CHAPTER - 1

INTRODUCTION

1.1Background of the Study

Public expenditure plays vital role in the development of an economy. It is a major tool of economic development from ancient period to modern welfare state. Hence, public expenditure is essential for providing welfare of the citizen through making investment in different sector.

In the modern age, the main objective of government is to provide maximum social welfare in society through economic progress. To meet this objective government conducts different plan and policies in different area like education, health, transportation, communication and other productive sector. For this, public expenditure is an important tool of the economy.

Public expenditure refers to all the expenditures made by government i.e. public authority like central government and other local bodies to meet the demand of the people. It is for protecting the citizens and promoting the socio-economic welfare. Goode defines public expenditure as a means to carry out essential function of administrative justice and provide demand and supply of additional goods and services that are advantageous to society but that would not be supplied by private enterprises because doing so would not be profitable (Goode, 1984).

Equity, growth and stabilization are the major objectives of any economy. To maintain this, public expenditure is essential in developed as well as developing countries. According to classical economist, government should not intervene in economy. It means, they argued laissez-faire economy. They believed on full employment. If the economy is fully employed, there is no need of government intervention. They argued that government intervention creates nothing but disturbance on automatic market mechanism. On the other hand, modern economists believed that strong government intervention is required to control the economy ifit is out of path. It means moderate level of government intervention is necessary in the economy.

After 1930's great economic depression classical model couldn't solve the existing problem of an economy. So, Keynes suggests public expenditure to increase effective demand. On the other hand, at the time of inflation,it is better to reduce public expenditure by the government and also imposes heavy tax through surplus budget.

In developing countries like Nepal infrastructure of development have not been created. It should be done by public expenditure. Thus, public expenditure increases employment opportunities, reduce inequality as well as regional balance in the country.

Today, in developing countries the gap between haves and haves not is increasing, the desire and aspiration of the peoples are high and huge amount of money should be invested in proper utilization of resources.

1.2 Statement of the Problem

Public expenditure is one of the most important tools of economic activities. It plays vital role in the development process of economy. It is useful in inflationary as well as deflationary situation.

Nepal started its systematic and planned development process after the establishment of democracy in 1951. After this, Nepalhas introduced planned development process. Various development projects are conducted i.e. huge amount of public expenditure is made in different sector but the achievement is below expectation. From the very beginning of planned process, public expenditure and policies have emphasized the high economic growth, better allocation of resources, equal distribution of wealth and maintaining price stability. However,the outcomes have not been realized as expected.Most of the economic indicators are poor.The public expenditure policy is facing the problem i.e.the growth rate of public expenditure is higher than growth rate of Gross Domestic Product (GDP).

In Nepal, public expenditure is increasing extensively from the planned development process but it is not concentrating to the development of socio-economic infrastructure. If such investment and expenditure program are not properly expanded, they have adverse effects on resource gap, lack of resources etc. It further affectsadversely on the long term objectives such as stability and growth.

Nepal has exercised thirteen (13) planned development process. However, the economic indicators have not shown positive sign. On the other hand, public expenditure is increasing year by year but the issues are same such as low economic growth, absolute poverty, heavy external debt, vast gap between rich and poor etc. The effectiveness of public expenditure policy and program should be reflected in the improvement of socio-economic indicator of citizen, but in our country socio-economic indicator are not satisfactory. On the other hand, there is no comprehensive public expenditure policy in Nepal. Due to these reasons low economic growth rate,huge unemployment and inequality has raised in the economy. In this situation this thesis is focused on the following questions:

- What types of trend and structure of public expenditure being practiced in Nepal?
- What is the relationship between public expenditure and GDP growth rate?
- What are the major factors that influence economic growth?
- What are the effects of public expenditure on GDP?
- How are these problems solved?

1.3 Objectives of the Study

The general objective of this research is to study the trend, structure and effects of public expenditure in the economic growth of Nepal.

The specific objectives of the study are as follows:

- To examine the trend and structure of public expenditure in Nepal.
- To show the relationship between public expenditure and GDP growth rate.
- To find out various factors that influence economic growth.
- To study the effects of public expenditure on Gross Domestic Product (GDP).
- To suggest appropriate policy recommendations.

1.4 Significance of the Study

Public expenditure has been increasing year by year from the planned development process. But its effectiveness is very low, so this study mainly deals with what are the problems on economic growth of public expenditure. This study analyzes the trend and structure of public expenditure from 1990/91 to 2012/13.The rationality of selecting this time period is that government has increased public expenditure in large amount, but the socio-economic problems are not solved effectively. It means public expenditure is not properly affecting on Gross Domestic Product (GDP).

1.5 Limitations of the Study

The limitations of the study are given below:

- This study covers only the period of 23 years from 1990/91 to 2012/13.
- This study is based on published secondary data and information and no attempt has been made to examine the reliability of the data.

1.6 Organization of the Study

There are six chapters in this study and each chapter is further divided into various sub-sections. The first chapter, which is introductory portion gives a general overview of whole study. The second chapter attempts to literature review. Review of literatures deal with the theoretical context along with both the international and national context, the relevant articles of the study. The third chapter provides the methodology of the study, nature and sources of data used in the study, methods of data analysis used in the study. Statistical tests are used to establish the relationship between variables is the core of this chapter. The fourth chapter explains the objectives of the study i.e. trend analysis of the public expenditure. In detail, this chapter has examined the trend and structure of public expenditure. The fifth chapter analyzes statistical and economic models used to establish the relationship between different economic variables and expenditure on respective sector. Finally, the last chapter carries conclusion of the study and recommendations for policy implications

CHAPTER - 2

REVIEW OF LITERATURE

2.1 Introduction

The term public expenditure refers the expenses of the state for the day to day administration and for overall development of the nation. Each and every nation tries to create a welfare state through its expenditure.

There are many theories, research papers, books, surveys, articles written on public expenditure in different time period with various conclusions. Some research papers and dissertations are concerned with developing economy whereas some are concerned with developed economy. Different research studies have shown that the trend, effects and achievements of the public expenditure came up with their own findings. In this regard, it is worthwhile to review some relevant theoretical, international and national level researches.

2.2 Public Expenditure in Developing and Developed Countries

Fiscal policy means the use and acquisition of government's resources in order to promote economic growth, bringing stability in the economy providing employment and income redistribution. It is closely related with the expenditure program of the government. Stabilization is the major role of fiscal policy to be played in developed countries. But in underdeveloped countries fiscal policy, besides stabilization should aim to promote economic growth, employment level and redistribution of income.

Most of the developing countries private sectors are performing the best for economic activities while in under developed countries there is a greater lack of entrepreneurs. Private sector are shy and timid, there is lack of capital resources in private sector while on the other hand the small number of investors likes to invest only on those sectors where profit can be earned very soon. They prefer investment which takes least gestation period for return.

2.3 Theoretical Development of Public Expenditure

There are so many theories on public expenditure. Classical economists gave less attention on public expenditure on economy. They gave narrow view that the government should not make interfere in the general activities. They advocated the laissez-fair policy. They suggested that government should reduce their expenditure, they believed on the existence of the full employment in the economy and there is no need of government intervention.

But later on, after the Great Depression of 1930's, many economists suggested that the government must intervene in the economy. A moderate level of government intervention is necessary to run the economy smoothly. Hence, the analysis of public expenditure in different time period and theories are examined.

2.3.1 Classical Views on Public Expenditure

The classical economists always believed in the existence of the full employment in the economy. They were against the heavy role of government because they believed in full employment. The classical economists ideas are based on say's law of market so they believed on perfect competition. They had strong argument that if the resources are fully employed, there is no need of government intervention. Government intervention creates nothing but disturbances on automatic mechanism of market economy. Classical economist took government expenditure and revenue programmes as "necessary evils". Hence necessary in the sense that certain function of the economy must be done by government and evil in the sense that government activity disturbs market mechanism. Thus, they emphasized in 'less government role'.

Classical economists were argued in favor of balance budget. In fully employed situation, if government increases public expenditure without increasing its revenues, this will lead to inflation. The classical view on government borrowing is that the expenditure should make on productive purposes. It is necessary for the state to borrow and then this borrowing must be confined to the financing of productive enterprises. Otherwise, borrowing will be meaningful if it is used in productive sectors.

Musgrave (1979) has given to raise the large and growing literature on the theory of public goods. According to Froyen, 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 (Froyen, 2003).

2.3.2 Keynesian Views on Public Expenditure

John Maynard Keynes opposed the classical theory in the sense that the classical notion of full employment equilibrium through wage price flexibility is a rare and special case. He argued that wages and prices are sticky to downward due to the presence of trade union and so many other reasons. Similarly he said that employment depends upon effective demand and there is no guarantee that there will be always adequate demand to generate full employment.

During the time period of inflation, the price is high. Hence, the government should reduce its own expenditure and increase tax rate to cut the level of consumption. Thus, in period of inflation, it is better to have surplus budget. But during the depression, there is deficiency of effective demand. Hence, the government should increase its expenditure and spend more on public works. In this way, additional resources can be employed. Thus in the period of depression it is better to have a deficit budget in order to increase the consumption.

In this way, after the Great Depression of 1930's, economists came on the conclusion that government expenditure is necessary in the economy. J.M. Keynes pointed out that the fundamental cause of depression was the lack of spending. The decision to save in the household sector can not lead to the decision to invest and the government had to take step up its expenditure in order to "prime to pump" of the economy. The modern economists have given more emphasis on public expenditure.

2.4 Pure Theories of Public Expenditure

For a long time period, many theories are developed in the field of public expenditure. But, the pure theory of public expenditure relates to those principles which govern the optimal provision of public goods. Two principles are generally considered in this context. They are 'ability –to –pay' principle and 'benefit' principle.

2.4.1 Pigou and Ability to Pay Theory of Public Expenditure

The ability-to-pay theory to be used to determination of optimum level of public expenditure has received most comprehensive treatment in the economy. He says goods and services, which are provided by the government departments and can be sold for fees so arranged as to cover the cost of production pose no problem. The amount of resources, which should be devoted to these purposes, is determined automatically by public demand. But, fees can cover neither bulk of non transfer expenditure of government such as 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 to be employed.

The optimum amount of government expenditure is determined at the point at which the satisfaction obtained from last rupee spent is equal to the satisfaction lost in respect of the last rupee called upon by government service. Pigou states the three conditions when government expenditure would be larger. First, the greater is the aggregate income of community, the larger will be the optimum amount of government expenditure. Second, under the circumstance where new opportunities for expenditure through government are opened up with no corresponding opportunities for private expenditure, balanced between marginal benefit of expenditure and marginal disutility of revenue will be struck at higher point. Third, given aggregate income and population, greater the concentration of income in 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.

2.4.2 Samuelson and Benefit Principle of Public Expenditure

Samuelson stated that his exposition of the pure theory of public expenditure, which aimed for the optimal resource allocation in an economy in which there are two types of goods, private and public. The theory takes into account both allocation and distribution facets of the problem and thus presents a unified system of general equilibrium (Samuelson, 1955).

2.5 Theories of Public Expenditure

(A) Wagner's Hypothesis

Adolf Wagner, a famous German political economist (1835-1917) tried to find a predictable, long run functional relationship between growth of an industrialization economy and growth of the public sector. Wagner's analysis provided a theory rather than just description and an economic justification for the prediction is known as "Law of increase of state activities". The basic cause of relative growth of government expenditure according to Wagner is social progress. Wagner hypothesis states that as per capita income in any economy increase, the relative size of public sector also increase.

In the words of Wagner comprehensive comparisons of different countries and of different times shows that among progressive peoples, with which alone we are concerned and increase in public expenditure regularly takes place in the activity of both central and local government constantly under take new function, while they perform both old and new functions more sufficiently and commonly.

(B) Peacock-Wiseman Hypothesis

Peacock and Jack Wiseman empirically developed this hypothesis (1961) by analyzing the British time series data during the period of 1890 to 1955 in public expenditure. This hypothesis is generally known as 'displacement effect'. This is probably one of the best known analyses of the time pattern of public expenditure. They found their analysis upon the political theory of public expenditure determination, namely that governments like to spend money, that citizens do not like to pay more taxes, and the governments need to pay some attention to the wishes of their citizens.

The approaches of this hypothesis are made in three separate concepts. They are as follow:

I. **Displacement Effect**

   Using empirical data for British economy from 1890 to 1955, they showed during the time of war and other social crisis, new higher budgetary levels displace the exiting lower tax and expenditure levels. After the social crisis has ended, the new levels of the tax tolerance, which have emerged, mark the society willing to support a higher level of public expenditure.

II. **Inspection Effect**

According to them, the inspection effect doesn't require that the new higher growth of expenditure should continue with the same expenditure pattern that was created by social disturbances. Although some of the increased expenditure, such as veteran benefits, debt interest, reconstruction expenses etc. is direct result of the social disturbances, other expenditure frequently involves the expansion of government into new areas of economic activities.

III. **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 government sector. In this process, the role of central government activities enlarges in proportion to the total public sector activities.

(C) Colin Clark Hypothesis

Colin Clark developed the theory of "Critical Limit Hypothesis" about public expenditure. He used on the interwar data of several western countries and argued that inflation inevitably occurs when government expenditure financed out of taxes and other receipts twenty-five percent of aggregate national income. To support this statement, Colin argues that when the government share of aggregate economic activity reaches the critical limit of twenty-five percent, the income earners are also affected by reduced incentives due to high tax incidence that their productivity suffers.

Clark's analysis of the relation between public expenditure and inflation is only partial. Inflation so far as it brought about spending, relates to the equilibrium situation between supply and demand for scarce resources i.e. between the capacity output of the economy and the aggregate spending for such output.

(D) Productivity Lag Hypothesis (Baumol's Hypothesis)

The Productivity Lag Hypothesis was developed by W.J. Baumol (1967). Sometimes it is also called "Baumol's Disease". It is based on productivity differentials of private and public sector. When the economy is not automatically stabilized, then expansion in public expenditure is made. Baumol has given two causes that create "Productivity-Lag".

- Techinical barriers opposing innovation in the public sector are higher than in the private sectors.
- Institutional barriers are greater in public sector in comparisons to the private sector.

(E) 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. His question is, is increasing government saving by taxation is reality or mirage? His conclusion is, if government increase the tax, theoretically increases in national saving. But increasing in tax rate that implies to 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. He suggested some policies in expenditure management which are as follows:

- Government should be more rational and more self disciplined in determining public expenditure policy.
- 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.
- 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.

2.6 Empirical Review

Many research papers and articles have been written under the subject of public expenditure. In developed and developing countries, there are different results of different researches for the trend, impact and achievement of government expenditure. This differentiation can be seen differently. Some research papers are concerned with developing economy whereas some are developed economy.

In this regard, it is better to review some relevant literatures both by the international and national researches.

2.6.1 International Context

Taylor (1961) in his book has discussed the significance of the public expenditure stressed 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. "Public works projects and landing functions during the depression were in stituted to cushion the effects of the worst feature of capitalism – its recurrent tendency to break down". "Pump-Priming" the injections of public expenditure to fill avoid left by deficient private expenditure in recession has as its goal the prevention of serious break down.

Due and Friedlaender (1973) in their research study concerned with public expenditure of U.S. for the decade 1963 to 1973 analyzing the magnitudes of government activities. Defining the pure public goods, they suggested that activities relating to the provision of these goods should be exclusively handled by public sector. By their nature, these goods be can't provided by private enterprises, i.e. national defenses. On the other side, increasing demand social services such as education, health, drinking water, in both developed and developing countries, the government has to invest in low enforcement and justice, fiscal management and operation of the executive department which clearly lies in to the part of public goods; causes a great volume of expenditure to the government.

United Nations (1979) in its publication has examined the patterns of government expenditure on social services in developing countries, developed market and centrally planned economies in the 1970's. The available data on public expenditure for education, health, social security and welfare and housing are analyzed. And the silent factors and policies shaping the evolving pattern of expenditure are reviewed. Patterns of government expenditure on social services in the developing countries and the policies are reflected to add fresh emphasis to the need for considering the provision of social services as a part of the integrated process of raising level of well being. The attempts of several governments to provide primary education to everyone may not be hampered so much by the lack of resources in education school and teachers, discrimination against females and the absence of transport facilities or sufficient income in the family to buy necessary things and for a child to attend school. This concern is an integral part of the changing perceptions of development that have attracted the attention of governments in most of the developing countries.

Tait and Heller (1982) in their study have provided a comparable framework for comparison of both functional and economic expenditure pattern of countries 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. They concluded that, first many international cross section studies of government revenue and expenditure used per capita income as a proxy for most of the underlying demographic, social and economic differences, yet it is striking how uncertain per capita income is as an explanatory variable. Second, it is encouraging to note how plausible the modeled relationships are, it is also reassuring to see how most of the expenditure indicates for individual countries performances and attitudes. Third, the technical coefficients functional categories that determine economic categories of public expenditure are powerful and suggestive. Fourth, the appeared to be clear support for the hypothesis that the majority of governments spent excessive amounts on wages relative to amounts had spent on goods and services; some country do appear to overspend on wages relative to other goods and services – some do not. However, a clear bias was evident toward greater than expected current expenditure relative to capital expenditure in Africa and in industrial countries; the same regions spend more than expected on subsidies relative to wages.

Finally, without a doubt, this study has provided departure points for discussions and assessment of government expenditure policies in individual countries.

The World Bank (1988) has studied on the role of public finance in development activities. One aspect of sound public finance is the prudent control of fiscal deficit. The report has underlined some general conclusion on public spending in developing and industrial countries. 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. Next, in developing countries the public sector trends to play a greater role as an investor than in industrial countries. Another is in most developing countries state owned enterprises account for important shares both of total public spending and gross domestic product (GDP). The state and local government appear in general to have smaller role in developing countries than in industrial countries.

Basanti (1990) in his study has discussed some of the public expenditure management measures that were included fund supported structural adjustment. It had briefly outlined that the central role of the fiscal programs and their interaction with structural policies, the key area where measures were taken to strengthen public expenditure management in SAP programs. This paper also addressed the question of the degree of effectiveness on such system and process reforms in an attempt to highlight problem areas that may need to be taken into account in the design and implementation of PEM measures. He concluded that during programme implementation, managing scarce resources in the public sector has often been the critical test to make or break programmes. Public expenditure management issues have usually been most pressing either because domestic resources have been slow to improve or because growth has not yet materialized; in which case, accommodating political pressures for expenditure may be financially destabilizing and constituting a serious set back to the adjustment efforts.

Premchand (1990) in his study has emphasized to the importance of expenditure controls on the context of growing fiscal problems. And the study provided solution to current and future fiscal problems that it required a combination of policy measures and improvements in controlling techniques and procedures. Although, the exact combination of such policy measures and improvements depends on the scientific situation and type of expenditure, the study mainly devoted to considering the nature of expenditure controls, practices, current problems and future direction. Expenditure controls essentially reflect a managerial process that includes the political and administrative levels, horizontal and vertical relationships within government organization. This study illustrated the continuing need of a regular review of the strategic, institutional and systematic approaches to expenditure controls. Indeed their effective contribution depends upon updating their capability and on eliminating weakness. He concluded that there is an important aspect related to the balance between policy measures and control techniques. An absence of restrictions on subsidies or less specific policies for entitlement payments can hardly be expected to be compensated for by stringent controls. Pragmatic approaches to control should be realistic in policy measures, the role of control and techniques and their mutual complementarily.

Andrews (2005) in his study has concerned with introducing incentives for fiscal producing in developing countries through the budgeting process. He observed that, some governments have shown interest in reforms aimed at establishing result oriented budgeting approach. The emphasis on result of 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 expenditures. It is suggested that there are three reasons why reforms still has a way to go in establishing performance based accountability system in governments. First, even though performance based targets are now being developed, they are generally kept separate from the actual budget. Second, performance information suffers weakness commonly allowed to be in literature related to other settings. Outputs are confused with inputs and outcomes remain unconsidered. Third, the lack of rational construct in the budget itself. Even where effective performance based targets are provided, this kind of system commonly fails to specify who should be accountable for results. He concluded that all countries intent to developing a performance based budgeting approach need to understand the sequences involved in introducing result based governance and to know general points for effective reform, because bad performance based reform is probably worse than a good line-item budget.

Schroeder (2007) in his study has reviewed the rationales for and techniques available to local government financial managers for forecasting revenues and expenditures in developing and transitional economics. It illustrated how the techniques can be used and buttresses that discussion with illustration of how they are actually used.

Several techniques have been used to forecast both revenues and expenditure. They range from simple judgmental approaches that rely on the knowledge of experts to more sophisticated multivariate statistical technique. For forecasts of revenues that are sensitive to economic conditions, statistical forecasting methods may be most appropriate. But statistical analysis requires considerably more data and forecaster expertise than the alternatives time trend analysis and deterministic approaches. This study revealed that the most commonly used approaches are deterministic approaches in which forecasts of revenues of expenditures are based on simple links to variables assumed to directly influence revenues and expenditure.

2.6.2 Nepalese Context

Singh (1977) in his book has analyzed the consistency between fiscal policy of Nepal and targeted growth rate from the time series data over the period of 1954/55 to 1974/75. He also analyzed the trend of revenue and expenditure during the same period. He found that there was substantial change in the ratio of total public expenditure to GDP. He found that the ratio of total government expenditure to GDP was just 2.44 percent in the fiscal year 1954/55, which increased to 10.57 percent in the fiscal year 1974/75. He also found that development expenditure ratio to GDP increasing from 4.04 percent in fiscal year 1965/66 to 6.75 percent in 1974/75. The growth rate of regular expenditure was quite slower registering 2.13 percent in 1965/66 to 3.82 percent in fiscal year 1974/75. On the revenue side, in 1950s tax revenue to GDP ratio was hopelessly low. In percentage term it was 1.27 percent of GDP, which stood up 6 percent of GDP in 1974/75.

Kanel (1985) in his thesis has found that the total government expenditure increased greatly during the study period of 1965/66 to 1984/85. He noticed that the total revenue collection and foreign grants also increased but not with the pace to meet the excess development expenditure. His finding supports the notion of growing trend of deficit financing with in the economy. Through the deficit financing provides some encouragement to the developing country like Nepal, he recommended using this source of financing up to a proper scale and level.

Upadhaya (1987) in his thesis has made a macro case study regarding resource allocation practices. It observed that large amount of public expenditure has centered on the central development region in the study period of 1972/73 to 1977/78. He found that the volume of development expenditure is increasing rapidly, through it has not affected for the overall economic growth of the country and there by the standard of living the per capita income. He concluded that the resource allocation practice were only growth promoting rather than balanced regional development.

Integrated Development System (IDS) (1987) carried out a study,which covers the period 1974/75 to 1984/85. It reported that government expenditure had grown rapidly relative to country's GDP. In 1974/75, the share of government expenditure in GDP was only 9.13 percent which reached to 20.11 percent on fiscal year 1984/85. The expenditure on economy services to GDP ratio was highest for every year. Nevertheless, the most rapid growth as reflected by the data was with respect to the payment of interest. Its share in GDP had increased to 1.21 percent in 1984/85 from 0.20 percent in 1974/75. IDS more over, 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 expanding at the expenses of the latter. The current expenditure, which was only 51.41 percent of the total expenditure in 1979/80, reached 59.24 percent in 1984/85. Except the year of fiscal crisis, there was found an upward trend of regular expenditure.

Khanal (1988) in his Ph.D. dissertation has 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 to1981. He 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 that the public expenditure between the studies time period has increased many folds in relation to country's GDP. The public expenditure has increased by 8.42 percent per annum on the average whereas the domestic product has increased only 2.04 percent during the same period of time. During the study period, regular development and public investment expenditure have increased by 8.66, 8.59 and 9.08 percent respectively. Public expenditure share was 5.5 percent in 1966, whereas it rises to 15 percent in 1981. He concluded that the major expansion of the public expenditure had taken place only after 1970. He found that the elasticity coefficient for total development expenditure, economic services and social services with respect to per capita income being more than unity. At the same time, his finding was that the elasticity coefficient for the public investment being less than the unity.

Lohani (1993) in his thesis has analyzed the trend of public expenditure, government revenue and problem of resource mobilization. He has concluded that the public sector is draining a private saving towards unproductive regular expenses instead of channelizing it towards productive investment in the study period of 1974/75 to 1990/91. In spite of a tremendous increase in the size of public sector, it has failed to generate surpluses required to finance, generate and sustained the process of development. Nepal's external dependence has risen alarmingly, he has argued that the continuous in the extend of budget without evolving medium and long-term investment planning and expenditure programming has delinked planning with annual budgeting for more resources have been allocated to capital items. Both macro and sectoral planning have been found to be weak due to absence of rigorous cost benefit analysis and programmed budgeting, three decade of planning have failed to substantiate a long term perspective plan with the view to maintain consistency among macro and sectoral physical targets on the one hand and insure necessary to the sectoral programmed on the other hand.

Basyal (1994) in his article has carried out a research about growth of development expenditure of Nepal in different plan periods and sources of financing it. He has underscored the dominance of foreign capital in Nepal's plan financing. During the fifth (1976 to1980), the sixth (1981 to 1985) and the seventh (1986 to 1990) plan periods, foreign grants and loan financed the total development expenditure of the extent of 47.3 percent, 48.1 percent and 59.5 percent respectively. This has clarified an upward trend in the reliance on foreign resources and consequently the downward share of revenue surplus in meeting the development expenditure.

Upreti (1996) has studied government expenditure pattern in Nepal covering the periods of 17 years from 1974/75 to 1991/92 using the simple regression analysis method and graphical analysis. He found that the growth of public expenditure in Nepal has taken place rapidly than the growth of GDP of the country. The growth rate of the development expenditure is almost equal to growth of development expenditure. He found that the larger percent of development expenditure has been covering from foreign aid. This trend highlights that the expenditure pattern in Nepalese economy is unable to create more resources and to get faster economic growth. He concluded that the expenditure on agricultural sector is not friendly to create more employment while more than 80 percent employment has been providing from agricultural sector. But on the other hand, the higher average growth rate of public expenditure to agricultural sector has become unsuccessful to get more GDP growth rate from agricultural sector.

Khadka (1998) has studied the role and trend of public expenditure and problem of resource mobilization during the period 1974/75 to 1994/95. He used log linear regression model to analyze the data. He found that the calculated t-values 18.017 , the regression coefficient of GDP in model-1 54.3, the regression coefficient of total revenue in model-2 45618, the regression coefficient of foreign aid in model-3 are strongly significant at one percent level and 1.578, the regression coefficient of total revenue in model 3 is significant at only 20 percent level. On the empirical analysis, he found that there is strong relationship between total expenditure and GDP. In the same way, the relationship between regular expenditure and total government revenue also shows strongly. But the relationship with development expenditure with total government revenue and foreign aid is weak. Hence, the estimated parameters are less than unity. In the study period, he found that all regular expenditure, development expenditure and GDP increased but average growth rate of regular expenditure is 19.9 percent whereas average growth rate of development expenditure is 17.1 percent. He found that the share of total expenditure in GDP was 9.1 percent in the initial period has increased to 21 percent in later time. In the same way, the regular expenditure covers 34.8 percent of the total expenditure and the remaining 65.2 percent in development expenditure on the average of the study period.

Sharma (1999) has found the steady growth in the public expenditure in the 1980s and in the first half of 1990s in his study. With an average annual growth of 17.7 percent, it has been rising faster than GDP. But relative growth of public sector is not seen as related to the growth of real per capita income. Instead, it seemed to be affected by the foreign aid given the domestic resource constraint.

NPC (2002) has reviewed the ninth plan. During the ninth plan period, the government expenditure of Rs 27846.8 corers over the targeted expenditure of Rs 33729 corers at the constant price of 1996/97, created the expenditure gap of 17.4 percent. During the ninth plan period there has been annual average increase of 9.3 percent in the regular expenditure. During the plan period the development expenditure had been decelerating by 1.1 percent annually. The share of development expenditure force to limit it to 46.9 percent during the plan period. The targeted expenditure on economic services, infrastructure, social services and miscellaneous was 29.4, 36.3, 33.4 and 0.9 percent of the development expenditure respectively. The actual figure turned out to be 22.7, 35.7, 39.9 and 1.7 percent respectively. The expenditure in productive sector especially on miscellaneous heading has exceeded the target, which the expenditure on productive sector like economic services and infrastructures has remained below the target.

Pyakuryal (2004) in his study has asserted that the Nepalese economy has lost its productive capacity to respond the sustained growth following the government expenditure pattern. He found the ratio of regular expenditure to GDP in FY 1996/97 was 8.6 percent but increased to 11.5 percent in 2001/02. The revenue during the same time period decreased from 7.3 in 1996/97 to 7 percent in 2001/02. Development expenditure also declined from 9.5 to 7.5 during the same period. Analyzing this pattern he recommended for contractionary fiscal policy rather then expansionary one during war period.

Karna (2007) in his article has emphasized on the performance of public expenditure of Nepalese economy. According to him, 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.

B.C. (2009) in his thesis has primarily confined to the analysis of trend and pattern of public expenditure and impact on GDP during the time period of 1991/92 to 2005/06. He found that the regular expenditure has surpassed the development expenditure as against the accepted fiscal norms; development expenditure exceeds the regular expenditure until fiscal year 1997, then after it is lesser than regular expenditure. He has also explained that public revenue is growing slowly than expenditure leading to the widening resource gap. This gap is further extended by the weakness of government towards strong commitment, clear vision and sufficient assessment necessary to chose programs to allocate budget for them in Nepal.

Shrestha (2009) in his research article has asserted a mix of public spending could lead to a higher steady–state growth rate for the economy. Based on the model, the empirical model suggests that expenditure on physical infrastructure is productive in Nepal but its share is declining in slow growth of per capita income. In this context, it would be better to allocate more resources to develop physical infrastructure in Nepal, which not only facilitates private productive activities, but also generates employment in the economy for the mass unemployment.

Timilsina (2010) in his thesis during the time period between 1987/88 to 2007/08 has found that the trend of public expenditure is increasing manner. Development expenditure has increased faster than regular expenditure from 1987 to 1997. There after regular expenditure has increased more than its development expenditure. The major portion of regular expenditure made in debt service payments, maintaining law and order and providing salary to civil servants. He further examined the positive relationship between total import and total government expenditure.

Sharma (2013) in her thesis has examined the role of public expenditure in GDP growth. According to her, the share of development expenditure in total expenditure is in decreasing rate. The share of regular expenditure on the total expenditure at the beginning of the study period was 37.49 percent where development expenditure was 62.51 percent. But at the end of the study period, the share of regular expenditure on total expenditure was 73.3 percent where development expenditure was only 26.7 percent of the total expenditure. It shows that there is very low share of development expenditure on total expenditure. She also argued that in Nepal, many development projects are conducted under the foreign aid. The donor agencies are also involved in the decision making process. On the other side, plans are made in ad-hoc basis. We have to depend upon foreigners for fund as well as skill work force too. Ad-hoc plan, political instability, lack of capital and geographic constraint are the major difficulties for the implementation and completion of the projects.

Subedi (2013) in her thesis during the time period between 1990 to2011, has found that the trend and pattern of public expenditure threat on the fiscal deficit and management. The regular expenditure has increased faster than development expenditure after 1997/98. She also examined the regular expenditure is highly responsive to GDP. Whereas, development expenditure is least responsive to GDP implying that it does not growth at the pace as much as increase in GDP.

MoF (2014) in its publication has examined the total government expenditure in fiscal year 2013/14 is estimated at Rs.517.24 billion. Of this, 68.3 percent has been allocated to recurrent, 16.5 percent to capital and 8.1 percent for repayment of principal and the rest for share and credit investments. Government's actual expenditure in fiscal year 2012/13 stood at

358.63 billion. Of this amount, 69 percent accounted for recurrent, 15.2 percent for capital, 9.8 percent for repayment of principal and the rest for share investment and loan. Expenditure trend and its structural analysis of past few years show that the share of recurrent expenditure to the total expenditure is on declining trend while capital expenditure recorded growth but not to significant level. The recurrent expenditure that hovered around 72 percent of the total expenditure in FY2009/10 declined in its succeeding years and got confined to 68.3 percent in the FY2013/14. In FY2011/12, about 6 percent of the total expenditure was spent on principal repayment against domestic and foreign loans while it grew to about 10 percent in FY2012/13. Its share in the total expenditure increased due to 216 percent increment in principal repayment of domestic borrowing in comparison to that of previous fiscal year. The average growth rate of aggregate expenditure between FY2010/11 and 2011/12 stood at 11.4 percent, while expenditure in the FY2013/14 recorded a higher growth rate.

2.7 Research Gap

Different theories have examined and analyzed the importance of public expenditure in each and every economy. Classical economists say resources are fully employed. There is no government intervention. Keynes say employment depends upon effective demand. Deficit can be effective at the time of depression in lifting the economy upward. Pure theory says amount of resources are determined automatically by public demand.

Even classical economists did not give more emphasis of public expenditure but later on after the Great Depression of 1930s, it came on light. Many economists suggest that government spending is necessary in economy. After the Great Depression of 1930s many economists had laid more attention on the field of public expenditure.

The trend in public expenditure still has their relevancy with respect to their theoretical justification for the optimal provision of goods in the economy consisting both private and public goods. The hypothesis of different economists help the planners and the policy makers to observe the different effects of public expenditure in the economy in different sectors. They help the planners to know before what happens when public expenditure is low or high in the economy.

In conclusion, the findings of various researchers largely differ. This is because different researchers have examined and analyzed their studies through different aspects. Some are concentrated mainly in social sectors, some are in the impact of public spendings in various sectors and some are concentrated in pattern and growth of public expenditure. After reviewing relevant literature in the context of Nepal, increasing trend of public expenditure from 1990/91 to 2012/13 than upward trend in reliance in foreign resources and downward shares of the revenue surplus to meet development expenditure underlines increasing trend of resource gap and high dependence of development expenditure in external resources.

CHAPTER - 3

RESEARCH METHODOLOGY

3.1 Research Design

Different techniques such as qualitative as well as quantitative data have been employed to achieve the above stated objectives. Quantitative techniques such as percentage, ratio, mean, standard deviation, regression equations and other measurable techniques are used. This study is based on certain research techniques consisting of simple regression analysis, tabular analysis and graphical analysis. The major variables are Gross Domestic Product (GDP), Government Regular Expenditure and Government Development Expenditure and so on.

3.2 Nature and Sources of Data

This research study is descriptive as well as analytical in nature. It is based on secondary sources of data and information published by different governmental as well as non-governmental organizations, which have been issued and published in books, magazines and reports, journals and so on. Secondary information and data have been collected from the following sources.

- Publications of Nepal Rastra Bank.
- Economic Surveys and budgetary speeches of different years – By Ministry of Finance.
- Documents and publications about various Five Year Plans – By National Planning Commission.
- Statistical pocket books of various years – By CBS.
- Newspapers, Published articles on different journals and magazines.
- Thesis and dissertations available at the central library of T.U.
- Publications of International Monetary Fund.
- Publications from international agencies such as world Bank, Asian Development Bank, United Nations Development programs and so on.

3.3 Period of the Study

This study is based on the time series data of 23 years covering the period between 1990/91 to 2012/13. The budgetary system of Nepal shows deficit budget in character. During early 1990s, democracy was restored in the country and implemented the Eight Plan (1992-1997). At this plan period, government introduced open, liberal and market-oriented policy which increased the role of government. Hence, rationale for choosing this period is that after the establishment of multiparty democracy system government has increased the volume of public expenditure but the economic indicators are very poor. So, this thesis mainly deals why after the multiparty democracy system there is low economic growth.

3.4 Methods of Data Analysis

Quantitative method has been employed for the purpose of data analysis. However, quantitative tools have been employed widely. Tabulation of data and graphical presentation of the data are made to make the information visible as well as understandable easily.

Hence, use of quantitative tools is the best method to analyze data and also to reach the conclusion. Different statistical tools for both estimation and tests have been employed as demanded by the objectives which are mentioned earlier. In general, following models of analysis are used:

3.4.1 Regression Analysis

Regression analysis is a statistical technique which deals with the relationship between variables. Regression equation has been used while studying the effects of public expenditure on output (GDP). For this, variables will be defined as per the purpose of analysis. Such variables are Gross Domestic Product, Regular Expenditure and Development Expenditure and so on. Regression equation can be defined as:

$Y = \alpha + \beta X$……….(ί)

Where, α is a constant and β is a regression coefficient which shows that the percentage change in dependent variable due to change in independent variable. Hence Y shows the growth rate of GDP and X shows the growth rate of development expenditure and regular expenditure. To examine the linear relationship of the variable, following statistical measures are carried out to check the reliability of the analysis.

(a) Coefficient of Determination (R^2)

The R-squared (R^2) statistic measures the success of regression predicting the values of dependent variable within the sample. The R-squared is the functions of variance of dependent variable explain by the independent variables. The R^2 statistic computed as,

$$R^2 = \frac{ESS}{TSS}$$

Where, ESS is the Explain Sum of square.

TSS is the Total sum of square.

Hence, the value of R^2 lies between the 0 and 1. That is $0 \leq R^2 \leq 1$. The value of R^2 will be one if the regression fits perfectly and zero if it fits no better than simple mean of dependent variable.

(b) Adjusted Coefficient of Determination (R^2)

This measure will also be employed to get additional information about the goodness of fit is that the R^2 will decrease as more regression are added. In the extreme case, we can obtain as (R^2) of one, if we include as many independent regressors as there are sample observations. The adjusted commonly denoted as (R^2) penalizes R^2 for the addition of regressors, which do not contribute to the explanatory power of the model. So, the adjusted R^2 is calculated to overcome this problem.

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

$$= 1 - \frac{\sum e2/n-k}{\sum y2/n-1}$$

$$=1-(1-R^2)\frac{n-1}{n-k}$$

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

(C) t- Test

It is used to test the hypothesis about any individual partial regression coefficient. To compute the t- test, the standard error for each output is computed separately. The t-ratio is the significant test of the regression coefficient of the hypothesis. In the broader sense, the test of significance is a procedure by which sample results are used to verify the truth or false of a null hypothesis. The decision to aspect or reject null hypothesis is made on the basis of the value of test statistic obtained from the data. The t- statistic, which is computed as the ratio of an estimated coefficient to its standard error is used to test the hypothesis that a coefficient is equal to zero.

To find the intercept of t-statistic, we should examine the probability of observing the t-statistic given that the coefficient is equal to zero. If the value of test statistic falls in the critical region then the null hypothesis is rejected.

3.5 Definition of Variables

In this study, regression equations have been carried out on different formats. The variables used in this study are as follows:

Total Expenditure (TE): Total public expenditure or government expenditure means the actual expenditure during the specified year. It has been taken about exclusively from the economic survey.

Regular Expenditure (RE): Regular expenditure is also the major component of the total expenditure. It is also known as recurrent expenditure. This type of expenditure includes expenditure made on defense general administration and interest payment.

Development Expenditure (DE): It is basically the capital expenditure. It is the public investment and desirable too from the development perspective.

Gross Domestic Product (GDP): GDP has been taken as a proxy variable for output. It has been taken out exclusively from the economic survey.

To obtain the percentage growth rate of GDP, revenue and public expenditure following methods have been applied. Growth rate of GDP is calculated as,

$$G = \frac{G_t - G_{t-1}}{G_{t-1}} \times 100$$

Where, G_t = GDP of current year (At current year price)

G_{t-1} = GDP of previous year

Similarly, the growth rate of public expenditure is calculated as,

$$G.\ Exp. = \frac{G.\ Exp._t - G.\ Exp._{t-1}}{G.\ Exp._{t-1}} \times 100$$

Where, $G.\ Exp._t$ = Government expenditure in current year price

$G.\ Exp._{t-1}$ = Government expenditure in previous year

But the average growth rate has been calculated as:

$$\text{Average Growth Rate} = \frac{\text{total growth rate}}{\text{number of year}}$$

The analysis is based on the evidence put forward by ordinary least square regression equation. However, a note of caution in terms of limited data set, application of limited explanatory variable and low degree of freedom has taken into the account while interpreting the results. Therefore, the result which is found through this process is taken as indicative only. The analysis is based on time series data of 23 years covering the period 1990/91 to 2012/13. Obviously, this study period doesn't correspond with high degree of freedom. This short study period certainly has to do with the significance of the parameters. After examining and analyzing the data, the necessary policy measures have been developed for recommendations. This is the last objective of the study.

CHAPTER - 4

TREND AND STRUCTURE OF PUBLIC EXPENDITURE IN NEPAL

4.1 Introduction

Government expenditure is an essential tool for an economy. It is a synonymous of public expenditure. In Nepal, the main objectives of the government expenditure are stability, growth and welfare.

After the establishment of democratic system in Nepal, it also started budgetary and planning process. The country started to keep relation with rest of the world. As a result, the volume of foreign aid, grant, loan and other financial supports also increased. From this time period, there is increasing trend of the size and are of public sectors activities in economy. Hence, there are two reasons behind the increasing of public expenditure. First, increasing demand pressure of public services due to increase in migration, population growth and urbanization. At that time, the population growth rate of Nepal was very high. Democratic government has to be responsible to provide education, health, sanitation and other basic requirements. Second, the economy was highly depended on agriculture. There were no infrastructures like roads, electricity, communication and so on. So the public sector completed to make larger investment in infrastructure and other industrial development activities to reduce more pressure on the subsistence level i.e. agriculture sector. It was necessary to create employment opportunities in the economy. On the other hand, in Nepalese economy private sector is not well developed. In such a situation, there is dual role of public sector in economy. On the one side, it has to be directly involved in the production process and on the other hand, it has to involve in such programs which can help to stimulate the private sector in participating development activities. Thus, both demand and supply side made excessive influences on expanding volume of the public expenditure in the economy.

The establishment of multiparty democracy system in 1991, Nepal also entered into the global economy. It also adopted liberalization and global policies. Many developed countries and international organizations such as International Monetary Fund, World Bank and Asian Development Bank gave fund to the developing countries to make investment in public sector to the government. As a result, there has been found a series of increasing trend in public expenditure. Some supported in establishing welfare state in democratic set-up while some were related to establish the norms in the fiscal practice. Nowadays, public expenditure is also taken as a tool to redistributive fiscal policy. It is being on important factor to reduce or minimize inequalities in the society.

The output and price of effects of a given level of public expenditure can play vital role but it depends upon the level of capacity utilization, method of financing the expenditure and the composition of expenditure. The budgetary system in Nepal is classified in two categories: regular expenditure and development expenditure. The development budget includes all projects and programs financed by foreign loan and grants. It has direct effect on output and productivity where regular expenditure is consumption type, generally general administration, social services, defense, loan repayments etc.

In the beginning of the 20^{th} century all modern government showed the increasing tendency of public expenditure in both relative and absolute term. Nepal is not exception of this tendency. There are several factors responsible for this tremendous growth in public expenditure in modern age. They are the concepts of welfare state, inflation, depression, urbanization, defense, provision of socio-economic services to the people, concept of regional planning and economic growth, debt servicing, direct production of public goods and establishment of corporate and public enterprises etc.

4.2 Reforms in Public Expenditure

The reform in fiscal front was started from mid 1980s. Nepal produced large fiscal deficits following the 1980 referendum, the verdict of which went into favor of part less panchayat system against multi-party system (Acharya, 1999). Successive government formed after the referendum followed an expansionary fiscal policy.

Reforms in public expenditure form as such were launched during late 1990s when the government was preparing a comprehensive Poverty Reduction Strategy Paper (PRSP) during the Tenth Plan. These reforms excessively include the public expenditure management as an important agenda. Critical actions in this area include prioritizing all development expenditures on the basis of PRSP priorities and providing adequate finding for high priority activities. For this purpose, a realistic Medium Terms Expenditure Framework was adopted, projects were ranked into these categories$P_{1,}$ P_2 and P_3 (NPC, 2002).

National Planning Commission and Ministry of Finance are optimistic that these initiatives will completely transform the traditional planning and budgeting, fund allocation and release process. Unlike in the past when hundreds of questionable projects found their way into the development budget, procedures for inclusion of projects in the budget and for funding them are now more transparent and explicit (MOF, 2004).

4.2.1. Medium Term Expenditure Framework (MTEF)

After the recommendation of Public Expenditure Reform Commission (PERC), Medium Term Expenditure Framework (MTEF) is included in the Tenth Plan. It is a transparent planning and budget formulation process in which ministry of finance (MOF) allocates public resources to their strategic priorities of development, while maintaining overall fiscal discipline. The need of MTEF has also been reinforced by a number of other considerations; the most important consideration is the poverty reduction strategy paper in the tenth plan. MTEF has different objectives to address different public expenditure issue. From that several reforms measures in the fiscal sector were introduce an initiated on both the revenue and expenditure side.

National Planning Commission more active in project selection, monitoring and evaluation. MOF will require preparing budget on the basis of three years rolling expenditure plan. The midterm evaluation of the budget will be conducted on time and budget will be managed accordingly. In 2000 budget gave especial emphasis on reform in Public Expenditure Management (PEM), revenue administration and improvement in the effectiveness of foreign aid.

Government of Nepal the Immediate Action Plan (IAP), in June 2002; which was design to public expenditure had adopted reforms in three critical areas prioritizing improving service delivery, strengthening anti-corruption and accountability measures. The main IAP points for public expenditure included setting a realistic budget ceiling and eliminating a number of low priority projects. Implementing public procurement and financial accountability reforms public posting of budget information and tracking of expenditure.

In the Tenth Plan (2002-2007) has focused on poverty reduction supplemented by rolling Medium Term Expenditure Framework (MTEF), which will be updated every year and provides for the first time in Nepal a effective mechanism to link the annual budget with the Five Year Plan and adjustment in programs as needed. Private and non-agriculture sector was given more priority with 76 percent resource allocation then social sector was given 38.6 percent. For such resource allocation, investment share of private sector in the plan was 72 percent and the remaining resource was finance by the government.

At the end of Tenth Five Year Plan, NPC has formulated and implemented the three interim plans, echoing the sentiments and expectations of the people’s revolution. The interim plan was prepare to address issues specific to the transition period, in a past conflict situation. This plan put special emphasis on increasing public expenditure to assist relief and generate employment as well as on peace building, reconstructions, rehabilitation, reintegration, inclusion and revitalization of the economy.

The Interim Approach Paper is successor of the Interim Plan (2007-2010) had main objectives to reduce poverty and exist unemployment establishing sustainable peace by allocating proper expenses and effective service delivery. In order to achieve development goals to improve socio-economic level of people through poverty reduction and permanent peace through inclusive and equity based employment and economic growth by allocating proper expenses. This has been stated recent budget speeches and Millennium Development Goals etc.

Resource Committee (RC) is chaired by Vice Chair Person of National Planning Commission, Comprising of Number of NPC, Macro sector and Governor of NRB, Financial Comptroller General and Secretary of Ministry of Finance. The RC determines the size of budget by analyzing overall economic situation of the country with the help of macroeconomic indicators. The NPC sets out the priority and policy goals with respect to plans and programs for forthcoming FY and provide necessary guidelines to the concerned ministry and the MoF, prior to sending of circular for preparation of budget. In the case of capital budget the first round of discussion takes place at the NPC.

Government of Nepal has initiated several reforms majors to strengthen monitoring and evaluation system. Result Base Monitoring and Evaluation Guidelines 2010 have been approved by NPC in July 2010. The guideline was prepared with wide consultation of sectoral ministry and other stakeholders including donor partners. So, the guideline will be implemented for donor funded programs and other priorities.

4.3 Trend of Public Expenditure and GDP

In Nepal, the trend of public expenditure is increasing and the budget is formulated under the tradition budgetary approach where total expenditure is divided under the two headings i.e. regular expenditure and development expenditure which is also known as capital expenditure. Besides that the functional classification like economic service, social service, defense, general administration etc. is the criteria of the budgetary management. Major public expenditure categories come under economic service, social service, loan repayment and interest payment etc.

Public expenditure figures presented in the table no 4.1 show the steady and increasing trend of expenditure programs during the period of 1990/91 to 2012/13. Although its development expenditure has increased faster than its regular expenditure until 1998/99 then after regular expenditure exceeds. More over the regular expenditure has surpassed the development expenditure as against the accepted fiscal norms. That is more resources have been devoted for recurrent expenses rather for accumulation of capital.

Table No. 4.1

GDP, Nominal Distribution and Percentage Distribution of Public Expenditure

(Rs. in million)

Fiscal Year	Total GDP	Nominal Distribution			Percentage Distribution (RE and DE as % of TE)		
		Total Exp. (TE)	Regular Exp. (RE)	Development Exp. (DE)	Regular Exp. (RE)	Development Exp. (DE)	Total Exp. (TE)
1990/91	116127	23549.8	7570.3	15979.5	32.15	67.85	100
1991/92	144933	26418.2	9905.4	16512.8	37.49	62.51	100
1992/93	165350	30897.7	11484.1	19413.6	37.17	62.83	100
1993/94	191596	33597.4	12409.2	21188.2	36.94	63.06	100
1994/95	209974	39060.0	19265.1	19794.9	49.32	50.68	100
1995/96	239388	46542.4	21561.9	24980.5	46.33	53.67	100
1996/97	269570	50723.7	24181.1	26542.6	47.67	52.83	100
1997/98	289798	56118.3	27174.4	28943.9	48.42	51.58	100
1998/99	330018	59579.0	31047.7	28531.3	52.11	47.89	100
1999/00	366251	66272.5	34523.3	31749.2	52.09	47.91	100
2000/01	425454	79835.1	42769.2	37065.9	53.57	46.43	100
2001/02	444052	80072.2	48863.9	31208.3	60.68	39.32	100
2002/03	473546	84006.1	52090.5	31915.6	65.44	34.56	100
2003/04	517993	89442.6	55552.1	33890.5	62.11	37.89	100
2004/05	566579	102570.4	61686.4	40884.0	60.15	39.81	100
2005/06	630301	110889.2	67017.8	43871.4	66.44	39.56	100
2006/07	696989	133604.6	77122.4	56482.2	57.72	42.28	100
2007/08	755257	161349.9	91446.9	69903.0	56.68	43.32	100
2008/09	909309	219662.0	127738.9	91923.1	58.15	41.85	100
2009/10	1060881	259689.1	151019.1	108670.0	58.15	41.85	100
2010/11	1161949	295363.4	170295.4	125068.0	57.66	42.34	100
2011/12	1387482	339168.3	243183.09	95984.40	71.7	28.3	100
2012/13	1522853	358638.5	247460.06	111177.94	69	31	100

Source: Economic Survey, 2000/01, 2011/12,2012/13 & 2013/14, MoF.

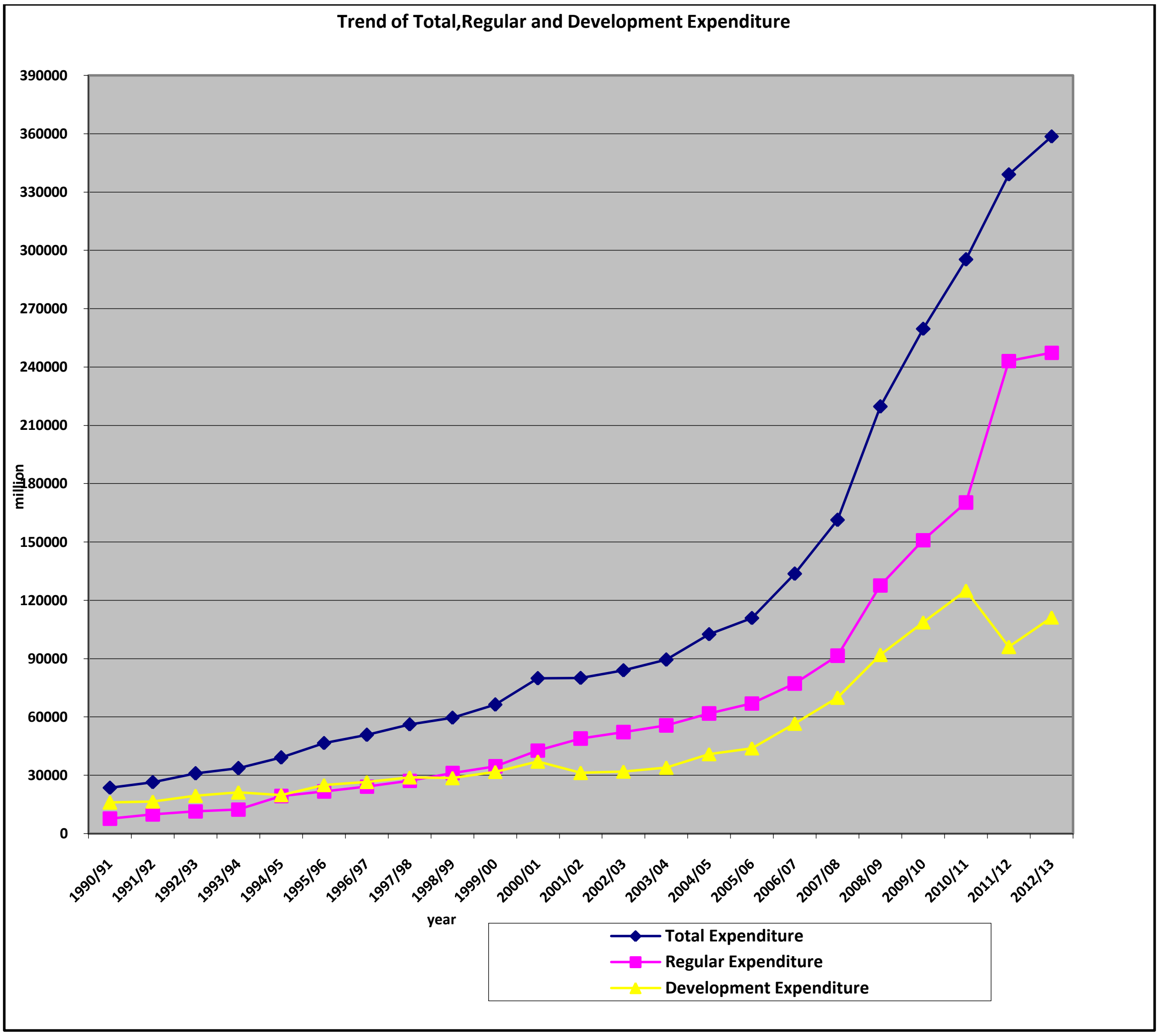
The table 4.1 shows that both regular and development expenditure are increased in each year. Moreover the regular expenditure has suppressed the development expenditure which is against the fiscal norms. In FY 1990/91 the total expenditure was Rs 23549.8 million which is increased to Rs 358638.5 million in the FY 2012/13. Regular expenditure was also increased from Rs 7570.3 million in the FY 1990/91 to Rs 247460.06 million in the FY 2012/13.The development expenditure does not consistently increase in the study period. Development expenditure was greater than the regular expenditure till fiscal year 1997/98 then after it is lesser than regular expenditure. In FY 1994/95, 1998/99 development expenditure is decreased by the amount Rs 1393.3 million and Rs 412.6 million respectively than the previous year. Here, again in FY 2001/02 development expenditure is decreased by Rs 5857.6 million from the previous year. But the overall development expenditure is increased from Rs 15979.5 million to Rs 111177.94 million in the study period.

The development expenditure grew in absolute term and the pace remained low. But regular expenditure is increasing in high pace mainly due to the responsibility of maintaining law and order, salary, high debt servicing obligation. In order to meet the minimum need such as food, clothing, health, drinking water, education, communication, transportation and other services the growth rate in development expenditure should increase both in absolute as well as relative terms. However, the growth of development expenditure remained lower than regular expenditure. This is due to the weak implementation of development projects resulting from political instability, unstable government and lack of commitment.

The table 4.1 also tells about the percentage share of regular and development expenditure in the total expenditure, which gives the more ideas about the structure of public expenditure. In this table the overall pattern shows increasing regular expenditure and decreasing development expenditure. It is clear indication that more resources have been allocated to recurrent expenditure than development expenditure. Here, regular expenditure is not only growing in absolute term but also growing as a share of total expenditure. In FY 1990/91 the share of regular expenditure on total expenditure was 32.15 percent where it raised to 69 percent in FY 2012/13 at the end of the study period. On the other hand the share of development expenditure was two third of total expenditure in FY 1990/91 and it decreased to 50 percent up to 1997/98. The regular expenditure started to suppress the development expenditure from FY 1998/99 and remained 31 percent in FY 2012/13. In fiscal year 2002/03 the development expenditure decreased by 8 percent against that the FY 2001/02 totaling Rs 29 billion. The ratio of regular and development expenditure is also different the tendency of regular expenditure is rising continuously from FY 2002/03. In terms of ratio of regular and development expenditure were 61 percent and 39 percent respectively in FY 2001/02.

The trend of total, regular and development expenditure during the period 1990/91 to 2012/13 is shown graphically as follow:

Figure No. 4.1



Source: Based on the table no. 4.1

On the basis of table 4.1, figure no. 4.1 is drawn which shows steady, constant and increasing trend of public expenditure during the period 1990/91 to 2012/13. Before FY 1998/99 development expenditure was greater than regular expenditure in total expenditure. After that regular expenditure was exceeds development expenditure. We can see from the table 4.1 and figure no.4.1, that the several important aspects of Nepalese public expenditure trend. The main goals of the government are to meet the major social objectives. Poverty alleviation is the one of the main social objective of government which increases the share of regular expenditure. The large portion of public expenditure is used in unproductive sector which have very little contribution for economic growth of the country. In Nepal, the private sector is in infant situation, the government expenditure has failed to do this job. Hence, the willingness and commitment of government to fulfill the major social objectives specified by periodic plans and fiscal discipline are questionable against the background of current public expenditure pattern. These trends have some important consequences of institutional weakness and political commitment of reforms in public expenditure management as well as resource allocation practices.

Hence to get more precise and meaningful picture, it is better to compare all these expenditure i.e. regular expenditure, development expenditure and total expenditure with respect to the country's Gross Domestic Product (GDP), which is shown in table 4.2, where all information have been expressed as percent of GDP (at current price).

Table No. 4.2

Total, Regular and Development Expenditure as Percentage of GDP (In nominal term)

(Rs. in million)

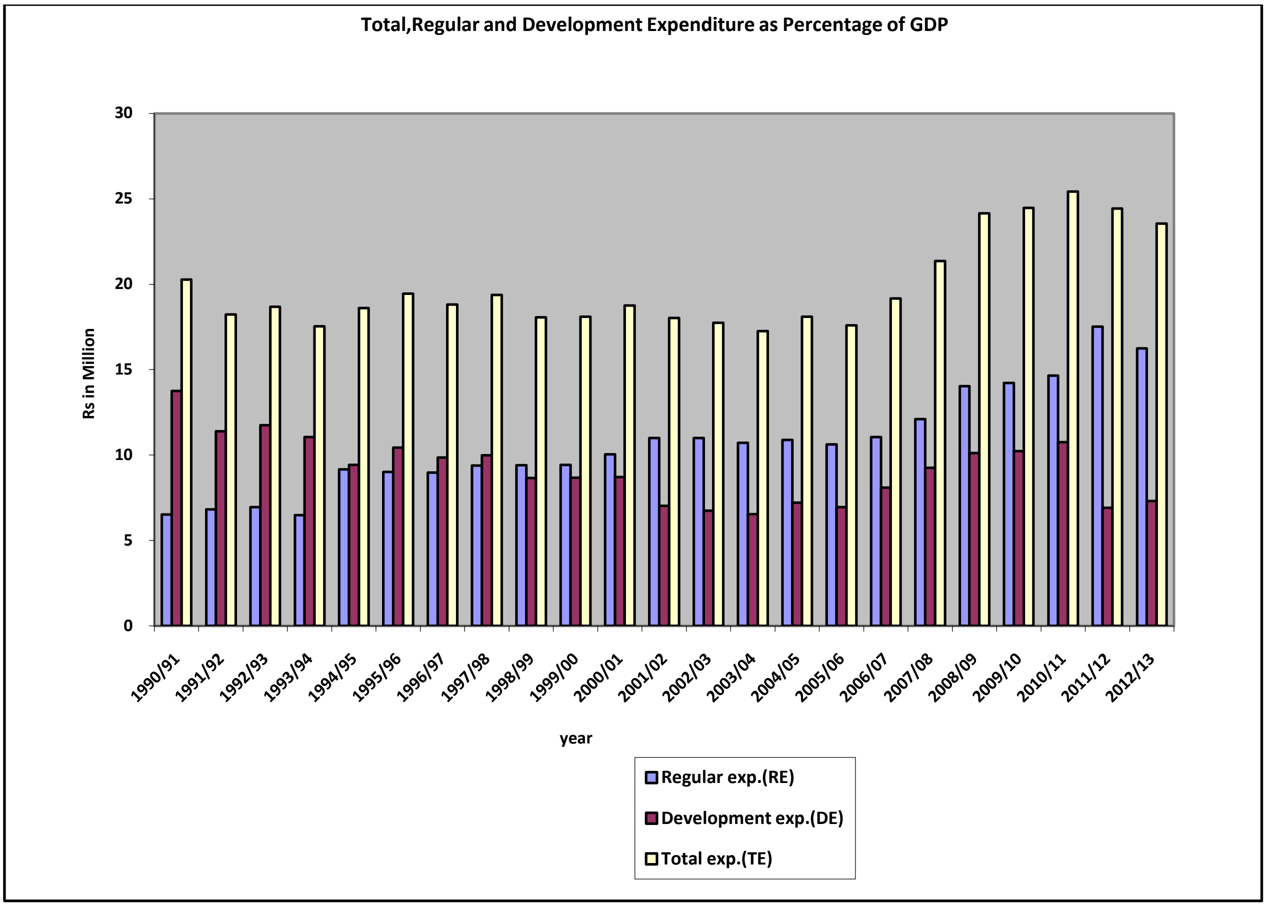
Fiscal Year	GDP (in million)	Regular Expenditure (%)	Development Expenditure (%)	Total Expenditure (%)
1990/91	116127	6.52	13.76	20.28
1991/92	144933	6.83	11.39	18.22
1992/93	165350	6.95	11.74	18.69
1993/94	191596	6.48	11.06	17.54
1994/95	209974	9.17	9.43	18.60
1995/96	239388	9.01	10.44	19.45
1996/97	269570	8.97	9.85	18.82
1997/98	289798	9.38	9.99	19.37
1998/99	330018	9.41	8.65	18.06
1999/00	366251	9.43	8.67	18.10
2000/01	425454	10.05	8.71	18.76
2001/02	444052	11.00	7.03	18.03
2002/03	473546	11.00	6.74	17.74
2003/04	517993	10.72	6.54	17.26
2004/05	566579	10.89	7.21	18.10
2005/06	630301	10.63	6.96	17.59
2006/07	696989	11.06	8.10	19.16
2007/08	755257	12.11	9.25	21.36
2008/09	909309	14.04	10.11	24.15
2009/10	1060881	14.23	10.24	24.47
2010/11	1161949	14.66	10.76	25.42
2011/12	1387482	17.52	6.92	24.44
2012/13	1522853	16.25	7.30	23.55

Source: Economic Survey, 2000/01, 2011/12, 2012/13& 2013/14, MoF.

Table 4.2 shows that the total expenditure has not changed in relation to GDP from the early 1990s to early millennium. Total public expenditure as a percentage of GDP has fluctuated around 19 percent during the study period. In FY 1990/91 the share of total expenditure was 20.28 percent while it went to 23.55 percent in FY 2012/13. In FY 2010/11 the share of total expenditure was 25.42 percent which was the highest during the study period and 17.26 percent in FY 2003/04 which was the lowest one. However, there are remarkable changes in case of regular expenditure and development expenditure. In FY 1990/91 regular expenditure as percent of GDP was just 6.52 percent which is reached to 16.25 percent at the end of the study period. It is near about two times more. But the case of development expenditure is just opposite. Development expenditure as percent of GDP was 13.76 percent in FY 1990/91 which is decline to 7.30 percent at the end of study period. The share of development expenditure is lowest 6.54 percent in the FY 2003/04.

Hence, the regular, development and total expenditure as a percent of GDP during the period 1990/91 to 2012/13 is shown graphically as follows:

Figure No. 4.2



Source: Based on the table no.4.2

Table no. 4.2 and Figure no. 4.2 shows the increasing trend of regular expenditure and decreasing trend of development expenditure. The declining total expenditure as the ratio of GDP may be justifiable under the content of liberalization and privatization. Due to the liberalization policy the expansion private sector and limiting the public activities. The production of commercial goods will certainly reduce the share of public expenditure to GDP. Simply because contribution of public enterprises who are supposed to add to GDP decline. However, the increasing share of regular expenditure and decreasing development expenditure is really alarming sign for developing economies like Nepal. Against the background of low growth rate of the revenue than government expenditure, this is leading to widening resource gap.

The government needs to revise its policy regarding government expenditure and restructure its expenditure pattern because huge amount of income used only repayment of principle and interest payment. Government should follow that policy in periodic plan which raised development expenditure. Hence, the above table also shows the misallocation of public expenditure which is the main cause of backwardness of Nepalese economy. So, the concerned stakeholders should correct their policies. The priority should be given development expenditure rather than the regular expenditure.

4.4 Growth Rate of GDP, Total, Regular and Development Expenditure

The trend and pattern of public expenditure has been analyzed with the help of nominal values excluding permanent influences like population and prices. A simple approach of examining the growth rate of public expenditure is shown below which help to examine the relation between these variables. Growth rate of total, regular and development expenditure do not show the any specific pattern rather than the random attribute. In some fiscal year, there are large upswing and in some fiscal year there are large downswing in the growth rate of all categories. Public expenditure in Nepal has shown faster than the national income. The growth rates of total, regular and development expenditure during the study period are presented in the following table 4.3:

Table No. 4.3

Growth Rate of GDP,Total, Regular and Development Expenditure

(Rs. in million)

Fiscal Year	Total Government Exp. (%)	Regular Exp. (%)	Development Exp. (%)	GDP (%)
1990/91	-	-	-	-
1991/92	12.18	30.85	3.34	24.81
1992/93	16.96	15.04	17.57	14.09
1993/94	8.74	8.06	9.14	15.87
1994/95	16.26	55.25	-6.58	9.59
1995/96	19.16	11.92	26.20	14.00
1996/97	8.98	12.15	6.25	12.61
1997/98	10.64	12.38	9.05	7.50
1998/99	6.17	14.25	-1.43	13.88
1999/00	11.21	11.19	11.28	10.98
2000/01	20.46	23.89	16.75	16.16
2001/02	0.30	13.61	-15.80	4.37
2002/03	4.91	13.13	2.27	6.64
2003/04	6.47	1.05	6.19	9.38
2004/05	14.67	11.04	20.63	9.38
2005/06	8.12	8.64	7.31	11.25
2006/07	20.5	15.1	25.8	10.58
2007/08	20.8	18.6	16.2	8.36
2008/09	36.1	39.7	25.7	20.39
2009/10	18.2	18.2	10.7	16.67
2010/11	13.7	12.8	6.5	9.53
2011/12	14.83	42.8	-23.25	19.41
2012/13	5.74	1.76	15.83	9.75
Average	12.83	17.02	8.25	11.97

Source: Economic Survey, 2000/01, 2011/12, 2012/13& 2013/14, MoF.

The growth rate of total public expenditure on the fiscal year 1991/92 is 12.18 percent than that of 1990/91. There were maximum growth rate in FY 2008/09 which becomes 36.1 percent where there is just 0.30 percent growth rate in the FY 2001/02. Similarly, regular expenditure in the beginning of the study period was 30.85 percent which increase to ever highest growth rate in FY 1994/95 of 55.25 percent, which was substantially higher than the periods average of 17.02 percent. Distinguishing feature of both total and regular expenditure from the development expenditure is that they never achieves negative growth rate during the period. In an average, total expenditure has increased by 12.83 percent against the increase in regular expenditure 17.02 percent. The growth rate of development expenditure in the beginning of the study perod was high but there is negative growth rate of development expenditure in the FY 1994/95, 1998/99, 2001/02 & 2011/12. In FY 1995/96 there is 26.20 percent growth rate in development expenditure which is the highest growth achieved during the study period. The average growth rate of development expenditure is 8.25 percent.

The GDP is also in increasing trend. In the beginning of the study period in FY 1990/91 the GDP was Rs 116127 million which increased up to Rs 165350 million in FY 1992/93. The nominal growth rate of GDP was 14.08 percent. The GDP growth rate in 2008/09 was 20.39 percent which was the highest growth rate during the study period. The growth rate of GDP is not constant, it is increasing and decreasing trend. The main reason behind the decline in growth rate of GDP was to decrease the share of development expenditure. The average growth rate of GDP is 11.97 percent.

The average growth rate figure shows that, the highest growth rate of regular expenditure followed by total expenditure. The main cause in negative growth rate of development expenditure in the economy is that, there is political instability in the country. So that, many development projects are not being completed on time. On the other hand, there is no well being planning mechanism. Most of the development projects are made by adhoc decision method. Similarly, for the proper management of development programs in local level, there is no local government since decads. On the other side, the volume of regular expenditure is increasing year by year. Hence, the main reasons for increasing regular expenditure are subsidies for inefficient government enterprises, overstaffing, defense, loan and interest payment and misutilization of public expenditure such as vehicles, fuel, electricity etc. So, the major implications of increasing regular expenditure and negative growth of development expenditure may lead to stagflation on Nepalese economy. It may create unemployment, inflation, trade deficit and also may be hampered in balance of payment. Increase in regular expenditure and decrease in development expenditure implies that only certain people may be benefited. It ultimately helps to create inequality in the economy.

4.5 Structure of Public Expenditure

The structure of public expenditure has important implication for the overall effectiveness of public expenditure programs. To know the structure of public expenditure the first attempt should be go from the viewpoint of sectoral pattern of spending. Regular and development expenditure are the two major components of public expenditure, this is the budgetary classification. In each and every fiscal year, the total expenditure is divided into these two headings. Then both types of expenditures are divided into various sub-headings as general administration, economic services, social services, defense, loan repayment, miscellaneous and others. The effective of public expending also depends on how resources are allocated among various sectors and how well the allocated resources are used in there sectors. The sectoral expenditure pattern during the study period shows that economic service sector received the highest share of total expenditure in the beginning years. But the share of economic services expenditure had been declining continuously and remained less than that of the social service sector at the end of the study period.

In the head of others like constitutional organs, revenue administration, economic administration, foreign services also higher volume of public expenditure in Nepalese economy. Here, the main sectors of public expenditure are social service, economic services, interest payment and defense. But the effectiveness expenditure of these sectors in economic development is very insignificant. Higher expenditure on interest payment means huge amount of total expenditure goes to out of country which is the burden to the developing economy like Nepal. Similarly, higher expenditure on defense means the expenditure is being made none productive sector. It creates only demand pressure in economy. On the other hand, there was high volume of public expenditure on economic and social service sector, it means the expenditure is not effective in the economy.

4.5.1 Regular Expenditure

According to the budgetary classification of public expenditure, expenditure can be divided in two heads i.e. regular expenditure and development expenditure. Regular expenditure includes the recurrent type of expenditure. It has also various components. The main functional components are constitutional organs (CS), 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 and interest (LRI) and miscellaneous (M). Miscellaneous includes traveling expenditure of dignitaries and government delegation, pension, allowances and gratuity, hospitality emergency help, donation and prizes, compensation, miscellaneous and contingency.

After the fiscal year 2011/12 the classification pattern of regular expenditure has changed. It has also divided in different headings like general public service, defense, public peace security, economic affairs, environment protection, residence & community facilities, health, education, entertainment, culture & religion and social security. Every heading has included various subheadings.

Table no. 4.4 show the composition of regular expenditure under different heads as percentage of GDP. These categories have been divided into different categories, which are not expenditure is of loan payment and interest followed by social service, defense, general administration and miscellaneous service respectively. In the table loan repayment and interest payment have higher share among than other categories.

Table No. 4.4

Regular Expenditure under Different Heads

(Rs. in billion)

Fiscal Year	Const. Organ	General Adm	Rev. Adm	Eco.adm Planning	Judical Adm	Foreign Service	Defense	Social Service	Eco. Service	Loan & invest	Loan Rep Interest	Misc	Environment Protection	Public Peace Security	Entertainment, Culture & Religion	Social Security	Residence & Community Facility
1990/ 91	0.19	1.18	0.12	0.048	0.08	0.18	1.15	0.74	0.37	0.01	2.41	1.08	-	-	-	-	-
1991/92	0.28	1.53	0.17	0.06	0.11	0.23	1.49	1.00	0.55	0.00	3.80	0.68	-	-	-	-	-
1992/93	0.17	1.82	0.19	0.07	0.15	0.31	1.72	1.27	0.59	0.2	4.56	0.62	-	-	-	-	-
1993/94	0.20	1.90	0.19	0.08	0.15	0.33	1.88	1.35	0.61	0.02	4.86	0.85	-	-	-	-	-
1994/95	0.21	2.12	0.22	0.09	0.16	0.38	2.00	4.44	1.35	0.01	6.08	2.20	-	-	-	-	-
1995/96	0.23	2.51	0.25	0.10	0.19	0.39	2.13	5.38	1.53	0.02	6.72	2.12	-	-	-	-	-
1996/97	0.47	2.84	0.26	0.10	0.22	0.44	2.36	5.91	1.74	0.03	7.53	2.28	-	-	-	-	-
1997/98	0.35	3.16	0.29	0.11	0.25	0.48	2.58	6.11	1.89	0.02	7.68	3.36	-	-	-	-	-
1998/99	0.38	3.62	0.31	0.12	0.28	0.61	2.99	7.38	2.17	0.02	8.72	4.45	-	-	-	-	-
1999/00	0.43	4.07	0.34	0.13	0.28	0.67	3.48	8.33	2.22	0.04	10.03	4.50	-	-	-	-	-
2000/01	0.44	6.26	0.38	0.19	0.32	0.60	3.81	10.88	1.63	0.01	10.39	7.86	-	-	-	-	-
2001/02	0.57	7.73	0.48	0.20	0.44	0.67	5.86	13.35	1.91	0.01	12.21	5.17	-	-	-	-	-
2002/03	0.82	7.82	0.47	0.21	0.44	0.72	7.38	13.75	2.05	0.002	16.8	5.13	-	-	-	-	-
2003/04	0.74	7.33	0.50	0.27	0.45	0.71	6.63	20.81	5.51	0.06	16.86	6.87	-	-	-	-	-
2004/05	0.82	8.23	0.54	0.33	0.50	0.79	8.58	23.4	7.17	0.00	18.84	5.30	-	-	-	-	-
2005/06	1.02	9.27	0.61	0.33	0.56	0.83	9.81	25.38	7.53	1.5	19.90	5.64	-	-	-	-	-
2006/07	0.88	11.16	1.00	0.66	0.58	0.85	10.13	29.49	8.38	6.16	-	7.90	-	-	-	-	-
2007/08	1.64	13.94	0.92	0.36	0.67	1.02	10.56	35.07	9.20	6.37	-	11.68	-	-	-	-	-
2008/09	1.42	16.86	1.21	0.38	0.81	1.15	13.75	47.44	12.05	8.15	-	24.51	-	-	-	-	-
2009/10	1.56	19.57	1.47	0.50	1.05	1.38	16.57	62.39	14.93	9.98	-	21.60	-	-	-	-	-
2010/11	2.41	22.21	1.87	1.38	1.13	1.81	17.41	70.54	17.79	12.74	-	21.01	-	-	-	-	-
2011/12	-	26.67	-	6.70	1.74	-	20.78	81.41	28.03	-	-	-	0.46	34.32	1.86	10.34	3.23
2012/13	-	37.45	-	7.21	1.81	-	18.48	81.21	28.75	-	-	-	0.29	33.02	2.25	11.59	2.31

Source: Economic Survey, 2000/01,2011/12,2012/13 & 2013/14MoF.

From the above table, we can analyze the expenditure for administration (constitutional organ, general, judicial, revenue etc.) all assert nearly one fourth of the total expenditure of which expenditure Foreign Service is substantial except then general administration. The expenditure on revenue administration and economic planning contains very nominal share of total expenditure. In FY 1990/91 the expenditure on Foreign Service was Rs 0.18 billion, while the expenditure on the same FY revenue administration and economic planning was just Rs 0.12 and Rs 0.048 billion. Though the expenditure on revenue administration and economic planning and administration increased in absolute terms of the subsequent years but still has little share over total regular expenditure. For example the share of this total regular expenditure in FY 2010/11 is Rs 1.87 billion and Rs 1.38 billion respectively while the share of constitutional organs, Foreign Service and defense on the same year is 2.41, 1.81 and 17.41 billion respectively all being higher than those two.

In FY 2012/13 the expenditure on general administration is Rs 37.45 billion, while the expenditure on the same FY in economic planning and administration and judicial administration is just Rs 7.21 billion and Rs 1.81 billion respectively. The expenditure on public peace security in FY 2011/12 is Rs 34.32 billion where in FY 2012/13 is Rs 33.02 billion which is less than previous year. On the other hand, the expenditure on social security has increased from 2011/12 to 2012/13 by 12.08 percent.

The amount of general administration, defense, social service, economic service is highest then other due to socio-economic and political nature of the country. Allocation on economic service is quite low in the initial FY then other categories. The share of loan repayment and interest payment have highest amount that shows bulks of resources is devoted for the maintenance of public enterprises. Public enterprises have been suffering heavy loses every year adding extra burden to government. So the categories also consist of loan and interest payment of foreign aid. Another important expect is that a substantial amount is allocated for the salaries, wages, categories (general administration, Foreign Service, constitutional organ, judicial organ) etc. which have left a little amount for other categories like social service expenditure, economic service expenditure and mainly for the organization and management.

4.5.2 Development Expenditure

The main role of public sectors is attaining sustaining growth rate of development. There is 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. It may be argued that as the process of development starts this may lead to increase the demand for such publicly provided goods. In additional to increase in the demand's needs of people in a changing society a further increase in the demand is caused by urbanization, demonstration and inspection effects development expenditure, like regular expenditure is made of different components the main components are constitutional organs, general administration, economic service, social service, miscellaneous etc.

The classification pattern of development expenditure has also changed from the FY 2011/12. It divided as general public service, defense, public peace security, economic affairs, environment protection, residence & community facilities, health, education, social security. The percentage of development expenditure in different headings is presented as;

Table No. 4.5

Development Expenditure under Different Heads as Percentage of Development Expenditure

Fiscal Year	Consi.organs	General Adm.	Eco.& Adm.	Social Service	Eco. Service/ Affiars	Misc	Defense	Public Peace Security	Environment Protection	Entertainment, Culture & Religion	Social Security	Residence & Community Facility	Dev. Exp
1990/91	-	0.07	0.52	22.33	74.43	2.64	-	-	-	-	-	-	15979
1991/92	-	0.08	0.23	30.52	66.99	2.15	-	-	-	-	-	-	16513
1992/93	-	0.14	0.09	37.32	62.38	0.04	-	-	-	-	-	-	19414
1993/94	-	0.14	0.09	33.53	65.32	0.90	-	-	-	-	-	-	21188
1994/95	-	0.16	0.16	31.44	64.94	3.29	-	-	-	-	-	-	19795
1995/96	-	0.16	0.13	3.47	67.98	1.24	-	-	-	-	-	-	24981
1996/97	-	0.13	0.06	34.96	64.25	0.58	-	-	-	-	-	-	26543
1997/98	0.01	0.16	0.06	35.66	61.84	2.24	-	-	-	-	-	-	28944
1998/99	0.10	0.27	0.07	35.98	60.72	2.85	-	-	-	-	-	-	28531
1999/00	0.12	0.49	0.13	57.04	85.74	2.44	-	-	-	-	-	-	31749
2000/01	0.03	0.34	0.52	34.72	56.96	7.40	-	-	-	-	-	-	37066
2001/02	0.04	0.31	0.29	36.62	55.43	6.80	-	-	-	-	-	-	31208.3
2002/03	0.05	2.21	0.12	46.42	47.83	3.33	-	-	-	-	-	-	31915.6
2003/04	0.17	2.73	0.42	33.75	62.10	0.81	-	-	-	-	-	-	33890.5
2004/05	0.15	3.54	0.97	31.84	61.74	1.74	-	-	-	-	-	-	90884
2005/06	0.36	4.46	0.76	38.39	55.95	0.05	-	-	-	-	-	-	43871.4
2006/07	0.11	11.76	0.68	40.32	46.58	0.57	-	-	-	-	-	-	56482.2
2007/08	0.20	3.85	1.73	44.09	48.13	1.97	-	-	-	-	-	-	69903.0
2008/09	0.11	2.49	0.66	47.07	44.81	4.20	-	-	-	-	-	-	91923.1
2009/10	0.08	2.33	1.01	42.45	49.97	4.14	-	-	-	-	-	-	108670
2010/11	0.10	1.80	1.72	46.39	46.41	3.55	-	-	-	-	-	-	125068
2011/12	-	1.25	-	6.84	65.92	-	3.65	6.21	0.88	0.39	0.46	13.20	95984.4
2012/13	-	2.09	-	5.66	66.46	-	4.43	5.37	0.60	0.29	0.36	12.98	111177.94

Source:Economic Survey, 2000/01,2011/12,2012/13 & 2013/14, MoF.

The table 4.5 shows the development expenditure pattern under different major components as percentage of development expenditure. Among economic, social and miscellaneous service, the highest percent share of economic services followed by social and miscellaneous service respectively. In FY 1990/91 economic service was 74.43 percent which decreased in FY 2012/13 and reached at 66.46 percent. The share of social service which claim second highest share of development expenditure and shows some FY in fluctuating trend. In FY 1990/91 the social service expenditure was 22.33 percent and it increased 46.39 percent in FY 2010/11. In FY 2004/05 the share of social service was low then it started to rising. After change in classification pattern of development expenditure from FY 2011/12 it reduced 6.84 percent and 5.66 percent in FY 2012/13. Third highest share of expenditure in this table is miscellaneous expenditure which was 2.64 percent in FY 1990/91 and it reached at 3.55 percent in FY 2010/11 of total development expenditure. This head is significantly higher than other categories like constitutional organ, general administration and economic administrating and planning. Government spend little amount of total expenditure on constitutional organ.

From FY 2011/12 the development expenditure on defense has increased where the expenditure on public peace security, environment protection, residence and community facilities and social security is decreasing trend in FY 2011/12 to 2012/13.

The table 4.5 also highlights some special characteristic. It is seen that social and economic service expenditure holds a large share on total development expenditure. The expenditure on administrations reforms side such as spending on constitutional organs, general administration and economic administration and planning also command some amount on development expenditure signifying the reforms process on the administrative side. These will contribute in realizing the efficient as well as good government with in the country. But at the same time the spending under the miscellaneous head leave an open debate about the productivity of such spending the expenditure must be clearly stated under specific head rather than miscellaneous.

Table No. 4.6

Development Expenditure under Social and Economic Services as Percentage of Total Expenditure

FY	Education	Health	Drinking water	Agriculture *	Forestry	Industries	Communication	Transportation	Electricity
1990/91	10.73	2.29	3.37	16.85	2.87	10.96	0.35	12.38	8.53
1991/92	14.50	3.07	8.08	21.31	5.35	14.69	0.70	14.41	8.56
1992/93	17.84	3.09	9.38	21.12	4.75	5.59	2.44	14.65	11.48
1993/94	18.03	2.64	5.06	26.13	4.56	3.05	2.06	15.87	10.91
1994/95	7.34	4.33	5.56	26.22	2.06	0.13	7.66	15.20	8.91
1995/96	7.17	3.66	4.82	20.57	1.51	1.22	4.61	23.89	12.85
1996/97	8.87	6.10	5.00	17.48	1.74	0.99	4.12	19.98	16.75
1997/98	7.03	7.17	5.77	16.00	1.41	1.64	4.10	19.41	16.25
1998/99	5.75	5.87	6.54	17.27	1.68	1.01	1.63	17.91	16.86
1999/00	8.10	6.69	7.63	16.37	1.63	2.62	0.89	14.78	17.44
2000/01	8.92	6.32	7.71	20.42	1.53	1.17	0.78	17.15	21.83
2001/02	8.82	6.01	5.59	18.60	2.02	1.86	0.86	14.47	14.08
2002/03	2.94	0.49	5.23	6.39	1.17	1.33	5.26	11.48	12.16
2003/04	2.96	0.42	6.09	6.63	1.35	0.12	1.05	11.67	14.00
2004/05	3.08	10.02	3.52	5.39	1.00	0.05	1.31	10.15	17.65
2005/06	3.66	2.16	4.44	6.38	0.33	0.07	0.66	9.52	14.26
2006/07	2.84	2.09	5.63	7.81	0.27	0.16	0.44	11.29	9.64
2007/08	4.24	3.48	5.28	9.79	0.35	0.13	0.44	10.27	8.36
2008/09	3.83	2.91	6.15	6.86	0.30	0.37	0.35	10.76	6.60
2009/10	3.59	2.91	4.90	8.02	0.52	0.32	0.37	15.65	11.50
2010/11	5.00	3.65	3.86	6.84	0.68	0.37	0.30	16.13	9.02
2011/12	0.27	6.56	5.64	20.55	-	1.37	0.50	17.51	10.35
2012/13	0.25	5.41	6.64	21.37	-	0.98	0.52	19.92	10.41

Source: Economic Survey, 2000/01, 2011/12, 2012/13& 2013/14,MoF.

*Agriculture includes irrigation and land reform, after 2011/12 it includes forestry, fishing and hunting.

Table 4.6 shows percentage share of social service and economic service with respect to total expenditure which hold only nominal expenditure are not taking for the analysis. The table exhibits that educations, health and drinking water are the important component of social services expenditure. Education under social service expenditure claims a largest share on the expenditure.

Table 4.6 also reveals that expenditure on these categories have increased from the early 1990s to early millennium. In FY 1990/91, the percentage share of education was 10.73, which decreased to 8.92 percent in FY 2000/01. Similarly the expenditure on health and drinking water was 2.29 and 3.37 percent in FY 1990/91 respectively, both increased by substantial amount of total expenditure but the share of drinking water is larger than health sector. Expenditure under different component of economic services reveals different pattern. The share of agriculture expenditure is higher than other development expenditure. This expenditure has rose by more than two times from FY 1990/91 to 2001/02 but decreased in the end of study period. However, the highest share of agriculture expenditure is 26.22 percent in the FY 1994/95. Similarly it is decreasing and 21.37 percent of total expenditure in the last year of study period. In the context of Nepal, agriculture is the major foundation of economy but not develop in this sector as properly. Thus, government should make appropriate agriculture prospective plan and implement it.

The expenses on transportation are another component which takes also large share of total economic service. The amount is Rs 1979.5 million in FY 1990/91 covers 8.40 percent of total expenditure. This is increasing rate still FY 1997/98 then it starting to decline in coming years. Government takes policy to enlarge the transportation facility to all districts. So that the expenses are growing up and it reached 19.92 percent in FY 2012/13. We can see the percentage of industrial and communication expenses have taken little share of total expenditure in the table, which refers to government try to focused other sector of social and economic sectors. 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 percentage share is on education expenditure. The percentage share of education in an average 6.77 percent of total development expenditure, health and drinking water respectively. Under the assumption of infant private sector and democratic 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 productive of such spending under the different component of social and economic service. Accordingly, there is needing have inter sectoral comparison to guarantee the high yield. So that the major objective of society is poverty alleviation which can be achieved in the desired period.

4.6 Factors Influencing Economic Growth

Economic growth is the rate of change in real output i.e. it is the increase in gross national product. There are various factors that affect economic growth which are as follows:

- Natural resources are the major factors that affect economic growth. If an economy has a plentiful supply of natural resources, it may help to expand economic growth.
- Capital formation is another important factor which affects economic growth. In reality the high rate of capital formation leads to high level of production of goods and services in an economy.The quality of capital is also important role in economic growth.
- Infrastructures of development like roads, electricity, transportation, communication, education, safe drinking water, health are also effect economic growth. If such infrastructures are properly developed, it leads to increase in economic growth directly as well as indirectly. Especially these resources have directly link up with economic activities. There also help in the productivity of an economy which leads to increase in economic growth.
- Technological change affects the economic growth. Technology is essential for the production of goods and services. If an economy adopt latest modern technology than huge amount of production is possible with high productivity. Technological progress produces high level of output with same resources.
- Industrial policy can help to increase economic growth. If the state is following sound industrial policy, total investment in economy increases. Here, government should adopt taxes, subsidies, protection, tax facilities to mobilize economy which increase the productivity of economy. It leads to increase in GDP.
- Economic stability is another factor that affects economic growth. If the economy is running smoothly without high fluctuations then production also increases. On the other hand, high level of fluctuations leads to the affects the productivity of economy. So, economic stability leads the growth promoting with high productivity.
- Human capitals are necessary to mobilize all other resources. It refers to the educated, trained, skillful work force. High level of human capitals has high production capacity to produce goods. Human capital increased the productivity which is vital for economic growth of any country.

- The rule of law is the supportive to increase output. It also create sound environment in economy. Nowadays, the rule of law is being important tools for economic growth. It leads to increase in output of an economy.
- Proper allocation of resources also helps to increase in production. Redistributing of resources helps to increase in aggregate demand of economy which leads to the pressure on more production. The allocation of resources from low to high production sector increase production capacity of economy with high productivity.
- Besides these factors, there are other components such as social and culture factor, size of population, right economic policies, rate of saving, consumption pattern, efficient organization, market situations, financial institutions and capital stock also affects economic growth.

4.7 Factors Responsible for Growing Public Expenditure

There are various factors that plays crucial role for growing public expenditure in the Nepalese economy.

- The Nepalese economy is predominant by the subsistence agricultural sector. Most of the people reside in the rural areas. Somehow the government is compelled to make larger investment in the infrastructure and other industrial development activities. This is done in order to reduce more pressure on the subsistence sector and generate more employment opportunities in the economy.
- The population growth of Nepal is 1.35 percent, according to the population census in 2068. The increased population has demands for more social and economic services. This creates demand pressure to the government. Similarly, due to increase in the level of money income, the demand pressure of public services is increasing consecutively. Every year, the government spends larger amount for providing educational, health and other basic minimum needs and services to the public. This is one cause for expanding the size of public expenditure.
- In Nepal, the government has faced over staffing problem in the government offices and public corporation. At the same time, technical man power is not sufficient in the country. In order to fulfill these requirements government invites the appropriate technical manpower from abroad. In this way large amount of regular expenditure has been spending as salaries and allowances. Over time this amount has been increasing.

- The supply factor possibly is another cause of growing public expenditure in Nepalese economy. The private sector is not well developed. Therefore, public sector needs to play dual role. It has to implement programs which can help private sector to participate in development activities.
- Every year the government fulfills the increasing resource gap with the help of internal and external borrowing. The internal borrowing contributes only group percent of the total deficit. Loan and interest payment has been covering large parts of regular expenditure.
- Nepalese economy has faced the problem of inflation over time. The price level rises in the economy either due to two factors: the internal causes and the external causes. The external possibly can be defined as worldwide inflation or the inflation of any neighbor country. In the context of Nepal, India can be the best example. To maintain the economy in the previous level from inflation, general expenditure needs to be increased by the government.
- Additionally, the budget for constitutional organs and general administrations under the heading of regular expenditure has been growing significantly. This as whole increased the size of public expenditure.

CHAPTER – 5

EFFECTS OF PUBLIC EXPENDITURE ON GDP

5.1 Introduction

In the developing countries, like Nepal where private sector is not well developed, so the public expenditure increases with its government's increasing activities. On the other hand, public expenditure is necessary to formulate human capital as well as physical infrastructure. In least developed countries, there are low infrastructure of development like electricity, transport, communication, health, education, drinking water and agriculture which are necessary for sustainable development. So, to perform such type of responsibilities public expenditure is really required. Hence by making investment in public sector the output or production can be increased. It leads to accelerate higher economic growth. When market works perfectly, price mechanism can solve the basic economic problem of what, how and to whom to produce. But in developing countries, government has to determine such activities. Private sector may not be induced in social service sector where there is less profitability. So through the public investment, government can solve such problems and achieve higher economic growth. However government intervention does not provide a guarantee that the society will benefit such action. Government failure may be as common as market failure. Tight budgets, high cost of raising revenue, corruption, delay of projects and other constraints like socio-economic factor may hamper to achieve the higher economic growth. Expecting countries with low capability and few resources have to undertake more complicated redistributed functions such as providing social safety like health care and retirement are also large responsibilities to the government.

The effects of public expenditure on output can be analyzed by establishing some models such as by analyzing the relationship between total expenditure and GDP, regular expenditure and GDP and development expenditure and GDP.

5.2 Public Expenditure and GDP

This relation examines the effect of total expenditure, regular expenditure and development expenditure on GDP. To check the effect of public expenditure on GDP, null hypothesis is set that there is no significant relationship between public expenditure and GDP. For this, ordinary least square (OLS) method is applied to estimate the relevant regression equation. Different statistical test like t-test, R squared test and adjusted R-squared are used to verify the relationship.

5.3 Empirical Findings

It is on effort to present on empirical analysis of the public expenditure and its effect on GDP. As mentioned earlier that different statistical test is used to find out the linear relation between dependent variable and independent variables. The basic starting point is the examination of the relationship between GDP and regular expenditure. The GDP is regressed with total, regular and development expenditure. For this, 23 years of data has been taken between the time period 1990/91 to 2012/13. The regression equation showed the cause and effect relationship between dependent and independent variables. All regression equation in this chapter is calculated by using SPSS computer software. The following results have been given by the regression model.

5.3.1 Total Expenditure (TE) and GDP

The ordinary least square (OLS) estimation of the relevant equation gives the following results:

Where, Total GDP is dependent variable and Total expenditure is independent variable.

$Y = \alpha + \beta X$ ……….(i)

$Y = 96160.779 + 3.882TE$

t-test = 34.684

F-test = 1202.966

Adj. R^2 = 0.982

The equation (i) shows that there is positive relationship between GDP and total expenditure. As the value of coefficient is 3.882 which means that one unit change in total expenditure contributes 3.882 units on GDP, which is less than the proportion to the change in total expenditure. The value of t-statistic is 34.684 which is significant with five percent level of significance, it means the contribution of total expenditure on GDP is significant. As the value of Adj. R^2 is very high, it represents the high goodness of fit 98.2 percent change in GDP is explained by the change in total expenditure.

5.3.2 Regular Expenditure (RE) and GDP

To examine the relationship between regular expenditure and GDP, linear regression models are estimated following equation.

Where, GDP is dependent variable and Regular expenditure is dependent variable.

$Y = \alpha + \beta X$………..(ii)

$Y = 157950.919 + 5.652RE$

t-test= 29.820

F-test= 889.247

Adj. $R^2 = 0.976$

The equation (ii) shows that there is positive relationship between GDP and regular expenditure. The sign of regression coefficient is positive (5.652) which means that one unit change in regular expenditure contributes 5.652 units on GDP, which is less than the proportion to the change in regular expenditure. As the value of Adjusted R^2 is very high, it represents the high goodness of fit of regression line. That is the value of Adj. R^2 is high enough to justify the 97.6 percent change in GDP is explained by the change in regular expenditure. The value of t-test represents the significance of the result.

5.3.3 Development Expenditure (DE) and GDP

The ordinary least square estimation of the relevant equation gives the following results.

Where, GDP is dependent variable and Development expenditure is independent variable.

$Y = \alpha + \beta X$………….(iii)

Y= 17675.176+11.216DE

t-test = 13.825

F-test = 191.130

Adj. R^2 = 0.896

The equation (iii) shows that there is positive relationship between GDP and development expenditure. As the value of coefficient is 11.216 which means that one unit change in development expenditure contributes 11.216 units on GDP which is less than the proportion to the change in development expenditure. As the value of t-statistic is 13.825, it is significant with five percent level of significance. This means there is significance relation between GDP and development expenditure. Hence, there is positive response of development expenditure on GDP. The value of Adj. R^2 is very high (0.896), it represents the high goodness of fit 89.6 percent change in GDP is explained by the change in development expenditure.

5.4 Conclusion

From the above analysis it is found that there is positive relationship between the aggregate level of GDP and public expenditure (total, regular and development). Among total expenditure, regular expenditure and development expenditure, GDP is found to be highly responsive to development expenditure and least responsive to regular expenditure.

CHAPTER -6

SUMMARY OF THE FINDINGS, CONCLUSION AND RECOMMENDATIONS

6.1 Summary of the Findings

As mentioned the above objectives of analyzing the trend, structure and effects of public expenditure in economic growth of Nepal, during the period of 1990/91 to 2012/13. This study has also thrown the light on some important and interesting fact of trend and structure of the public expenditure in Nepal. The trend and pattern of public expenditure threat on the fiscal deficit and management. There are many factors giving to rights the increasing trend of regular expenditure rather than development expenditure. The regular expenditure has surpassed the development expenditure as against the accepted fiscal norms. Development expenditure exceeds the regular expenditure until FY 1997/98, than after it is lesser than regular expenditure.

Although, Nepal initiated development activities only after the inception of democratic system in 1951, the advent of planning has led to tremendous increase in the size of public expenditure. The massive investment is in each successive plan for rapid expansion of the economic and social infrastructure has been mainly responsible for it. In spite of, phenomenal increase in its size, the actual performance of the Nepalese economy has been below expectation. Expressed differently, constant or even declining trend in real per capita income. The economy problems have further aggravated due to growing in efficiencies in the allocation in resources and inflationary pressures. In such a situation, present study has been addressed essentially to examine the growth and pattern of public expenditure and to examine the relation of public expenditure with GDP.

The social and economic service sectors occupy the major share of development expenditure whereas general administration, interest payment, loan repayment and defense claim a larger share of regular expenditure. However, the threat to the social objective of poverty alleviation has been caused from high burden of defense expenditure, loan repayment and general administration expenditure. The rapid growth of regular expenditure on later years of study period can be attributed to the increasing expenses on defense. From the analysis the trend of public expenditure, economic and social service expenses hold a large share of total expenditure. Finally, the defense components of social service, which hold large amount of total expenditure lead to conclude that greater concentration have been provided to education followed by local development health and drinking water respectively.

Summary of the findings are as follows:

- There is a nominal increase in total public expenditure in relation to GDP from the FY 1990/91 to 2012/13. During this period, the regular expenditure has increased as percentage of GDP whereas development expenditure reveals the opposite.
- In FY 1990/91, regular expenditure as percent of GDP was just 6.52 percent which reached to 16.25 percent, which is two fold higher in FY 2012/13. In the case of development expenditure it is just the opposite. Development expenditure as percent of GDP was 13.76 percent in the FY 1990/91 which is the highest of the study period; it came down to the figure of 7.30 percent in FY 2012/13.
- The analysis of real growth rates shows that the public expenditure in Nepal has grown faster than national income. The real growth rate analysis also boosted that the highest growth rate of regular expenditure followed by development expenditure. The regular and development expenditure in FY 2012/13 is 69 percent and 31 percent respectively of total expenditure.
- The average growth rate of total, regular and development expenditure in the study period is 12.83 percent, 17.02 percent and 8.25 percent respectively.
- The average growth rate of GDP in the study period is 11.97 percent. Among the regular expenditure, the highest growth has been obtained of social services followed by miscellaneous loan repayment and interest respectively. And the development expenditure categories the higher growth rate has been obtained for miscellaneous services and constitutional organ.
- The GDP growth rate of FY 1991/92 was 24.81 percent which is decreased and remains 11.97 percent at the end of the study period.

6.2 Conclusion

The public expenditure in Nepal is growing rapidly. The growth rate of regular expenditure and development expenditure are approximately equal. But there is a fluctuation in regular as well as development expenditure. There is increasing trend in regular as well as development expenditure, but the growth rate of regular expenditure is higher than development expenditure. The share of regular expenditure on total expenditure at the beginning of the study period was 32.15 percent where development expenditure was 67.85 percent. But at the end of this study period, the share of regular expenditure on total expenditure was 69 percent where development expenditure was 31 percent of the total expenditure. It shows that there is very low share of development expenditure on total expenditure. The growing public expenditure reflects alarming situation with regard to the fiscal discipline and overall development programs of the country. The huge investment in each successive plan and annual budget for rapid economic growth and social infrastructure leads to the increase in public expenditure but the expenditure on development activities are not utilizing properly.

6.3 Recommendations

Based upon the above conclusion and findings, some recommendations can be presented as:

- The government should focus its resources on the core priority areas where resources can be optimally utilized. By doing this maximum economic benefit can be achieved.
- The rapid growth in the regular expenditure should be reduced and development expenditure should be increased to increase its revenue.
- It is necessary to reduce non-productive type of public expenditure in order to promote the capital accumulation process. The development expenditure must be increased and that should utilize in the productive sector. So the major reforms in planning and budgeting are required, to gain economic goals.
- The rapid growth of regular expenditure especially over few years can be attributed to the increase in defense expenditure. Therefore, peace is necessary condition for economic growth and development, there must be cut in defense expenditure and should be allocated to social economic sectors for economic welfare to the citizens.

- Government should choose major priority sector that generate income and should spend on these sectors on planned basis which increase supply capacity of an economy.
- There is misallocation of public expenditure in Nepalese economy. Huge share of public expenditure is spent on regular expenditure instead of development expenditure. So, development expenditure should be increased for proper utilization of public expenditure.
- Public expenditure should be allocated for the development of transportation, communication and social service in order to reduce geographical fragmentation and increase in profitability of private investment as well as by extending the size of market skill and efficiencies of labor.
- The utilization and scope of subsidies should be properly analyzed. The unnecessary subsidies should be cut off. The feasibility study to privatize the public enterprises should be done. The ownership of public enterprises which are operating in loss should be transferred in private sector which can help to reduce unnecessary public expenditure.
- The share of agricultural sector in developing expenditure is low, adequate attention must be given to this sector because majority of population is directly or indirectly dependent on it. So, there must be increased development expenditure in agriculture sector.
- A complete and vigorous cost benefit analysis must be done before receiving loan for any project from external sources as well as from domestic borrowings for economic benefit.
- Political stability and clear policies should be made to increase investment in economy which leads to economic growth.

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