when the total monetary value of exports is lower than the total monetary value of import (Joshi, 2005).

6.2 Trend of Total Government Expenditure and Total Import

Import as well as government expenditure has been increasing during the study period. This is because the increasing trend of the spending activities. The growing government expenditure indicates both short term and long term effect in the economy. An increase in government expenditure, that is irrespective of public consumption and public investment creates additional demand for goods and services in the economy through multiplier effect and thereby induce rise in aggregate output. Similarly, Import is increasing due to the lack of human resources and the economic condition of our country. Nepal import huge amount of goods and services from the international market. Import increases due to the following reasons. Firstly, the pressures to increase wages and allowance, lack of regular supply of electricity and increasing strike in and around industrial complexes have shot up cost of production. Those make Nepalese goods and services relatively uncompetitive in the world market especially in the Indian market. Secondly, persistent strikes demanding for life-long permanent employment status irrespective of labor productivity and efficiency and forced closure of firms has compelled shot down factories. Not only domestic firms but also multinational firms have stopped production due to obtuse, business-unfriendly drama orchestrated by different party's armed forces and trade unions. This has led to decrease in manufacturing activity and total production of the country. These are the main reasons that government must increase import to fulfill basic needs.

Table 6.1

Trend of Total Government Expenditure and Total Import and Its Changes

Rs. in million

Fiscal Year (FY)	Total Government Expenditure(TGE)	Total Import (TIM)	% Change of TGE_t	% Change of TIM_t
1987/88	14105.2	13869.6	-	-
1988/89	18005.2	16253.7	27.6	17.18
1989/90	19669.7	18324.9	8.4	12.74
1900/91	23533.6	23226.3	16.4	26.74
1991/92	26418.2	31940.0	11.9	37.52
1992/93	30897.7	39205.6	14.5	22.74
1993/94	33597.4	51570.8	8.0	31.53
1994/95	39060.0	63679.5	14.0	23.47
1995/96	46542.4	74454.5	16.0	19.92
1996/97	50723.7	93553.4	8.0	25.65
1997/98	56118.3	89002.0	6.0	-4.86
1998/99	59579.0	87525.3	10.7	-1.65
1999/2000	66272.5	108504.9	11.23	23.96
2000/01	79835.1	115687.2	20.5	6.61
2001/02	80072.2	107389.0	0.296	7.17
2002/03	84006.1	124352.1	4.91	15.69
2003/04	89442.6	136277.1	0.06	9.58
2004/05	102560.4	149473.6	14.66	9.68
2005/06	110889.2	173780.3	7.51	16.26
2006/07	133604.6	194694.6	17.00	12.03
2007/08	161349.9	221037.7	17.19	13.53
2008/09	219662.0	279227.8	26.54	26.32
2009/10	259689.1	366692.3	15.41	31.32
2010/11	295363.4	396175.2	13.10	7.44

Source: Economic Survey 2011/12

Table 6.1 shows that the increasing trend of government expenditure as well as Import receipts. During the study period, the growth rate of import and government expenditure is high. In FY 1987/88, total government expenditure was of Rs. 14105.2 million, it reached to Rs 66272.5 million in FY 1999/2000. Similarly, in FY 1987/88, total import was of Rs. 13869.6 million and it reached to Rs. 108504.9 millions in FY 1999/2000. At last fiscal year (FY 2010/11) of study period, total government

expenditure reached to Rs. 295363.4 million whereas total import increased to Rs. 396175.2 million. From these studies we conclude that when the total government expenditure increases, total import also increases. So, total expenditure and total import have positive relationship.

6.3 Empirical Observation

The relationship between total government expenditure and total import has analyzed by using the least square method. Various statistical tests like t- test, F-test, DW-test, R-squared test, Adjusted R-square test, have used to verity the relationship between government expenditure and import. And lag structure is also considered of estimation. These equations are shown in the following paragraphs.

In this, the first model has developed making no changes in import and expenditure. The second model has developed considering changes of expenditure and import to one fiscal year to another fiscal year. These models are presented as below.

The ordinary least square (OLS) estimation of the relevant equation gives the following result.

TIM = -1337.791 + 1.481 TGE ……..(I)

St. Error = (3774.548) (0.053)

T-test = -0.356 (29.146)*

R^2 = 0.980 $\overline{R^2}$ = 0.998

F-test = (849.389)* DW-test = 0.978

Equation (I) shows that there is a positive relationship between Total Import (TIM) and Total Government Expenditure (TGE). The sign of regression coefficient is positive (1.481) telling that one percent change in total government expenditure will induce to have 1.481 percent change in total import. As the values of R^2 and adj. R^2 are very high. It represents the high goodness of fit of regression line. That is- the value of R^2 is high enough to justify that 0.980 variation in TIM is explained by TGE. The DW-test value is of 0.978 suggested that there is autocorrelation. The calculated

value F-test and t-test are 849.389 and 29.146 respectively and support for the overall fitness of the model.

Let us estimate the regression equation in first difference form.

TIM = 4413.713 + 0.807 TGE_t

……..(II)

St. Error = (2582.77) (0.807)

T-test = 1.710 (3.134)**

R^2 = 0.355 $\overline{R^2}$ = 0.318

F-test = (9.817)** DW-test = 2.364

Equation (II) shows that there is a positive relationship between Total Import (TIM) and Total Government Expenditure (TGE). The sign of regression coefficient is positive (0.807) telling that one percent change in total government expenditure will induce to have 0.807 percent change in total import. The value of R^2 and adj. R^2 are 0.355 and 0.318 respectively. The value of R^2 and adj. R^2 represents the goodness of fit of regression line. That is the value of R^2 is enough to justify the 35.5 percent variation in TIM is explained by TGE. The DW value of 2.364 suggests that there is no autocorrelation. The calculated value of F-test and t-test are 9.817 and 3.134 respectively. The values of t-test represent the significance of the result. The high F-value supports the same result.

CHAPTER VII

FINDING, CONCLUSION AND RECOMMENDATION

7.1 Major Findings:

- This study is primarily confined to the analysis of trend and pattern of public expenditure and examines the gap between growth rate of public expenditure and GDP during the period 1987/88 to 2010/11. Data indicates that there has been increasing trend of public expenditure in Nepal. Both regular and development expenditure have encroached the economy in a steady and constant manner. Development expenditure has increased faster than regular expenditure from 1987 to 1997. From 1998 to 2011, regular expenditure has increased more than its development component. It means that bulk of expenditure have gone towards non-productivity activities. Public expenditure is growing rapidly to the country's gross domestic product (GDP) as well. From 1987/88 to 1997/98, the share of development expenditure in GDP is greater than regular expenditure. Nevertheless, from 1998/99, the share of regular expenditure in GDP overshadowed that of development expenditure. That is, in the latter part of the study, the expenditure on regular services to GDP ratio is grater for every year.
- The expenditure heads till FY 2002/03 were classified as regular and development expenditure. Since FY 2003/04, such expenditure has been classified as recurrent, capital, and principal repayment expenditure. After FY 2003/04, the expenditure on heads and sub-heads has been presented by reclassifying as recurrent, capital and principle repayment. Loan repayment and interest expenditure have been growing very fast. Loan repayment and interest share stood at 29.4 percent in FY 2002/03. However its share is very high, after FY 2003/04 loan repayment and interest is included somewhere in recurrent, capital and principal repayment expenditure. Likewise the economic services and defense have been most priority components of the government spending for regular expenditure. The pattern of regular expenditure concludes that increasing in regular expenditure is due to the growing burden of debt service payments, maintaining law and order and providing salary to civil servants.

- Economic and social service expenditure hold a large share on total development expenditure. The analysis of the different component of social services, which hold a large share in total development expenditure, lead to conclude that grate concentration have been provided to educational followed by local development, drinking water and health respectively. Among the economic services categories under development expenditure, it is found that major chunk of resources have been devoted to transportation, followed by electricity, irrigation and agriculture respectively. The percentage share of transportation on an average command 15.8 percent. Likewise, that of electricity, irrigation and agriculture was 15.4 percent, 10 percent and 6.5 percent respectively during the same period. The low spending on agriculture reveals the fact that government is not keen to implement the Agriculture Prospective Plan (APP), which is the master plan of the agriculture development of the country.
- The government has been practicing deficit budget due to lack of sufficient revenue base. As a result, government expenditure for foreign aid and internal loan has highly increased. Foreign aid was Rs. 5892.6 million in FY 1987/88 and reached to Rs 45922.2million in FY 2010/11.
- In Nepal, lack of sufficient financial resources is the main constraint for the economic development. Total expenditure on Nepal government has been increasing every year due to the expansion of government activities. Nepal is always facing financial problem in every year. There is serious problem of resource gap in Nepal which is also follow the increasing trend. In FY 1987/88, overall resource gap was Rs. 6699.7 million whereas it reached Rs 95544.7 million in FY 2010/11.
- During the study period, the growth rate of import and government expenditure is high. In FY 1987/88, total government expenditure was of Rs. 14105.2 million, it reached to Rs 66272.5 million in FY 1999/2000. Similarly, in FY 1987/88, total import was of Rs. 13869.6 million and it reached to Rs. 108504.9 millions in FY 1999/2000. At last fiscal year (FY 2010/11) of study period, total government expenditure reached to Rs. 295363.4 million whereas total import increased to Rs. 396175.2 million. From these studies we

conclude that when the total government expenditure increases, total import also increases. So, total expenditure and total import have positive

- Total government expenditure is Rs. 63154.7 million, total government revenue is 41201.0 million and the resource gap is Rs. 23395.1 million where total expenditure is greater than total revenue. As a result the resource gap is increasing and in order to fulfill this gap the government borrowing is increasing every year rapidly.
- The growth rate of total public expenditure on the FY 1988/89 is 28.1 percent that was the maximum growth rate whereas there was just 0.3 percent growth rate in the 2001/02**.** In FY 2010/11, the growth rate of public expenditure was 25.2 percent. Similarly, in the beginning of the study period regular expenditure's growth rate was 22.8 percent. It increased to ever highest growth rate in FY 1991/92 of 30.8 percent, which is substantially higher than the decade's average of 16.5 percent. In addition, in FY 1988/89, the growth rate of development expenditure was 30.8 percent whereas there were -20.4 percent, negative growth rates in FY 2003/04.

7.2 Conclusions:

Public expenditure programs are the main viable sources of expanding the production base of the economy. The very slow process of structural change, low rate of capital accumulation and non-significant change in employment pattern indicate that Nepalese economy has not been still able in advancing towards sustained growth. Nepal's budgetary process has been highly unrealistic. In almost all the years in the review period, the budget targets have been set at extremely high levels, particularly for the revenue and foreign aid. This overestimation of resources has in turn enabled the Government of Nepal to set similar unrealistic targets for the development budget and to accommodate too many new projects.

Among the sources of financing of public expenditure, total revenue is the major components, followed by foreign aid and internal borrowing respectively. It can be concluded that because of incapacity to raise revenue, there is higher dependence in foreign aid and internal borrowing. Growing revenue expenditure has been narrowing the revenue surplus necessary to finance development expenditure. Due to the inefficient government revenue system, the revenue collective has not become

responsive to the need of the expenditure. As government has to resort to both foreign borrowing to finance fiscal deficit, higher fiscal deficit has many implication on the economy creating liability to the nation. There is random flow and use of foreign aid. Such a situation has been creating a dependency syndrome in the Nepalese economy. To look at the relationship of GDP with total development expenditure, total regular expenditure and their sub-components, there is positive relationship.

The growth rate analysis concludes that the highest growth rate is of regular expenditure followed by development expenditure. Among the components of regular expenditure, the highest growth rate is shown for social services followed by miscellaneous services and loan repayment and interest respectively. Among the development expenditure categories, the higher growth rate has been obtained for miscellaneous services and social services respectively. Among the component of social services, the higher growth has been achieved by local development, followed by education, drinking water and health respectively during the study period. The study of growth rate of these sub functional groups point out that adequate attention is not paid to health yet.

In the above analysis, relationship between public expenditure and total import are analyzed by establishing some models. By using these models, it is summarized that there is positive relationship between public expenditure and import. Total expenditure has been seen highly responsive to total import.

The empirical analysis shows the relationship between public expenditure and total import which are analyzed by establishing some models. By using these models, it is summarized that there is positive relationship between public expenditure and import. Total expenditure has been seen highly responsive to total import.

7.3 Recommendations

In any useful budgetary policy, public expenditure has an important and essential role for the overall development of the nation. In Nepal, public expenditure assumes importance because of the responsibility which the government has been assumed through various measures. The government has to insure an equitable distribution of income and decentralization of economic power. There is also need to bring about a self sustained and rapid economic growth in the country for which the rate of saving

and investment has to be supported up. Based upon all those findings, some general recommendation about policy, structure and trend, resource gap, resources mobilization, institution and methods and etc. can be presented for further development of nation through adequate and systematic government expenditure.

i) In order to reduce import, the government should take action to establish import distribution industries.

ii) The government should pay attention and take immediate plans and policies to increase production capacity of the economic sectors.

iii) At first government should make clear vision in policy making. It should make clear cut distinction between the role of the public sector and private sector. As major priority sector, government must choose income generating sector and the amount as much as possible should be regularly spend in this sector on planned basis. It is also reduce the increasing reliance on foreign aid in our budgetary system.

iv) The rapid growth in regular expenditure especially over few years can be attributed to the increased in defense expenditure, loan repayment expenditure, employee expenditure. Though peace is the necessary condition for economic growth and development, economic valuation of alternative investment of defense expenditure must be considered.

v) The trend of expenditure and revenue, the ratio of total expenditure is greater than the revenue which signals adverse impacts on the economy in the long run. After the fiscal year 1997/98, development expenditure has been decreasing, so there are challenges for government to maintain macro-economic stability by rationalizing the regular expenditure, stream lining development expenditure in highly productive sector, broadening the tax base, and reducing the size of deficit financing.

vi) The major part of domestic resources should be utilized in financing consumption expenditure. The very low amount goes to public sector investment. Public investment expenditure is highly dependent on external sources. Therefore, it is necessary to reduce the consumption type of public expenditure and increase investment expenditure.

vii) The pattern of public expenditure should be rearranged. The budgetary classification should be done according to the productivity nature of different sectors. The trend of classifications budget should be changed, it should be

properly classified and planning of expenditure should be realistic as well as comprehensive.

viii) Enlarging problem of resource gap will certainly create problems to our economy. So, attention should be paid to checking the unnecessary increase in resource gap. The major part of development budget is fulfilled by foreign aid. The donor agencies also interfere in the decision making. Over dependence on the foreign loan can further create resource problem in the near future. Government should only take foreign loan for productive purposes that have high revenue possibility.

ix) Public expenditure is the main tool to increase the overall output of the nation. Thus, government has to increase the development expenditure to the long run projects for steady increase in the GDP.

x) There should be established norms regarding the internal borrowing practices. At the same time, excessive dependence on foreign aid especially foreign loan should be curtailed seeking more of domestic resource mobilization prospects and opportunities. Moreover, foreign loan should be used more effectively. The GON should establish an effective monitoring system for better utilization of foreign aid.

xi) It is necessary to reduce non productive type of government expenditure in order to promote the capital accumulation process. In overall, the development expenditure must be increased.

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