CHAPTER 1
INTRODUCTION

1.1 General Introduction

Nepal is a small, landlocked and geographically disadvantaged country with per capita income of less than $250. Rapid economic development is possible only through government expenditure. It is therefore, necessary on the part of the state to assume the responsibility of creating infrastructures needed for progress and stability and growth of the economy. Importance of government expenditure in economic development of country like Nepal lies in increasing growth rate, raising income and status of the people, reducing inequalities of income and wealth, removing regional imbalances, promoting private initiative and maintaining macroeconomic stability.

The word ‘budget’ is derived from French word “Bougette”, which means a small leather bag or pouch. It was used first in England to describe the white leather bag, which held the seal of medieval Court of Exchequer. Later known ‘Budget’ contained proposals of financial plan of government expenditure. But word budget, has now been used in all countries and in many languages. The term budget is now commonly understood as a government document. In fact, it is a proposal of proposed expenditure for a given period and proposed means of financing them for the approval of legislature.

The budget, being a financial statement of the government, is a decision making process to incur expenditure and generate revenue. Budgeting is carried out to fulfill certain state responsibilities and objects of social and economic development. “Public budgeting involves the selection of ends and the selection of means to reach those ends. Public budgeting systems are systems for making choices about ends and means. Complex channels for information exchange and assessments about what is or is not being achieved. Series of intricate processes that link both political and economic values are integral to budgeting system”. Government is entrusted with number of social and economic obligations. Some of the objectives are social while 2 others are political. It can become a good source of public information of past activities, current decision and future prospects.

There was a time when the budget was considered merely a report of information of legislation. But today the budget is the nerve center of public economy. It has developed into a major instrument of social and economic development.

In today's world the budget is known as the device for influencing the allocation of resources throughout the economy directly through expenditure decisions and indirectly through policy decisions built into the budget. It is important tool in learning the relationship of government programs to economic and financial conditions and trends in fashioning suitable economic and financial policies and measures.

A number of developing economies are driven by economic plans. Economic planning has specified social and economic objectives to be achieved in the short run and long run. Budgeting should be carried out with a view to attaining the objectives laid down in economic planning. The budgetary process being widely accepted as an effective strategy to accomplish the development goals of the nation, it is thus found essential and important to pursue a study that would highlight and assess the policy framework of the budgets of the country.

The role of budget in a developing country is much different from that of developed country. In developed countries (economies), budgetary measures can minimize the cyclical influence through the maintenance of aggregate demand. Conversely, unemployment is not cyclical in nature in developing countries but chronic, reflecting structural bottlenecks of the economy. Therefore, injection of additional purchasing power, instead of increasing the level of production and employment causes larger imports and raises the price level. This is why budget is used in developing countries as an integral part of development plans.
Deficit budgeting is common characteristic of almost all budgets in today's world. As state has right to use all the available resources in the economy and not limited to its possession only, government can have expenses in excess of its revenue. Deficit financing may add productivity and additional value in the economy but it may also create burden to the economy. Deficit financing is productive when

expenditure is made on capital goods and productive channels. Deficit financing for the current expenditure and consumption may cause the burden to society.

The historical background of budget in Nepal is not very old. It is just dates back to a period of less than five decades. Prior to 1951 the country was ruled by Rana's Oligarchy who was interested to the collection of revenue and maintenance of law and order. The Rana Regime was overthrown in 1951 and the first annual budget was prepared in 1952.

However the budget presented by the finance minister of the first elected government in 1958/59 of Nepal considered as the first scientific budget in Nepal. After that at the end of each fiscal year government presents its plan and programs and strategies through budget for the coming year. In Nepal, fiscal year starts from first of Shrawan to the last of Aashadh of the next year.

Budget becomes more important in managing government finance mainly after the introduction of development plan in 1956. The concern over the status and efficiency of budgetary systems of GON increased specially after the political change of 1990. Growing challenges encountered in relation to the rising expectation of people have prompted the government to become serious as to the means and the use of the scarce resources in a more organized and effective manner.

1.2 Statement of the Problem

The government expenditure has been increasing each year because of expanding activities. And increase in government revenue is not sufficient to finance increased government expenditure. Domestic resources have been ever inefficient and there is vast difference between outlay and revenue. Therefore, increasing resource gap is the characteristic phenomena of Nepalese Budget each year as shown in the table below:

Table 1.1
Resource gap in Nepalese economy

Rs. in million

FY	Resource Grap (Amount)	% of total expenditure	% of GDP
1998/99	12819.90	54.44	11.03
2002/03	14484.80	37.08	6.89
2006/06	22328.02	37.47	6.76
2010/11	27776.30	33.06	6.38
2012/13	32437.70	31.63	6.37

Source*: Economic Survey, 2010/11 and 2012/13*

Pattern of government expenditure shows that there is significant growth of recurrent expenditure and principal repayment expenditure but there is only a little (even negative) growth of capital expenditure.

Table 1.2: Pattern of Government Expenditure

Rs. in million

Year	Recurrent Expenditure	% Change	Principal Repayment	% Change	Capital Expenditure	%Change
2007/08	35579.10	11.38	5212.70	12.28	25480.70	10.82
2008/09	45837.30	28.83	5690.60	9.17	28307.20	11.09
2009/10	48863.90	6.60	6434.90	13.08	24773.20	(12.48)
2010/11	52090.50	6.60	9559.50	48.56	22356.10	(9.76)
2011/12	55552.10	6.65	10794.90	12.92	23095.60	3.31
2012/13	61686.40	11.04	13533.30	25.37	27340.70	18.38

Source: *Economic Survey 2012/13*

Public savings and its efficient use are important aspects of domestic resource mobilization for a country like Nepal. Private savings are important resources for development but are often inadequate to sustain rapid economic growth. Public savings, which are the difference between total revenue and government consumption expenditure, can play a vital role in economic development. The government should be able to supply certain goods and services to promote flexibility and build capacity for future output. These types of government investments normally will have a lasting impact on society.

Budgetary process does not function in an independent or autonomous fashion but is viewed as an integral part of the overall management of the economy. Budget is just an implementation of plan of the country that has specified social objectives both for short run and long run. Problems in Nepal regarding public spending are due to the lack of coordination between policy, planning and implementation. Many programs and projects are implemented through the budget each year, which are not mentioned in plan. This has given rise to “implementation failure” model in overall resource allocation practice. The biggest fallacy is that priorities have been changing from plan to plan and from budget to budget.

The study aims at addressing this issue and examines the trend and pattern of budget in Nepal.

1.3 Objectives of the Study

This study aims to analyze the Nepalese budgetary system and its structure after restoration of democracy in 2007. The general objectives of this study are:

i. To review the structure of the Nepalese budgetary system

ii. To analyze the trends and patterns of its important components.

iii. To analyze the budgetary deficit and its sources of financing

1.4 Significance of the Study

Budgeting plays the important role in the developing countries like Nepal. It has number of social and economic objectives. For the rapid development of the economy, budget should fulfill the objective of increasing employment opportunities, reducing poverty and inequality, increasing the standard of living of its people and the most important the stability in the economy.

The most of the investment comes from the government sources. Private sector is not well developed and more social investment is needed which cannot be brought out in the economy from private sector due to the existence of public goods, externalities in consumption or production, indivisibilities, market imperfections, problems of the income distribution, and so forth prevent the private market from allocating goods efficiently or equitably. Government investments are only the alternate for such projects. Decision on the government fiscal transaction has a direct and immediate influence in the national economy. As the government makes decision considering the national interest, attention has to be focused on the process through which public revenue is collected and public expenditure is determined, allocated and controlled.

Government has just implemented the three year interim plan with economic growth target of 5.5% per annum, target for the agriculture sector being 3.6% per annum and 6.5% per annum for the non agriculture sector during the plan period. This Plan puts special emphasis on increasing public expenditure to assist relief and generate employment as well as on peace building, reconstruction, rehabilitation, reintegration, inclusion, and revitalization of the economy. To tackle with the adverse and challenging issues regarding Nepalese budgeting system, further researches and studies in this field are relevant. Since the literature regarding the Nepalese budget is scanty, the work in this field will be of great importance. Therefore this study entitled “An analysis of Structure and Pattern of Budget of Nepal” will help to add additional information in the preparation and implementation of budget in Nepal.

1.5 Limitations of the Study

1. This study is based on the published secondary data and desk research.

2 No attempts are made to examine the reliability of the available secondary data since the related authorities officially release them.

1.6 Organization of the study

The whole study is divided into six different chapters. The first chapter is the introductory one. The problem has been defined in this chapter, which is followed by focal point of the study. The objectives, limitations and organization etc. of the study have been presented.

The second chapter presents the reviews done of different literatures. This chapter is divided into two units. The first unit contains theoretical aspects of budget and the second unit contains findings of the researchers in the context of Nepalese Budgeting System. The research methodology, which is very important aspect of any research work, has been presented separately in the third chapter.

The Nepalese budgetary system has been analyzed in fourth chapter. It includes historical background, budget formulation process and budgetary reforms and policies.

The fifth chapter deals with data analysis. It includes the analysis of expenditure, revenue and budget deficit and relationship among the variables under study. And the chapter six provides the summary, conclusion and recommendations.

CHAPTER 2
LITERATURE REVIEW

2.1 Budget: Theoretical Context

No government can afford to take taxation, borrowings, expenditure and other fiscal decisions at random. On account of their inter-connection, all decisions and policies must form a part of its overall set of objectives. The whole approach has to be quite systematic if chaos and wastage are to be avoided. In general, a budget shows financial accounts of the previous year, the budget and revised estimates of the current year, and the budget estimates for the forthcoming year. In addition, the estimates for the forthcoming years are split up into two parts – those based upon the assumption that existing taxes and their rates would continue, and those based upon the proposed changes therein. A budget, in this sense, becomes both a description of the fiscal policies of the government and the financial plans corresponding to them. (Bhatia: 2009)

2.1.1 Theoretical Aspect of Budget Structure

Budgetary structure, simply means the items of objects of budget, either these are in expenditure side or in the revenue side, which a budget incorporate within it to facilitate better understanding on various ways in which the public sector transactions can take place.

The modern government has to be in position to take decision which can be crucial for the stability of country's economy in the present and for its growth in the future. They have accepted new and wider range not only for the balance and growth of their economy but also for the social welfare of their people. These emerging phenomenons stresses lay emphasis on the structural reform of the budget that serves to asses at the needs arising from those new responsibilities for economic and social policy. (Gupta:1967)

A budget structure of modern government involves essentially the design of suitable function and program format of the budget, but it also encompasses issues concerning the extent to which the budget reflects government and public sector activity.

There are two concepts analyzing the budget structure of any country i.e. (a) divided budget; (b) the coverage of the budget. (Beyer: 1973)

The divided budget is a feature common to the budgeting systems of all developing countries. Though the form and terminology of the budget's division may vary (regular, development, plan non-plan, revenue-capital, current capital and so on), the division of the budget into distinct components usually involves separate procedures for preparation, separate budget staff and occasionally separate sources of financing.

While the divided budget has few benefits in its favor, it does carry certain costs probably the most important cost is the adverse effect on resources allocation arising from the problem of coordinating expenditure in separate budget (example, teachers salaries but no schools). The divided budget restricts program analysis by failing to identify full program costs and account for interrelationship between expenditure activities.

Concerning the second concept, the coverage of the budget can be extended in several ways. One is a formal extension that incorporates the activities directly into the budget itself. Another is to extend the coverage informally so that at minimum the decisions on the budget are made in the context of the larger set of public sector activities still another is to remove constraints on the use of revenue, which applies mainly to the earmarking of the funds.

2.1.2 Classification of Budget

In view of the importance of governmental activities on the national economy, there is need for the organization of budget data on expenditures and revenues in such a way as to bring out their full economic significance. From this angle and idea of budget classification becomes meaningful since it gives information on government operations and provides the form and structures necessary for analysis and policy making.

Budget classification is the structural key to conscious and rational government budgeting. The manner in which items of revenue and expenditure are grouped in the budget, will be determined by, and also determine, the character of the decisions that can be made in the budgetary process. The purpose of budget classification is to present the data in such a way that it gives information desired from different points of view. (Gupta: 1967)

The traditional approach towards budgetary accounting is designed for an effective legislative control over the executive, and to meet the requirements of fiscal management. It is an excellent aid to government auditors and effective check against misappropriation of funds and other fraudulent practices. To this end, therefore, accounts are classified into categories corresponding to individual ministries, departments and sections; and within each, there are further heads and sub-heads, etc. But there is a lack of correspondence between the purpose and the account head. This approach does not provide information required for the formulation of fiscal policies.

It does not provide a basis for assessing the effect for alternative budgetary policies and operations and for devising improvements therein. To that end, a system of economic and functional classification of the budget on the one hand, and the introduction of programme and performance budgeting, on the other are very essential. (Bhatia: 2006)

The arrangement of budget items should be such as facilitative formulation, execution and accountability of program. In the arrangement of budget items, the following facts must be considered. (Beyer: 1973)

(i) The budget classification should facilitate formulation of program. In this context the finance minister purposes to undertake certain projects which are based on the responsibilities assumed by the government and are shaped by its political, social and economic philosophy. It is also essential to show the source of finance for a particular program.

(ii) The budget classification should also be helpful in effective budget execution.

(iii) The budget classification should serve the purpose of accountability. For this it is necessary that the responsibility of collection of revenues and incurring of expenditure should be clearly determined between different departments of officials of the government.

(iv) The budget classification should be established in such a way that it is possible to analyze the economic effect of government activities in all cases where there had been an assumption of responsibility for economic stabilization or economic development.

Often these objectives which the arrangements of budget items should consider can be served by functional classification, object classification, economic classification and program and performance classification of budget.

2.1.2.1 Functional Classification

The term functional means a purpose such as defense, education, health etc. This classification is to supplement the type of functional classification which the budget in its original form carries. Further the functional classification covers only the expenditure and not the receipts. (Bhatia, 2006)

The functional classifications of transaction provides macro-economic data and are useful largely at the policy formulation level where they enable the decision makers to review in broad terms the pattern of resource allocation and its impact on the rest of the economy.

A functional classification is concerned primarily with governmental expenditures, and is designed to facilitate program formulation at the chief executive's level and at the level of legislative review. The functional classification sets forth on the expenditure side, the broad programs which the government is conducting in items of the economic or interest group, which are served. (Burkhead: 1956)

While presenting the budget before the legislature for approval the finance minister has to satisfy himself that the money is allotted in a manner which will help in the attainment of intentions of his government. This is the expenditure side of the budget. On the revenue side, he must see that the burden of taxation is distributed in accordance with the accepted principle of social justice. These aims of the budget can be realized if government expenditures are classified by the types of services provided. It is the functional classification of expenditure and accordingly expenditures are divided into following way:

(a) General services (defense, justice, police and general administrations); (b) community services (roads and bridges, sanitation and others), (c) Social services (education, health, social security and others) and (d) Economic services (agriculture, fuel and power, industrial and mineral, transport and communication and others).

Revenue can similarly be classified into:
(a) Tax-revenue (income tax, commodity tax etc.). (b) Non-tax revenue. (Singh : 1977)

2.1.2.2 Object Classification

The object classification lays strong emphasis on the accounting aspects of financial administration in government and helps in designing the pattern of accounts. Object classification was the direct product of an era when both legislators and the citizenry at large were filled with distrust for administrators. It was a great technical step forward in budgeting, since it permitted the installation of government accounting systems which could be linked with budget accounts and thus limit defalcations. (Burkhead: 1956)

The system of object classification has limited uses and is generally used in conjunction with organizational type of classification in the conventional budgets for purposes of financial accountability to the legislature. If such objects of expenditures are carefully chosen, the system can serve to highlight the broad structure of material resources used in the completion of public sector projects. In the conventional budgets the emphasis on personnel policy has given rise to objects such as salaries, travel allowances, honoraria, etc. While the emphasis on material objects has not proceeded in many cases beyond the identification of type writers, stationery, stores etc. Through the identification of the resource pattern, an object classification could be a substantial aid to planning. It may not be very difficult to co-ordinate a system of object classification with an economic and performance classification of transactions.

2.1.2.3 Economic Classification

Economic Classification of budget accounts is designed to reflect the Government transactions with rest of the economy.

This classification is designed in such a way that it can be linked with a system of national income and expenditure accounts depicting the activities associated with the generation of national income and capital formation. It, therefore, provides a breakdown of Government expenditure into consumption and capital formation, and the impact which the Government expenditure has upon the rest of the economy. Furthermore this classification also provides information concerning financial assets and liabilities and is very helpful in assessing the changes in the composition and ownership of financial assets as also the borrowing and lending transactions of the Government. An analysis of financial transactions also helps us in assessing the indirect contribution which the budgetary operations make to the capital formation by other agencies. (Bhatia: 2006) This classification of the budget has six accounts or tables covering the following:

Account 1: Transactions in commodities and services, and transfers Current Account of Government Administration

Account 2: Transactions in commodities and services, and transfers Current account of Departmental Commercial Undertaking

Account 3: Transactions in commodities and services, and transfers, Capital Account of

Government Administration and Departmental Commercial Undertaking

Account 4: Changes in financial assets: Capital Account of Government Administration and Departmental Commercial Undertaking

Account 5: Changes in financial liabilities: Capital Account of Government Administration and Departmental Commercial Undertaking

Account 6: Cash and Reconciliation account of Government Administration and Departmental Commercial Undertakings

Economic classification of budget provides material for policy making. This type of classification supplies important information necessary for formulating the economic policy of the government, especially in regard to the promotion of economic development without sacrificing the stability. The main aim of this classification scheme is to provide the data required for examining the economic effect of government activity.

Economic classification of budget is useful for distinguish between, payments for capital formation,…………Payments for government consumption……………, Payments (such as social security benefits) and receipts (such as taxes) which redistribute the income of the rest of the economy; payments (such as loans and advance) which make funds available for capital formation by the rest of the economy, and receipts (such as borrowing) which transfer part of savings of the rest of the economy to the government. (Burkhead: 1956)

2.1.2.4 Program and Performance Classification

Program budgeting stresses the relationship between various outputs or programs and the inputs necessary to produce them. The work of each department is classified into programs which are broken down into sub-categories. Programs include all work seeking to attain the same objective. This in turn facilitates use of PPBS and cost benefit analysis. (Due and Friedlander: 1977)

The resources at the disposal of the government are always scarce in comparison with the services which it would like to provide to the society. Accordingly, it must try to use the resources most economically and efficiently. To this end, therefore, choice of projects should be based upon cost-benefit analysis and the chosen programmes should be subjected to the tests of actual performance against their expected standards. A system of assessment is needed because actual performance seldom equals the expected one. By implication, a decision to spend a particular set of resources for a particular purpose (which may be called a project) should first comprise programming or a stage-wise sequence of steps for executing it; and secondly, it should comprise performance budgeting, that is, tests for assessing the actual performance. When budgeting covers both the above – mentioned aspects, it may be termed Performance and Programme Budgeting System (PPBS). (Bhatia: 2006)

Programs and performance budgeting emphasis the things done by government rather than things brought by government. But the program and performance budgeting does not supplant but only supplements the conventional system of budgeting. Introducing program and performance classification into budget and also by relating expenditure on program and activities to their result in physical terms, program and performance techniques focus attention on the goals and objectives in the budgetary process and through this techniques the annual budget is effectively coordinated with development plan, (Tripathy:1968)

Program budgeting has to be distinguished from performance budgeting. In program budgeting, the principal emphasis is on a budget classification which functions, program and their sub-divisions are established for each agency and these are related to accurate and meaningful financial data. Performance budgeting involves the development of more refined management tools, such as unit cost, work performance. Of course, the measurement of work, both in physical and financial sense, presumes an already formulated set of work units which can be divided only when programs and their subdivisions are first established.

A performance classification is an indispensable tool of program budgeting. A budgetary system embracing these principals of classification and management would be closely attuned to the requirements of planning.

2.1.3 Budgeting and Planning:

Budgeting is a form of planning. Traditionally directed toward financial planning in a rather narrow sense, the budget process and the budget document increasingly have come to include other kinds of economic information and analysis as well. A comprehensive plan will attempt to cover the whole economy and to take account of the external economic environment. Partial plans omit some sectors or industries. Centralized planning is essential if the aim is a high degree of state direction of production and distribution. (Goode: 1984) Planning has been adopted in some form by many developing countries, though; plans differ greatly in coverage and detail. The appeal of planning is evident. To many intellectuals it appears almost synonymous with rationality. Political leaders may regard a plan as a modern version of the promises of a better life that they and their predecessors have long been accustomed to holding out to the people.

A good budget is one which is able to satisfy certain conditions and is formulated according to certain well drawn principles. One such principle is that the budget should be accompanied by an account of the performance of the fiscal policies and programmes of the government during the previous year. This provide a necessary basis for deciding as to what was to be done, what has been accomplished and what more should be aimed at and in what decisions. (Bhatia, 2006)

To facilitate annual decision making on expenditures, governments have developed budget systems, which provide for systematic presentation of recommendations for expenditures by the executive to the legislative branch. The budget systems, through appropriations legislation and control of expenditures, also provide a basis for ensuring that actual expenditures conform with the law. A budget may therefore be defined as a financial plan that served as the basis for expenditure decision making and subsequent control of expenditures. (Due and Friedlander: 2002)

In a developing country with a mixed economy, where formal operative planning takes place with respect to the public sector, the budgetary system plays a very important role in the implementation of public sector development programs. The planning and budgetary processes are essentially complementary each other but in actual practice, the relationship between them has often weak and tenuous. Weaknesses lie on both processes and reinforce their support to each other. What is needed in the formulation and elaboration of plans is continuity, flexibility, consistency and a rational approach to project evaluation. The important considerations in improving the budgetary process are constructing the plan problems in the budgetary system, a proper organization and accounting of the available data
and introduction of work measurement systems so as to evaluate performance and create cost consciousness.

Few developing countries, however, have discarded planning altogether. The proper coordination of budgeting and planning remains important. Care needs to be exercised in translating the multiyear plan into the specific provisions of annual budgets. As Waterston has remarked, the nature of the link between the plan and the budget is a test of whether a government is serious about its plan and intends to carry it out. Problems often arise because of poor communication and cooperation between the planning and budgeting staffs. Planners usually are economists, and often they are intrigued by the techniques of input-output analysis and model building. (Goode: 1984)

2.1.4 Components of the Budget

2.1.4.1 Government Expenditure

Public Expenditure refers to the expenses which a government incurs for (i) its own maintenance, (ii) the society and the economy, and (iii) helping other countries. In practice, however, with expanding State activities, it is becoming increasingly difficult to separate the portion of public expenditure meant for the maintenance of the government itself from the total. (Bhatia: 2006)

Public expenditure, in the traditional view, was regarded as a subtraction from and a substitute for private expenditures. Government outlay was deemed desirable, generally speaking, only in those circumstances where the private sector could not conduct the activity. (Burkhead: 1956)

The concept of public expenditure plays a very prominent role in public finance. In the nineteenth century, the economist paid a very little attention to public expenditure as there were no sound classification of the expenditure by Central Government, State Government and Local Government. There were no principles for this public expenditure. Basically, the functions of government were restricted to justice, police and arms. They were also of the confirmed belief that government expenditures are totally wasteful and money can be best utilized by the private persons rather than government in the ancient times. With the passage of time, the situation has altogether changed and economic activities have become complex which has forced the economists to pay a great attention to public expenditure.

A part from resource mobilization the expenditure program of the government also forms an integral part of fiscal policy. As one expert rightly said," The government has to use its expenditure and revenue programs to produce desirable effects and avoid undesirable effects on the national income, production and employment." Though the classical economists did not give much importance to public expenditure, Keynesian economists has given a new trend to fiscal policy and increased the importance of public expenditure as a contra-cyclical method. (Pant: 1970)

It is assumed that the impact of public expenditure on national economy is not of a waste but of a preventive of national economy since 1930. And is also assumed that for full employment, reducing income inequalities and economic stability, public expenditure is a powerful measure.

2.1.4.2 Government Receipts

Government receipts may take the form of taxes, charges, or borrowing. Taxes and charges are withdrawn from the private sector without leaving the government with a liability to the payee. Borrowing involves a withdrawal made in return for the government's promise to pay interest in the interim. Taxes are compulsory imposts, whereas charges and borrowing involve voluntary transactions. Among these three sources, taxes provide much the larger part of receipts. (Musgrave and Musgrave: 1989)

It is a normal practice with a government to divide its receipts into “revenue” and “capital” categories. Broadly speaking, revenue receipts include “routine” and “earned” ones. For this reason, they do not include borrowings and recovery of loans from other parties, but they don include tax receipts, donations, grants, fees and fines etc. Capital receipts on the other hand, cover those items which are basically of no repetitive and non-routine variety and change government's financial liabilities/assets. (Bhatia: 2006)

Revenue receipts are divided into tax – revenue and non – tax revenue. Tax revenue itself is divided into three sections:

a) Taxes on Income and Expenditure

b) Taxes on Property and capital transactions

c) Taxes on commodities and services

Non – tax revenue of Government is divided into three sections:

a) Currency, coinage and mint

b) Interest receipts, dividends and profits

c) Other non-tax revenue

Capital receipts of the government take many forms. The most important one comprises of fresh borrowings which can be classified in terms of their origin and maturity etc. For example, on the basis of origin, public borrowings may be external (i.e. from outside country) or internal. In terms of maturity, there may be nonterminable (or perpetuities), long term, medium term, or short term loans with specific demarcation of boundaries for each. They may be marketable or non-marketable, interest free or interest bearing etc.

The next category of receipts covers recovery of loans due from debtors to the government. Some capital receipts may be in the form of grants and donations, deposits and appropriation to various funds and so on. (Bhatia: 2006)

While public receipts include receipts from all sources, public revenue is a narrower concept and excludes public borrowings, income from the sale of public assets or receipts from the use of "printing press".

2.1.4.2.1 Taxation

A tax is a compulsory levy payable by an economic unit to the government without any corresponding entitlement to receive a definite and direct quid pro quo from the government. The benefits received by taxpayers from the government are not related to or based upon their being taxpayers. A tax is a generalized exaction, which may be levied on one or more criteria upon individuals, groups of individuals, or other legal entities. (Bhatia: 2006)

In the tradition of classical and Neo Classical economics, which dominated most of the thinking about public finance until the 1930s, taxation was viewed as a means of obtaining revenue for government, as a means of transferring resources from the private to the public sector. The more recent approach stresses that taxation does not serve solely to channel funds to finance government outlay. Taxation is also instrumental in controlling the volume of expenditure in the private sector. (Burkhead: 1956)

The economic effects of taxation are manifold. They include micro effects on the distribution of income and the efficiency of resource use as well as macro effects on the level of capacity output, employment, prices, and growth. All these effects interact. Thus, the distributional effects (or incidence) of particular budget measures depend on their effects on capacity output and employment just as the latter depend on concurrent changes in distribution. Nevertheless, each type of effect is of interest in itself and must be considered as such in policy formulation. One policy may be superior with regard to distributional results but inferior with regard to efficiency, growth or employment effects. Tradeoffs must then be made. Moreover, as a matter of exposition, not all aspects can be dealt with at once. (Musgrave and Musgrave: 1989)

Hence the taxation has the decisive and extensive role for controlling the volume of expenditure in the private sector and also for reducing the inequalities of income and wealth in the country along with the direction of resources in more desired channel to ensure rapid economic development. A good tax system therefore is one which is designed on the basis of an appropriate set of principles, such as equality and certainty. Mostly however objectives of taxation conflict with each other and a compromise is needed.

2.1.4.2.2 Public Debt (Borrowing)

The issue of public borrowing in developing countries has assumed great importance in view of the increasing magnitude of budgetary deficits. In the literature of public borrowing some economists have put forth some issues regarding burden of public debt. So, the underlying questing by whether public debt inflicts burden in the economy or, it is an essential factor to promote development activities.

The classical economists were against public borrowing and favored the minimum expenditure from the government side. However, they were not against all types of public debt. They liked to approve public debt only for productive proposes and believed that debt servicing did not necessitate additional taxation. The classical economists preferred self-liquidating project that generate required income to serve the incurred debt.

Household debt must be repaid sooner or later because conduct of the household is a finite affair. Public debt need not be repaid since the budget and the economy are a continuing undertaking. When a particular debt issue matures, it is paid off; but the necessary funds are obtained by issuing new obligations. The debt is “refunded”. In short, refunding operations are a management problem and whether we can “repay” the debt is a misdirected question. The issue rather is how interest service will affect the economy and how outstanding debt enters into the liquidity structure of the economy. (Musgrave and Musgrave: 1989)

Public debt can be used to regulate the economy’s financial system through variation in the volume, composition and yield rates of public debt. A lengthening of the maturity composition of public debt is expected to reduce its over all liquidity while a shortening is expected to have the opposite effect. (Bhatia: 2006)

Resource mobilization through public borrowing is important as a source of investment in the development works. Public borrowing when invested in some development works has positive implication over the growth of national economy. On this account, public borrowing need not be discouraged. So long as it helps to increase the productive assets or productivity of the economy on the one hand and the real saving of the community on the other.

2.1.5 Deficit Financing

The term deficit financing refers to the excess of government expenditure over its revenue. Deficit financing refers to the financing of total budgetary deficit of government comprising of both revenue and capital budget. The excess of government revenue over its regular expenditure is known as revenue surplus which is used to finance the capital expenditure. The revenue surplus, however, may not be sufficient to cover the capital expenditure hence the overall budget may be in deficit.

Government uses various methods to finance such budget deficit. Taxation, external as well as internal loan, drawing upon its accumulated cash balances through central bank etc are some of the sources used to finance such deficit. The effort so made to fulfill the gap created due to budget deficit is called deficit financing.

Deficit financing is a technique for getting capital for development schemes. Deficit financing means the government is spending in excess of revenue and the deficit is being met by drawing money from the Central Bank of the country. This leads to creation of money. Deficit financing is helpful in initiating the process development where a large volume of unemployed resources exist. It will also bring about an expansion of the monetized sector. The main danger from deficit financing is from inflation. The economy may have to face inflationary pressure if the excess propensity to consume does not correspondingly lead to an increase in the level of output due to some bottle-necks of the economi8c system. The possibility that price level, rather than the level, of output may increase as a result of deficit financing has often created more problems than it has solved. For successful deficit financing there should be correct forecasting about the possible developments in future in the field of production and consumption. If forecasting is correctly done and price level does not materially increase, the deficit financing will become a blessing for economic development. (Gupta: 1967)

Deficit financing can not create real resources, which do not exist in the economy. It is only a device that helps to transfer resources to government. The real resources economic development must exist in the form of materials, equipment, labor and skill. Printing money or issuing bank credit can not create these things. Deficit financing only can put the funds at the disposal of government, which can be used for acquiring the real resources provided they are available in the economy. There is however a limit beyond which it is injurious to the economy to use deficit financing. It may lead to inflationary pressure and loss of confidence in the currency. Thus, the effect of deficit financing may be disastrous to economy if its limit is exceeded.

2.2 Nepalese Context

John C. Beyer (1973) had conducted a research on the topic “Budget Innovation in Developing Countries, The Experience of Nepal”. In the study he pointed out that, the budgeting system of developing countries continue to be dominated by the traditional objectives of control and accountability rather than a concern for allocating limited public sector resources to well defined programs and projects that are intended to serve a set of national objectives. He came to the conclusion that, there has been no formal earmarking of revenue in Nepal. The extension of the budget coverage has involved a combination of formal and informal incorporation of expenditure activities. Formal extension of the budget has involved only two relatively small expenditure activities. One is the incorporation into the budget of the lending operation of Nepal Government to its employees, which had traditionally been handled outside the budget. The other formal extension involved the incorporation of foreign assistance programs, which were previously outside the budget. In short, the traditional budgeting system is the antithesis of planning the allocation of scarce Resources.

Nirmal Kumar Sharma (1988) has made a research about the Nepalese budgetary structure. His research clarifies that the pattern of government expenditure has followed more or less the uniform course throughout the reference period. He observes that government expenditure and revenue both have increased in absolute and relative terms. Government expenditure has increased in greater trend than the revenue. This pace has not been enough to cope up with the development objectives and targets as preceded by periodic development plan. There is inadequate mobilization of domestic resources through government revenue. Thus, he points out a serious problem of widening resource gap existing since the inception of the budget history in Nepal.

Tek Bahadur Malla (1996) has made a research work on the topic “Study on Planning and Development Budget in Nepal”. He has attempted to examine the allocation of development expenditure on the various sectors according to the order of priority, which is known as expenditure pattern. He remarks that expenditure allocation for various sectors were very rough. Foreign assistance was the main source of development financing and deficit financing is in increasing order.

He further clarifies that budgeting and planning formulation and implementation is bounded by various inherent problems such as lack of the co-ordinations and cooperation between planning and budgeting agencies and sacrifice of the people, lack of the trained manpower in planning and budget sector, lack of the stable and honest administration, absence of higher mutual character and imbalance between agricultural and industrial sector.

Rita Pathak (1999) has made a research work on the topic “A Study on Deficit Financing in Nepal”. In the study she pointed out that, the main problem of the

Nepalese economy is lack of proper domestic resource mobilization. Domestic resource can be mobilized properly, if there is progressive taxation and effective borrowing system. Commodity taxation in Nepal is very popular which is said to be a regressive type of tax as compared to the income tax. Similarly, the fact is that there is chance of tax evasion and corruption resulting from administrative inefficiency and tax law. Therefore, deficit financing has become a necessity to some extent.

World Bank (2000) found that many factors have contributed in varying degrees to the lack of effectiveness of public spending in Nepal. There is little doubt that institutional factors (including deficiencies in the planning, budgeting and expenditure monitoring process, as well as weaknesses in institutions, particularly the civil service/ administration) have played a key role in the over-programming of the budget, its lack of focus and prioritization and implementation problems. The eagerness of external donors to help has also encouraged over-programming and the lack of prioritization of the public expenditure program. The lacks of ownership of projects/ programs at various levels and the absence of accountability, have also undermined the quality and effectiveness of public spending.

Kashi Nath Poudel (2002) has made a research entitled “A Study on budgetary Pattern of Nepal”. His study covers the time span of twenty years. In his study the pattern of government expenditure shows a significance difference between receipts (revenue and grants) and expenditure. The gap between development expenditure and revenue surplus is widening due to the growth of government expenditure as compared to the growth rate revenue mobilization.

The study conducted by Poudel has suggested some recommendations to improve budgeting system in Nepal. Some of them are as: (a) proper coordination between National Planning Commission and Ministry of Finance should be maintained , (b) budget should be prepare depending upon economic prosperity, (c) expenditure on unproductive sector should be reduced, and (d) transparency in earning and spending should be enhanced.

Budgetary analysis reveals that Nepal Government spent regular expenditure as budgeted but development expenditure and revenue lagged behind the targets.

This is a gloomy fiscal scenario—low development expenditure, high regular expenditure, low revenue collection and high fiscal deficit with high foreign loan inflows. So far, the donors have provided loan at concessional interest rates and with high gestation period. But, we can not expect the same situation to continue in the coming years in the changing world scenario where there is drying up of the flows of foreign aid and the donors are reluctant to provide concessional loans. Hence, managing national budget has become increasingly challenging for Nepal Government despite its sole objective of poverty alleviation. (Adhikari: 2004)

Asian Development Outlook (2005) revealed that the Nepalese economy remains well inside its production possibilities frontier, which makes further acceleration of the growth rate perfectly feasible. With 71% of its labor force in agriculture and underemployed, Nepal can hasten its transformation from an economy based primarily on agriculture to one based primarily on services and industry. If labor incentive services and industry grow and pull even a quarter of the rural labor force into more productive employment, the economy can be expected to grow much faster.

Simultaneously, the accompanying reduction in the population pressure on farmland will help raise agriculture productivity and wage.

Anjana Khanal (2005) observes that government expenditure, revenue and their components are linearly related and she has forecasted the components of budget using the linear trend up to the year 2015/16. She further observes that growth rate of recurrent expenditure is more than capital expenditure.

Babu Ram Pandey, in his research thesis "An analysis of Budget Structure of Nepal 1990/91 to 2002/03" remarks "The pattern of government expenditure shows a significant difference between receipts (revenue and grants) and expenditure. Total receipt of government has covered 68.26% of the annual government expenditure in the review period. Government expenditure recorded 18.84% to GDP where as revenues was 11.13% to GDP in average. The percentage of regular expenditure to total expenditure is increasing whereas the percentage of development expenditure is declining.

As per recent economic survey carried out in 2012/13, it was pointed out that:

a) Gap between expenditures and revenue collection needs to be minimized for the fiscal balance. However, the increase in revenues is not keeping pace with the increase in expenditures. It therefore, calls for prompt actions towards gearing up revenue mobilization, improvement in current expenditure management and expansion in capital expenditures.

b) Adjustment made in the customs duties and excise, positive changes observed in tax paying attitude, increase in non-tax revenue collection, to mention a few, have provided a breathing space due to positive changes in revenue collection this year compared to the past performances. To maintain this momentum, the task of tracking and plugging leakage in tax revenue lies ahead.

c) Measures to make the tax administration fully automatic, to make the customs evaluation system more objective through administrative reforms, to simplify the income tax procedures and to reduce the tax exemption ceilings should receive priority attention.

d) Tax revenue has an important role in revenue generation. To further reap its potential, review of tax base and rates changes is in order. Programs designed to enhance taxpayer awareness through tax education should go a long way in increasing tax revenue.

e) Burden of foreign debt servicing on internal revenue has been raising due to the increasing use of foreign aid in the development works. To keep the foreign debt servicing liability within sustainable limit special focus to increasing national saving rate, avoiding as well as containing unproductive current expenditure, and making the development expenditure more productive is warranted.

f) In foreign aid, grant element needs to be enhanced and its use needs to be prioritized. Overall, rational utilization of foreign aid should be a matter of constant review. (Economic Survey, 20012/13)

CHAPTER 3
RESEARCH METHODOLOGY

3.1 Conceptual Framework

Government budget is the sole tool for the successful implementation of fiscal policy designed for attaining specific objectives. Financial operations of the government are properly planned and administered through budgeting. The budget provides a scientific and systematic way of presenting items of public expenditure and revenue.

3.2 Research Design

This is an economic research which is descriptive and analytical in design. The research is mainly based on secondary data. The presentation of Trend and pattern of budgets and relationship between the variables is the main concern of the study. The available data will be reclassified, regrouped and analyzed in order to make them useful in examining the objectives of the study. To make the information easily understandable and visible, the data will be presented in graphs and figures.

Regression Analysis

Linear Regression lines are fitted between the variables based on the observed data if it is felt that the linear relation between the two variables exists. The independent variable is denoted by x and dependent variable by y. In such case, the relationship between y and x is given by:

y = a + bx

where a and b are constants to be obtained from the regression analysis. Values are estimated by:

$$b = \frac{\sum xy - n\overline{x}.\overline{y}}{\sum x^2 - n.x^{-2}}$$

a = $\overline{y} - b\overline{x}$

And degree of fitness between the variables under consideration is evaluated by the coefficient of determination R^2 given by:

$$R^2 = \frac{\sum xy - n\overline{x}.\overline{y}}{\sum x^2 - n.x^{-2} \times \sum y^2 - n.y^{-2}}$$

3.3 Selection of Study period

The period taken for the study is from FY 1998/99 to 2012/13. That is, the analysis is basically for the period since the economic reforms started in the country. In 1990, democracy was restored on the country. The governments then formed centered their effort on increasing peoples welfare through the making of market-oriented economy. This period is supposed to be the appropriate one to analyze trend and pattern of budget in the country.

3.4 Sources of Data and Information

This research will be mainly based on Secondary data published by various Government organizations like CBS, GON, MOF, NRB, CEDA etc. They are: GON, Ministry of Finance (MOF): Various issues of Budget Speeches, Economic Surveys, National planning commission (NPC): Tenth plan., Nepal Rastra Bank (NRB): various issues of Quarterly Economic Bulletin, Economic Report and Current Economic Situation of the Nation, Central Bureau of Statistics (CBS): Various issues of Statistical Yearbook and Statistical pocket book and Center for Economic Development and Administration (CEDA).

3.5 Analysis and Interpretation of Data

Processing of data from Secondary sources will be carried out. The trends, indexes and regression will be calculated to analyze data. Presentations will be made in the form of tables, graphs, charts and figures for analysis and better understanding of variables.

3.6 Definition of the Research Variables

Total Expenditure (TE): Total Government Expenditure is the actual expenditure during the specified period. This is the sum of Current Expenditure, Principal repayment expenditure and Capital expenditure.

Current Expenditures (CE): Expenditures on current outlays on public consumption and revenue expenditures, which create no productive assets such as salaries of employees.

Principal Repayment Expenditure (PRE): Expenditure incurred by government on repayment of loan from Domestic and Foreign sources.

Capital Expenditure: Capital Expenditures are those expenditures which are appropriated and designed to add the productive capacity or the capital stock of the economy.

Foreign Aid (FA) : Foreign aid is any type of capital inflow or other assistance given to a country which would not generally have been provided by natural market forces.

Internal Borrowing (IB): Internal loan raised within the state by government for Deficit financing.

Foreign Loan (FL): Foreign Loan is the loan raised by Government to finance Deficit financing which is to be repaid in future.

Overall Budget Deficit (OBD): It is the difference between Total expenditure and total revenue of the government.

Budget Deficit (BD): Budget deficit is the difference between Total expenditure and total government receipt. Government receipt includes government revenue and grant.

CHAPTER 4

NEPALESE BUDGETING SYSTEM

4.1 General

In today's world, budget is prepared and presented by every economy whether it is capitalist economy, socialist economy or mixed economy. Government has certain social and economic obligations to be fulfilled towards the people of the state. Government budgeting is an essential element in the sound financial administration. Traditionally, budget was the occasion when the government made changes to the level and structure of taxation and merely a report for information of legislative. But the modern economy that has changed from industrial economies to information economy and the budget can be regarded as heart for lives of prosperous economy. Introduction of Development plans in the economy has also increased the importance of Budget. Budget presents the mirror for the allocation of resources among various administration and development activities of the government. With maximum and significant role of welfare state, it has been developed into a major instrument of overall socio – economic development of the country.

In order to provide overall view on Nepalese budgeting system, historic background of the budgeting system in Nepal has briefly been discussed first in this chapter. It is then followed by the discussion process of budget formulation and implementation in Nepal. Weakness in the process of budget formulation and budgetary reform policies will also be discussed.

4.2 Historical Background

The history of public budgeting in Nepal is not very old. The first annual budget of Nepal was presented in 1952. Prior to 1951 the country was ruled by Rana's Oligarchy. The Rana Regime was overthrown in 1951 and subsequently in 1951/52 the first budget was prepared and presented. For conveniences, the budget development history of Nepal is therefore divided mainly in three different phases.

4.2.1 Before 1951

Before 1951 the state treasury belonged to the Rana Prime Ministers. The government mechanism was geared towards maintenance of law and order. The country itself had imposed self- isolation to the outside world. The ruling elites had little or no concern at all about development of the country.

During the period, the treasury offices in different district headquarters were responsible for collection of revenue and disbursement of expenditure. The central level office responsible to control the whole exercise was Kumari Chowk, the state treasury office. The concept of systematic budgeting and economic development through budget were not in practice at that time.

The major sources of revenue consisted of traditional items like land revenue, costumes, excise duties, royalties on contracts for felling trees and for supplying of porters, vehicles, liquor licensing fees and so on. Similarly the major expenditure items included salaries of army, police and administrative staffs. There was no system of planning for revenue and expenditures.

4.2.2 After 1951

After the down fall of Rana Regime and political change of 1951 in Nepal, the responsibility of the government to launch different programs increased. In 1952, a national budget was presented in the form of an annual plan by the then Finance Minister Subarna Shamser with the estimation of expenditure of Rs. 5.25 crore. The revenue estimation was amount of Rs. 3.05 crore. According to Interim Government Act 1952, it as mandatory to prepare income and expenditure estimate for coming year and obtain assent from the King. Budget was made public only after obtaining assent from king.

In those days, the budget used to contain just the revenue estimates from different sources and the expenditure needed for different heads. In 1957, the budget was classified into regular budget and development budget. First development plan was introduced in 1958 with certain economic and social objectives. Priorities were set for the rapid development of the economy. For the achievement of set objectives and investment on priority sector, the government began to increase the budget size and customary budgeting process was changed. Since then, Nepal has been preparing annual budget every year regularly with the classification of regular budget and development budget. The regular budget to deal with the administrative and ordinary expenditure of the government where as the development budget deal with the expenditure as provided for the development plans. However this has been adjusted to international classification of current budget and capital Budget from FY 2010/11.

Due to several reasons during the fifties no break through was brought about to increase the revenue or reduce the expenditure. Cutting off expenditure was simply not feasible because the government organizations were at the expansion phase. Some progressive efforts were introduced in fiscal year 1959/60 to increase the tax and mobilized resources. The tax fare on customs, land revenue has been increased in due period. Urban tax, business tax and revenue surcharge were introduced in the fiscal year 1959/60. The innovative efforts were resisted by the urban dwellers simply because of the lack of tax paying habits of the common people and also because there were several ways to evade the tax payment. In the mean time the administrative machinery was not strong enough to collect the tax on the basis of original estimates.

In 1959, a new accounting system was devised for facilitating the preparation and execution of budget.

Like many other developing countries, Nepal "has relied on centrally directed, bureaucratically controlled development strategies and the government itself has been the most rapidly expanding sector in the economy. One noticeable phenomenon has been the massive increase in development expenditures during the 1962-90 periods. These expenditures increased in nominal terms from $12.48 million in 1962 to an estimated $507 million in 1990 as a result of an expansionary fiscal policy financed through overdraft borrowing and implemented during the 1980s. (Narayan Khadka, 1991).

In the budgetary history of Nepal, FY 1962/63 is of much importance because some structural change in the budget took place from that fiscal year; perhaps this was the year when Nepal Government implemented its second three year plan. In

1962, a functional classification scheme was introduced and it has been prepared in continuous basis from that year with some reform measures. It organized the budget items in terms of general purposes or functions of governments. Accordingly, the Nepal Government classified its budget as : Economic Administration and planning, social services, Economic Services, and Miscellaneous (on the development budget side), and similarly Constitutional Bodies, General Administration and Planning, Judicial Administration, Foreign Services, Social Services, Economic Services,

Defense and Miscellaneous (on the regular expenditure side). The main theme of the early sixties was to reduce the expenditures and increase the revenues. Thus, efforts were made to reduce deficit.

The preparation of the functional classification of Nepal's budget facilitated simultaneously for allocating the resources according to the intention of the government and for reforming the accounting system in more consolidated manner.

Subsequently along with this classification of the budget the accounting system was also revised and improved in 1963. This new accounting system, gradually introduced all over the country, has been facilitating the preparation of the budget by providing the necessary financial data. This change in the budget became it flexible and more informative.

Subsequently along with the functional classification of the budget first attempt at economic classification was made by the Ministry of Finance in the fiscal year 1969/70 to identify the impact of the budgets transactions on the economy since it distinguishes between current and capital expenditure. It further facilitated for constructing the comprehensive system of national accounting for the economy.

The government started to contribute to development work every year after generating some surplus on the regular budget from the very beginning of budget introduction. The amount of revenue had been increased in this period to meet the increased expenditure. However the revenue for the government as such was limited. As a result the government had to run in deficit budget. It was only in 1961/62 and in 1963/64, the government made some surplus. In other years government budgets always remained deficit. During the seventies and eighties, foreign aid occupied important place in the Nepalese Budgetary system. Most of the Development Expenditure during the period was met from Foreign aid. For financing budget deficit, government adopted policy of borrowing from internal and external sources.

First five year plan was started in 1956. The party less Panchayat System was established in 1962 by King Mahendra. Major reorganization was done in economic planning, with the high-powered planning board under the previous government dissolved in 1961 and the National Planning Council (NPC) was established. The king had direct control over economic policies for some time because, as chairman of the Council of Ministers, he headed the NPC. The king appointed royal commissions on taxation and land reform.

4.2.3 After 1990

After the political revolution of 1990, multiparty Democracy was restored with presence of king. After the restoration of democracy, liberalization of Nepalese Economy took pace. The budget of the kingdom of Nepal for the FY 1991/92 was the first budget in the direction towards liberalization of the Nepalese economy. In that time, it was realized that the government's role in the industrial and other enterprises should gradually be decreased with corresponding increased participation of the private sector. Many reform measures in the fiscal sector were introduced and initiated on both the revenue and the expenditure side.

The first budget of the Ninth Plan, 1997/98 budget had envisaged to pursue the major objective i.e. poverty alleviation in a more co-coordinated, integrated and effective manner. The budget was committed in such a way that "NPC will be made more active in project selection, monitoring and evaluation. MOF will require preparing budget on the basis of three year rolling expenditure plan. The mid term evaluation of the budget will be conducted on time and budget will be managed accordingly." Further the budget for the FY 2000/01 had given special emphasis on reform in public expenditure management, reform in the revenue administration, improvement in the effectiveness of foreign aid.

During 1990s, two measures were taken to widen the tax base. The first was reduction in both the tax rates and slabs of various taxes prior to the reforms, tax rates were as high as 300 percent. An excessively higher rate encourages tax evasion and act as a disincentive for further production. Consequently, revenue mobilization falls below the potential level. Under the circumstances, raising revenue requires lowering tax rates with a view to widening the tax base and improving tax collection, Nepal lowered the tax rates. Similarly, the number of tax slabs has also been brought down to a manageable level from the numerous tax slabs earlier years that have made tax administration too cumbersome. Indirect taxes which was dominating in the Nepalese tax system and exemptions and loopholes. Realizing this and under the advice of multilateral agencies such as the IMF and the World Bank, Nepal introduced the VAT, a unified indirect tax instrument. However, because of the opposition from the business community, the introduction of VAT was frequently postponed before it was finally implemented.

4.3 The Formulation Process

Budget being a part of economic plan, it is necessary to determine resource allocation in conformity with the objectives, policies, programs and strategies set in the plan document while formulating it.

Budget in Nepal used to categories into a regular Budget and Development Budget until FY 2011/12. However, this has been adjusted to international classification of current budget and capital budget from FY 2012/13.

The current budget is prepared at the Ministry of Finance and the major headings under current budget are expenditures on consumption expenses, office operation and service, grants and subsidies, service and production expenses, contingency expenses, principal and interest payments on domestic and foreign loans.

Likewise, items falling under capital expenditure are capital transfer, capital formation, investment in share and loan, and capital grants. (Budget Speech: 2011/12)

The NPC determines the size of capital/development expenditure conformity with the policies, programs and priorities envisaged in the national plan also by considering the extent of external borrowing both bilateral and multilateral grants and loans as well as domestic borrowing available to treasury during the given fiscal year. Items falling under capital expenditure are capital transfer, capital formation, investment in share and loan and capital grants.

The magnitude of current/regular expenditure is estimated on financial ceiling provided by the Ministry of Finance and the NPC.

Budget formulation consists of the four steps or phases, which are also known as budget cycle:-

Phase 1: Preparation

Phase 2: Enactment/Legislation

Phase 3: Execution

Phase 4: Auditing

4.3.1 Preparation

Preparation is the first step of budget formulation. It starts with resource estimation. Budget division of finance ministry has the responsibility for preparing budget. For development budget, NPC play major role and for regular budget, budget division of finance ministry play major role. The Resource Committee (RC) comprising Vice Chairperson of National Planning Commission (NPC), Member of NPC – Macro Sector, Governor of Nepal Rastra Bank (NRB), Financial Comptroller General and Secretary of Ministry of Finance determines the size of the budget by analyzing overall economic situation of the country with the help of macro economic indicators. Resources estimate comprise estimates of revenue, foreign loan, foreign grant and domestic borrowing. Upon accomplishing resource estimation, the Resource Committee sets the ceiling for budget for the next fiscal year. Revenue Consultative Committee (RCC) set up at the national level under MOF provides recommendations for designing policies, determining tax base and tax rates, setting the level of exemptions, and personal and business deductions. The budget ceiling is fixed considering availability of both internal and external resources. 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 course of preparing the budget documents, finance ministry issues some guidelines and priorities consistent with economic planning and fiscal policy and sends the circulars to all ministries and departments to prepare the budget with following information:

- Ceiling of funds including external assistance available for each Ministry for various budget funds.
- Formats to be used for various estimates and instruction to be followed in preparing the estimates.
- Policy guidelines to be followed in prioritizing activities
- Manual to be used for resource allocation for the various budget headings.

Budget preparation at the Ministry level begins after receiving the circular based on its programs and policies. The respective Ministry submits the prepared budget proposal and the annual program – one copy each to NPC and MOF in the beginning of the third trimester of the fiscal year.

In the case of capital budget, the first round of discussion takes place at NPC. The proposed program is critically examined in the prospective of policy guidelines and the circular. The MOF staff assesses the aid – involved projects in the context of the confirmed and unconfirmed commitments of the respective donors. The final round of discussion takes place at MOF, represented by the concerned ministries/ departments and NPC staff. MOF prepares a statement of expenditure containing description of all estimated expenditure for each sector Ministry, which would be ready by June/ July.

4.3.2 Enactment/ Legislation

Enactment/Legislation is the second step of budget formulation. The phase enactment begins with budget speech by the Finance Minister at the joint session of parliament in the second or third week of July. It is followed by a brief discussion of the underlying budgetary principles and policies. The minister also submits an Appropriation Bill and the Finance Bill to the Parliament. The Appropriation Bill is accompanied with a description of programs and their regional distribution. The discussion in parliament lasts for one and half to two months, when subjects are analyzed item wise, followed by a voting on the bill in parliament in September. After about one to two weeks from the date of parliamentary approval of the bill, the bill gets the royal assent to become an Act.

4.3.3 Execution

The third cycle of budget is known as a phase of execution. In this stage, budget is executed by the executive body of the government. The fund release process begins with the approval of the budget by the parliament. The process of releasing budget is given below:

- One third of the previous year's expenditure can be released as the Advance Bill before royal assent. Subsequent releases are possible only after the Appropriation Bill gets royal assent.
- Release of budget is made on a monthly basis.
- For donor funded projects, budget is to be released on a pre – funding (donors have to put deposit to GON Treasury in advance) and reimbursement basis (applied for loan-financed projects and to some extent for bilateral donor – financed projects depending upon the agreement).

The Financial Comptroller General Office (FCGO) and District Treasury Office (DTO) play an important role in the budget release process. It is noted here that DTO release the fund upon the receipt of the following documents.

a) Authority letter from the concerned ministry

b) Release order to DTO by FCGO

c) Project/Program duly approved by NPC and documented in the budget

d) Statement of expenditure of the previous month from the requesting agency

4.3.4 Auditing

The last phase of budget cycle is auditing. The overall responsibility of auditing goes to the Auditor General (AG). AG prepares the annual report after accomplishing auditing of all government transactions. The AG presents its annual report to His Majesty. This is later forwarded to parliament for discussion and implementation.

4.3.5 Weaknesses of Budget Formulation in Nepal

Over Estimation

The resource estimation in Nepal is mostly based on accounting trend and intelligent judgment. Sometimes it leads as much as 25 percent differences between the estimated and the realized revenue. With weak estimation, whole expenditure planning becomes a failure.

Political Intervention

Budget in Nepal is driven by more political objectives rather than social and economical objective of the government. The Nepal Public Expenditure Report (PER) 2000 points out that the development budget is heavily over programmed. Because of the political pressures, the size of the budget is set at levels, which are not consistent with the actual availability of resources and institutional capacity. The consequence is that the limited resources are spread too thinly among too many projects.

Lack of Participatory Approach

Local ownership of the projects may improve the effectiveness of public spending. Budget formulation is not participatory in real sense, which explains why there is lack of ownership of projects and programs by local communities. It results into poor performance.

Not a Performance Based or Zero Based Budgeting

Zero based or performance based budgeting system is effective to cut down expenditures. It is not practiced in Nepal, although it is recommended from various quarters that the government should introduce it. Past performance is not reviewed while formulating budget and it follows incremental approach.

No Earmarking of the funds

There is no practice of earmarking the certain revenue for the certain purpose only.

Donor's Pressure

Some projects are kept under first priority just because they are donor financed.

4.4 Budgetary Reforms and Policies

Every democratic government makes vigorous efforts for maximizing the welfare of the community in the modern times. In order to achieve, the government takes in hand various socio-economic activities. This requires proper manipulation of the budgetary policy of the government.

In Nepal, after restoration of democracy government initiated the economic strategy of maximizing public participation by promoting the role of the government from a controller to facilitator for the economic development of the country. Liberal and market oriented economic policy is followed against the inward looking and controlled economic policy for the attainment of sustainable higher growth rate in non agricultural sector.

Budgetary policies of Nepal Government during the Nineties were directed towards economic liberalization, privatization, poverty reduction and decentralization. Policies and programs of the budget during Nineties were essentially concerned with agriculture, modernization, employment promotion, women empowerment, financial sector reform, government expenditure management, tax reform, good governance, social service and the development of basic and physical infrastructure. The budgetary policy measures adopted by the first two budgets deserve appreciation at least in terms of the direction towards liberalization through they were still inadequate in terms of achieving the desired results. (Adhikari: 2004)

Developed and developing economies need to design economic policies that facilitate implementation of structural reforms and should also be flexible enough to achieving sustainable and broader economic growth. (Economic Survey: 2012/13)

4.4.1 Structural Adjustment Program (SAP) and Enhanced Structural Adjustment Facility (ESAF)

The government adopted a stability program supported by the IMF Standby Arrangement and a Structural Adjustment program in 1987 and in 1989 financed by the World Bank Structural Adjustment Credits and by an IMF Structural Adjustment Facility. The specific objectives of the adjustment program in Nepal were:

- Macroeconomic Stabilization,
- Increased resource mobilization,
- Enhanced investment efficiency,
- Improvement in financial management of public enterprises,
- Increased productivity and employment in the agriculture sector, and
- Encouraging private sector involvement in agriculture, forestry, trade and industry.

Nepal entered into another agreement with IMF under the Enhanced Structural Adjustment Facility in 1992 after second SAP expired in 1990. The objectives were:

- Raising GDP growth to about 5 percent per annum in the next three years,
- Reducing annual inflation to 5 percent and limiting current account deficit to 9.6 percent of GDP,
- Reducing fiscal deficit to 7.8 percent of the (before grant) with domestic borrowing limited to 0.2 percent of GDP by the end of the program period (1994-95).

4.4.2 Immediate Action Plan (IAP) and Medium Term Expenditure Framework (MTEF)

In June 2010, Nepal Government adopted the IAP that was designed to expedite reforms in three critical areas-prioritizing public expenditures, improving service delivery and strengthening anti-corruption and accountability measures. Main IAP actions as regards public expenditure include:

- Setting a realistic budget ceiling and eliminating a number of low priority projects.
- Assuring funding for high priority projects, but tying funds release to performance.
- Implementing public procurement and financial accountability reforms.
- Public posting of budget information and tracking of expenditures.

Based on the recommendation of the 2008 public expenditure Review and the work of the public expenditure Review Commission in 2009, and prompted by the worsening fiscal situation, Nepal Government decided to introduce MTEF Starting in FY 2010/11. Overcoming the entrenched tendency to seek increased foreign aid to cope with fiscal stress, the reform minded NPC and MOF used the fiscal pressure to motivate serious adjustment in budget allocations.

Nepal Government is implementing the time bound Immediate Action Plan, on the selected important areas at the national level, with clear responsibility, since last 3 years. In FY 2012/13, IAP-2005 with important 22 activities is under implementation.

Monthly progress on IAP-2005 is being updated and reviewed periodically at the meetings held under the chairmanship of vice-chairman of NPC. Necessary follow up actions are being undertaken to achieve the lagged targeted goal identified at the review. Observing the implementation status of this IAP-2005 so far, it is likely that all activities under this plan will be accomplished in time. (Economic Survey: 2005)

4.4.3 Three Years Interim Plan (2010/11 to 2012/13)

After coming to an end of Tenth Five Year plan, NPC has formulated and implemented the Three years interim plan (2010/11 to 2012/43). This interim plan, being prepared at prevailing a special moment in the country's history, is expected to give continuity to previous achievements, and to address issues specific to the transitional period in a post-conflict situation. This Plan puts special emphasis on increasing public expenditure to assist relief and generate employment as well as on peace building, reconstruction, rehabilitation, reintegration, inclusion, and revitalization of the economy. Following budgetary reform policies have been envisaged in this interim plan:

4.4.1.1 Expenditure Policies

a) In the past, there was negative impact on national income growth and other economic indicators as the regular expenditure was more than targeted and development expenditure far less than targeted. The following policies will be adopted in order to improve public expenditure management.

b) Additional efforts will be made to increase efficiency in public expenditure to strengthening fiscal system, and maintaining fiscal discipline in order to help maintain macroeconomic stability. Additional measures will be adopted to reduce the imbalance between current and capital expenditure.

c) Medium Term Expenditure Framework will be reviewed and input/outcome/impact system will be adopted in a concrete manner for new methods of Sectoral prioritization and investment effectiveness.

d) Budget release and control system will be reviewed and improved.

e) Unproductive expenditure will be gradually reduced, and auditing enforced to maintain fiscal discipline.

f) Feasibility study will be carried out to implement a zero-based budgeting system.

g) Gender accountable budget system will be institutionalized.

4.4.1.2 Tax Policies

a) The system of collecting and mobilizing taxes will be made transparent and simple by reviewing existing tax system and acts.

b) Revenue leakage will be controlled by strengthening revenue administration capacity.

c) Value added tax system will be made more effective

d) The tax base will be gradually broadened.

e) Customs rate and other tax systems will be adopted in line accordance with Nepal's commitment to international and regional organizations like World Trade Organization, and SAFTA.

f) Domestic revenue mobilization will be strengthened by broadening reintegration and inclusive development.

The Projection of Government budgets for the interim plan are given as follow:-

Table 4.1: Budgeted expenditure for the Three years interim plan

(Rs. in million)

	Current	Capital	Principal Repayment	Total
2009/10	80330 (59.30)	36370 (26.8%)	18840 (13.90%)	135540 (100.00%)
Three Year's total	285483 (55.80%)	178990 (35.00%)	46905 (9.20%)	511378 (100.00%)

Src: Three Year Interim Plan: Approach Paper (2067/68 to 2069/70)

Table 4.2 Sources of Financing in Three years interim plan

(Rs. in million)

	Revenue	Grant	Foreign Loan	Domestic Loan	Toal
2009/10	86894 (64.10%)	20000 (14.80)	12000 (8.90%)	16646 (12.30)	13554 (100.0%0
Three Year's total	318893 (62.40%)	84137 (16.50%)	56522 (11.10%)	51826 (10.10)	511378 (100.00)

Source: Three Year Interim Plan: Approach Paper (2067/70 to 2069/70)

From above table it can be seen that

a) Revenue receipt (62.40%) is not even sufficient to finance the current and principal repayment expenditure (73.20%) during the planning period.

b) Expenditure on capital projects is largely dependent on Foreign Grant and Loan. Hence, estimated outlay on plan is not self sufficient and largely dependent upon external sources.

c) Though Principal Repayment expenditure (9.20%) is expected to be lower during the plan period, it is extremely high when compared with capital expenditure (35.00%).

d) Foreign and Domestic loan (21.20 %) raised during the period will create burden in the coming future years. Hence, the above budget for the plan period doesn’t seem to be self-reliant.

CHAPTER 5
AN ANALYSIS OF STRUCTURE OF BUDGET AND ITS COMPONENTS

In this chapter, an attempt has been made to analyze the structure of budget and trend and pattern of its components expenditure, revenue and budget deficit of government during the period of 1993/94 to 2007/08. Components of the budget will be analyzed and forecasting for the year 2010/11, 2015/16 and 2020/21 will be carried out based upon the data of the study period.

Macroeconomic performance is judged by looking few key variables. Brief discussion on Gross Domestic Product and Per capita income of the household of Nepal is presented first before going to the discussion on the above budget components

5.1 Gross Domestic Product

GDP is the market value of all final goods and services produced during the period of one year. All the economic activity are affected by the value of goods and services produced during the period i.e. GDP.

In Nepalese context GDP is divided into two sectors, i.e. Agriculture and Non – Agriculture. Table 5.1 and Fig. 5.1 present the total GDP with the share of Agriculture and Non – Agriculture Sector. National accounts have been published in new series compatible with international classification from 2007/08. The table shows that GDP at current prices has increased in absolute term from 116127 in 1993/94 to 504101 in 2007-08. But increase in GDP is not regular during the review period. Percentage increase in GDP during the recent years from 2002/03 onwards is lower due to unfavorable economic and political conditions. Share of Agriculture sector in total GDP is in decreasing trend. In the year 1993/94, contribution of Agriculture sector was 47.68% while its share has decreased to 38.34% in 2007-08.

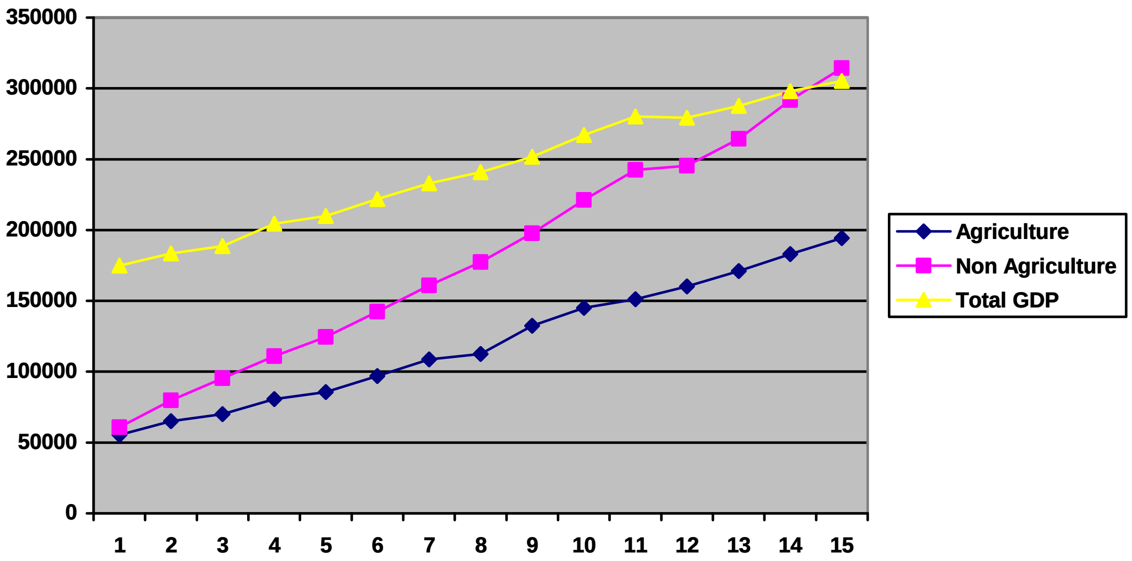
Table 5.1: Gross Domestic Product and its Sectoral Contributions

Rs. in million

Financial Year	Year Notation	GDP at current price	Agriculture	Non Agriculture	Agriculture (%)	Non Agriculture (%)	GDP (at 1994/95 price)	% change (Real GDP)
1998/99	1	116127	55368	60759	47.68	52.32	174908	-
1999/00	2	144933	65156	79777	44.96	55.04	183371	4.84
2000/01	3	191596	70090	95260	42.39	57.61	188780	2.95
2001/02	4	209976	80589	111007	42.06	57.94	204397	8.27
2002/03	5	239388	85569	124407	40.75	59.25	209976	2.73
2003/04	6	269570	96896	142407	40.48	59.52	221930	5.69
2004/05	7	289798	108785	160785	40.36	59.64	233040	5.01
2005/06	8	269570	112495	177303	38.82	61.18	240816	3.34
2006/07	9	330018	132373	197645	40.11	59.89	251758	4.54
2007/08	10	366251	145131	221120	39.63	60.37	267096	6.09
2008/09	11	394052	151059	242507	38.33	61.54	280106	4.87
2009/10	12	406138	160144	245488	39.43	60.44	279169	-0.33
2010/11	13	437546	171104	264427	39.11	60.43	287689	3.05
2011/12	14	474919	183117	291802	38.56	61.44	298023	3.59
2012/13	15	508651	194363	314288	38.21	61.79	305244	2.42

Source : Economic Survey 2011/12 and 2012/13

Figure 5.1: Gross Domestic Production and its Sectoral Contribution



Source : Table 5.1

It can be seen from above figure that linear trend can be fitted for all the variables Total GDP, Agricultural contribution and Non – agricultural contribution. R2 is above 0.99 in all cases. The linear equations as shown in Fig. 5.1 are given below:

Regression equation for total GDP is

Y=79722 + 27904 t (5.1) (R^2 = 0.998)

Where Y is Total GDP and t is notation
year. For the year 1998/99, t = 1.

Regression equation for Agricultural sector GDP is

Y= 10073 t + 40228 (5.2) (R^2 = 0.997)

Where Y is Agricultural Sector GDP and t is notation year.

Regression equation for Agricultural sector GDP is

Y=39670 + 7782 t (5.3) (R^2 = 0.998)

Where Y is non-Agricultural Sector GDP and t is notation year.

Based upon these estimates forecasted value for 2010/11, 2015/16 and 2020/21 are given
below:

Table 5.2: Forecast of Total GDP and its Sectoral Contribution

Rs. in million

Financial Year	Year Nation	Total GDP	Agriculture	Non Agriculture
2010/11	21	665707	251770	413107
2015/16	26	805227	302137	502018
2010/21	31	944747	352504	590929

It can be seen from above table that Total GDP will rise to 944747 million in FY 2020/21 from 508651 in 2004/05. Hence within 16 years from 2004/05, GDP of Nepal will increase by 86% (Growth rate of 3.95% p.a. in nominal terms).

For calculating the real GDP growth rate, the trend is fitted for semi logarithmic curve for the real GDP of the corresponding year. The fitted curve is given by

$$\ln Y = 12.05 + 0.041\,t \qquad (5.4)$$

Where Y is the real GDP and t is the time. t = 1 for the year 1990/91

From the curve fitted, it can be seen that real GDP is growing at the rate of 4.1% during the review period.

The National Planning Commission Secretariat in association with Ministry of Population and Environment made a population projection for Nepal in 2003. The projected population given below is based on the assumption of Fast Fertility Decline variant.

Table 5.3: Population Projections for Nepal

Year	**2006**	**2011**	**2016**	**2021**
Population (in million)	**25.77**	**28.18**	**30.17**	**32.03**

Source: Population Projection by Age and Sex for Nepal, 2001- 2021

Hence, from the forecasted value of GDP (Table 5.2) and Population projections of Nepal, we can forecast the value of Per Capita Income as given in table 5.4.

Table 5.4: Estimated Per Capita GDP (In Rs.)

Year	GDP Forecasted By this study	Population Projections	Per Capita GDP Forecasted
2010/11	66507	28.18	23623
2015/16	805227	30.17	26690
2020/21	944747	32.03	29496

From table 5.4, based upon the data of the study period, it can be seen that Per capita GDP will rise to Rs. 23623 in 2010/11 and Rs. 29496 in 2020/21. During the period of these ten years, there will only a nominal growth rate of 24.86% (2.24% p.a) based upon the above projections of data.

5.2 Components of Nepalese Budget

Budget structure means the various components incorporated within the budget. Nepalese budget not only comprises of expenditures and revenues but also heavily depends on foreign grants and loans. The main components of Nepalese budget can be divided into the following main headings:

a) Government Expenditure

b) Government Revenue

c) Foreign Grants

d) Loans (Internal and External)

As per international classification, Government Expenditure is classified as current expenditure, capital expenditure and principal repayment expenditure from FY 2012/13.

Government Revenue can be divided into tax revenue and non-tax revenue.

5.2.1 Government Expenditure

Government expenditure refers to the expenses incurred by the government for the maintenance of the government and to preserve the welfare of society as a whole. In other words, it refers to the expenses made by public authorities i.e., (State Government, Central Government and other local bodies) to satisfy the common wants of the people. It is for protecting the citizens for promoting the common and social welfare. Government expenditure was classified into two headings, regular expenditure and development expenditure till 2011/12. From the year 2012/13, the same has been classified as recurrent expenditure, capital expenditure and principal repayment expenditure.

Nepal being a developing country, there is an urgent need of expanding development expenditure. However, here is also a growing compulsion to maintain law and order as well as debt servicing. Financing expenditure requires increment in revenue collection. Situation of revenue receipts determines the amount necessary for foreign assistance and internal borrowing. The growth of government expenditure in Nepal has been phenomenal as evident from the fact that every finance minister ever since the beginning of the budgeting system in 1951 has presented a public expenditure program larger than that of the previous year. (Adhikari: 2004)

As the data is available from the fiscal year 1998/99 to 2004/05 as per new classification, trend and pattern of the public expenditure will be analyzed for the period 2006/07 to 2012/13.

a) Recurrent Expenditure

Recurrent expenditure is one of the major components of total expenditure which is the current expenses of government for maintenance of law and order in the economy and expenditure on regular activities which is in the nature of consumption. No capital equipment is added from such type of consumption. Its main components are expenditures on general administration, social service, economic service, defense, loan, principal payment and interest payment etc.

b) Capital Expenditure

Capital expenditure is the investment made by government in the economy to add productivity and capital equipment in the economy. Capital expenditure is importance for the developing countries like Nepal for its rapid growth and development. Capital expenditure is also made up of different components. Its main components are economic service, capital expenditure on defense, economic administration and planning etc.

c) Principal Repayment

Principal repayment is the share of internal loan payment and external loan payment. Its share is nominal while comparing with the whole budget. But repayment of principal in Nepal is gradually increasing due to increasing budget deficit each year and budget deficit are financed through internal and external loan which are to be paid back in later years.

5.2.2 Trend of Government Expenditure

Table 5.5 reflects the amount of current expenditure, capital expenditure, principal repayment expenditure and total expenditure during the review period 2006/07 to 2012/13, the total expenditure was only Rs. 23459.8 million in 1998/99, rose to Rs. 59579 million in 2006/07 and that has further increased to Rs. 102560.4 in 2012/13. Though this shows the steady and increasing trend of government expenditure in absolute term, percentage of total expenditure to GDP has risen by nominal figure only. In the year, 2006/07, total expenditure was 18.05% of GDP which has increased to 20.16% of GDP in the year 2012/13.

Table 5.5: Trend of Government expenditure and its share on GDP

Rs. in million

Facial Year	RE[a]	CE[b]	PR[c]	TE[d]	% of TE			% of GDP			
					RE[a]	CE[b]	PR[c]	RE[a]	CE[b]	PR[c]	TE[d]
2006/07	31944.20	22992.10	4642.70	59570.00	53.62	38.59	7.79	9.68	6.97	1.41	18.05
2007/08	35579.10	45480.70	5212.70	66272.50	53.69	38.45	7.87	9.71	6.96	1.42	18.09
2008/09	45837.30	28307.20	5690.60	79835.10	57.41	35.46	7.13	11.63	7.18	1.44	20.26
2009/10	48863.90	24773.40	6434.90	80072.20	61.02	30.94	8.04	12.03	6.10	1.58	19.72
2010/11	52090.50	22356.10	9559.50	84006.10	62.01	26.61	11.38	11.91	5.11	2.18	19.20
2011/12	55552.10	23095.60	10794.90	89442.60	62.11	25.82	12.07	11.70	4.86	2.27	18.83
2012/13	61686.40	27340.70	13533.30	102560.40	60.15	26.66	13.20	12.13	5.38	2.66	20.16

* From the year 2012/13, public expenditure has been classified as current, capital and principal repayment. Hence the figures of previous years classifying expenses as regular and development expenses are not comparable

[a] refers to recurrent Expenditure

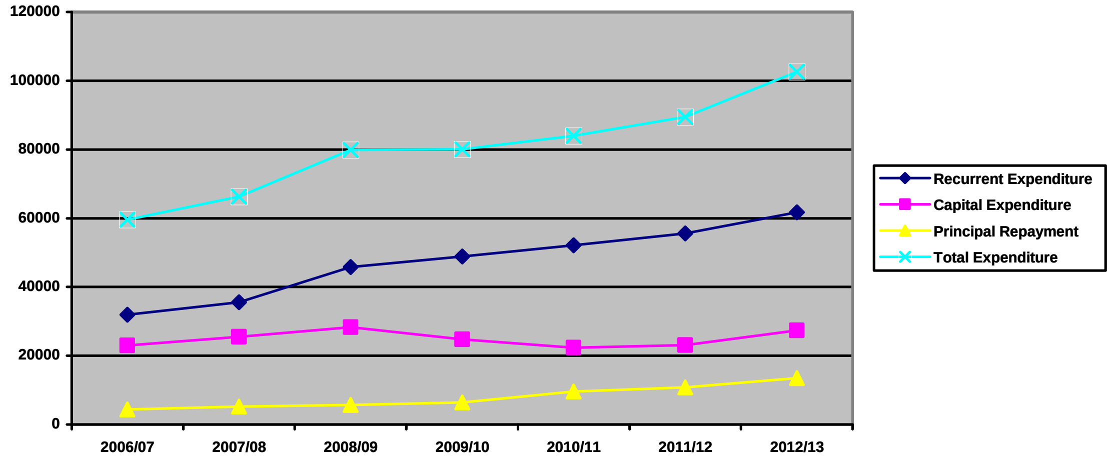
[b] refers to capital expenditure

[c] refers to principal repayment expenditure

[d] refers to total expenditure

Source: *Economic Survey, FY 2012/13 MOF*

Figure 5.5: Trend of Recurrent Expenditure, Capital Expenditure Principal Repayment Expenditure and Total Expenditure



Source: *Table 5.5*

In the same fashion, recurrent expenditure heavily increased during the review period. In absolute term, it has risen from Rs. 31944.20 million in 2006/07 to Rs. 61686.40 million in 2012/13. The percentage share gives clear idea of the very trend of recurrent expenditure. It is increasing in every fiscal year. In the year 2006/07, the percentage of recurrent expenditure to total expenditure was 53.62 percent which has increased to 60.15 percent in the year 2012/13. This clearly shows that government expenditure is increasing in absolute term to finance more expenditure on current activity.

However, capital expenditure of government has increased slowly as compared to recurrent expenditure. In absolute term it has increased during the review period. Though capital expenditure has increased in absolute amount from Rs. 22992.10 million in 2006/07 to Rs. 27340.7 million in 2012/13, it shows fluctuating trend during the review period. In the year 2010/11, capital expenditure has decreased to 22356.10 in the absolute term and has again increased to Rs. 27340.7 million in 2012/13. The percentage share of capital expenditure to total expenditure shows a continuous decreasing trend. It was as high as 38.59 percent in 2006/07. However, it decreased and reached 26.66 percent in the final year of the review period. Share of capital expenditure is decreasing in every fiscal year.

Principal repayment of internal and foreign loan shows the increasing trend during review period. It was Rs. 4642.70 million in 2006/07 and has increased by more than three times and reached up to 13533.30 in 2012/13. Percentage share of principal repayment has also increased from 7.79 percent of total expenditure in 2006/07 to 13.20 percent of total expenditure in 2012/13. Increasing trend of recurrent expenditure and principal expenditure has left only the little amount for capital expenditure which is the base for growth and development in the economy.

The percentage share of recurrent expenditure to GDP shows increasing trend. However, small fluctuation is seen during the review period. It was as low as 9.68 percent in 2006/07 and as high as 12.13 percent in 2012/13.

The percentage share of capital expenditure to GDP also has presented a fluctuating scenario; however, it indicated a downward trend in the recent years of the review period. In the fiscal year 2008/09, the percentage was as highest as 7.18 whereas in the year 2011/12, the percentage was as lowest as 4.86 percent. This shows the failure of government to mobilize the resources on capital formation in the economy.

From the Figure 5.4, it can be seen that total expenditure and its component recurrent expenditure and principal repayment show the linear trend over a study period. ($R^2 > 0.95$ in all the cases). Capital expenditure shows the fluctuating trend over a period of study.

Regression equation for Total Expenditure is

$$Y = 54616 + 6409\,t \tag{5.4}$$

($R^2 = 0.97$)

where Y is Total Expenditure and t is notation year.

Regression equation for Recurrent Expenditure is

$$Y = 28018 + 4837\,t \tag{5.5}$$

($R^2 = 0.98$)

where Y is Recurrent Expenditure and t is notation year.

Regression equation for Principal Repayment Expenditure is

$Y = 2023 + 1489\,t$ (5.6) ($R^2 = 0.96$)

where Y is Principal Repayment Expenditure and t is notation year.

Based upon above trend equation the forecasted value of the total expenditure and its components for the year 2010/11, 2015/16 and 2020/21 is given in Table 5.6.

Table 5.6: Forecasted value of total expenditure and its components

Rs. in million

Fiscal Year	RE	CE	PR	TE	% of Forecasted GDP			
					RE	CE	PR	TE
2010/11	90894.51	25653.70	21386.44	137934.65	13.65	3.85	3.21	20.72
2015/16	115077.69	26068.79	28833.78	169980.26	14.29	3.24	3.58	21.11
2020/21	139260.86	26483.88	36281.12	202025.86	14.74	2.80	3.84	21.38

From the table 5.6, if the above trend follows in the coming year, it can be seen that by the year 2020/21, the revenue expenditure, capital expenditure, principal repayment expenditure and total expenditure will be Rs. 139260.86 million, Rs. 26483.88 million, Rs. 36281.12 million and Rs. 202025.86 million respectively. Percentage of these components on GDP will be 14.74 percent, 2.80 percent, 3.84 percent and 21.38 percent respectively.

5.2.3 Pattern of Government Expenditure

5.2.3.1 Pattern of Recurrent Expenditure

This category is in the nature of consumption expenditure and therefore it includes recurring type of expenditure. Recurrent expenditure consists of various components. The main functional components are constitutional organs (CO), general administration (GA), revenue administration (RA), economic administration and planning (EAP), judicial administration (JA), foreign services (FS), Defense (D), Social Services (SS), economic services (ES), interest payment (IP) and miscellaneous (M).

Table 5.7: Recurrent Expenditure under Different Heads

Rs. in million

Fiscal Years	CO	GA	RA	EAP	JA	FS	D	SS	ES	IP	M	TRE
2006/07	336.20 (1.05)	3435.00 (1.05)	311.60 (0.98)	140.30 (0.44)	211.60 (0.98)	136.20 (0.05)	2823.80 (8.84)	10794.60 (33.79)	4480.40 (14.03)	4080.30 (12.77)	4767.90 (14.93)	31944.20 (100.00)
2007/08	424.00 (1.19)	3864.20 (10.86)	338.80 (0.95)	154.60 (0.43)	328.80 (0.95)	224.00 (1.19)	3124 (8.78)	12814.10 (36.02)	4683.20 (13.16)	4820.00 (13.55)	4512.90 (12.68)	35579.10 (100.00)
2008/09	431.10 (0.94)	5419.80 (11.82)	383.20 (0.84)	364.00 (0.79)	283.20 (0.84)	231.10 (1.94)	3457.20 (7.54)	15366.30 (33.52)	4899.90 (10.69)	4697.80 (10.25)	9912.60 (21.63)	45837.30 (100.00)
2009/10	571.00 (1.17)	7140.10 14.61	476.20 (0.97)	289.10 (0.59)	376.20 (0.97)	471.00 (1.28)	5264.80 (10.77)	16953.10 (34.69)	5795.10 (11.86)	5770.30 (11.81)	5494.80 (11.25)	48863.90 (100.00)
2010/11	819.20 (1.57)	7335.90 (14.08)	470.50 (0.90)	235.70 (0.45)	370.50 (0.90)	419.20 (1.59)	6168.30 (11.84)	18886.90 (36.26)	5078.50 (9.75)	6621.80 (12.71)	5326.40 (10.23)	52090.50 (100.00)
2011/12	737.20 (1.33)	7325.30 (13.19)	496.60 (0.89)	269.60 (0.49)	169.60 (0.49)	637.20 (0.99)	6629.60 (11.93)	20808.50 (37.46)	5512.80 (9.92)	6543.90 (11.78)	6069.40 (10.93)	55552.10 (100.00)
2012/13	813.90 (1.32)	8226.30 (13.34)	540.80 (0.88)	328.50 (0.53)	228.50 (`0.53)	413.90 (0.32)	8580.30 (13.91)	23208.80 (37.62)	7167.80 (11.62)	6218.00 (10.08)	5303.00 (8.60)	61686.40 (100.00)
Average	1.22	12.67	0.92	0.53	0.80	1.40	10.52	35.62	11.58	11.85	12.89	100.00

CO = constitutional organs, GA = general administration, RA = revenue administration, EAP = economic administration and planning, JA = judicial administration, FS = Foreign Service, D =

defense, SS = social services, ES = economic services, IP = Interest Payment, M = miscellaneous, TRE = total recurrent expenditure.

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

Sources: *Economic Survey, FY 2012/13, MOF*

Table 5.7 exhibits the composition of recurrent expenditure under different heads. These components have again been divided into different sub components, which are not mentioned here in the table. The components general administration, revenue administration, judicial administration, financial service, defense, social service and economic services have been showing increasing trend. The components constitutional organ also shows the increasing trend till the year 2010/11. But in 2011/12 it has decreased to 737.20 and again increased to Rs. 813.90 million in 2012/13. Remaining components of recurrent expenditure i.e. economic administration and planning, interest payment and miscellaneous show a fluctuating scenario over the years of study.

The parenthesis in the table indicate percentage share of different heads to total recurrent expenditure. Among its components social service claims a highest amount with in all fiscal years compared to others. These alone claims at an annual average of 35.62 percent, nearly one third of total revenue expenditure incurred within the period. Next components with substantial amount are the expenditure on general administration (12.67%), defense (10.52%), economic services (11.58%), Interest Payment (11.85%) and miscellaneous (12.89%).

Due to political situation prevalent at the time and increase in defense activities, defense expenses shows increasing trend during the period 2006/07 to 2012/13. It was only Rs 2823.80 million in 2006/07 which has increased by more than 300 percent to Rs. 8580.30 million in 2012/13. In percentage term also, current expenditure on defense has increased from 8.84 percent of total revenue expenditure in 2006/07 to 13.91 percent in 2012/13.

5.2.3.2 Pattern of Capital Expenditure

In the initial stage of development, the government should play the strategic role to the public sector in sustaining growth. Literature strongly argues the necessity of expanding productive investment in an economy by the state in order to accelerate the process of capital formation as well as to increase and improve the quality of human capital. Government's capital expenditure comprises constitutional organs (CO), general administration (GA), revenue administration (RA), economic administration and planning (EAP), Judicial administration (JA), foreign services (FS), Defense (D), Social Services (SS), economic services (ES), interest payment (IP) and miscellaneous (M).

Table 5.8: Capital Expenditure under Different Heads

Rs. in million

Fiscal Year	CO	GA	RA	EAP	JA	FS	D	SS	ES	LI	M	TCE
2006/07	76.5	259.9	3.3	2.1	23.3	85.60	171	7495.5	14349.60	15.1	510.2	22992.10
2007/08	34.20	314.30	0.30	4.80	2.60	102.80	358.10	8638.50	15466.70	39.20	519.20	25480.70
2008/09	19.80	965.80	0.90	17.40	48.10	12.50	356.20	8489.00	17745.10	10.00	642.40	28307.20
2009/10	11.90	838.00	1.00	7.60	58.30	3.90	595.00	7927.50	13562.10	12.60	1755.50	24773.40
2010/11	16.80	581.30	1.60	3.70	36.90	13.10	1230.20	7050.9	12561.00	2.00	875.60	22356.10
2011/12	36.90	578.10	7.30	8.90	46.80	36.00	1890.10	7135.20	13129.00	55.00	172.00	23095.60
2012/13	38.00	883.60	9.40	24.20	141.30	61.00	2412.60	7940.70	15394.90	0.00	435.00	27340.70
Average	0.14	2.50	0.01	0.04	0.20	0.22	4.04	31.42	58.55	0.089	2.84	100.00

CO = constitutional organs, GA = general administration, RA = revenue administration, EAP = economic administration and planning, JA = judicial administration,
FS = Foreign Service, D = defense, SS = social services, ES = economic services, LI = Loan and Investment, M = miscellaneous, TRE = total recurrent
expenditure.

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

Source: *Economic Survey, FY 2012/13, MOF*

The Table 5.8 reflects that there is small fluctuation in each component of capital expenditure. The expenditure on economic service claims a higher amount than other components. This is because it comprises subcomponent which holds a substantial share of total capital expenditure. In the fiscal year 2006/07, the expenditure under economic services was Rs. 14349.6 million, which has increased to Rs. 15394.90 in 2012/13. The highest amount spent under this component is in 2008/09 amounted Rs. 17745.1 million. But in the recent year of the review period, it has dramatically decreased to Rs. 15394.9 million. In average, the share of expenditure on economic services in total capital expenditure was 58.55 percent in the review period.

Likewise, social service expenditure claims second large share in total capital expenditure. The data reflects that, the overall trend in social service shows the fluctuating trend. Capital expenditure spent on social service has increased only by a nominal amount. Even share of social service in total capital expenditure is decreasing. In the fiscal year 2006/07, the percentage share of social service was 32.60 percent while that of economic service was of 62.41 percent. However in the last year of the study under consideration, the share of social service decreased to 29.04 percent and that of economic service declined to 56.31 percent to total capital expenditure.

Expenditure incurred under defense is also significant. It claims third large share in total capital expenditure. Expenditure on defense is increasing in every financial year. It was only 171 million in 2006/07. The same has increased by more than 14 times during the period 2006/07 to 2012/13 and reached up to Rs. 2412.60 million. Share of capital expenditure on defense is also increasing in every fiscal year. Whereas defense expenditure was only 0.74 percent of total capital expenditure in the year 2006/07, the same has risen to 8.82 percent of capital expenditure in the year 2012/13.

5.2.3.3 Pattern of Principal Repayment Expenditure

Principal repayment includes the repayment of internal loan and loan raised from external sources in the past.

Table 5.9: Principal Repayment under Different Heads

Rs. in million

Fiscal Year	Principal Repayment (PR)	Domestic Loan (DL)	Foreign Loan (FL)	% of PR	
				DL	FL
2006/07	4642.7	1447.4	3195.3	31.18	68.82

2007/08	5212.7	1532.8	3679.9	29.41	70.59
2008/09	5690.6	1190.0	4500.6	20.91	79.09
2009/10	6434.9	1683.6	4751.3	26.16	73.84
2010/11	9559.5	4063.3	5496.2	42.51	57.49
2011/12	10794.9	5029.1	5765.8	46.59	53.41
2012/13	13533.3	7580.1	5953.2	56.01	43.99

Source: *Economic Survey, FY 2012/13, MOF*

Table 5.9 reflects that principal repayment expenses are increasing in every subsequent financial year. Both Domestic loan and Foreign loan repayment is in increasing trend. In the fiscal year 2006/07, Rs. 1447.4 million of Domestic loans and Rs. 3195.3 million of foreign loans have been repaid. Repayment of domestic loan in 2012/13 amounted to Rs. 7580.1 million and Rs. 5953.2 million of foreign loans were repaid in the same year. Above data shows that foreign loan repayment has always been higher than domestic loan repayment except in the year 2012/13. It shows that larger part of deficit financing is borne by foreign loan.

5.2.4 Government Revenue

Revenue is the major source of government finance. The principal among them is the government revenue collected through tax and non-tax sources. But limited growth of economy with low level of income as well as the rate of saving in Nepal makes the collection of tax revenue as a difficult task. Besides, high taxation often adversely affects the private enterprises and contributes to a decline in the net investment capacity of the economy. Therefore, proportion of government revenue in national income stands less than eleven percent in the developing countries whereas it remains as high as forty percent in the developed countries.

5.2.5 Trend of Government Revenue

Below the table shows the trend of total revenue during the period of 1998/99 to 2012/13.

Table: 5.10: Trend of Total Revenue

Table: 5.10: Trend of Total Revenue

Rs. in million

Fiscal Year	GDP	Total Revenue	% of GDP	% change in Total Revenue
1998/99	116127	10729.90	9.24	-
1999/00	144933	13512.70	9.32	25.94
2000/01	165350	15148.40	9.16	12.10
2001/02	191596	19580.80	10.22	29.26
2002/03	209976	24575.20	11.70	25.71
2003/04	239388	27893.10	11.65	13.50
2004/05	269570	30373.50	11.27	8.89
2005/06	289798	32937.90	11.36	8.44
2006/07	330018	37251.00	11.29	13.09
2007/08	366251	42893.80	11.71	15.15
2008/09	343566	48893.60	12.42	13.99
2009/10	405632	50445.50	12.44	3.17
2010/11	437546	56229.80	12.85	11.47
2011/12	474919	62331.00	13.12	10.85
2012/13	508651	70122.70	13.79	12.50

Source: *Economic Survey, FY 2011/12 and 2012/13, MOF*

Table: 5.10 reflect the continuous increasing trend of total revenue. In absolute term, it has increased from Rs. 10729.90 million in 1998/99 to Rs. 70122.70 million in the year 2012/13. The percentage of total revenue to GDP gives clear idea of the very structure of government revenue. Government revenue was 9.24% of nominal GDP in 1998/99 and has increased to 13.79% of nominal GDP in 2012/13. However it shows a fluctuating trend. In the current years since 2005/06, Government revenue shows increasing trend to GDP. Though the government revenue has increased in each financial year compared to the previous year in absolute term, but the increase in percentage terms is irregular during the period of study.

5.2.5.1 Share of Tax and Non-Tax Revenue in Total Revenue and GDP

In the Nepalese economy, tax revenue has contributed more than non-tax revenue in total revenue and GDP as shown in Table 5.11.

Table 5.11: Contribution of Tax and Non- Tax Revenue

Rs. in million

Fiscal Year	TR[a]	GDP	Tax Revenue			Non-Tax Revenue		
			Amount	%of TR[b]	% of GDP	Amount	%of TR[b]	% of GDP
1998/99	10730	116127	8176	76.20	7.04	2554	23.80	2.20
1999/00	13513	144933	9876	73.08	6.81	3637	26.92	2.51
2000/01	15148	165350	11663	76.99	7.05	3486	23.01	2.11
2001/02	19581	191596	15372	78.50	8.02	4209	21.50	2.20
2002/03	24605	209976	19660	79.90	9.36	4945	20.10	2.36
2003/04	27893	239388	21668	77.68	9.05	6225	22.32	2.60
2004/05	30374	269570	24424	80.41	9.06	5949	19.59	2.21
2005/06	32938	289798	25940	78.75	8.95	6998	21.25	2.41
2006/07	37251	330018	28753	77.19	8.71	8498	22.81	2.58
2007/08	42894	366251	33152	77.29	9.05	9742	22.71	2.66
2008/09	48894	394052	38865	79.49	9.86	10029	20.51	2.55
2009/10	50446	406138	39330	77.97	9.68	11115	22.03	2.74
2010/11	56230	437546	42587	75.74	9.73	13643	24.26	3.12
2011/12	62331	474919	48173	77.29	10.14	14158	22.71	2.98
2012/13	70123	508651	54105	77.16	10.64	16018	22.84	3.15

[a] TR refers to Total Revenue (Tax Revenue *plus* Non Tax Revenue)
[b] percentage of Total Revenue
Source: *Economic Survey, FY 2011/12 and 2012/13, MOF*

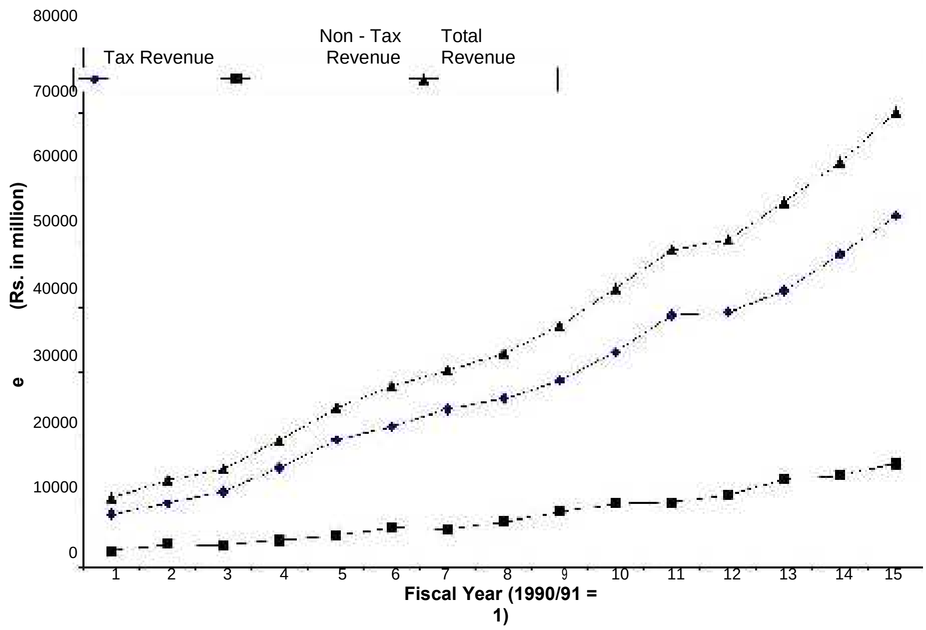
Both tax revenue and non – tax revenue has increased in absolute term during the study period. Tax revenue has increased to Rs. 54105 million in 2004-05 from Rs. 8176 million in 1998/99. The percentage of tax revenue to total revenue during the study period shows more or less same pattern. There is only small changes in the share of tax and non – tax revenue in total revenue. Changes in the share of tax and non – tax revenue shows the fluctuating trend. In the fiscal year 1999/00, the percentage is as lowest as 73.08 percent whereas in the year 2004/05, the percentage is as highest as 80.41 percent. In the year 2012/13, contribution of tax revenue was 77.16 percent. The percentage of tax revenue to GDP has presented a fluctuating scenario. It was as low as 6.81 percent to as high as 10.64 percent of GDP during the study period.

During the study period, non-tax revenue has presented a fluctuating scenario. The percentage of non tax revenue to total revenue lies between 19.59 percent to 26.92 percent in the review period. The percentage of non-tax revenue to GDP has been as low as 2.11 percent in the year 2000/01. Coming to the final year of the study it has been increased as high as 3.15 percent of GDP.

This shows that the contribution of tax revenue is greater than non tax revenue while the pattern of contribution of the tax and non – tax revenue in total revenue is more or less constant.

The total revenue and its components (tax and non tax revenues) are plotted in Fig. *** below. It can be seen from this figure that all these components are found linearly increasing in the considered fiscal years. Linear regression lines are fitted to these data. (R2 is greater than 0.98 for each line of regression).

Figure 5.11: Trend of Total Revenue, Tax Revenue and Non-tax Revenue



Source: *Table 5.11*

Regression equation for Total Revenue is

Y = 3417 + 4097 X (5.7) (R^2=0.99)

Where Y is Total revenue and t is notation year

Regression equation for Tax revenue is

$Y = 2783 + 3167\ t$ (5.8) (R^2=0.99)

Where Y is Tax revenue and t is notation year

Regression equation for non tax revenue is

$Y = 634 + 931\ t$ (5.9)

(R_2=0.98)

Where Y is non – Tax Revenue and t is notation year

Based upon above equations we can see the growth rate of total revenue, tax revenue and non tax revenue are Rs. 4097 million, Rs. 3167 million and Rs. 931 million. Forecasted values of government revenue are shown in Table 5.12.

Table 5.12: Forecast of Tax and Non-tax revenue

Rs. in million

Year	Forecasted GDP	Total Revenue	Tax Revenue	Non Tax revenue	% of GDP		
					TR	Tax	Non Tax
2010/11	665707	89463	69282	20181	13.44	10.41	3.03
2015/16	805227	109950	85115	24834	13.65	10.57	3.08
2020/21	944747	130437	100948	29488	13.81	10.69	3.12

Hence, it can be observed from above table that total revenue of the financial year 2020/21 will be Rs. 130437 million (13.81 percent of GDP). Share of Tax and Non – tax revenue will be Rs. 100948 million (10.69 percent of GDP) and Rs. 29488 (3.12 percent of GDP) respectively.

From the above analysis of the Government revenue and its component it can be seen that percentage of government revenue to GDP is very lower. This shows the inefficiency in increasing the tax base and collection of taxes which are the characteristics phenomenon of developing economy. In the developed industrial countries, ratio of revenue to gross domestic product (GDP) is above 40 percent. (Musgrave and Musgrave: 1989).

5.2.5.2 Pattern of Tax Revenue

Tax revenue comprises customs, tax on consumption and product of goods and services, land revenue and registration, tax on property, profit and income. Tax is major source of government revenue. It contributed more than 75 percent to the total revenue.

Table: 5.13: Tax Revenue under Different heads

In Rs. Million

Fiscal Year	Customs	Tax on Consumption and product of goods and services	Land revenue and registration	Tax on property profit and income	Total tax revenue
1998/99	3044.3	3763.0	538.7	829.8	8175.8
1999/00	3358.9	4921.5	636.1	959.1	9875.6
2000/01	3945.0	5681.3	754.9	1281.3	11662.5
2001/02	5255.0	7261.2	833.2	2022.1	15371.5
2002/03	7018.1	8792.6	937.7	2911.6	19660
2003/04	7327.4	9684.7	1066.6	3589.3	21668
2004/05	8309.1	10775.2	1015.4	4324.6	24424.3
2005/06	8502.2	11249.7	1004.2	5183.7	25939.8
2006/07	9517.7	11719.1	1003.2	6512.9	28752.9
2007/08	10813.3	13387.3	1015.9	7935.6	33152.1
2008/09	12512.1	16153.6	612.9	9546.5	38865.1
2009/10	12658.8	16074.3	1131.8	9465.7	39330.6
2010/11	14236.4	18244.8	1414.3	8691.5	42587.0
2011/12	15554.8	20705.6	1697.5	10215.1	48173.0
2012/13	15701.6	25331.3	1799.2	11272.6	54104.7

Source: *Economic Survey, FY 2011/12 and 2012/13, MOF*

The table above shows the growth rate of different components of tax revenue during the study period. The revenue from customs and tax on consumption and production of goods and service shows the continuous growing trend. It has increased from Rs. 3044.3 million in 2006/07 to Rs. 15701.6 million in the year

2012/13. Tax on consumption and product of goods and services was Rs. 3763 million in 1998/99. However it increased and reached to Rs. 25331.3 in the year 2010/11.

Similarly, revenue from land and registration, in absolute term, has moved from Rs. 538.7 million in 1998/99 to Rs. 1799.2 million in 2012/13. Revenue from tax on property, profit and income has increased from Rs. 829.8 million in 1998/99 to Rs.11272.6 million in 2012/13. This has shown downward trend in the year 2009/10 and 2010/11.

Table 5.14: Percentage of Tax Revenue under Different Heads

(In percentage)

Fiscal year	Customs		Tax on Cons. Prod[a]		Land rev. and reg [b]		Tax on prop, prof [c]	
	% of TR [d]	% of TR [e]	% of TR [d]	% of TR [e]	% of TR [d]	% of TR [e]	% of TR [d]	% of TR [e]
1998/99	37.23	28.37	46.03	35.07	6.59	5.02	10.15	7.73
1999/00	34.01	24.86	49.83	36.42	6.44	4.71	9.72	7.10
2000/01	33.83	26.04	48.71	37.50	6.47	4.98	10.99	8.46
2001/02	34.19	26.84	47.24	37.08	5.47	4.26	13.15	10.33
2002/03	35.70	28.56	44.72	35.78	4.77	3.82	14.81	11.85
2003/04	33.82	26.27	44.70	34.72	4.92	3.82	16.56	12.88
2004/05	34.02	27.36	44.12	35.48	4.16	3.34	17.70	14.24
2005/06	32.78	25.81	43.37	34.15	3.87	3.05	19.98	15.74
2006/07	33.10	25.56	40.76	33.46	3.49	2.69	22.65	17.48
2007/08	32.62	25.21	40.38	31.21	3.06	2.37	23.94	18.50
2008/09	32.30	25.67	41.56	33.04	1.58	1.25	24.56	19.53
2009/10	32.19	25.09	40.87	33.87	2.87	2.25	24.07	18.76
2010/11	33.43	25.32	42.84	32.45	3.32	2.52	20.41	15.46
2011/12	32.29	24.96	42.98	33.22	3.52	2.72	21.21	16.39
2012/13	29.02	22.39	46.82	36.12	3.33	2.57	20.83	16.08

[a] tax on consumption and product of goods and services
[b] land revenue and registration
[c] tax on property, profit and income
[d] percentage of Tax revenue
[e] percentage of Total Revenue

Source: *Economic Survey, FY 2011/12 and FY 2012/13, MOF*

Table 5.14 reveals the percentage share of all components in tax revenue and total revenue. The percentages of customs to tax revenue and total revenue were 37.23 and 28.37 percent in the year 2006/07. Coming to the final year of the review period, the percentages have been decreased to 29.02 and 22.39 percent respectively. The percentages of tax on consumption and product of goods and services to tax revenue and total revenue were contributed more among all components. It was 46.03 percent and 35.07 respectively in the year 2006/07 and it has contributed 46.82 percent and 36.12 percent of tax revenue and total revenue respectively in 2012/13. However, there is fluctuating scenario during the review period.

Similarly the percentages of land revenue and registration to tax revenue and total revenue were contributed less among all components. The percentages were 6.59 and 5.02 percent in the year 1990/91. in the fiscal year 2004/05, the percentage have been decreased to 3.33 and 2.57 percent respectively. The percentages of tax on property, profit and income show the continuous increasing trend after 1991/92 to 2000/01. However, after 2000/01, the percentages show downward trend.

Higher rate of increase in the revenue from tax on consumption and production of goods and services is attributable to the increasing revenue from VAT. Revenue from VAT was only Rs. 8765.9 million in 2006/07 which has risen to Rs. 18885.4 million in 2012/13.

5.2.5.3 Pattern of Non- Tax Revenue

Non- tax revenue comprises charges, fees, fines and forfeiture, receipts from sales of commodities and services, dividend, royalty and sale of fixed assets, principal and interest payment, and miscellaneous items. Its contribution to total revenue has been more than 20 percent during the study period.

Table: 5.15: Non- Tax Revenue under Different Heads

In Rs. Million

Fiscal year	Charges, fees, fines and forfeiture	Receipts from sales of commodities and services	Dividend	Royalty and sales of fixed assets	Principals and interest payments	Miscellaneous items	Total Non Tax Revenue
1998/99	1012.6	511.4	459.5	27.9	498.0	43.8	2553.5
1999/00	1106.3	765.0	644.4	137.8	971.4	12.2	3637.1
2000/01	333.4	889.5	755.5	59.9	1431.1	16.5	3485.9
2001/02	248.0	1270.0	775.7	90.4	1801.0	14.3	4209.4
2002/03	207.1	1388.3	1060.1	196.9	2083.1	9.6	4945.1
2003/04	286.1	1673.3	1363.0	67.8	2818.8	16.1	6225.1
2004/05	270.8	1799.6	1134.4	447.9	2220.7	75.8	5949.2
2005/06	329.6	2255.5	1311.0	565.2	2461.1	75.7	6998.2
2006/07	336.1	2146.6	1782.8	202.3	3927.5	102.8	8498.4
2007/08	386.3	2428.9	2507.5	563.3	3751.0	104.6	9741.6
2008/09	386.7	2728.0	2336.5	949.6	3497.2	130.8	10028.8
2009/10	518.8	2611.1	2512.9	723.9	3109.5	1638.8	11115.0
2010/11	579.6	3063.0	2497.6	1945.4	2464.3	3092.8	13642.7
2011/12	377.5	3497.0	2661.1	1465.0	3507.1	1825.3	14158.0
2012/13	481.6	3849.9	4589.9	1931.4	2714.3	1572.6	16018.0

Source: *Economic Survey, FY 2011/12 and 2012/13, MOF*

The table 5.15 exhibits the growth of components of non tax revenue during the review period. The revenue from charges, fees, fines and forfeiture has decreased from Rs. 1012.6 million in 1998/99 to Rs. 481.6 million in 2012/13. Receipts from sales of commodities and services have moved up form Rs. 511.4 million in 1998/99 to Rs. 3849.9 million in 2012/13.

Similarly, revenue from dividend has risen from Rs. 495.5 million in 1998/99 to Rs. 4589.9 million in 2012/13. Revenue from royalty and sales of fixed assets has moved from Rs. 27.9 million in 1998/99 to Rs. 1931.4 million in 2012/13.

Likewise, non-tax revenue from principal and interest payment, in absolute term reached to Rs. 2714.3 million in the year 2012/13, however, it was Rs. 498 million in 1998/99. The revenue from miscellaneous items has excessively moved from Rs. 43.8 million in 1998/99 to Rs. 1572.6 million in the year 2012/13.

Table 5.16:
Percentages of Non- Tax Revenue under Different heads

(in percentage)

Fiscal year	Charges, Fees[a]		Receipts from[b]		Dividend		Royalty and Sal[c]		Principal and Int[d]		Miscell[e]	
	% of NTR[f]	% of TR[g]	% of NTR[f]	% of TR[g]	% of NTR[f]	% of TR[g]	% of NTR[f]	% of TR[g]	% of NTR[f]	% of TR[g]	% of NTR[f]	% of TR[g]
1998/99	39.66	9.44	20.03	4.77	18	4.28	1.09	0.26	19.50	4.64	1.72	0.41
1999/00	30.42	8.19	21.03	5.66	17.72	4.77	3.79	1.02	26.70	7.19	0.34	0.09
2000/01	9.56	2.20	25.52	5.87	21.67	4.99	1.72	0.36	41.06	9.45	0.47	0.11
2001/02	5.91	1.27	30.24	6.49	18.47	3.96	2.15	0.46	42.89	9.20	0.34	0.07
2002/03	4.19	0.84	28.07	5.65	21.44	4.31	3.98	0.80	42.13	8.48	0.19	0.04
2003/04	4.60	1.03	26.88	6.00	21.90	4.89	1.08	0.24	45.28	10.11	0.26	0.06
2004/05	4.55	0.89	30.25	5.92	19.07	3.73	7.53	1.47	37.33	7.31	1.27	0.25
2005/06	4.71	1.00	32.23	6.85	18.73	3.98	8.08	1.72	35.17	7.47	1.08	0.23
2006/07	3.95	0.90	25.26	5.76	20.98	4.79	2.38	0.54	46.21	10.54	1.22	0.28
2007/08	3.97	0.90	24.93	5.66	25.74	5.85	5.79	1.31	38.50	8.74	1.07	0.24
2008/09	3.86	0.79	27.20	5.58	23.30	4.78	9.41	1.94	34.87	7.15	1.30	0.27
2009/10	4.67	1.03	23.49	5.18	22.61	4.98	6.51	1.44	27.98	6.16	14.74	3.25
2010/11	4.25	1.03	22.45	5.45	18.31	4.44	14.26	3.46	18.06	4.38	22.67	5.50
2011/12	2.67	0.61	24.70	5.61	18.80	4.27	10.35	2.35	24.77	5.63	12.89	2.93
2012/13	3.01	0.69	24.03	5.49	28.65	6.55	12.06	2.75	16.95	3.87	9.82	2.24

[a] refers to charges, fees, fines and forfeiture [c] refers to royalty and sales of fixed assets [e] refers to miscellaneous items

[g] TR refers to Total revenue

[b] refers to receipt from sales of commodities and services [d] refers to principals and interest payment

[f] NTR refers to Non- Tax revenue

Source: *Economic Survey, FY 2011/12 and 2012/13 MOF*

The table 5.16 shows, the percentages of charges, fees, fines and forfeitures to non-tax revenue and total revenue were 39.66 and 9.44 in the year 1998/99. However, the percentages have been decreased to 3.01 and 0.69 percent respectively in the year 2012/13. The percentage share of receipt from sales of commodities and services shows a fluctuating trend. Its percentage shares to non-tax revenue and total revenue, in the year 1998/99, was 20.03 and 4.77 respectively. There have been increase in percentage of shares and reached to 24.03 and 5.49 in the final year of the review period. Initially, the percentage shares of dividend in non-tax revenue and total revenue were 18 and 4.28 percent, in 1998/99, however, it increased to 28.65 and 6.55 percent respectively in 2012/13.

Likewise, the percentage shares of royalty and sales of fixed assets in non-tax revenue and total revenue have been increased from 1.09 and 0.26 percent in 1998/99 to 12.06 and 2.75 percent respectively in 2012/13. the percentage shares of principals and interest payment, however, decreased from 19.50 and 4.64 percent in 1998/99 to 16.95 and 3.87 in 2012/13. the shares of miscellaneous items have been increased from 1.72 and 0.41 percent in 1998/99 to 9.82 and 2.24 in the final year of the review period.

5.2.6 Earmarking of Funds

Nepal Government has never allocated particular taxes to specific functions – a practice called earmarking either by constitutional provisions, any enactments or budgeting process. Earmarking reflects in part the desire to make a particular tax more palatable to the public by allocating its revenues to a purpose for which there is strong popular support. For example, vehicle tax may be allocated for the purpose of construction or maintenance of road, so that there will be more desire to pay the tax on the tax payers as they are directly benefited from the payment of tax. As Buchnan quotes, earmarking gives the individual voter and representative greater choice in expressing his attitudes about various forms of government spending. Hence earmarking may help achieve better budgetary goals.

5.2.7 Budgetary Deficit and Sources of Financing

Growing fiscal deficit has been one of the underlying causes of distortions in the Nepalese economy. The unbridled increase in government expenditure due to increasing state activities and responsibilities and for fulfilling certain political interest without much benefit to the society accompanied by constantly low level of revenue realization has been mainly responsible for acceleration in government budget deficit. Every year, capital expenditure as well as recurrent expenditure is increasing continuously but revenue resources of the government are not increasing to cope up with the pace of expenditure. So Deficit financing is the common phenomenon of every budget in Nepal.

After the restoration of democratic system in Nepal (1990) the amount of deficit financing is increasing due to the increase in many governments sector activities. Such as administration, large number of cabinet member, increase in the number of ministries and other social welfare activities and to finance expenses for the royal family members.

5.2.7.1 Trend of Overall Deficit and Budget Deficit

After the political change of 1990 in Nepal, the scarcity of adequate internal resources has been the main constraint in the realization of development program.
This fact is explained by the table 5.17. The table exhibits the growing resources gap in the Nepalese fiscal system. Budget deficit is shown as the difference between total expenditure and total receipts and overall budget deficit is the difference between total expenditure and total revenue.

Table 5.17: Trend of Fiscal Deficit

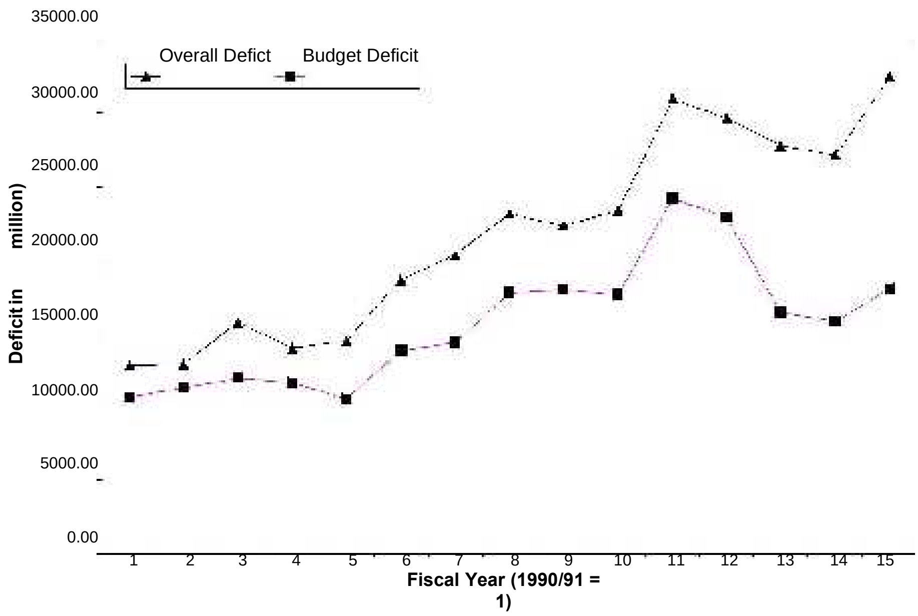
Rs. In million

Fiscal Year	Overall Deficit				Budget Deficit			
	Amount	%of TE[a]	% of CE	%of GDP	Amount	%of TE[a]	% of CE	%of GDP
1998/99	12819.90	54.44	-	11.04	10655.10	45.24	-	9.18
1999/00	12905.50	48.85	-	8.90	11261.70	42.63	-	7.77
2000/01	15749.30	50.97	-	9.52	11956.00	38.70	-	7.23
2001/02	14016.60	41.72	-	7.32	11623.00	34.59	-	6.07
2002/03	14484.80	37.08	-	6.90	10547.70	27.00	-	5.02
2003/04	18649.30	40.07	-	7.79	13824.20	29.70	-	5.77
2004/05	20350.21	40.12	-	7.55	14361.90	28.31	-	5.33
2005/06	23180.40	41.31	-	8.00	17777.80	31.68	-	6.13
2006/07	22328.02	37.48	97.11	6.77	17991.40	30.20	78.25	5.45
2007/08	23378.70	35.28	91.75	6.38	17667.00	26.66	69.33	4.82
2008/09	30941.50	38.76	109.31	7.86	24188.10	30.30	85.45	6.15
2010/10	29626.70	37.00	119.59	7.30	22940.60	28.65	92.60	5.66
2010/11	27776.30	33.06	124.24	6.38	16437.10	19.57	73.52	3.77
2011/12	27111.60	30.31	117.39	5.71	15828.20	17.70	68.53	3.33
2012/13	32437.70	31.63	118.64	6.38	18046.50	17.60	66.01	3.55

[c] refers to Percentage of Total Expenditure

Source: *Economic Survey, FY 2011/12 and FY 2012/13, MOF*

Figure 5.17: Overall and Budget Deficit



Source: *Table 5.17*

Table 5.17 exhibits the continuous growing trend of overall deficit. In the fiscal year 1998/99, the deficit was Rs. 12819.9 million. Coming to the final year of the study, the deficit has grown to Rs. 32437.70 million that is 2.53 times greater than the first year of the study period. The percentage of overall deficit to GDP, however, shows a fluctuating trend. In the fiscal year1998/99, the percentage is as highest as 11.04 percent whereas in the year 2011/12 it was lowest as 5.71 percent. The percentage of overall deficit to the capital expenditure has also presented a fluctuating scenario, however it indicated an upward trend. In the year 2006/07, the ratio of budget deficit was 97.11 percent of capital expenditure, where as it has risen to 118.64 percent of capital expenditure. This shows that in the recent years, deficit financing is increasing and government revenue is even not sufficient for its revenue expenditure and repayment of principal. Deficit financing is more than its capital expenditure and expended on consumption by the government.

The budget deficit also shows the growing trend. In the fiscal year 1998/99, the budget deficit was Rs. 10655.1 million. It has increased by 1.54 times and reached Rs. 18,046.50 million in the year 2012/13. the percentage of budget deficit to GDP also shows a fluctuating trend. It has declined during the study period as 9.18 percent in 1990/91 to 3.55 percent in the year 2012/13.

5.2.7.2 Sources of Deficit Financing

The main sources of financing the deficit have been foreign (external) and internal (domestic) loans. External foreign sources of deficit financing include assistance, particularly loans and grants, internal sources include internal loan along with borrowings and cash surplus.

Nepal has been receiving substantial external supports in its developmental endeavors. Nepal receives both grants and loans under bilateral and multilateral assistance. Nepal has also made a substantial progress in mobilizing its own resources and government also take loan from internal sources. External and internal sources of budget deficit are presented in Table 5.18 and Figure 5.18.

Table 5.18: Budget Deficit and Source of Financing

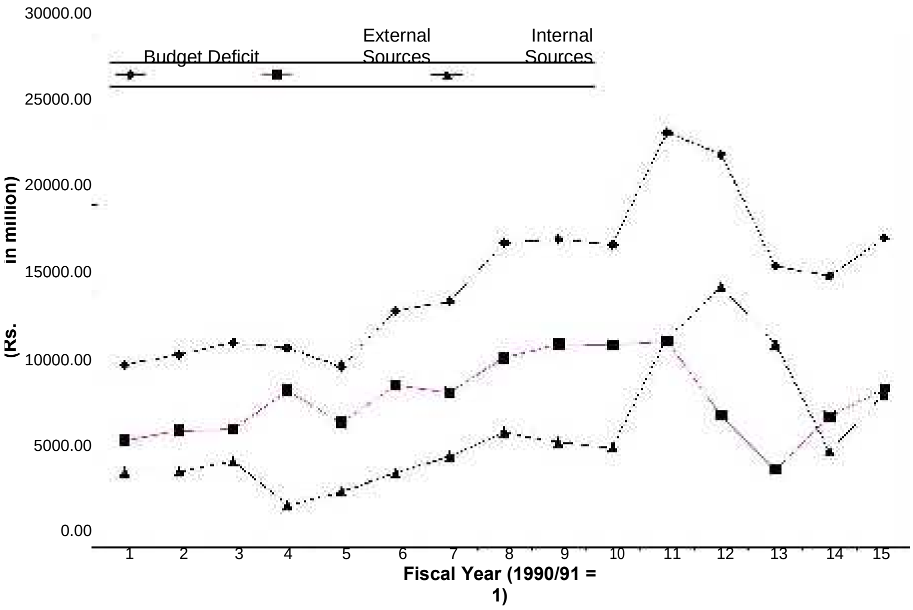
Rs. in million

Fiscal Year	Budget Deficit	External Sources (Foreign Loan)				Internal Sources (Including cash balance)			
		Amount	%of BD[b]	% of CE[c]	%of TE[d]	Amount	%of BD[b]	% of CE[c]	%of TE[d]
1998/99	10655.10	6256.72	58.72	-	26.57	4398.40	41.28	-	18.68
1999/00	11261.70	6816.94	60.53	-	25.80	4444.80	39.47	-	16.82
2000/01	11956.00	6920.93	57.89	-	22.40	5035.10	42.11	-	16.30
2001/02	11623.00	9163.59	78.84	-	27.27	2459.40	21.16	-	7.32
2002/03	10547.70	7312.29	69.33	-	18.72	3235.40	30.67	-	8.28
2003/04	13824.20	9463.90	68.46	-	20.33	4360.30	31.54	-	9.37
2004/05	14361.90	9043.60	62.97	-	17.83	5318.30	37.03	-	10.48
2005/06	17777.80	11054.50	62.18	-	19.70	6723.30	37.82	-	11.98
2006/07	17991.40	11852.40	65.88	78.25	19.89	6139.00	34.12	26.70	10.30
2007/08	17667.00	11812.20	66.86	69.33	17.82	5854.80	33.14	22.98	8.83
2008/09	24188.10	12044.00	49.79	85.45	15.09	12144.10	50.21	42.90	15.21
2010/10	22940.60	7698.70	33.56	92.60	9.61	15241.90	66.44	61.53	19.04
2010/11	16437.10	4546.4	27.66	73.52	5.41	11890.70	72.34	53.19	14.15
2011/12	15828.20	7629.00	48.20	68.53	8.53	8199.20	51.80	35.50	9.17
2012/13	18046.50	9266.1	51.35	66.01	9.03	8780.40	48.65	32.11	8.56

[a] BD refers to Budget Deficit or Total Deficit [b] percentage of budget deficit
[c] percentage of capital expenditure [d] percentage of total expenditure

Source: *Economic Survey, FY 2011/12 and 2012/13, MOF*

Figure 5.18: Sources of Deficit Financing



Source: *Table 5.18*

Table 5.18 exhibits that a major portion of deficit has been financed through external loans. External loan financed as high as 78.84 percent of budget deficit in the fiscal year 2001/02. However, it has declined as low as 27.66 percent of budget deficit in the year 2010/11 and it contributed 51.35 percent of budget deficit in 2012/13. In the fiscal year 1998/99, the external source of financing of budget deficit was 26.27 percent of the total expenditure which has decreased to 9.03 percent in 2012/13. However, coming to the recent periods, the share of external source has declined whereas that of share of internal source in budget deficit has risen.

The table further shows that the account of internal sources presents low performance as compared to the external sectors assistance in the economy. The contribution of internal borrowing plus cash surplus was 41.28 percent of budget deficit in the fiscal year 1998/99.It has increased to 72.34 percent of budget deficit in the year 2010/11 and in the year 2012/13, it has contributed 48.65 percent of total budget deficit. Furthermore, the share of internal source of financing revealed a fluctuating trend during the study period. Internal source financed was as low as 21.16 percent of budget deficit in the year 2001/02.

It is indeed the economy of Nepal is heavily depending upon the foreign assistance, particularly loan and grant. Therefore, we can conclude that the foreign assistance plays a significant role in Nepalese economy.

5.2.7.3 Pattern of External Sources

The foreign assistance in Nepal comes either as loans or as grants. The contribution of foreign loan in the Nepalese economy has been relatively higher as to foreign grants during the study period.

Theoretically, it is considered that the foreign assistance is the tool for the economic development of the under developed economy. The inside view of this theoretical aspect is that the developing countries are often gripped either by shortage of domestic resources or by shortage of foreign exchange or by both. In Nepal, virtually, these two causes have been occurring simultaneously. Nepal has been relying heavily upon the foreign assistance since the very inception of her economic development to cover the resource gap and on the other hand for utilizing the domestically raised resources.

Table 5.19: Contribution of Foreign Assistance

Rs. in million

Fiscal Year	TA[a]	Foreign Loan				Foreign Grants			
		Amount	% of TA[a]	%of CE[b]	% of GDP	Amount	% of TA[a]	%of CE[b]	% of GDP
1998/99	8421.52	6256.72	74.29	-	5.39	2164.80	25.71	-	1.86
1999/00	8460.74	6816.94	80.57	-	4.70	1643.80	19.43	-	1.13
2000/01	10714.23	6920.93	64.60	-	4.19	3793.30	35.40	-	2.29
2001/02	11557.19	9163.59	79.29	-	4.78	2393.60	20.71	-	1.25
2002/03	11249.39	7312.29	65.00	-	3.48	3937.10	35.00	-	1.88
2003/04	14289.00	9463.9	66.23	-	3.95	4825.10	33.77	-	2.02
2004/05	15031.92	9043.62	60.16	-	3.35	5988.30	39.84	-	2.22
2005/06	16457.10	11054.5	67.17	-	3.81	5402.60	32.83	-	1.86
2006/07	16189.00	11852.4	73.21	51.55	3.59	4336.60	26.79	18.86	1.31
2007/08	17523.90	11812.2	67.41	46.36	3.23	5711.70	32.59	22.42	1.56
2008/09	18797.40	12044	64.07	42.55	3.06	6753.40	35.93	23.86	1.71

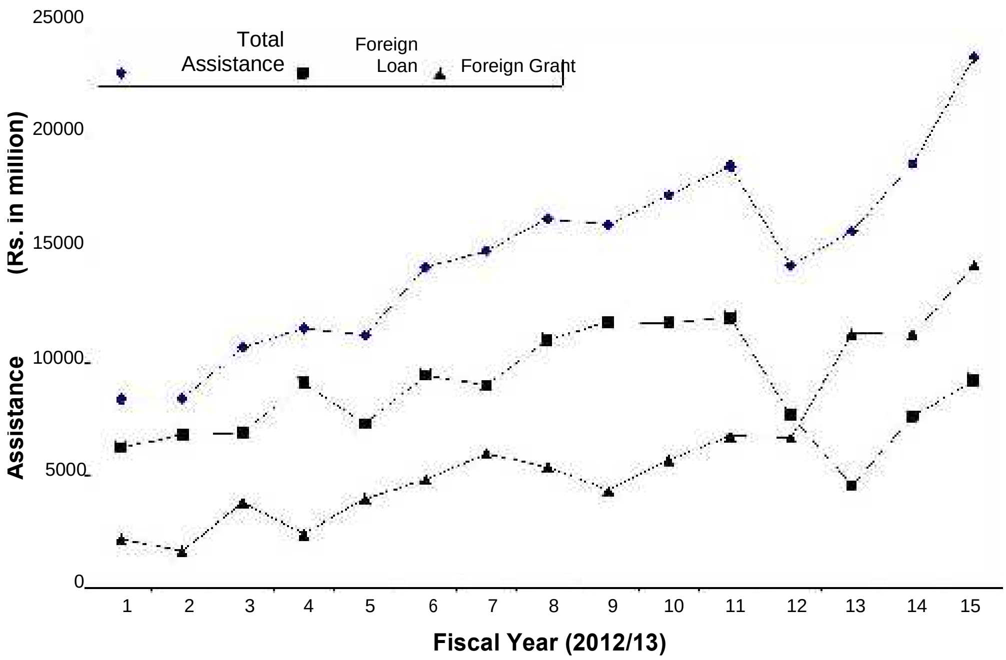
2010/10	14384.80	7698.7	53.52	31.08	1.90	6686.10	46.48	26.99	1.65
2010/11	15885.50	4546.4	28.62	20.34	1.04	11339.10	71.38	50.72	2.59
2011/12	18912.40	7629	40.34	33.03	1.61	11283.40	59.66	48.86	2.38
2012/13	23657.30	9266.1	39.17	33.89	1.82	14391.20	60.83	52.64	2.83

[a]TA refers to Total Assistance i.e. Foreign Loan plus foreign Grants

[b]refers to percentage of Capital Expenditure

Source: *Economic Survey, FY 2011/12 and 2012/13, MOF*

Figure 5.19: Foreign Assistance



Source: *Table 5.19*

Table 5.19 shows that more than fifty percent of total foreign assistance has been coming through loans. The magnitude of foreign loan, however, is declining throughout the study period. The amount of foreign loan in the fiscal year 1998/99 was Rs. 6256.72 million. However it increased as high as Rs. 12044 million in 2008/09 and rapidly decreased in the years 2009/10 and 2010/11. It has risen to Rs. 9266.1 million in the year 2012/13. The share of foreign loan as a percentage of GDP has, however, declined continuously after the fiscal year 2005/06. The percentage is as highest as 5.39 percent in the year 1998/99 and as lowest as 1.04 percent in the year 2010/11.

One of the potential sources of government receipts to meet the budgetary deficit in developing country like Nepal is the foreign assistance in the form of grants. It is a non interest bearing and non refundable transfer assistance of developing countries and international agencies to the developed countries. The percentage of foreign grants in total assistance was 25.71 percent in the fiscal year 1998/99. However, it has been increased to 60.83 percent in the year 2012/13. The share of grant in foreign assistance was highest in the fiscal year 2010/11, when it contributed 71.38 percent in total foreign assistance. Furthermore, the percentage share of foreign grants to capital expenditure shows the increasing trend. The percentage share of foreign grants to capital expenditure has moved up from 18.86 percent in 2006/07 to 52.64 percent in the year 2012/13. The percentage share of foreign grant in GDP has also shown the increasing trend during the review period. It was only 1.86 percent of GDP in 2006/07. In the year 2012/13, it was 2.83 percent of the GDP. This reveals surprising growth of foreign grant for deficit financing and the trend shows still rising situation. And more of capital expenditure is financed through foreign grants and foreign loans.

5.2.7.4 Pattern of Internal Sources

In developing countries, due to the limited capacity of government to mobilize revenue in comparison to the spending government expenditures, public debt in the form of internal borrowing has been a common phenomenon. Nepal is not exception of this fact and has been resorting partly to this means for financing the development expenditure for meeting the requirement of fiscal deficit.

Internal loan is the domestic source of financing to meet the deficit arisen from the increased government expenses. Internal loan is comparatively lower than the external loan in the ratio of total loan, which is generally financed through the internal borrowings. For the national economic activity, it has also significant role to play since it may reduce external debt burden.

Table: 5.20: Contribution of Internal Sources

Rs. in Million

Fiscal Year	IS[a] Amount	Banking		Non Banking		Cash Surplus (+/-)	
		Amount	%of IS	Amount	% of IS	Amount	% of IS
1998/99	4398.40	3713.00	84.42	893.50	19.08	-154.30	-3.51
1999/00	4444.80	1178.90	26.52	900.00	20.25	2366.00	53.23
2000/01	5035.10	920.00	18.27	700.00	13.90	3415.10	67.83
2001/02	2459.40	1000.00	40.66	820.00	33.34	639.40	26.00
2002/03	3235.40	1300.00	40.18	600.00	18.54	1335.40	41.27
2003/04	4360.30	750.00	17.20	1450.00	33.25	2160.30	49.54
2004/05	5318.30	1500.00	28.20	1500.00	28.20	2318.30	43.59
2005/06	6723.30	1600.00	23.79	1800.00	26.77	3323.30	49.43
2006/07	6139.00	2850.00	46.42	1860.00	30.30	1429.00	23.28
2007/08	5854.80	3300.00	56.36	2200.00	37.58	354.80	6.06
2008/09	12144.10	N/A	N/A	N/A	N/A	5144.10	42.36
2010/10	15242.90	N/A	N/A	N/A	N/A	7241.90	47.51
2010/11	11890.70	N/A	N/A	N/A	N/A	3010.80	25.32
2011/12	8199.20	N/A	N/A	N/A	N/A	2591.40	31.61
2012/13	8780.40	N/A	N/A	N/A	N/A	-157.70	-1.80

[a] refers to Internal Sources

Source: *Economic Survey, FY 2011/12 and 2012/12, MOF*

As shown in the table 5.20, internal sources presented a fluctuating scenario over the study period. In the fiscal year 1998/99, an internal source was Rs. 4398.4 million. It gradually increased and reached to Rs. 11890.7 million in the year 2010/11 and decreased to Rs. 8780.40 million in the year 2012/13. The percentage of internal source through banking system to internal sources also has presented a fluctuating scenario, however it indicated an upward trend. The contribution of banking sector to the internal sources was the highest in the fiscal year 1998/99 that declined significantly in the years thereafter. The lowest contribution was Rs. 750 million in the year 2003/04 whereas highest contribution was Rs. 3300 million in the year 2007/08. In the year 2008/09 to 2012/13, the data of banking sector as well as non banking sector were not presented.

The contribution of non-banking sector has declined in the initial years of the study period but in the later years, it increased. However, the contribution of non banking sector of total internal sources was lowest in the fiscal year 2002/03, whereas highest in the year 2007/08.

Although the cash balance also contributes in meeting the fiscal deficits can be noted as the marginal. In the fiscal year 1998/99, the contribution was negative whereas it contributed the highest in terms of internal sources in the year 2009/10. As such, cash balance and internal loans can be identified as not contributing substantially as compared to the external sources for financing budgetary gap.

Hence from the above analysis it is observed that government could not mobilize the internal resources for capital formation in the economy. Nepal's financial sources for meeting regular and development effort are heavily supported by foreign assistance in the form of grant and loans. The budgetary allocation is heavily dependent on foreign assistance.

5.2.8 Debt Servicing

In every year budget deficit is increasing. The deficits are being financed by internal sources and external sources in the form of grants and loan. The loan raised during the year creates the liability in the future years for payment of interest and repayment of loan. Loan raised from internal and external sources should be used in productive channels so that there may not be burden in the economy in future for servicing the debt. As the foreign loan is increasing every subsequent year for financing the budget deficit, debt servicing has also increased. Increasing the debt and service costs is likely to result in increasing government expenditure on non productive purposes. The debt service ratio is calculated as the ratio of debt service payments made by or due from a country to that country's export earnings.

Table 5.21

Debt Servicing

Rs. In Million

Year	TFL	BR	Export	Repayment of Interest and Loan						
				Interest	FL	Total	% of BR	% of EX	% of TFL	% of GDP
1998/99	52797.6	7296.7	14226.0	497.5	589.0	1086.5	14.89	7.64	2.06	0.94
1999/00	64584.3	7281.8	23909.0	722.7	942.2	1664.9	22.86	6.96	2.58	1.15
2000/01	81752.8	6920.9	30948.0	879.0	1252.9	2131.9	30.80	6.89	2.61	1.29
2001/02	94271.4	9163.6	47548.0	1020.5	1468.2	2488.7	27.16	5.23	2.64	1.30
2002/03	107516.9	7312.2	53084.0	1156.5	1828.2	2984.7	40.82	5.62	2.78	1.42
2003/04	120568.2	9463.9	55405.0	1316.6	1987.7	3304.3	34.91	5.96	2.74	1.38
2004/05	125225.3	8963.9	73853.0	1247.0	2102.4	3349.4	37.37	4.54	2.67	1.24
2005/06	150137.3	13850.9	68659.0	1421.0	2780.2	4201.2	30.33	6.12	2.80	1.45
2006/07	161822.9	10839.5	78150.0	1549.0	3196.5	4745.5	43.78	6.07	2.93	1.44
2007/08	182009.9	12362.4	88360.0	1640.3	3681.1	5321.4	43.05	6.02	2.92	1.45
2008/09	193800.7	11104.3	91821.0	1700.8	4500.6	6201.4	55.85	6.75	3.20	1.57
2009/10	214827.5	10049.5	77068.0	1816.1	4751.4	6567.5	65.35	8.52	3.06	1.62
2010/11	222738.3	6192.4	73085.0	2021.7	5497.5	7519.2	121.43	10.29	3.38	1.72
2011/12	228949.0	9597.4	83429.0	2141.8	5767.1	7908.9	82.41	9.48	3.45	1.67
2012/13	217852.7	7743.7	86552.0	2146.8	5954.5	8101.3	104.62	9.36	3.72	1.59
Average	**147923.7**	**9209.5**	**63073.1**	**1418.5**	**3086.6**	**4505.1**	**48.92**	**7.14**	**3.05**	**1.49**

TFL – Total Foreign Loan
BR – Borrowing during the year
EX – Export
FL – Foreign loan repayment during the year

From the above table 5.21, it can be seen that debt financing of the foreign loan is increasing in the recent years. Debt service ratio (Ratio of the interest and principal repayment to the export earnings) was 7.64 % in the year 1998/99 and decreased to 4.54 % in 2004/05. Since then this shows the increasing trend. It has risen to its highest figure of 10.29 % in 2010/11 and it was 9.36 % in the fiscal year 2012/13

Financing of the Debt is also increasing in terms of the fresh amount of loan raised for deficit financing. It can be seen that, in 1998/99, repayment of interest and loan was only 14.89 % of fresh loan. This shows the increasing trend and in the fiscal year 2012/13, repayment of nterest and loan is 104.62 % of the fresh loan raised during the year. This shows that external debt is creating burden in the Nepalese Economy. Fresh loans are raised for servicing the debt rather than for other developmental activities.

In average, about 3.05 % of the total foreign loan outstanding is paid during the year. Interest and Foreign loan repayment was 0.94 % of GDP in 1998/99, which has risen to 1.72 % of GDP 2010/11 and 1.59 % of GDP in 2012/13.

CHAPTER 6

SUMMARY, CONCLUSION AND RECOMMENDATIONS

6.1 Summary and Conclusions

Budget is a guideline of annual programme and policy of a government. The budget is the main instrument of economic policy, incorporates policies, programs and activities related to government expenditure, revenue and other sources of financing. The main aspects of budget are expenditure, sources of revenue and financing of deficit. Tax and non – tax revenue plays vital role in collection of revenue for meeting the requirement of government expenditure. Foreign grants are also included in the sources of finance. Any difference between government expenditure and government receipt is financed through external (foreign loan) and internal sources (banking, non banking and cash surplus/deficit. As government activities and obligations are increasing, deficit financing is the common phenomenon of every budget.

After the re-establishing democracy in Nepal in 1998/99, democratic government has attempted to increase the amount of expenditure and revenue, which is clearly seen in its annual budget. This study has tried to show the pattern of government budgetary system or the trend of expenditure, revenue, foreign aid and deficit financing. Following are the major findings of the study. These findings are based on the analysis of the budget data for the FY 1998/99 to 2012/13. Budget data for the expenditure and its components are analyzed for the period 2006/07 to 2012/13 as the data for the previous years are not available as per the new classification brought out from 2012/13.

1. GDP and its Sectoral contribution were found to be increasing linearly during the study period. If the GDP maintains the same trend , the total GDP of FY 2015/16 and 2020/21 will be Rs. 80227 million and Rs. 94447 million. In 2020/21 GDP will increase by 86 percent from the FY 2012/13. The growth of real GDP is about 4.1 % during the review period.

2. It was found that government expenditure and its components recurrent expenditure and principal repayment expenditure can be well described by linear function for the period 2006/07 to 2012/13. Capital expenditure show fluctuating trend over the review period. Based upon these derived relation, the anticipated figures of total expenditure for the year 2015/16 and 2020/21 will be Rs. 169980.26 million and Rs. 202025.86 million respectively. These values are almost 35.73 percent and 56.98 percent respectively more than the total expenditure of 2012/13.

3. The pattern of government expenditure shows a significant difference between receipts (revenue and grants) and expenditure. Total receipt of government has covered 72.94 percent of the annual government expenditure in the review period. Foreign grants have covered 10.44 percent of the government expenditure. Government expenditure recorded 19.12 percent to GDP where as revenue was 13.94 percent to GDP in average.

4. The percentage of recurrent expenditure and principal repayment to total expenditure is increasing whereas the percentage of capital expenditure is fluctuating over a period of study. On the total budgetary expenditure recurrent expenditure covers 59.02 percent to total expenditure during the review period in average. Capital expenditure covers 31.04 percent of total expenditure. The share of recurrent expenditure to GDP is 11.36 percent whereas the share of capital expenditure is 5.98 percent during the study period. In average, during the study period, principal repayment expenditure is 9.95 percent and 1.91 percent of total expenditure and GDP during the review period. In general, it is found that government is not able to increase capital expenditure to the desired level and more expenditure have been made in recurrent and principal repayment expenditure which is increasing in faster pace than capital expenditure in every fiscal year.

5. Both recurrent and capital expenditure on defense have increased heavily during the review period. Expenditure on defense was only Rs. 2994.8 (recurrent 171

million and capital 2412.60 million) million in 2006/07 which has increased to Rs. 11404.10 million (recurrent 2823.80 million and capital 8580.30 million) in 2012/13. There is increase of 281% over a period of 6 years.

6. Sometimes growth rate of the capital expenditure have found to be negative. In the year 2010/11, it has decreased by 9.76 percent over the previous year amount.

7. The contribution of revenue to total receipt has not been increased significantly as compared to the total expenditure. Total revenue, in an average increased by Rs. 4097 million during the review period. Total expenditure is increasing at the rate of Rs. 6409 million in an average. The share of total revenue to GDP recorded 11.95 percent of which as the share of tax and non-tax revenue on GDP stood as 9.28 and 2.67 percent respectively. The gap between capital expenditure and revenue surplus is widening due to the growth of government expenditure as compared to the growth rate of revenue mobilization.

8. Share of revenue in the total sources of financing has been 68 percent and share of total government receipt in the total sources have been 73 percent. On an average, foreign grant have financed 5 percent of the total expenditure over a period of analysis.

9. Total revenue, tax revenue and non-tax revenue all are linearly increasing during the period of study. Tax revenue has always contributed more than the non tax revenue in total revenue. Tax revenue has occupied 78 percent of the total revenue during the review period and non – tax revenue has contributed only 22 percent. Based upon the fitted trend equation, the total revenue, tax revenue and non- tax revenue for the year 2020/21 be Rs. 130437 million, Rs. 100948 million and Rs. 29488 million respectively. This is 186 percent of the revenue of the year 2012/13.

10. Tax revenue from customs, tax on consumption and production of goods and services and tax on property, profit and income are increasing in faster rate than

land revenue and registration. VAT has contributed substantial amount for the growth of tax on consumption and production of goods and services.

11. Both the overall and budget deficit is in decreasing trend. The overall deficit has been generally higher than the budget deficit.

12. In the Nepalese context, external source, particularly foreign loan has been an important source to meet the budgetary deficit. During the study period of 13 years, the average percentage of foreign loan to budget deficit has been 55.67 percent, which is 2.88 percent to GDP.

13. Similarly, the average annual percentage of internal sources to budget deficit has been 44.33 percent, which is 2.29 percent to GDP.

14. Overall budget deficit as a percentage of capital expenditure is increasing each year. In the recent years, it has even exceeded the capital expenditure, which clearly shows that government revenue is even not sufficient to finance the recurrent expenditure and principal repayment expenditure. Development activities carried out in the economy are wholly based upon the foreign sources (grant and loan) and internal borrowings and cash deficit/surplus.

During the period of study, on an average, overall deficit represents 111 percent of total capital expenditure.

15. Percentage of deficit financing on capital expenditure shows fluctuating trend. On an average, budget deficit represents 76 percent of the capital expenditure.

16. Nepalese budgetary allocation is highly dependent on foreign sources. Foreign aid is flowing haphazardly. Such a situation has been creating aid dependency syndrome in the Nepalese economy. Over reliance on foreign aid has been creating the situation of loss in self-dignity. There is severe lack of monitoring mechanism during budget execution.

17. Debt servicing of the Nepalese Economy is increasing. It was 7.64 % of export earning in 1998/99 which has risen to 10.29 % in the year 2010/11 and 9.36 percent in 2012/13.

18. There is no earmarking of funds in the Nepalese Budgeting system.

6.2 Recommendations

Nepal is an underdeveloped country and its economic situation is not improving in a satisfactory manner. It is facing economic as well as social problem for its development. The huge investment from government side to increase GDP has failed to achieve the target. Development efforts through various fiscal measures have been unsuccessful and increasing government outlays could not increase productivity. Actually the external capital inflow has not strengthened the national economy. The resource gap is generally widening due to limited internal resource mobilization and their potentiality. On the other hand, the government needs to bear the responsibility of creating employment opportunities, need to support the people living below the absolute poverty line and other social obligation along with developmental responsibilities. In Nepal, government has still a greater role to play in development activities even after the adoption of liberalized economic policy especially with respect to developing infrastructures conducive to development and providing facilities to the people under social safety net. With this background, some general recommendations can be outlined as follows:

1. Adequate mobilization of domestic resources:- Government revenue is only 11.95 percent of GDP in the context of Nepal. Though it is as high as 40 percent in developed economies. Hence tax base in the economy is to be increased. The principles of equity, justice and revenue productivity should be given consideration in forming tax policy. Administrative aspect of direct and indirect taxation should be strengthened. Direct tax contributes only 15.61 percent of total revenue in the review period. This should be increased by introduction of tax

structure reforms, proper administration and lowering evasion of tax by strengthening the direct tax laws.

2. The use of customs duties highlight their historical importance which may decline along with the recent developments in regional and international trade organizations like SAPTA, WTO and trade liberalization. Thus, there is an urgent need to reform the domestic taxes.

3. Expenditure on recurrent activities is increasing at the faster rate than revenue and capital expenditure. As this does not add any productivity in the economy, unnecessary recurrent expenditure should be discouraged.

4. Bringing peace in the economy could save expenditure on defense. Resources can be diverted to more economical and productive infrastructure development. There must be cut in defense expenditure.

5. Nepal is currently facing a serious problem of resource gap and this urgently needs to be narrowed. Budgetary deficit need to be reduced by mobilizing additional resources. The government should take a number of measures such as strengthening the tax administration, increase tax base to promote revenue generation and control corruption.

6. Debt servicing is increasing every subsequent year. Debt raised for incurring recurrent expenditure may create burden in the economy and for future generation. Therefore, loan from external sources should be received only when needed. Foreign aid must be utilized in more productive sector and infrastructural development.

7. Proper co-ordination between National Planning Commission and Ministry of Finance should be maintained and budget should be prepared depending upon economic prosperity. Expenditure on unproductive sector should be reduced and transparency in earning and spending should be enhanced. In order to discourage

corruption and irregularities, property earned through unfair means should be nationalized.

8. The budgetary decision should be carried out with social and economic objectives in view rather than to fulfill political objectives.

9. Earmarking of fund can help better achieve the budgetary goals.

10. 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. It will ascertain the benefit from any project.

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APENDIX – A

PUBLIC EXPENDITURE, RECEIPTS AND DEFECITS

Rs. in million

Fiscal Year	GDP	Expenditure				Receipts			Deficit	
		Recurrent	Capital	Principal Repayment	Total	Revenue	Grants	Total	Overall	Budget
1998/99	116127	-	-	-	23549.8	10729.90	2164.80	12894.70	12819.90	10655.10
1999/00	144933	-	-	-	26418.2	13512.70	1643.80	15156.50	12905.50	11261.70
2000/01	165350	-	-	-	30897.7	15148.40	3793.30	18941.70	15749.30	11956.00
2001/02	191596	-	-	-	33597.4	19580.80	2393.60	21974.40	14016.60	11623.00
2002/03	209976	-	-	-	39060	24605.00	3937.10	28542.10	14484.80	10547.70
2003/04	239388	-	-	-	46542.4	27893.10	4825.10	32718.20	18649.30	13824.20
2004/05	269570	-	-	-	50723.7	30373.50	5988.30	36361.80	20350.21	14361.90
2005/06	289798	-	-	-	56118.3	32937.90	5402.60	38340.50	23180.40	17777.80
2006/07	330018	31944.20	22992.10	4642.70	59579.00	37251.00	4336.60	41587.60	22328.02	17991.40
2007/08	366251	35579.10	25480.70	5212.70	66272.50	42893.80	5711.70	48605.50	23378.70	17667.00
2008/09	394052	45837.30	28307.20	5690.60	79835.10	48893.60	6753.40	55647.00	30941.50	24188.10
2009/10	406138	48863.90	24773.40	6434.90	80072.20	50445.50	6686.10	57131.60	29626.70	22940.60
2010/11	437546	52090.50	22356.10	9559.50	84006.10	56229.80	11339.10	67568.90	27776.30	16437.10
2011/12	474919	55552.10	23095.60	10794.90	89442.60	62331.00	11283.40	73614.40	27111.60	15828.20
2012/13	508651	61686.40	27340.70	13533.30	102560.40	70122.70	14391.20	84513.90	32437.70	18046.50

Note: The expenditure head till FY 2011/12 were classified as regular and development. Since FY 2012/13, such expenditure has been classified as recurrent, capital and principal repayment. Data as per new classification were available from 2006/07 onwards only.

Sources: *Economic Survey, FY 2011/12, and 2012/13, MOF*