TREND AND PATTERN OF PUBLIC EXPENDITURE IN NEPAL

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RECOMMENDATION LETTER

This thesis entitled **"Trend and Pattern of Public Expenditure in Nepal"** has been prepared by Mr. Barma Raj Khanal under my supervision. I here by recommend this thesis to the thesis committee as a partial fulfillment of the requirements for the Degree of MASTER of ARTS in ECONOMICS.

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APPROVAL LETTER

We certify that this thesis entitled **"Trend and Pattern of public Expenditure in Nepal"** Submitted by **Mr. Barma Raj Khanal** to the Central Department of Economics Faculty of Humanities and Social Sciences, Tribhuvan University, in Partial fulfillment of the requirements for the degree of **MASTERS OF ARTS in ECONOMICS** has been found satisfactory in scope and quality. Therefore we accept this thesis as a part of the said degree.

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Finally I have to say I alone bear the full responsibility for any errors and discrepancies that might have occurred in this research work.

Barma Raj Khanal

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ABBREVIATIONS

CEDECON	=	Central Department of Economics
DE	=	Development Expenditure
DW	=	Durbin Watson
GNP	=	Gross National Product
GNP	=	Gross National Product
GON	=	Government of Nepal
IDS	=	Integrated Development System
IMF	=	International Monetary Fund
LDCs	=	Least Developed Countries
MOF	=	Ministry Of Finance
NPC	=	National Planning Commission
OLS	=	Ordinary Least Square
ORG	=	Overall Resource Gap
RE	=	Regular Expenditure
SAP	=	Structural Adjustment Program
TU	=	Tribhuvan University
UDCs	=	Underdevelopment Countries
UK	=	United Kingdom
UN	=	United Kingdom
US	=	United States
WB	=	World Bank

CHAPTER-ONE

INTRODUCTION

1.1 Background

The concept of public expenditure plays a very prominent role in public finance. In the nineteenth century, economists paid very little attention to public expenditure as there was no sound classification of the expenditure by central government, state government and local government. There were no exact principles for public expenditure. Basically, the functions of the government were limited to justice, police and arms. They were also of the confirmed belief that government expenditures are totally waste and money can be best utilized by the private persons rather than government. With the passes of time, the situation has altogether changed and economic activities have become complex, which have forced the economists to pay a great attention to public expenditure. Thus, in modern times, the subject of public expenditure has earned great significance.

Public expenditure refers to the expenses, which the government incurs for its own maintenance as well as for the society and the economy as a whole. Those days, some governments are incurring expenditure to help other countries and that would also form a part of the total expenditure. With expanding state activities, it is becoming increasingly difficult to judge what portion of the public expenditure can be ascribed to the maintenance of the government itself and what portion to the benefit of the society and the economy. Goode defines public expenditure as a means to carry out essential functions of administrating justice and providing national defense and to supply certain additional goods and services that are advantageous to a great society but that would not be supplied by private enterprises because doing so would not be profitable. (Goode, 1984).

Today public expenditure deals with every aspect of economy. It's impact upon the economy are the causes for its importance, public expenditure together with fiscal tools, exert distinct impact on economic growth, equity, income, redistribution, employment, etc. Public part of the government activity is considered as welfare of the community. From the model of the national income analysis, we conclude that public investment promotes aggregate demand (C+ 1+ G) where C is personal consumption, I is the investment and G is the amount of Government expenditure (and to fulfill the aggregate demand national output and income has to be increased). Thus public expenditure can generate national output and income.

In any underdeveloped country, where the basic infrastructures for economic development have not been created, it is no other than the act of public expenditure, which is responsible upon the means for it. Economic development demands cooperation form both public and private parts. Private cooperation for economic development comes later on. Public expenditure may have direct and indirect impact on development. Directly, public expenditure on industry, commerce may aggregate economic development, where as, indirectly it can feed up the economic development by its suitable policies and cooperating private participants by providing the transportation, communication, health, education and other social welfare program in the economy. The growing popularity of planning and budgeting, in underdeveloped on well the developed countries have given importance to public expenditure promoting and planning the pace of economic development.

Today the income disparity, between developed and developing nations, is continuously increasing. The development gap and the discrepancies between the haves and have not in every country, is quite severe and distinct. What is the solution left for them? As part of the solution to give momentum to economic development and lessening the income gap, public expenditure is though to be quite essential. Realizing these importance, the public expenditure of every country of the globe, is increasing both in relative and absolute term.

Nepal although initiated its development activities only after the inception of democratic system in 1951, the advent of planning has led to tremendous increase in the size of the public expenditure in the past years. In spite of the phenomenal increases in its size, the actual performance of Nepalese economy has been below the expectation and has not been still able in advancing towards sustained growth (Khanal, 1988). From the very beginning of planned development, public expenditure polices have been mainly guided by the objectives of accelerating economic growth, better allocation of resources, achieving equitable distribution of income and maintaining price stability. However, the outcomes have not been realized as expected.

Public expenditure in Nepal since its planned development process has not only been increasing tremendously but they have mostly been concentrated to the development of socio-economic infrastructures. If such an investment and expenditure programs are not properly expanded, they have adverse impact on increasing resource gap, lack of resource, income disparities, etc. Such consequences may have adverse impact on long term objectives such as stability and growth.

Thus, the government of under developed countries like Nepal by increasing their expenditure on economic development and capital formation are making valuable contribution towards increasing income and opportunities of employment. Therefore, public expenditure plays a very important role in raising the level of income and employment.

1.2 Statement of the Problem

Since the late 1950s Nepal has been implementing periodical economic plan for economic development. It has six decades of experiences in systematic planned economic development. Now, the three years interim plan (Eleventh) is running in its last year. Nevertheless, the basic issues of the country are the same. The revenue has increased during the period but not at the rate of expenditure. Still the economy of the country is backward.

This study is primarily concerned on analyzing the trend and pattern of public expenditure rather than the management and efficiency issues. The problem found so far are basically efficiency issues oriented. The overall fiscal problems have been showed as: first, there has been increasing trend in public expenditure. The growth rate of public expenditure is higher than that of growth rate of gross domestic product (GDP). The GDP growth rate is not substantial while there has been high public expenditure growth rate. Public expenditure in Nepal has grown faster than the national income; second, the reliance of development expenditure on foreign aid is mounting up continuously. Internal and external borrowings are the main sources to fulfill the resource gap. The increasing reliance on foreign loan has led the requirement of large amount of resources for principal repayment and interest. Third, there has been increasing trend in resource gap in Nepal. In the third five-year plan (1965-70) for the first time, the concept of deficit financing was used. In the beginning of the planned development, there was no such problem to meet the required expenditure of the government. After second plan period, the increase in expenditure exceeded the increase in the revenue. Therefore, there exist the situation of resource gap which widening over years. In this context the study try to evaluate either there is significant effect of public expenditure or not.

1.3 Objective of the Study

The objective of the study is as follows:

a. To analyze the trend and structure of public expenditure in Nepal.
b. To study the effect of public expenditure on gross domestic product.

1.4 Significance of the Study

Although many economists have under taken studies regarding the public expenditure situation in Nepal, the study mainly deals about the effects of public expenditure in GDP. Therefore in this study public expenditure shows how effective it is to generate the output (GDP). Hence, this study would help by different angles to the policy makers, planners, researches, university students, etc for further study.

1.5 Limitation of the Study

This study is subject of following limitations:

a. This study mainly deals with public expenditure and economic development in Nepal, but it does not study the organizational aspect and other aspects of government of Nepal.
b. This study is based on the secondary source of data; no test has been done for the check of reliability of those data.
c. This study covers only period of 1992/93 to 2007/08, because the study aims to evaluate the effect of public expenditure after the multi-party democratic system in Nepal.

1.6 Scheme of the Study

There are six chapters in this study and each chapter is further divided into various subsections. The first chapter, which is introductory portion, gives a general overview of whole study. The second chapter attempts to literature review. Reviews of literatures deals with the theoretical context along with both the international and national context. The third chapter provides the methodology of the study, sources of data used in the study, methods of analysis and variables used in the study. Statistical and econometric models used to establish the relationship between variables are the core of this chapter. The fourth chapter explains the objective of the study that is, trend analysis of the public expenditure. In detail, this chapter examined the trend and pattern, of public expenditure. The fifth chapter, statistical and economic models used to establish the relationship between different economic variables and expenditure on respective sectored. Finally the last or sixth chapter carries conclusion of study and recommendation for policy formulation.

CHAPTER-TWO

LITERATURE REVIEW

2.1 Theoretical Concept

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

In modern time, every individual contributes in the financing of the government expenditure. With this money they buy various public services, defray the cost of public work and make interest payment on the public debt, directly support millions of government employees and indirectly millions of other individual where businesses benefit from government spending.

One can make hypotheses about the identity of the factors that are likely to influence spending in a given functional sector and the significance of such factors can be empirically tasted. Six groups of factors can be identified: (1) demographic influences (2) sociological concern (3) the structure of the economy (4) the level of economic development (5) technological factors and environment factors.

These variables focus on the major factors underlying the demand for public services-yet clearly the real per capita income is the ultimate constraint on how much, in total, of that demand can be satisfied. Thus, in analyzing the determinants of the share in gross domestic product (GDP) of public spending on a sector the level of development (as measure by per capita GDP) seems to place a fundamental limit on possible spending in many sectors. It may also influence the likely balance in spending between the economic sectors, which are oriented towards stimulating current productivity and capital accumulation and the social and administrative sectors, which aim at providing current consumption

2.2 Public Expenditure in Developing and Developed Countries

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

The role of expenditure in fiscal policy is partly dependent, on their overall ratio to GNP and partly on their functional and economic characteristics. Government expenditures can be divided for analytical convenience into those for (a) traditional public goods and merit wants (defense, education etc.); b) direct trading and industrial activities of governments c) transfers to productive sectors (e.g. industries, agricultural and d) transfer to household and individuals. Admittedly, each is dependent on the political perceptions of the state and on the reliance placed on the market system. The role and responsibility of a state, is greater in underdeveloped countries than in developed countries.(B.C. 2009)

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

In developing countries a high percentage of the population in depend upon their own agricultural produce for their live hood, while the commercial and industrial sectors of the economy are small in scope compared to that of agricultural sectors.

Similarly, formal education is typically very limited. The widespread illiteracy and lack of other skills have become too difficult for modern economic development similarly public health standards are frequency low. The number of doctors and the hospitals are too limited while the wide spread endemic diseases are severe which are the main causes for reducing output of the labor force. In such structural factor, it has been realized that public expenditure can play a significant role to eliminate such factors for enhancing the growth rate.

Countries in the developing world spend more on economic service, ranging broadly from a fifth to a third of total expenditure. While the corresponding outlay in industrial countries is relatively minor. Defense expenditure and do not lend themselves to any clear conclusion owing to the cost- sharing arrangements of alliances and to the geographical forces at work. Outlays on education and health tend to be higher in developing countries in turn reflecting the direct involvement of the state in the provision of social services.

In the western world, after world war, public expenditure was thought as an instrument to cure the war decocted economy. Economic growth was the concern topics for every body. Harrod-Domar growth models proposed to raise the level of saving and investment for economic growth. Government as a saver and investor was taken into consideration. Capital concept was replaced by the welfare concept. Due to the advent of socialism direct state control measures of production distribution and mass welfare programmes are getting much more popularity. Today the economics-isolation and iron-curtain measures are difficult to assume, but nobody deny the mass-participation of government in developmental programmes. In developing countries, both direct and indirect measure of government participation and control are being practiced to uplift the economy and to provide welfare to the people.

2.3 Theories of Public Expenditure

2.3.1 Classical Views on Public Expenditure

The classical economists always believed in the existence of the full-employment in the economy. They were against the heavy role of government because they believed one full employment. They had strong belief that if the resources are already employed, there is no need of government intervention.

Thus, the classical economists developed esoteric arguments to justify the role of government and thus defined the areas of public wants. Their arguments were designed to restrain government interference in the private sector, because government has viewed with apprehension and fear, hence was suspected of corruption. The position of classical economists can be epitomized "The less government, the better" (Khanal, 1998)

The principle British fiscal economists viz; Pigou (1947) and Dalton (1954) advanced the notion of equalizing marginal social benefits and marginal social costs. Given this view, the main task of the public finance was simply to make the best of a bad lot and to allocate the burden of taxes as fairly as possible among the numbers of the community. (Khanal, 1998)

The normative of orientation of public expenditure reached a higher stage thought the seminal articles by Samuelson in the early 1950's. There articles viewed the concept of a pure public goods as something which people desired but which could to be provided through the normal provided through the normal market mechanism. Because the way the goods and services are provided ensures that they will be equally consumed all citizens. That is no one can be excluded from enjoying the services provided whether he pays forty or not Samuelson work together with a largely independent formulation by Musgrave (1959) has given rise to the large and growing literature on the theory of public goods. In short, classical economists had no faith in the government activities. According to their view, the main theme of public expenditure was simply to make the best of a bad lot and to allocate the burden of taxes as fairly as possible among the members of community.

2.3.2 Keynesian Views of Public Expenditure

After the great depression of 1930s J.M. Keynes brought a new thought of economics. Keynes, in his General Theory propounded a new approach towards economic development challenging the desirability of maintaining pure capitalism, Keynes put forward a logical theory prove that in the interest of general people and economy. He justified the role of public expenditure in achieving full employment and pausing up the rate of economic growth.

Keynesian contributions have influenced economy in more than one sphere and they may broadly be examined in terms of economy theory, as policy prescriptions to deal with unemployment and as a philosophy that minimize unemployment. Keynes pointed out that the fundamental causes of the depression was the lack of spending. The decision to save in the household sector didn't necessarily lead to a decision to invest and the government therefore had to step up its expenditures in order to "prime to pump" of the economy. It was recognized that public borrowing absorbed private saving, but such borrowing contributed to greater. Economic activity while money retained in the private sector would have more likely contributed to greater unemployment than to increase private investment. In Keynesian terms, budget deficits were viewed as positive instruments to shore up aggregate income to stimulate all vectors to spend more. Keynesian economics freed the thinking of the treasury from the narrow concept of balancing the budget to the wider role of balancing the whole economy. The Keynesian view of the state implied that it had both an obligation and an ability to control any instability in the economy and to restore functioning order (Prem Chand, 1983)

At the time of depression, Keynes favors higher public expenditure through deficit financing, which can increase effective demand. On the other hand, at the time of inflation, demand is high, hence it is better to reduce public expenditure by the government and also impose heavy tax though surplus budget.

Various theories in the field of public expenditure, developed for a long time period can be divided into two groups

1. Pure theories of public expenditure
2. General theories of public expenditure

Under the pure theories we are here discussing Pigou's. Ability to pay theory, voluntary exchange theory, Lindal Johansen theory and Samuelson's theory. The general theories consists of three well known theories Wagner's

Hypothesis, Peacock Wiseman Hypothesis and Colin clerk's Critical Limit Theory.

a. Ability to pay theory of public expenditure

It was the Pigou who provided an analysis which comprehend both the tax and expenditure sides of fiscal operations. The ability to pay theory satisfies the marginal rule for optimum allocation that public expenditure should be increased up to the point where the utility or benefit derived from marginal unit of money spent on public expenditure is equal to disutility arising from the marginal unit of money taken away in tax or the benefit lost in not spending this amount in the market. This principle implies that equivalence of inter sectoral marginal utility. That is to say, the marginal utility derived from expenditures incurred in both the private and public sector is equalized (Mathew, 1972)

The optimum amount of government expenditure is determined at the point at which the satisfaction obtained from last rupee spent is equal to the satisfaction lost in respect of the last rupee called upon by government service Pigou was concern with the aggregate marginal social benefit derived by the community as a whole from its expenditure in the private and public sectors and not with the equalization of individual benefits in the two sectors.

b. The voluntary exchange theory

The voluntary exchange theory of optimal determination of public expenditure derives itself from the "benefit received" principle governing the distribution of tax burden the voluntary exchange theory seems to suggest that resources will be allocated to the public sector in a manner analogous to that which obtains in the market place through the price mechanism. Just as the individual private goods in exchanged for the money value placed on them by their suppliers, he obtains public goods and services in exchange for the tax payments which he makes to the public authorities, in proportion to the benefits be receives from the consumption of the public goods and services in exchange for the tax payments which he makes to the public authorities, In proportion to the benefits he services from the consumption of the public goods. This theory assumes that the consumer the tax payers will reveal their true preferences for public goods, and hence there may not be the need for the application of any game-theoretic analysis in the determination of the desirable level of public expenditure.

c. Lindal - Johanson Theory of public expenditure

At first Lindal developed the theory with some assumptions such as; people revel their preferences for public goods, individual has the fixed budget constraint, and the distribution of income as between individuals and group is given. Later on this theory was reformulated by Johansen.

This theory concerned only with the allocation of resources between the public and private sector against the background of a ‘state of income distribution already accepted by the community as just proper’. In the theory of welfare economics, under certain conditions when consumer and producers maximize respectively, their utility and profit on the basis of prices which non of them can alter, conditions necessary for parato optimality are satisfied. Such conditions do not prevail in the 'bilateral monopoly' discussed in the Lindal version (Mathew, 1972). However the reformulation of the Johansen theory which seems to have very close affinity to the theory developed by samuelson satisfies the pareto optimality conditions.

d. Samuelson's theory

Samuelson assumes that there a planner who is clairvoyant enough to know each man's preference function. The planner now derives for each man his demand functions for both public and private goods and solves or each of them his utility maximization conditions subject to the budget constrain. Having derived at the individual demand functions for both these categories of goods and maximized the individual utility function, a “super clairvoyant planner”. Now solves the general equilibrium problem in which all market are cleared in terms of supply and demand, keeping in mind however the peculiar quantity of the public good being consumed 'equally' by all (Mathew' 1972)

2.4 Some Other Theories of Growth of Public Expenditure

a. Wagner Hypothesis:

One of the popular fiscal literatures known as the Wagner Hypothesis is associated with the propositions propounded by Adolf Wagner in his "law of increasing expansion of public and particularly state activities." This law seeks to establish a functional cause and effect relationship between rate of growth of economy and relative growth of its public expenditure. The basic cause of the relative growth of public expenditure, according to Wagner, is 'social progress.'

b. Peacock Wiseman Hypothesis:

From the empirical analysis of the data on public expenditure for the British economy during the period 1890 to 1955, they were able establish that fiscal activities had risen step by step to successive new heights all along the period they had investigated. Some social disturbances and such as war and depression take place which shows the need of increased expenditure as the existing public revenue could not meet the situation. Peacock and Wiseman analyzed the process of growth of public expenditure in terms of three separate but related concepts of the displacement, inspection and concentration effects.

Social disturbances create a "displacement effect" by which the previous lower tax and expenditure are replaced by new and higher budgetary levels. The increased expenditures are partly direct result of disturbance while other frequently involves the expansion of government into new areas of economic activity. For instance war and other social disturbances frequently force people and their government to find out the solution problems, which previously had been neglected. This is known as the "Inspection effect". And 'concentration effect' refers to the evaluation of expenditures under taken at different level of governments and their tendency to be concentrated in the central government.

c. Colin Clark: Critical Limit Hypothesis

Colin Clark argued that inflation inevitably occurs when government expenditure financed out of taxes and other receipts, exceeds 25 percent of the aggregate national income. This has been alleged to be true even under circumstances when the budget remain in balance. Clark's analysis of the relation between public expenditure and inflation is only partial. Inflation so far as it brought about spending, relates to the equilibrium situation between supply and demand for scarce resources i.e. between the capacity output of the economy and the aggregate spending for such output.

There are many research papers, surveys, articles and books written on public expenditure with various conclusions. Different researchers of the trend impact and achievements of public expenditure come up with their own findings. Some research papers and dissertation are concerned with developing economy whole as some are too concerned with industrial economy. In this regard, it is worth while to review some of the relevant literature both by the international and by the national researchers.

2.5 International Context

Phillip Taytor (1961) in his study "The Economic of Public Finance" discussed the significance of public expenditure stressed the expansion of government had often been characterized a movement in the direction of socialism that government obviously tended to socialize through public expenditure. It helped to correct the disorder that had created by cyclical fluctuation, which mostly appeared during the depression. "Public works projects and landing functions during the depression were instituted to cushion the effects of the worst feature of capitalism-its recurrent tendency to break down". 'Pump-priming' the injection of public expenditure to fill a void left by deficient private expenditures in recession has as its goal the prevention of serious break down.

Alan a Tait and Heller (1982) made a study on "International Comparisons of Government Expenditure". This study provided a comparable framework for comparison of both functional and economic expenditure pattern of countries having similar economic and demographic position. It further provided an implicit technological norm for predicting the economic characteristics of a country's expenditure pattern, based on its choice of priorities for functional expenditure. They concluded that; first, many international cross section studies of government revenue and expenditure used per capita income as a proxy for most of the underlying demographic, social, and economic differences, yet it is striking how uncertain percapita income is as an explanatory variable. Second, it is encouraging to note how plausible the modeled relationships are; it is also reassuring to see how most of the expenditure indicates for individual countries performances and attitudes.

Third the technical coefficients functional categories that determine economic categories of public expenditure are powerful and suggestive. Fourth, the appeared to be clear support for the hypotheses that the majority of governments spent excessive amounts on wages relative to amounts had spent on goods and services; some countries do appear to overspend on wages relative to other good and services-some do not. However, a clear bias was evident toward greater than expected current expenditure relative to capital expenditure in Africa and in industrial countries; the same regions spend more than expected on subsidies relative to wages.

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

Anwar Shah (2005) in his book ‘Public Expenditure Analysis’ provided tools of analysis for discovering the orientation of the public sector and creating a scorecard on its role in safeguarding the interests of the poor and those otherwise disadvantaged. The book further provided a framework for citizen-centered governance-in other words, creating an institutional design with appropriate incentives to make the public sector responsive and accountable to a median (or average) voter. It illustrated tools of analysis for addressing the following questions:

i. Who bears the burden of taxes and who benefits from public programs?
ii. Are existing public programs intended to reduce poverty? Are they likely to do so?
iii. Are there adequate safeguards for income security for the elderly and the poor?
iv. Do program ensure equality of access to women?
v. Are public programs responsive to citizen preferences?
vi. Are citizens empowered to demand accountability from elected and appointed officials?

As a methodological tool, a welfare reform index is derived and applied to property data gathered in the Philippines to rank policy changes in terms of their impact on social welfare. He concluded that in South Africa, a few local governments that had a strong commitment to citizen voice effectively used voice mechanisms to improve local governments; however, simply considered voice mechanism as unnecessary and burdensome processes and these mechanisms had no impact on local government performance.

Larry Schroeder (2007) in his study 'Forecasting Local Revenues and Expenditures' reviewed the rationales for and techniques available to local government financial managers for forecasting revenues and expenditures in developing and transition economics. It illustrated how the techniques can be used and buttresses that discussion with illustrations of how they are actually used.

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

2.6 Nepalese context

S.K. Singh (1977) in his book "The Fiscal System of Nepal" analyzed the consistency between fiscal policy of Nepal and targeted growth rate from the time series data over the period of 1954/55 to 1974/75. He also analyzed the trend of revenue and expenditure during the same period, found a substantial change in the ratio of total public expenditure to GDP. He found that the ratio of total government outlay to GDP was just 2.44 percent in the fiscal year 1954/55, which increased to as high as of 10.57 percent in the fiscal year 1974/75. He also found that development expenditure ratio to GDP increasing from 4.07 percent in fiscal year 1965/66 to 6.75 percent in 1974/75. The growth rate of regular expenditure was quite slower registering 2.13 percent in 1965/66 to 3.82 percent in fiscal year 1974/75. On the revenue side, in 1950s tax revenue to GDP ratio was hopelessly low. In percentage term it was 1.27 percent of GDP, which stood up 6 percent of GDP in 1974-75.

P.P. Upadhaya (1987) in his thesis of M.A. entitled ‘Public Expenditure and Regional Development in Nepal: A Macro Case Study’ making a study regarding resource allocation practices, observed that large amount of public expenditure has centered on the central development region in the study period of 1972/73 to 1977/78. He found that the volume of development expenditure is increasing rapidly, though it has not affected for the overall economic growth of the country and thereby the standard of living the per capita income. He concluded that the resource allocation practice were only growth promoting rather than balanced regional development.

He also noticed increasing development expenditure during his study period but contributing to low rate of economic growth. Consequently, the standard of living along with per capita income did not increase as per expectation. His another finding was that government expenditure mainly confined to the infrastructure development rather than the basic needs of people.+

Mahendra B.C. (2009), his thesis of M.A entitled An Analysis of public expenditure in Nepal. This study is primarily confined to the analysis of trend and pattern of public expenditure and impact of public expenditure on GDP during the period 1991 to 2005. B.C. observed that the trend and pattern of public expenditure threaten the fiscal discipline and management. The regular expenditure has surpassed the development expenditure as against the accepted fiscal norms. Development expenditure exceeds the regular expenditure until FY 1997, than after it is lesser than regular expenditure. The very slow process of structural change, low rate of capital accumulation and non significant change in employment pattern indicate that Nepalese economy has not been still able in advancing towards sustained growth. B.C. also has presented the various conceptual ambiguities in classifying the budget. He has explained that public revenue is growing slower than expenditure leading to the widening resource gap. This gap is further extended by the weakness of government toward strong commitment, clear vision and sufficient assessment necessary to choose programs and to allocate budget for them in Nepal. He has given several suggestion to improve the performance of the public expenditure such as reduce consumption type of public expenditure in order to promote capital accumulation, to allocate scarce resources on core priority areas, ensure greater realism in resource forecasting to streamline the development budget.

D.R. Khanal, (1988) in his, Ph. D dissertation entitled Public Expenditure in Nepal: Growth, Pattern and Impact examined and analyzed the growth pattern and impact of public expenditure on the basis of time series data of Nepal over the period of 1965 to1981. He has analyzed public expenditure growth through both supply and demand oriented factors such as targeted income, internal revenue and foreign aid in order to reveal the likely impact on country's long term development. He found, between fiscal year 1965 to 1981 that public expenditure has increased many folds in relation to country's GDP. The public expenditure increased by 8.42 percent per annum on the average where as the gross domestic product increased by only 2.04 percent during the same period. During the period, regular, development and public investment expenditure have increased by 8.66, 8.59 and 9.08 percent. Public expenditure share was 5.5 percent in 1966, where as it rose to 15 percent in 1981. He concluded that the major expansion of the public expenditure had taken place only after 1970. He found that the elasticity coefficient for total expenditure development expenditure, economic services and social services with respect to per capita income being more than unity. At the same time, his findings was that the elasticity coefficient for the public investment being less than unity.

Bhisma Upreti (2002), in his article ‘A Study on Performance of Public Expenditure in Nepal’ emphasized on the performance of public expenditure of Nepalese economy ad also assisted in the preparation to develop further policies to reform fiscal weakness. For testing the performance of public expenditure t-test and f-test have been used. In the both tests he found that there is no significance different between budgeted and actual public expenditure in practice, even if variation exists.

He regarded that input output Model is one of the appropriate Model for judging the performance of public expenditure, however, other to the data constraint, it is difficult to employ this model in assessing the degree of deviation in relationship between targeted and actual public expenditure of Nepal.

He has found both demand ad supply side factors contributing to the rapid growth of public expenditure in Nepal. He has explained that public revenue is growing slower than expenditure leading to the widening resource gap. This gap is further extended by the weakness of government towards strong commitment, clear vision and sufficient assessment necessary to choose programs and to allocate budget for them in Nepal. This increases the share of foreign aid in development expenditure to bridge the resource gap.

He was given several suggestions to improve the performance of the public expenditure such as to allocate scarce resources on core priority areas, to promote local ownerships of the government expenditure program for improving the effectiveness of the government spending.

Another notable study on Nepalese budget is done by Deepak Adhikari (2004) in his article "Nepal is budgetary exercise the nineties: An Assessment" with descriptive and analytical method his study, at first highlight the policy frame work underlying each of annual budgets of GON during the Nineties were directed towards economic liberalization, privatization, poverty reduction and decentralization policies and programe of the budget during the nineties were essentially concerned with agriculture modernization, employment promotion, woman empowerment, financial sector reform, government expenditure management tax, reform, good government, social service and development of basic and physical infrastructure.

He has also explained about the trend and pattern of the government expenditure. The regular expenditure shows a tendency to double in every five year. It has increased by 18.5 percent an average during the last decade. Development expenditure in the review period went up with all average annual growth rates of 9.8 percent in the sectoral expenditure pattern during the 1990s he found that priority had been accorded to the social sector, mainly education and then health. However, the achievements in the both sectors were not satisfactory. In the intersectoral pattern, expenditure on social sector was followed by the expenditure economic services.

2.7 Concluding Remarks

Public expenditure is clearly one of the central, indeed often the central instrument through which governments influence economics events. Public expenditure leaves its imprint on the very structure of an economy. The level of government spending relative to available resources powerfully shapes the environment in which private firms operate. The nature of public expenditure that is the respective sphere of public and private activity influences economic development not only by circumscribing the role of the private sectors. The influence of public spending on development is particularly clear when substantial increases or cuts take place and when the sphere of public sector activity increase or is reduced relative to the private sector areas.

Public expenditure has from antiquity, been used as an investment of state policy. The maintenance of a civilian machinery of government providing law, order and justice and the defense of the realm has been its time honoured objectives. Improvement in the well-being of citizens, development of the infrastructure and the promotion of structural change and development in the economy as objectives of government expenditure policies are of relatively recent origin.

Since expenditure and not revenue is the governing factor in public finance, it is more logical to start with the expenditure side of the account. The increase in expenditure that accompanied the more active role assumed by the state brought with it a transformation in the size of the budget, since fiscal policy could be meaningful only when public expenditure comprised a substantial portion of the gross national product (GDP).

CHAPTER-THREE

RESEARCH METHODOLOGY

3.1 Research Design

This study is based on the published secondary sources of data and information. In this study different techniques have been employed to achieve the above stated objectives. Quantitative technique is used mostly wherever possible. This study is based on certain research methodology consisting of simple regression analysis, tabular analysis, graphical analysis etc. secondary data are used for the purpose of analysis.

3.2 Study Coverage

This analysis is based on the time series data of 16 years covering period of 1992/93 to 2007/08. Rational of choosing this period is mainly availability of data itself.

3.3 Method of analysis

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

Use of quantitative tools has been seen as the best method for the data analysis also to reach at conclusion. Different statistical tools for both estimation and test have been employed as demanded by the objectives so specified above. In general, following models of analysis are used.

3.4 Regression Analysis

Regression Analysis is statistical technique which deals with the relationship betion variables. The main objectives of this model is to predict or estimate the value of one variable corresponding to a given values of another variable. Thus regression analysis shows how the variables are selected. Here, regression equation has been used as:

Y_{TE} = $\alpha + \beta \times$ ……………….(i) $0 \leq \beta \leq 1$

Y_{RE} = $\alpha + \beta \times$ ………………(ii) $0 \leq \beta \leq 1$

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

Where

Y_{TE} = Total Expenditure, Y_{RE} = Regular Expenditure

Y_{DE}= Development Expenditure,

x = Total Government Expenditure is independent variable.

Y = Total import is dependent variable.

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

α= Constant, representing the Y intercept, it specific the value of the dependent variable when independent variable has zero value. When the zero value for the independent variable is possible then it has practical meaning.

3.5 Interpretation of Data

1. Coefficient of determination (R^2)

The R- squared (R^2) statistic measure the success of regression in predicting the values of the dependent variable with in the sample. (R^2) is the fraction of the variance of the dependent variable explained by independent variables.

The statistics will equal one if the regression fits perfectly, and zero if it fits no better than the simple mean of the dependent variable. It can be negative if the regression does not have an intercept or constant or if the estimation method is two stage least squares.

2. Adjusted coefficient of determination (R^2)

This measure will also be employed to get additional information about the goodness of fit. Our problem with using (R^2) and a measure of goodness of fit is that the (R^2) with never decrease as never repressors are added. In the extreme case, we can always obtain as (R^2) of one if you include as many independent repressors as there are sample observations

The adjusted, commonly denoted as (R^2) penalizes the (R^2) for the addition of repressors, which do most, contribute to the explanatory power of the model.

So, the adjusted R^2 is calculated to overcome this problem

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

$$= 1- \frac{\sum e^2 / n\text{-}k}{\sum Y^2 / n\text{-}1}$$

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

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

3. Test of significance of Parameter

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

4. T-Test

The t-test is based on the student's distribution. It is used to test the hypothesis about any individual partial regression coefficient. To compute t-statistic, the standard errors for each input are computed separately. The t-ratio is the significant test of the regression coefficient of the hypothesis broadly speaking. A test of significance is a procedure by which sample results are used to verify the truth or falsity a null hypothesis. The decision to accept or reject null hypothesis is made on the basis of the value of the test statistic obtained from the data at hand. The t-statistic, which is computed as the ratio of an estimated coefficient to its standard error, is used to test the hypothesis that a coefficient is equal to zero.

it is defined by

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

Where S.E ($\bar{\beta}_i$) = Standard error or $\bar{\beta}_i$

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

The t statistics has n-k degree of freedom

N = No. of observation, k = No. of parameters in the regression.

5. Durbin-Watson (DW) Test

The Durbin-Watson statistics is a test for first order serial correlation. More formally the DW test statistic Measures the linear association between adjacent residuals from a regression model.

The Durbin- Watson is a test of the hypothesis P=o in the specification the null and alternative hypotheses are formulated as:

Null hypothesis (P=o); there is no auto correlation on errors terms.

Alter hypothesis (P+o); there is autocorrelation on errors terms

It there is no serial correlation, the DW statistic will be around 2. The DW statistic will fall below 2 If there is positive serial correlation (In the worst case, It will be near zero). If there is negative correlation the statistic will lie somewhere between 2 and 4. Positive serial correlation is the most commonly observed phenomenon in time series data.

6. F-Test

For the purpose of the analysis of variance this test is employed. The F-Test statistic tests the hypothesis that all of the slope coefficients (excluding the constant, or Internet) in a regression are zero. For ordinary least square models, the F-statistic is computed as F = $\frac{R^2 / K-1}{\left(1-R^2\right)/ N-K}$

Under the null hypothesis with normally distributed errors. This statistic has an F distribution with K-1 numerator degrees of freedom and N-K denominator degrees of freedom.

The p-value denoted probability (F-statistic) is the marginal significance level of F-test. If the p value is less than the significance level is testing say 0.5, we regret the null hypothesis that all stop coefficient are equal to zero. For the example above, the p-value is essentially zero, so we reject the null hypothesis the all of the regression coefficients are zero. (F test is a joint test so that even if all that- statistic are insignificant the F-statistic can be highly significant).

3.6 Definition of Variables

In this study regression equations have been carried on different format assure specified under models title. The variables used in this study are as follows:

1. Total expenditure (TE)

Total public Expenditure or government expenditure means the actual expenditure during the specified year. It has been taken about exclusively from the economic survey. Regular expenditure (RE): regular expenditure, one of the major components of total expenditure, is the current expenses. That is it is the government consumption type of expenditure.

Development expenditure (DE): It basically is the capital expedition it is the public investment and desirable also from the development perspective.

2. Total Revenue (TR)

It is the total Revenue of the government collected during year. It includes tax as well as non tax revenue. At the same time both direct and indirect taxes are included. Internal borrowing (IB): This is in fact the internal loan for deficit financing. To some extent, this desirable as well for LDCS.

3.7 Sources of Data

The study is basically based on the secondary data published by different governmental as well as non-governmental organization. However some informal interviews and interactions have done with respective. Experts, which could be the primary sources secondary information and data, have been collected from following sources.

1. Various publication of National Planning Commission Central Bureau of Statistics, Nepal Rastra Bank, The Economic Survey of the ministry of finance and publications of other ministries.
2. Various books and journals and previous research report published by different agencies and personal.
3. Information from international agencies such as, World Bank, Asian Development Bank, United Nation Development Programme etc.

CHAPTER-FOUR

TREND AND PATTERN OF PUBLIC EXPENDITURE

4.1 Introduction

There has been increasing trend in the public expenditure since the restoration of democracy in the country. Some support of notion of there being welfare state in democratic set up while some outshine the established norms in the fiscal practice. Today it is customary that the expenditure is also taken as a tool to implement fiscal policy. Implementation of fiscal policy in UDCs may approach the problem of reducing in equalities both from the point of view of redistributive public expenditure and redistributive tax policy. Likewise investment on human capital improves productivity and technology. Improvements in sanitation, health and educational services increasing the quality of manpower a available for development. Such investment is great equalizers for opening up new opportunities to the low income groups and increasing their standard of living. (Basyal, 2007)

Economic policies in general and budgetary policies in particular have emphasized over the past decade restraint on growth of total expenditure and restructuring on both current and development expenditure Regarding current expenditure there has been increasing emphases on fully meeting the recurrent cost requirements of completed public investment and on the minimization of the costly subsidy programs. Development expenditure has been increasingly directed to priority sectors such as physical and social infrastructure and to early completion of the ongoing development projects.

The output and price effects of a given level the public expenditure can vary a great deal, depending on the level of capacity utilization, the method of financing the expenditure and the composition of expenditure. The budget in Nepal is classified into regular and development categories the letter development budget includes all project and programs financed by foreign loan and grants. Any program or project where expenditure are largely, recurring, rather than in the form of investment, is also considered to be developmental if it has a direct impact on output and productivity. Even subsidies teacher's salaries and operation and maintenance are included under the development grouping as it is considered that these expenditures contribute to development. Though there are some anomalies in making such a distinction between regular and development expenditures this classification broadly exhibits the level of plan and non-plan expenditures of the government.

4.2 Trend of Public Expenditure

The world economy has displaced encouraging growth despite some unfavorable developments and Nepal's immediate neighbors China and India have also showed impressive high economic growth. Despite such favorable situation, Nepal couldn't take benefit due to various factors. Nepalese economy which had exhibited a good performance during the early 1990s witnessed a set back in recent years and registered only the modest growth (NRB 2006). The Nominal GDP has been continuously growing during the decade of 1990 s and first half of 2000. However the pace is not yet sound. GDP is increased from 144933 Million in FY 1990/91 to 724286 million in 2007/08, which is more than 5 times higher than that of base year.

Public expenditure figures, presented in the table no 4.1 show the steady and increasing trend of expenditure programs during the period of 1992/93 to 2007/08. Although its development expenditure has increased faster than its regular expenditure until 1998/99 then after regular expenditure exceeds. More over the regular expenditure has surpassed the development expenditure as against the accepted fiscal norms. That is more resources have been devoted for recurrent expenses rather for accumulation of capital.

Table 4.1

Trend of Public Expenditure

Rs. in million

Year	Regular expenditure	Development expenditure	Total expenditure
1992/93	11484.1	19413.6	30897.7
1993/94	12409.2	21188.2	33597.4
1994/95	19265.1	19794.4	39060.0
1995/96	21561.9	24980.5	46542.4
1996/97	24181.1	26542.6	50723.8
1997/98	27174.4	28943.9	56118.3
1998/99	36586.9	22922.1	59579.0
1999/2000	40791.8	25480.7	66272.5
2000/01	51527.9	27879.5	79835.1
2000/02	55299.8	24102.6	80072.2
2002/03	61650.0	21089.3	84006.1
2003/04	66347.0	21060.1	89442.6
2004/05	75219.7	24716.4	102560.5
2005/06	81282.6	26260.4	110889.2
2006/07	95329.9	38274.7	133604.6
2007/08	116068.2	45281.8	161349.9

Source: Economic survey 1999/00, 2008/09

As seen from the table 4.1 the recurrent expenditure has reveled the continuously increasing trend. It was Rs. 11484.1 million in 1992/93 and Rs.116068.2 million in 2007/08 increasing about 10 folds during review period. Development expenditure however has not maintained positive change all the times. Development expenditure exceeds the regular expenditure till FY 1997/98 than after it is lesser than regular expenditure. In FY 1994/95 it has decreased by the amount 1393.3 million from the previous years. In FY 1998/99 the development expenditure amounting Rs. 5951.8 million has again been decreased registering the negative change over previous years. This is so in FY 2001/02 and 2002/03 where development expenditure has decreased by Rs. 3776.9 million and RS. 3113.3 million from previous year respectively. Although the development expenditure grew in absolute term the pace remained low. Regular expenditure has been increasing at a higher pace mainly due to the responsibility of maintaining law and order, salary-hike and debt servicing obligation. Debt servicing is the faster growing expenditure and now forms the single largest head of regular expenditure. In order to meet the minimum needs of food, clothing, health, education, drinking water, transport, communication and other services, the rate of growing in development expenditure should increase both in absolute as well as relative terms. However, the growth of development expenditure remained lower than regular expenditure because of weak implementation of development projects resulting from political instability and lack of commitment. This indicated the public expenditure is rising faster than resource mobilization resulting in expanded government borrowing to match such expenditure. As much of the government expenditure is used for non-commercial purposes, and even commercial financing has not generated a surplus for the government, borrowing-led expenditure growths forebode a budgetary crisis.

Table 4.2
Regular and Development Expenditure as Percentage of Total Expenditure

Rs in million

FY	RE	DE	PR	TE	Percentage Share in TE of			
					RE	DE	PR	TE
1992/93	11484.1	19413.6	-	30897.7	37.2	62.8	-	100
1993/94	12409.2	21188.2	-	33597.4	36.9	63.1	-	100
1994/95	19265.1	19794.9	-	39060.0	49.3	50.7	-	100
1995/96	21561.9	24980.5	-	46542.4	46.3	53.7	-	100
1996/97	24181.1	26542.6	-	50723.7	47.7	52.3	-	100
1997/98	27174.4	28943.9	-	56118.3	48.4	51.6	-	100
1998/99	31047.7	28531.3	-	59579.0	52.1	47.9	-	100
1999/2000	34523.3	31749.2	-	66272.5	52.1	47.9	-	100
2000/01	42769.2	37065.9	-	79835.1	53.6	46.4	-	100
2001/02	48490.0	31482.2	-	80072.2	60.7	39.3	-	100
2002/03	54973.0	29033.0	-	84006.1	65.4	34.6	-	100
2003/04	55552.1	23095.6	10794.9	89442.6	62.2	25.8	12.0	100
2004/05	61686.4	27340.7	13533.3	102560.5	60.1	26.7	13.2	100
2005/06	67017.8	29606.6	14264.8	110889.2	60.4	26.8	12.8	100
2006/07	77122.4	39729.9	16752.3	133604.6	57.8	29.7	12.5	100
2007/08	91446.9	53516.1	16386.9	161349.9	56.7	33.2	10.1	100

Source: Economic survey 1999/00 and 2008/09 MOF

The expenditure heads till FY 2002/03 were classified and regular and development expenditure since FY 2003/04 such expenditure has been classified as recurrent, capital and principle repayment expenditure after FY 2003/04, the expenditure on heads and sub-heads has been presented reclassifying as recurrent, capital and principle repayment.

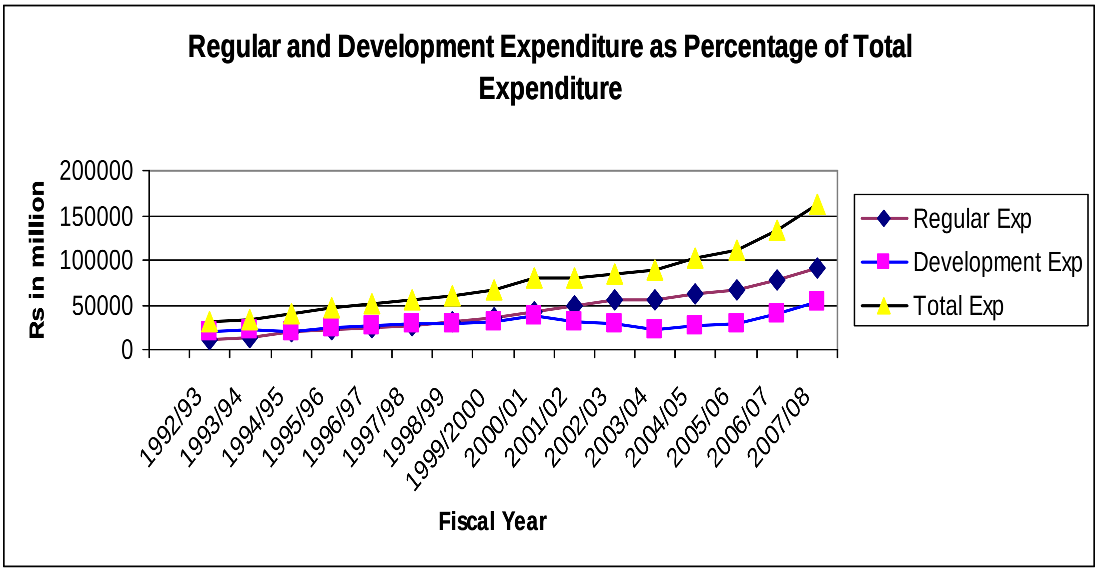
Table 4.2 reflects the amount of regular, development expenditure and total expenditure during the study period. In 1992/93 the total expenditure was only Rs.30897.7 million that mounted up to Rs. 46542.4 million in 1995/96 similarly it goes up to Rs.7983.5 in 2000/01 and in the fiscal year 2007/08 it reaches Rs.161349.9 million of which 56.7 percent was current expenditure 33.2 percent was capital expenditure and 10.1 percent was expenses against principal repayment. This clearly depicts the steady and increasing trend in public expenditure in Nepal. Public expenditure trend is going up before and after the restoration of democracy and republic too.

Table No. 4.2 also tells about the percentage share of regular and development expenditure in the total expenditure. The percentage distribution gives clear idea of the very structure of the public expenditure. In fiscal year 1992/93 the percentage share of regular expenditure to total expenditure was 37.2 which were 46.3 in 1995/96. However small fluctuations is seen in the share of regular expenditure to total expenditure the average overall share during 1992/ 2001 was around 47.1 percent of total expenditure. Hence during the early 9 years period under consideration the average over all share of development expenditure was 52.9 percent.

Nevertheless, in the second half of the study, the picture is reversed. The overall pattern shows decreasing development expenditure and increasing regular expenditure. That is more resources have been devoted for recurrent expenses rather for accumulation of capital. In FY 1992/93 the share of regular expenditure to total expenditure was 37.2 percent. This reaches up to 56.7 percent in FY2007/08 while the development expenditure has decreased from share of 62.8 to 33.2 percent during the same period. It is from the TY 1998/ 99 the regular expenditure started raising then the development expenditure.

In FY 2002/03 development expenditure decreased by 7.8 percent against that of FY 2001/02 totaling of 29033 million. In the ratio of regular and development expenditure, tendency of regular expenditure rise through TY 2992/-3. In terms of ratios, regular expenditure and development expenditure were 60.7 percent and 39.3 percent respectively in FY 2001/02. In FY 2002/03, regular expenditure ratio increased to 65.4 percent while that development expenditure increased to 34.6 percent from FY 2003/04 total expenditure had been classified into three groups, recurrent, capital and principle repayment expenditure. In FY 2003/04, recurrent was of Rs.55552.l million FY2007/08 recurrent expenditure increased by 18.6 percent compared to that of FY2006/07 in FY 2003/04 capital expenditure was Rs.23095.6 million. In the last study period, FY 2007/08, capital expenditure is increased by 34.7 percent against that of FY 2006/07 and from FY 2003/04 principle repayment expenditure has been classified separately and its share was Rs.10794.9 million in total expenditure. In FY 2007/08 principle repayment expenditure decreased by 2.2 percent compared to the FY 2006/07. In the ratios, recurrent expenditure capital expenditure and principle repayment expenditure were 57.8 percent 29.7 percent and 12.5 percent respectively in FY 2006/07. In FY 2007/08 recurrent expenditure ratio decreased to 56.7 percent while that of development expenditure increased 33.2 percent and principle repayment expenditure ratio decreased to 10.1 percent.

Figure 4.1



Source: Table 4.1

From the figure 4.1 some unique trend can be seen. It is seen that the rate of change in both regular and development expenditure were almost same in the initials years of 1990s. This trend is broken in the late 1990s share regular expenditure shows an explosive increment where as development expenditure increases at very nominal rate and ever experienced negative rate in some year of study. Development expenditure never surpassed the regular expenditure after 1998/99. Table 4.2 and figures 4.1 lead to several important aspects of Nepalese public expenditure structure. First is that government goal to meet Major social objectives of poverty alleviation is over shadowed by the increasing share of regular expenditure. The bulky reserves have been devoted to unproductive recurrent expenditure with very little scope of contribution for acceleration of economic growth. No doubt, government expenditure should contribute to economic growth of the country when private sector is at infant. However, the government has failed to maintain this assertion. Accordingly government's willingness to fulfill the major societal objective specified by periodic plan and parallelly the government's commitment to maintain fiscal discipline is questionable against the background of the current public expenditure pattern. These trends have some importance consequences of institutional weakness and the political commitment of reforms in public expenditure management as well as on resource allocation practices.

To get more precise and meaningful picture, an attempt is made to compare all these with respect to country's gross domestic product Table 4.3 picture the scenario where all information's have been expressed as percentage of GDP (at current price)

Table 4.3
Total, Regular and Development Expenditure as % of GDP

Rs in million

Year	Total Exp.	Regular Exp.	Development Exp
1992/93	18.69	6.95	11.74
1993/94	17.54	6.48	11.06
1994/95	18.60	9.17	9.43
1995/96	19.44	9.01	10.44
1996/97	18.82	8.97	9.85
1997/98	19.36	9.38	9.99
1998/99	18.05	11.09	6.97
1999/2000	18.09	11.14	6.96
2000/01	20.29	13.20	7.09
2001/02	19.72	13.78	5.94
2002/03	19.20	14.38	4.82
2003/04	18.83	14.40	4.43
2004/05	20.16	15.30	4.86
2005/06	19.88	15.17	4.71
2006/07	20.67	14.75	5.92
2007/08	22.28	16.03	6.25
Average	19.35	11.83	7.12

Source: Economic Survey1999/00 and 2008/09

Table 4.3 shows that total expenditure has not changed in relation to GDP from the early 1990s to early millennium. Total expenditure as a percentage of GDP) however fluctuates around 19 percent during the period under review. In FY 1992/93 the share was 18.69 percent and reached to 22.28 percent in 2007/08. In FY 2000/01 as an exception the share in reached to 20.29 percent breaking the trend of past years. In an average it remained 19.35 percent during those 16 years. However, remarkable changes are in case of regular expenditure as percent of GDP was just 6.95 percent which reached to 16.03 percent nearly two fold higher, in FY 2007/08. The case of development expenditure is just opposite. Development expenditure as percent of GDP is only 11.74 in the base year which come down to the figure of 6.25 percent nearby two fold less, in FY 2007/08.

Figer 4.2 next page

Thus Table No. 4.3 and figure 4.2 again justifies that fact of increasing regular expenditure and decreasing development expenditure. Decrease in the total expenditure, as a ratio of GDP maybe justifiable under the context of liberalization and privatization. The expansion of private sector and limiting the government activities from the production commercial goods will certainly reduce the share of public expenditure to GDP simply because contribution of public enterprises who are supposed to add to GDP decline. However increasing share of regular expenditure and decreasing that of development expenditure is really alarming sign for developing economics like Nepal. Against the background of low growth rate of the revenue that government expenditure, this is leading to widening resources gap. Accordingly, the increasing share of foreign aid, especially foreign loan in development expenditure for bridging resource gap affects the economy adversely in the long run by forcing repayments of large amounts as principle and interest payments. Government thus, needs to restructure its expenditure pattern and need to revise its policy regarding government expenditure.

4.3 Pattern of public expenditure

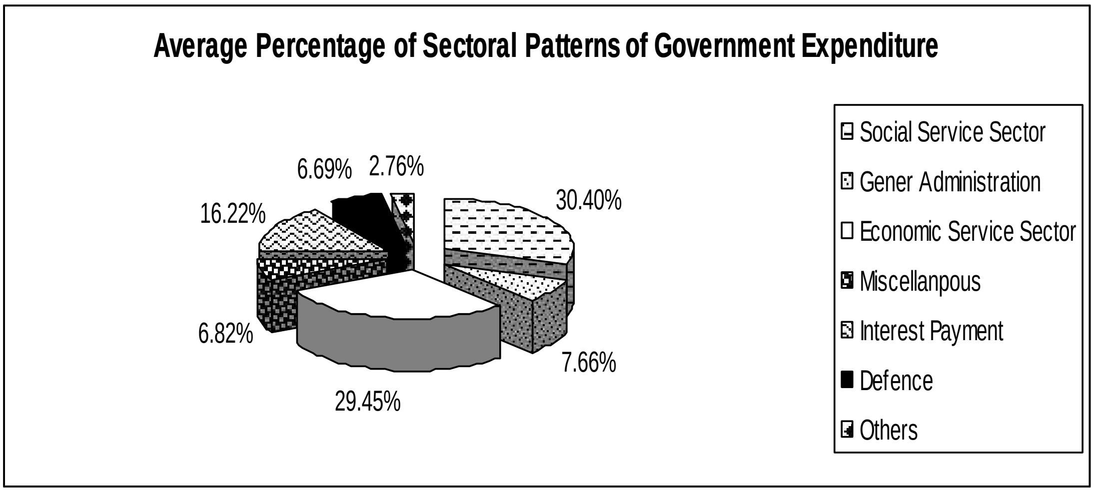
Expenditure pattern shows the degree of priorities of the government regarding various issues/projects. To know the pattern of public expenditure the first attempt should be to go from the viewpoint of sectoral pattern of spending. However, it can be analyzed employing some other ways. It has important implications for the overall effectiveness of the public expenditure programmed. Apart from systematic factors which have contributed significantly too poor expenditure performance in Nepal, the effective of public expending also depends on how resources are allocated among and within sectors (inter and intra sectoral allocations) and how well the allocated resources are used in there sectors. If we look at the sectoral expenditure pattern during the review period, it is found that economic services sectors received the highest share of total expenditure in the beginning years But the share of economic services expenditure had been declining continuously and remained less than that of social services sector in the end period the share of economic service sector stood at 41.10 percent of total expenditure. Reducing continuously it becomes 31.61 percent in 1998/99 and 19.43 percent in2007/08. On the other hand expenditure on social service sector was 27.56 percent in 1992/98 and increased to 34.31 percent in 2007/08. Such result are because of the lack of investment environment in economic infrastructure on the one hand and on the other, government's high priority to social service sector mainly in education to improve the indicator of high literacy rate and enrolment. In an average, economic service sector and social service sector have received 29.45 and 30.4 percent of total expenditure respectively during the review period

Table 4.4 next page

After the social sector and economic sector: Interest payment general administration defense and miscellaneous sector received the large share of expenditure. The shares of these sectors in an average were 16.22, 7.66, 6.69 and 6.82 percent of total expenditure respectively. However, other sectors such as constitutional organs, judicial administration economic administration and planning and foreign service, in an average received less than one percent of total expenditure during the review period.

The share of general administrative expenditure on total expenditure is going continuously from 1992/93 to 2997/08. The main reasons behind this increasing were extension of the activities of the government and increment in administrative cost as a result of insurgency. The expenditure on economic service sector was declining during those periods as the development projects were seriously hampered due to the internal conflict and their high dependency on foreign assistance. Expenditure on social service sectors was on the upward trend as the social sector remained less affected by conflict than other sectors.

Figer 4.3



Source: Table4.4

4.3.1 Pattern of Regular Expenditure

The regular or current expenditure are appropriated and designated as the current out lays on public consumption and revenue expenditures, which create on productive assets such as salaries of employees It includes expenditures on goods and services like wages and salaries, Pensions, interest payments, subsidies, and other current transfer etc. it is made up of from various heads are constitutional organs, general administration revenue and judicial administration, defense, social services, economic services loan repayment and interest, loan and investment and miscellaneous. The pattern of regular expenditure has been presented in table 4.5 into various functional components.

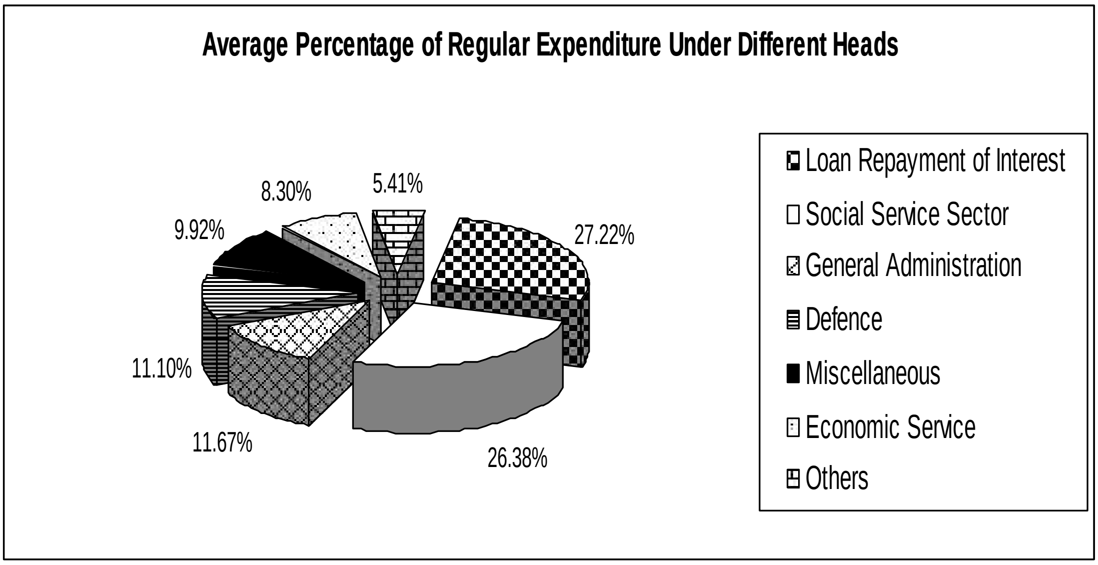
The regular expenditure has increasing trend. As the total regular expenditure increases, the amount of such expenditure distributed in to functional categories are also increases. Loans repayment and interest alone claims at an annual average of 27.22 percent, More then one fourth, of total regular expenditure incurred with in the period, The height share of loan repayment and interest payments shows that bulk of resources is devoted for the maintenance of public enterprises. Ironically, these public institution have be suffering heavy loses every year adding extra burden to government. Next category with substantial amount is the expenditure on social services. Except some initial years, it has stood as one of the major category that claims a large share of total regular expenditure. This has, in an average, a share of nearly 26.38 percent of total regular expenditure. Social services which accounted for only 11 percent in FY 1992/93, jumped up 30 percent in FY 2007/08.

Table 4.5

Data revels that expenditure for constitutional organs was increasing over time. It was only Rs.169.7 million that spent in this heading in the FY 1992/93 and reached Rs.1642.9 million at the end of the study period. But its share on total regular expenditure was 1.5 percent and it decreased to 1.4 percent at in 2007/08 expenditure on general administration was 15.8 percent in FY 1992/93 and dipping to the bottom at 9 percent in1988/99 which again picked up gradually to reach a level of 12 percent in FY 2007/08. Defense expenditure which itself has remained as the center of gravity among the ficklest also claims a large share in the total regular expenditure was around 15 percent, fell sharply to reach the bottom level of 8 percent in 1998/99, which again reached to 10 percent in FY 007/08.

Expenditure under miscellaneous heading on the other hand has a remarkable bearing on the total regular expenditure. The expenditure on loans and investment, economic administration judicial administration and revenue administration accounts for small share in total regular expenditure. In the FY 2007\08 general administration in Rs.13942 million while that of loans and investment is of Rs.6903 million, economic administration of Rs.362 million, judicial administration of RS.950 million and revenue administration of Rs.1180 million.

Figer 4.4



Source: Table4.5

Figure 4.4 shows that loan Repayment and Interest, Social Services Sectors, General administration, Defense, Miscellaneous and economic service sectors received the large share of expenditure. The shares of these sectors in an average were 27.22, 26.38, 11.67, 11.1, 9.92 and 8.3 percent of total regular expenditure respectively. However other sectors such as constitutional organs, judicial administration, economic administration and planning and foreign service, in an average, received less than one percent of total expenditure during the review period.

4.3.2 Pattern of Development Expenditure

Expenditure on development refers to those development activities of the government, which are linked with the expansion of capital formation, social welfare, human resource development etc. It includes the expenditure on the development of economic, social and other sector. The development expenditures are appropriated and designated to add the productive capacity or the capital stock of the country which would raise the "Level of living" of the people expressed in dishes of health, food consumption and nutrition, education, employment and condition of works, housing, social security, clothing, recreation.

The main components of development expenditure include general administration revenue and fiscal administration, economic administration and planning, social services, economic services and miscellaneous.

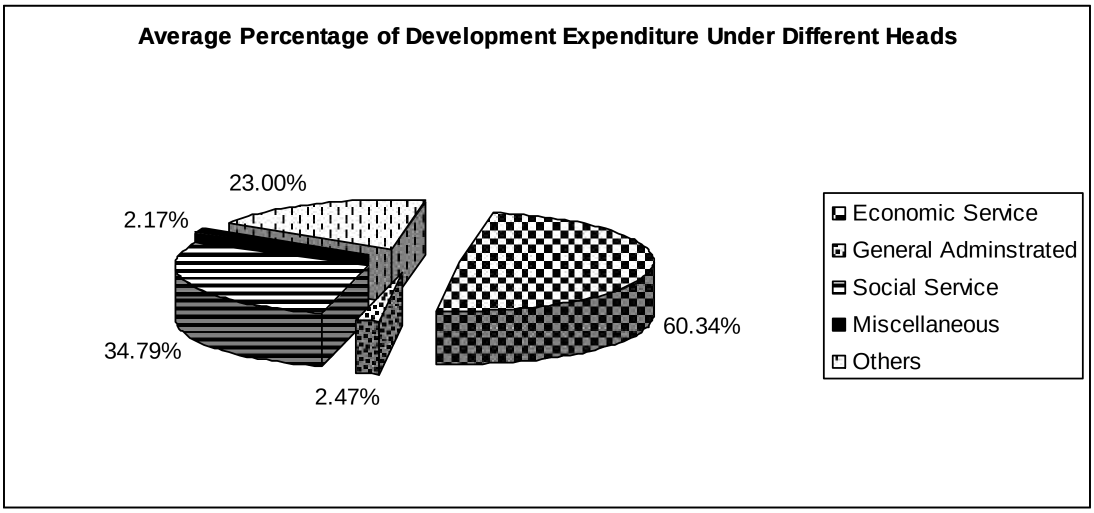
The development expenditure pattern under different major component of development expenditure has been presented in Table 4.6 it exhibits that the expenditure made under the head economic service is substantial; it's because this category comprises subcomponents which hold a substantial share of total development expenditure. Next category is social services, which also command a noticeable share in the development expenditure.

Table 4.6

In FY 1992/93, the expenditure under economic service was Rs.12111.5 million, which reached a peak at Rs.17900.2 millions in FY 1997/78 and then started declining. But the highest amount spent under this head is in FY 2007/08 amounted Rs.22142.7 million. Social services expenditure shows ups and downs in different fiscal year. In FY 1992/93, the share of social services was Rs.7245.5million less than the expenditure on economic services by the amount Rs.4866 million on the same FY. However, in the last year of study under consideration, the share of social service boosted to Rs.20283.6 million and that of economic service reached Rs.22142.7 million of total development expenditure. Expenditure incurred under miscellaneous heading is also significant. Except the FY 1992/93 and 2007/08, the amount allocated under this head is significantly higher than other categories like constitutional organs, general administration and economic administration and planning.

Miscellaneous category has maintained an average of Rs.551.52 million during the period under review, while that average for constitutional organs, general administration and economic administration and planning is just Rs.43.08, Rs.756.53 and Rs.20.91 million respectively during the same period. However other sectors such as constitutional organs and economic administration and Planning, in an average, received less than one percent of total expenditure during the review period.

Figer 4. 5



Source: Table 4.6

Table 4.6 and figure 4.5 highlight some special characteristic. It is seen that economic service and social service expenditure and hold a large share on total development expenditure. The expenditure on the administration reforms side such as spending on constitutional organ, general administration, economic administration and planning also command some amount on development expenditure signifying the reforms process on the administrative side. These will contribute in realizing the efficient as well as good governance with the country. However at the same time the spending under the miscellaneous head leave an open debate about the productivity of such spending. The expenditure must be clearly stated under specific head rather than miscellaneous.

4.4 Inter sectoral expenditure pattern

When considering the budget as a tool for socioeconomic development what matters most is the time pattern of sectoral allocations. Indeed the efficiency of a budget largely depends on inter and intra-sectoral consistency in allocations. This section provides an over view of the inter-scrotal pattern of public resource allocations. It then briefly reviews intra-scrotal priorities and the effectiveness of use of resources with in key sectors. Social sectors (education, health and drinking water); decentralized local development, agriculture, irrigation, transportation and electricity.

An examination of the pattern of expenditure in the study period revealed that total sectoral expenditures, economic and social sectors combined, have had an impressive annual growth rate comparatively; the social sector has an edge over the growth of economic sector.

Total 4.7

Development Expenditure and Respective share of Sub- functional Group of Social Services

Rs in million

FY	Education	Health	Drinking water	Local develop	Total expend.	percent share of TDE			
						E	H	DW	LD
1992/93	3465.0	600.2	1821.4	656.1	19413.6	17.8	3.1	9.4	3.4
1993/94	3822.1	560.5	1073.6	1006.9	21188.2	18.0	2.6	5.1	4.8
1994/95	1453.6	858.5	1102.2	2416.1	19794.9	7.3	4.3	5.6	12.2
1995/96	1791.0	915.5	1206.4	3345.3	24980.5	7.2	3.7	4.8	13.4
1996/97	2356.2	1621.2	1327.1	3622.9	26542.6	8.9	6.1	5.0	13.6
1997/98	2037.1	2076.1	1670.1	3678.8	28943.9	7.0	7.2	5.8	12.7
1998/99	1641.3	1677.2	1866.8	3968.7	28531.3	5.8	5.9	6.5	13.9
1999/2000	2573.7	2126.7	2423.0	4136.7	31749.2	8.1	6.7	7.6	13.0
2000/01	2783.9	1972.4	2407.2	4626.2	37065.9	7.5	5.3	6.5	12.5
2001/02	1103.0	899.3	1418.0	3872.4	31482.2	4.4	3.6	5.7	15.6
2002/03	940.7	159.3	1665.9	4009.4	29033.0	4.2	0.7	7.5	17.9
2003/04	1003.4	142.2	2065.8	3538.8	23095.6	4.3	0.6	8.9	15.3
2004/05	1260.4	409.3	1440.0	4468.6	27340.7	4.6	1.5	5.3	16.3
2005/06	1609.6	948.2	1949.8	4682.4	29606.6	5.4	3.2	6.6	15.8
2006/07	1604.9	1185.5	3182.7	7671.6	39729.9	4.0	3.0	8.0	19.3
2007/08	2963.6	2437.7	3693.5	7885.3	53516.1	5.5	4.5	6.9	14.7
						7.5	3.9	6.6	13.4

Source: - Economic survey 1999/00 and 2008/09 MOF

Table 4.7 takes into accounts only important of social service. In the social sector, local development had the highest growth rate, followed by education, drinking water and health, Before FY 1994/95 highest share was of education in development expenditure. Though the education and health sectors had good growth performances in the 1990 and early of the 2000 the current allocation to these sectors is considered low in relation to the needs of the country and also as compared with other developing countries. There is an increasing trend in the education, health, drinking water and local development .In the fiscal year 1992/93 expenditure under education was Rs.3465.0 million which rose to Rs.2963.6 million in FY 2007/08. Similarly expenditure on health reaches to Rs. 2437.7 million in 2007/08 from Rs.6002 million of FY 1992/93 likewise expenditure on drinking water was Rs.1821.4 million in 1992/93 which rose to 3693.5 million in FY 2007/08. The highest increase is seen in the local development from Rs.656.1 million FY 1992/93 to amount Rs. 7885.3 million in FY 2007/08.

Table No. 4.7, while analyzing the average percentage share in 16 years study period of the selected components of social services to that of development expenditure. It is observed that the highest average percent share is of local development expenditure. The percentage share of local development in an average command 13.4 percent of the total development expenditure. During the same period, the average share of education was 7.5 percent, while that of health and drinking water was of 3.9 percent and 6.6 percent respectively.

Toble 4.8
Development Expenditure and Respective Share of Sub-functional groups of Economic Services.

Rs in million

FY	Agri-culture	Irri-gation	Transportation	Electri-city	Dev. Exp	Percentage share of TDE			
						A	I	T	E
1992/93	2077.2	2017.3	2844.0	2229.1	19413.6	10.7	10.4	14.6	11.5
1993/94	2300.3	3232.1	3363.2	2312.2	21188.2	10.9	15.3	15.6	10.9
1994/95	2639.4	2550.8	3010.6	1764.9	19794.9	13.3	12.9	15.2	8.9
1995/96	2224.0	2884.6	5968.5	2310.2	24980.5	8.9	11.5	23.9	9.2
1996/97	1889.6	2725.6	5305.2	4447.3	26542.6	7.1	10.5	20.0	16.8
1997/98	2144.3	2437.6	5619.9	4704.7	28943.9	7.4	8.4	19.4	16.3
1998/99	1926.3	2940.7	5111.3	4811.3	28531.3	6.8	10.3	17.9	16.9
1999/2000	2089.5	3044.6	4695.4	5537.9	31749.2	6.6	9.6	14.8	17.4
2000/01	2329.5	3959.3	5354.9	6813.7	37065.9	6.3	10.7	14.4	18.4
2001/02	505.4	2913.5	4429.6	4317.9	31482.2	2.0	11.8	17.9	17.6
2002/03	187.0	1840.9	3664.9	3881.6	29033.0	0.8	8.2	16.4	17.4
2003/04	160.2	2070.9	3958.0	4746.2	23095.6	0.7	8.9	17.1	20.5

2004/05	217.5	1921.5	4149.6	7219.1	27340.7	0.8	7.0	15.2	26.4
2005/06	265.4	2462.7	4178.1	6256.4	29606.6	0.9	8.3	14.1	21.1
2006/07	1374.2	3012.6	6382.1	5450.0	39729.9	3.4	7.6	16.1	13.7
2007/08	3211.8	3605.1	7178.9	5847.6	53516.1	6.0	6.7	13.4	10.9
Average Percentage Shave of TDE						5.8	9.9	16.6	15.9

Source: Economic Survey 1999/00 and 2008/09

Table No.4.8, analyzed only four different important subcomponents agriculture, irrigation, transportation and electricity of development expenditure and excluding other components have minor share. It is observed that the highest average percentage share is in transportation which takes average 16.6 percent of total development expenditure the average share of electricity was 15.9 percent. Likewise, that of irrigation and agriculture was 9.9 and 5.8 percent respectively the low spending on agriculture reveals the fact that government is not been able to implement the agriculture perspective plan, which is the master plan of the agriculture development of the country.

In FY 2007/08, total expenditure under economic services head was 41.4 percent the total development expenditure while social service shared 37.9 percent and rest of the category shared 20.7 percent under the assumption of infant private sector, domestic governmental set up justifies the need economic service. The real debate however, should be the productivity of such spending under the different components of social comparison to guarantee the higher field so that the society's major objective of poverty alleviation can be achieved with the desired period.

4.5 Growth of public expenditure

Growth of all total, regular and development expenditure do not show any specific patterns rather are of random attribute. In some FY there are large upswing and in some FY there are large downswing in growth rate of all categories.

Table 4.9

Growth Rate of total, Regular, Development Expenditure and GDP (in %)

Rs in million

FY	Total Exp.	Regular Exp.	Development Exp.	Gross domestic product GDP
1992/93	-	-	-	-
1993/94	8.7	8.1	9.1	15.9
1994/95	16.3	55.3	-6.6	9.6
1995/96	19.2	11.9	26.2	14.2
1996/97	9.0	12.2	6.3	12.6
1997/98	10.6	12.4	9.0	7.5
1998/99	6.2	34.6	-20.3	13.9
1999/00	11.2	11.5	10.8	11.0
2000/01	20.5	27.4	9.4	7.6
2001/02	0.3	7.7	-13.5	3.1
2002/03	4.9	12.4	-12.5	7.7
2003/04	6.5	8.7	-0.1	8.5
2004/05	14.7	13.8	17.4	7.1
2005/06	8.1	8.7	6.2	9.7
2006/07	20.5	12.6	45.8	15.8
2007/08	20.8	21.8	18.3	12.1
Average	11.8	17.2	7.04	10.41

Source: - Economic Survey 1999/00 and 2008/09

The growth rate of total public expenditure on the FY 1993/94 as 8.7 percent. There were maximum growth rate in 2007/08, which becomes 20.8 percent where as there is just 0.3 percent growth rate in 2001/02. Similarly regular expenditure in the begging in the study period was 8.1 percent. It increased to ever highest growth rate in FY 1994/95 of 55.3 percent, which was substantially higher than the decade's average of 17.8 percent. Distinguishing feature of both total and regular expenditure from that of development expenditure is that they never achieves negative growth rate during the study period. In an average, total expenditure increased by 11.8 prevent against 17.3 percent increase in regular expenditure.

The growth rate of development expenditure in the early period of the study was high but there were negative growth rate in the development expenditure in FY 1994/95, 1998/99, 2001/02, 2002/03, 2003/04. In FY 2006/07 there was 45.8 percent of growth rate in development expenditure is occurred which was the highest growth rate achieved during the period of analysis. Similarly there was growth rate of 6.2 percent in FY 2005/06, which drastically has increased positive growth of 45.8 percent in FY 2006/07. The average growth rate of expenditure is 7.04 percent. The growth rate of GDP in FY 1993/94 was 15.9 percent, which is the highest during the study period. The average growth rate of GDP is 10.4 percent.

It can be seen that there are random fluctuations in the all categories discussed so far. The trend, as we saw, falls beyond the established norms of public expenditure management. The increase in regular expenditure in the period under review had led to important consequence that it has preempted much of the limited growth rate in government revenue leaving only a small surplus for financing development activity, which seems to collapse in recent years. The decreasing trend on development expenditure on the other hand is a clear threatens to the social objective of poverty alleviation. But in 2006/07 development expenditure has jumped the splendid step establishing new record of almost 17 percent more than the top growth record it had made in 1995/96.

4.5.1 Growth of Regular Expenditure

The ever growing regular expense has the growth rate differing in different headings in different time schedules Trend of growth rates in each category are of very much eccentric nature.

Table 4.10
Growth rate of Regular Expenditure Categories

Rs in million

FY	General Administration	Defense	Social Service	Economic Service	Loan Repayment & Interest
1992/93	-	-	-	-	-
1993/94	4.6	8.9	6.6	3.28	6.5
1994/95	11.5	6.6	228.3	123.67	25.3
1995/96	18.4	6.3	21.0	13.27	10.4
1996/97	13.3	10.9	9.9	13.35	12.1
1997/98	11.1	9.6	18.4	8.73	2.1
1998/99	8.7	16.0	54.4	137.1	13.5
1999/00	12.5	16.3	18.7	4.53	15.0
2000/01	40.3	9.5	19.9	4.63	3.5
2001/02	31.7	53.7	10.3	18.30	17.5
2002/03	2.7	26.0	11.4	(-) 12.36	32.6
2003/04	(-) 0.1	15.4	10.2	8.55	7.2
2004/05	12.3	29.0	11.5	30.02	13.9
2005/06	12.7	2.9	9.4	5.05	3.4
2006/07	19.5	(-) 1.6	16.2	11.35	12.2
2007/08	25.8	2.2	18.9	9.73	(-) 6.8
Average	15.0	14.1	31.0	25.27	11.2

Source: - Economic Survey 1999/00 and 2008/09

While analyzing the growth rate of various heads of regular expenditure, social services sector has ever positive growth rate. However this rate fluctuates between 5 to 54 percent. The growth rate is negative at 2006/07 in defense. It may occur because of the completion of assembly election, partial settlement of vital rebellion parties, endogenous, ethnic groups and other who were raising the political issue and rights.

4.5.2 Growth Rate of Development Expenditure

Manner of growth trend under development heading is similar to that of regular expenditure.

Table 4.11

Growth rate of Development Expenditure under Different Heads.

Rs in million

FY	Constitutional organs	General Administration	Eco Administration Planning	Social sources	Economic services	Mis cellaneous
1992/93	-	-	-	-	-	-
1993/94	-	7.93	4.28	-1.95	14.28	2056.18
1994/95	-	7.03	62.05	-12.38	7.14	239.92
1995/96	-	24.18	5.06	22.29	32.13	-52.43
1996/97	-	-17.06	-47.89	21.92	0.42	-50.11
1997/98	-	34.49	11.56	11.23	4.96	320.48
1998/99	2025.0	460.12	-89.12	-27.39	-19.83	24.21
1999/00	-55.29	20.93	128.57	15.25	7.78	26.43
2000/01	-44.44	207.28	262.5	-1.73	14.73	-37.08
2001/02	-37.37	-13.23	-56.31	-6.61	-23.57	172.93
2002/03	41.18	-30.63	-51.31	-11.06	-7.38	-50.12
2003/04	119.05	-0.55	140.54	1.19	4.52	-80.34
2004/05	2.45	52.84	171.91	11.29	17.25	152.93
2005/06	154.91	33.74	-16.11	27.84	-3.88	-857.1
2006/07	-52.86	281.82	29.06	52.97	21.23	1552.59
2007/08	111.92	-60.69	204.58	30.61	23.44	306.19
Average	226.45	67.2	50.62	8.9	5.26	248.31

Source: - Economic Survey 1999/00 and 2008/09

Among the development expenditure categories, the higher growth rate has been obtained for miscellaneous services and general administration keeping laggard to the constitutional organs which had the top growth rate in 2005/06.

Economic administration and planning records increment at the moderate rate. As shown in table, miscellaneous services are rising faster rate (248.31 percent per annum) than other services. Higher increase or decrease growth rate of miscellaneous is because of not clear cut oblivious and flexibility of the expenses to avoid and adder any type of uncertainty and urgent issues forwarded by the government. When compared to the capital expenditure of FY 2007/08, capital expenditure for social services increased by 31 percent, that for economic services by 23.4 percent and general administration decreased by- 61 percent (2008/09, MOF)

The expenditure on general administration and economic administration and planning increased at a rate of 67.21 and 50.62 percent per annual, respectively during 1992/93 to 2007/08. An economic service has the lowest rate of growth of nearly 5 percent.

4.6 Trend of Government Expenditure and Revenue

4.6.1 Trend of Government Expenditure

In the initial stage of development, developing country generally faces the problem of supply constrains due to the massive participation of government in development and welfare activities. Due to the growing demand of public good and services, the public expenditure in absolute terms has been growing successively in each year. It has increased tremendously by 422 percent from Rs.0897.7 million in 1992/93 to Rs.161349.9 million in 2007/08. During the period, the government expenditure grew at on annual average of 12 percent with the highest growth rate of 20.8 percent in FY 2007/08.

4.6.2 Trend of Government Revenue

In the 16 years period from 1992/93 to 2007/08, government revenue reported an increasing trend but with the fluctuating growth rate, during the period, the government revenue grew at an annual average of 14.2 percent with the height growth rate of 29.3 percent in FY 1993/94 and the lowest of 3.1 percent in FY 2005/06. In most of the review years, revenue recorded a double-digit growth rate while the snail-pace growth of the economy is one major reasons for low growth rate of revenue mobilization, the declaration in tax revenue especially customs revenue is the other.

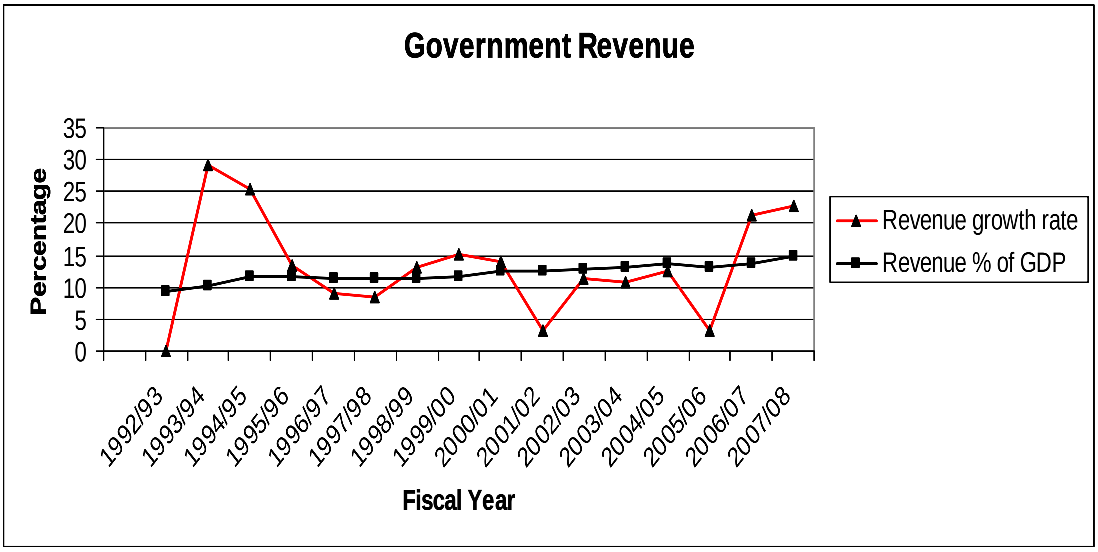
Table 4.12
Government Revenue

Rs in million

FY	GDP(Rs in million)	Revenue			Revenue growth rate	Revenue as % of TE	Revenue % of GDP
		Tax	Non - tax	Total			
1992/93	165350	11662.5	3485.9	15148.4	-	49.0	9.2
1993/94	191596	1531.5	4209.4	19580.9	29.2	58.3	10.2
1994/95	209974	19660.0	4945.1	24575.2	25.5	62.9	11.7
1995/96	239388	21668.0	6225.1	27.893.1	13.5	59.9	11.7
1996/97	26957-	24424.3	5949.2	30373.5	8.9	59.9	11.3
1997/98	289798	25939.8	6998.1	32937.9	8.4	58.7	11.4
1998/99	330018	28752.9	8504.5	37257.4	13.1	62.5	11.3
1999/00	366251	33152.2	9741.6	42893.8	15.1	64.7	11.7
2000/01	394052	38865.0	10028.6	48893.6	14.0	61.2	12.4
2001/02	40618	39330.6	11114.9	50445.5	3.2	63.0	12.4
2002/03	437546	42586.9	13642.9	56229.9	11.5	66.9	12.9
2003/04	474919	48175.7	14155.3	62331.0	10.9	69.7	13.1
2004/05	503651	54104.8	16018.0	70122.7	12.5	68.4	13.8
2005/06	557870	57427.0	14855.1	72282.1	3.1	65.2	13.0
2006/07	646159	71126.7	16585.5	87712.1	21.3	65.6	13.6
2007/08	724286	85155.5	22467.0	107622.5	22.7	66.7	14.9

Source: - Economic Survey 1999/00 and 2008/09

Figure 4.6



Source: Table 4.12

In 1992/93, the government revenue stood at Rs 15148.4, million, amongst which Rs.11662.5 million from tax revenue and the remaining Rs.3485.9 million collected from non-tax sources. In FY 2007/08, the government revenue increased to Rs.107622.5 million, with the contribution of tax revenue being Rs.85155.5 million. The share of non-tax revenue reached to Rs. 224670 million. The proportion of government revenue was 9.2 percent of GDP in FY 1992/93, and in 2007/08, this was 14.9 percent of GDP. This indicates that though, the public receipt from revenue has been increasing, it has not been able to contribute significantly to the GDP.

4.7 Trend of Resource Gap

The massive governmental participation in developmental programmes demands huge amount of public expenditure. If the revenue for these activities is not sufficient to meet the amount of government expenditure, resource gap then comes into existence. There are two types of resource gap: a) Domestic resource gap and b) Overall resource gap. Domestic resource gap is the amount of net deficit of resource or revenue after meeting expenditure. Here we exclude the contribution made by the foreign grants. But in overall resource gap, we include the contributions made by foreign grants in financing the public expenditure.

As we see on the table the amount of domestic resource gap has also been growing continuously. In the FY 1992/93, the gap was Rs 15749.3 million coming to the fiscal year of the study, the gap has grown to Rs 53727.4 million that is 3 times greater than the first year of review period, the percentage of Domestic Resource Gap to GDP however shows a fluctuating trend. The percentage is as highest as 9.52 percent in the year 1992/93 and as lowest as 5.71 percent in the year 2003/04.

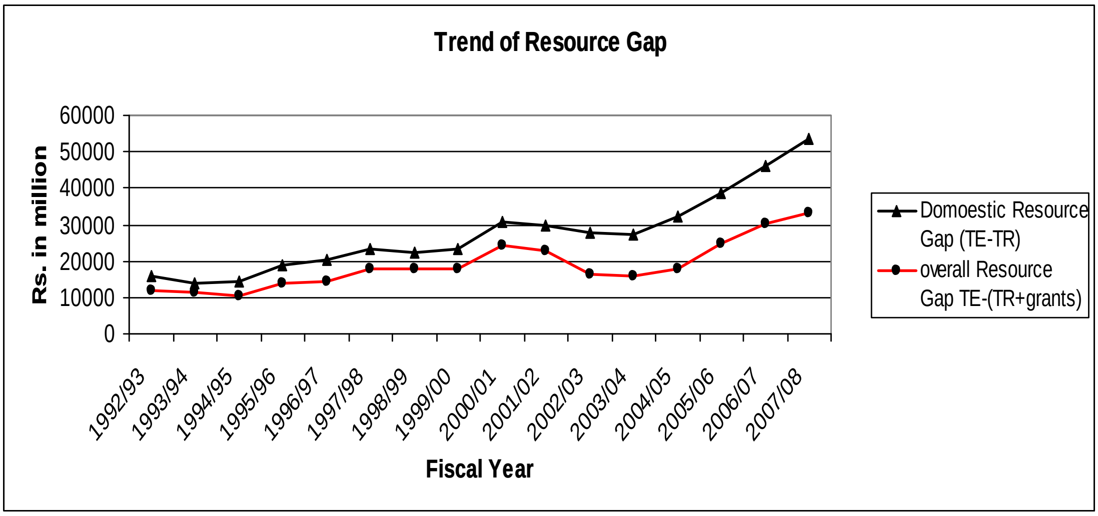
Table 4.13
Trend of Resource Gap

Rs in million

FY	GDP	Domestic Resource Gap (TE-TR)	Overall Resource Gap TE-(TR+ grants)	Domestic Resource Gap as % of GDP	Overall Resource Gap as % of GDP
1992/93	165350	15749.3	11956.0	9.52	7.23
1993/94	191596	14016.6	11623.0	7.32	6.07
1994/95	209974	14484.9	10547.7	6.90	5.02
1995/96	239388	18649.3	13824.2	7.79	5.77
1996/97	269570	20350.2	14361.9	7.55	5.33
1997/98	289798	23180.4	17777.8	8.00	6.13
1998/99	330018	22321.6	17991.4	6.77	5.45
1999/00	366251	23378.7	17667.0	6.38	4.82
2000/01	394052	30941.5	24188.1	7.85	6.14
2001/02	406138	29626.7	22940.6	7.30	5.65
2002/03	437546	27776.3	16437.1	6.35	3.76
2003/04	474919	27111.6	15829.2	5.71	3.33
2004/05	508651	32437.8	18046.6	6.38	3.55
2005/06	557870	38697.1	24779.6	6.92	4.44
2006/07	646159	45892.5	30091.7	7.1	4.66
2007/08	724286	53727.4	33406.7	7.42	4.61

Source: Economic Survey 2008/09

Figure 4.7



Source: Table -4.13

The overall resource gap also shows the same trend as the domestic resource gap. In the FY2007/08, the overall resource gap has increased by 2.79 times it as in the FY 1992/93. The percentage of GDP has declined during the review period; however, marginal increases during some years were noticed. In the FY 2007/08, the percentage has declined to 4.61 percent of GDP. The gap between fiscal and overall resource gap is of growing tendency.

In the table 4.13 it is seen that, though the total revenue in absolute term is in increasing trend, at the same time the size & magnitude if total deficit has increased overtime. This increasing trend of resource gap resembles that ceteris paribus, either the resources have been diverted toward the non- productive type of recurrent expenditures or the pattern of investment has been such that due return could not come within a short span of tine in order to release the resources through the induce and spill over effect in the economy. True, foreign aid has helped considerably to overcome the problem of resource gap but from the broader economic perspective it seems that foreign aid, which constitutes major source of development expenditure, has not been highly helpful in sustaining the process of economic growth and development either. Therefore, it Rs. pertinent to extend our discussion on the existing public expenditure policies and general repercussion on the economy.

4.8 Trend of Deficit Financing

The trend of deficit financing shows that a major portion of it has been financed through external loans. External loan financed as low as 26.88 percent to as high as 78.84 percent of total deficit during the study period. The share of foreign loan, however, has been declining in last years of the review period. Before 2000/01 its share in total deficit has not been less than 50 percent. However coming to the recent periods, the share has declined where as that of share of internal source in total deficit has risen. The share of external sources has been fallen from 4.2 percent in 1992/93 to 1.24 percent in 2007/08.

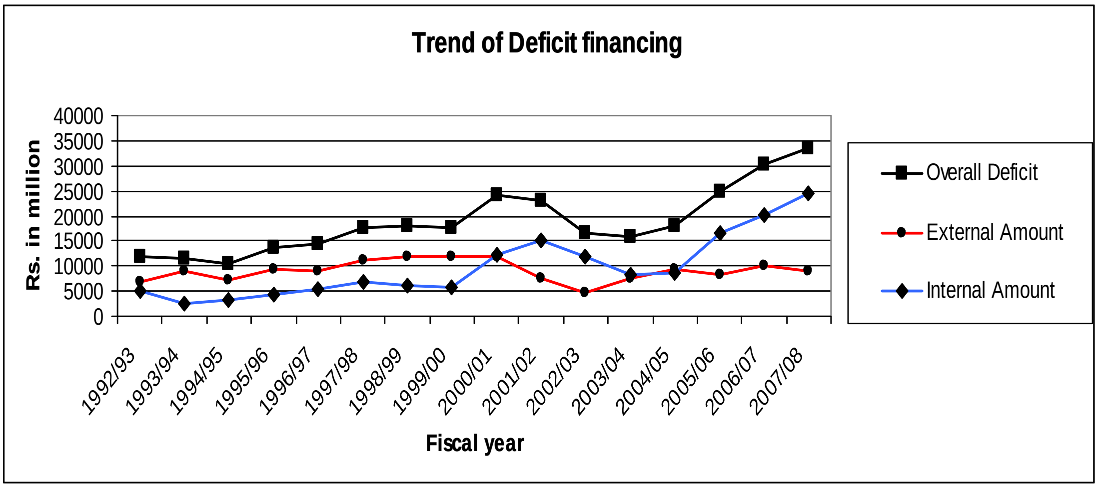
Table 4.14
Trend of Deficit financing

Rs in million

FY	Overall Resource Gap(ORG)	External Sources Foreign Loan			Internal Sources Borrowing Plus Cash Balance		
		Amount	% of ORG	% of GDP	Amount	% of ORG	% of GDP
1992/93	11956.0	6920.9	57.89	4.19	5035.1	42.11	3.05
1993/94	11623.0	9163.6	78.84	f.78	2459.4	21.16	1.28
1994/95	10547.4	7312.3	69.33	3.48	3235.4	30.67	1.54
1995/96	13824.2	9463.9	68.46	3.95	4360.3	31.54	1.82
1996/97	14361.9	9043.6	62.97	3.35	5318.3	37.03	1.97
1997/98	17777.8	11054.5	62.18	3.81	6723.3	37.82	2.32
1998/99	17991.4	11852.4	65.88	3.59	6139.0	34.12	1.86
1999/00	17667.0	11812.2	66.86	3.23	5854.8	33.14	1.68
2000/01	24188.1	12044.0	49.79	3.06	12144.1	50.21	3.08
2001/02	22940.6	7698.7	33.56	1.90	15242.0	66.44	3.75
2002/03	16437.1	4546.4	27.66	1.04	11890.7	72.34	2.72
2003/04	15828.2	7629.0	48.20	1.61	8199.5	51.80	1.73
2004/05	18046.6	9266.1	51.35	1.82	8780.4	48.65	1.73
2005/06	24779.6	8214.3	33.15	1.47	16565.3	66.85	1.27
2006/07	30091.7	10053.5	33.41	1.56	20038.3	66.59	3.10
2007/08	33406.7	8979.9	26.88	1.24	24426.8	73.12	3.37

Source: Economic Survey 2008/09

Figure 4.8



Source: Table 4.14

The account of internal sources presents low performance as compared to the external sector assistance in the economy. The contribution of internal borrowing plus cash balance was 42.11 percent of total deficit and 3.05 percent of GDP in the initial year. We can observe fluctuations in the trend of internal source financing. Internal source financed as low as 21.16 percent of total deficit and 1.27 percent of GDP to as high as 73.12 percent of total deficit and 3.75 percent of GDP during the review period.

4.9 Concluding Remarks

During the study period, from FY1992/93 to 2007/08 the analysis of data revels that there has been increasing trend of public expenditure in Nepal. In the first part of the study period, the percentage share of regular expenditure total expenditure was smaller than development expenditure. However this condition reversed in the latter part of study. The raising share in regular expenditure is witnessed in loan repayment and interests. Incase of total development expenditure, economic service, social service and miscellaneous services hold substantial share in total development expenditure public sector expansion has been maintained either through the internal resource mobilization efforts or through the increasing inflow of foreign resources the low resource mobilization and increasing trend in public expenditure has led to alternatively narrowing Revenue Surplus.

CHAPTER-FIVE
AN ANALYSIS OF PUBLIC EXPENDITURE

5.1 Introduction

In the developing countries, like Nepal private sector is not well developed. So the public expenditure increases with its government's increasing activities. When market works perfectly, price mechanism will solve the basic economic problem of what, how and to whom to produce. Government intervention, however, does not necessarily provide a guarantee that society will benefit form such action. Government failure may be as common as market failure. Tight budgets, high cost of rising revenue (particularly the administrative, and distortion costs of taxation) and a multiplicity of claims on the public purse, dictate the government activity and demonstrates its ability to add tangibly to the economy. Expecting countries with low capability and few resources to undertake more complicated redistributive functions such as providing social safety nets (health care and retirement) could be order to fill. Improving government performance requires, among other things sustained commitment of a political support from key, governmental and societal players and a realistic time frame to carry out appropriately sequenced reforms. Incremental changes are better than no changes, but far-reaching institutional reforms take time. The impact of public expenditure on GDP can be analyzed by establishing some models (Linear model, log-line model, line-log model and log linear model).Though each model carries its own merits and demerits. Emphasis is given to the log linear model for two reasons. Firstly, the results are found quite close to each other. In additions log linear model gives directly elastic ties that are easier to interpret.

5.2 Public expenditure and GDP

This relation examines the impact of total expenditure regular expenditure and development expenditure on GDP. The null hypothesis set for this purpose is that there is on significant relationship between public expenditure (S) and GDP. Ordinary least square (OLS) method is applied to estimate the relevant regression equation various statically tests like t-test, F-test, DW test R- squared, Adjusted squared, are used to verify the relationship.

5.2.1 Total Expenditure (TE) and GDP

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

In GDP= 4.032+ 0.904 In TE

(7.894) * (44.191) *

R^2 = 0.993 Adj. R^2 = 0.992 F- test = 1952.815

DW = 1.676

Figure in parenthesis indicate t-value

* Significant at 1 percent or better level.

Equation shows that there is positive relationship between GDP and total expenditure. The sign of regression coefficient is positive (0.904) telling that one percent charge in total expenditure will induce to have 0.90 percent change in GDP. As the value of R^2 and Adj R^2 are very high. It represents the high goodness of fit 99.2 percent change in GDP is explained by the change in total expenditure. The value of t-test represents the significance of the result. The high f-value supports the over all fitness of the model which is about 1952.815 the DW test result indicates that there is positive auto correlation among the errors terms.

5.2.2 Regular expenditure (RE) and (GDP)

To examine the relationship between regular expenditure and GDP linear regression models are estimated following equation verify the impact of change in regular expenditure on change in GDP.

In GDP = 11.894 +0.602 In RE

(2.6242) * (30.478)*

R^2 = 0.985 Adj. R^2 =0.984 F-test = 92.904

DW = 1.511

The figures in parenthesis indicate t-value.

Equation shows that there is positive relationship between GDP and regular expenditure. The sign of regression coefficient is positive (0.602) telling that one percent change in regular expenditure will induce to have 0.60 percent change in GDP. As the values of R^2 and Adj.R^2 are very high. It represents the high goodness of fit of regression line. That is the value of R^2 is high enough to justify the 98.5 percent change in GDP is explained by the change in regular expenditure. The value of t-test represents the significance of the result. The high F- value supports the same result, i.e. the variable in the equation shows a better association. The DW test result indicates that there is positive autocorrelation among the errors terms.

5.2.3 Development Expenditure and GDP

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

In GDP = -3.916 +1.27 in DE

(-0.426) (3.322)**

R_2 = 0.441 Adj. R^2 = 0.401, F-test = 11.033

DW = 0.309

The figures in parenthesis indicate t-value

* Significant at 5 percent or better level.

Equation shows that there is positive relationship between GDP and development expenditure. The sign of regression coefficient is greater than unity. It implies that hundred percent increases in development expenditure will increase GDP by 127.4 percent the value of R^2 and Adj. R^2 reveals the fact that about 44.1 percent change in GDP is explained by change in development expenditure. The F- value supports for the overall fitness of the model which is 11.038. The DW test result indicates that there positive autocorrelation.

5.3 Concluding Remarks

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

CHAPTER- SIX

SUMMARY OF MAJOR FINDINGS, CONCLUSION AND RECOMMENDATIONS

6.1 Conclusion

Public expenditure programs are the main viable sources of expanding the production base of the economy. The very slow process of structural change, low rate of capital accumulation and non-significant change in employment pattern indicate that Nepalese economy has not been still able in advancing towards sustained growth. This study is primarily confined to the analysis of trend and pattern of public expenditure and impact of public expenditure on GDP during the period 1992/93 to 2007/08.The trend and pattern of public expenditure threaten the fiscal discipline and management. There are many factors giving rise to the increasing trend of regular expenditure rather than development expenditure. The impact of public expenditure on GDP is analyzed by establishing some models.

The regular expenditure has surpassed the development expenditure as against the accepted fiscal norms. Development expenditures exceed the regular expenditure until FY 1997/98, than after it is lesser than regular expenditure. The pattern on public expenditure clearly justifies the fact that social service and economic service categories hold substantial amount of total public expenditure under development expenditure where as general administration, interest, payment, loan repayment and defiance claims a large share over regular expenditure. However the threat to the social objectives of poverty alleviation has been caused from high burden of defense expenditures, loan repayment and general administration expenditure. The rapid growth of regular expenditure on later years of study period can be attributed to the increasing expenses on defense. Another important aspect is that a substantial amount is allocated for the salaries, wage categories (e.g. general administration, foreign services, constitutional organs, judicial administration etc.) which have left a little amount for other categories like social service expenditure, economic service expenditure and mainly for the organization and management. In effect allocations for operations and maintenance activities in the regular budget have been higher inadequate. The over all pattern, thus, corresponds to the fact that public expenditure is mainly diverted to the consumption type only instead of capital expenditure.

Economic and social service expenditures hold a large share on total expenditure. The analyze of the different component of social service, which hold a large share in total expenditure lead to conclude that greater concentration have been provided to education followed by local development health and drinking water respectively. Among the economic service categories, it is found major chunk of resources has been devoted to electricity followed by transportation, irrigation agriculture respectively.

The growth of public expenditure in Nepal is taking a rapid tempo. The growth rate of revenue is lower than that of government expenditure during the study period leading to widening resources gap. The over riding trend on the public expenditure reflects alarming situation with regard to fiscal discipline and the overall development program of the country. The massive investment in each successive plan and annual budget of rapid expansion of economic and social infrastructure leads to the increase in government expenditure. It leads the country to continue in the low level of equilibrium trap. With this background, the study of the trends and patterns of government expenditure, revenue and budget deficits leads us to conclude that the slow pace of revenue collection compared to expenditure growth has been creating fiscal imbalance for which the nation has to depend upon foreign assistance. Due to the tendency of declining foreign grants and increasing foreign loans, the debt burden of Nepal has been increasing, with almost one-third of the regular expenditure to be allocated for the debt service. If fiscal imbalances increase continuously over the coming years, or debt stock as well as debt service payments increase steadily emptying Nepal's narrow coffer, there would be problems for earmarking resources for productive projects while complying with the need for maintaining macroeconomic stability.

Nepal's budgetary process has been highly unrealistic. In almost all the years in the review period, the budget targets have been set at unduly high levels, particularly for the revenue and foreign aid. This over estimation of resources has in turn enables the Government of Nepal to set similar unrealistic targets for the development budget and to accommodate too many projects. However, actual budget outcome fell significantly short of the optimistic expectations every year. Among the expenditures, regular expenditure has been increasing rapidly due to the growing burden of debt service payments, maintaining law and order and providing salary to civil servants. Growing regular expenditure has been narrowing the revenue surplus necessary to finance development expenditure.

As the government has to resort to both foreign and international borrowing to finance fiscal deficit, higher fiscal deficit has many implications on the economy including creating a liability to the nation. The trend of sources of financing the deficits shows that a major part of it has been financed through external sources but from FY 2000/01 to 20007/08 contribution of internal sources is higher. There is a haphazard flow and use of foreign aid. Such situation has been creating aid dependency syndrome in the Nepalese economy.

In a nutshell, the trend, structure and impact of public expenditure on GDP during the period under review show a miserable situation with regard to fiscal discipline and management. The regular expenditure is excessively increasing where the total revenue is unable to meet the current expenditure. It is a clear threat to the nation's long term objective of poverty alleviation. Moreover, the exercise dependence on foreign aid especially foreign loan will certainly pull the country to debt trap in the long run. The important consideration in Nepalese resource allocation practice is the highly buoyant public expenditure with respect to foreign aid. Many projects are implemented with the funding of donor agencies. The donor agencies are too much involved in the decision making. So many difficulties are created in the implementation and completion of the projects.

6.2 Recommendation

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

1) The rapid growth in regular expenditure especially over few years can be attributed to the increase in defense expenditure. Though, peace is the necessary condition for economic growth and development for the country like Nepal which has lost its productive capacity to respond to the sustained economic growth, there must be cut in defense expenditure and should be allocated to social and economic sectors.
2) Social sector development is needed to upgrade the quality of life pattern and for rapid economic growth sub-section of social sectors such as basic education, health, safe drinking water should be accorded high priority because of their significant role in human capacity development and their determining position in human development which directly effect poverty alleviation.
3) It is found that a substantial part of internal resources are utilized in financing consumption type of expenditure under the regular expanses. In effect, it has very little recourses left to public investment especially in economic and social service front. Accordingly the dependence on foreign aid has increased for financing development activities. So it is necessary to reduce consumption type of public expenditure in order to promote the capital accumulation process. In overall, the development expenditure must be increased.
4) 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 similarly; unnecessary regular expenditure should be discouraged.
5) Government should choose major priority sector that generate income and should spend on those sectors on planned basis.
6) Public expenditure should be best allocated for the development of transpiration, communication and social service in order to reduce

geographical fragmentation and increase the profitability of private investment as well as by extending the size of the market, skill and efficiency of labor.

7) Development projects should be screened based on cost-benefits analysis. To streamline the development budget and minimize the waste of resources associated with over programming. It is essential to ensure greater realism in resource forecasting.

8) Administrative cost control systems through setting up of clear expenditure norms should be strengthened.

9) Financial management and internal auditing system should be improved.

10) Political stability.

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