CHAPTER ONE

INTRODUCTION

1.1 General Back ground

Nepal is least developed country in the world where per capita income is only US 320 dollar (World Development Report, 2008). According to Nepal Living Standard Survey 2003/04, 30.85 percent of the population of Nepal falls below the poverty line. Similarly, on the basis of the survey's benchmark of one dollar a day as per the purchasing power, 24 percent of the total population falls below the poverty line. Consequence, living standard of the general people is deteriorating every year, though large amount of money is spending from government and government sector to uplift the living standard of the people. This situation mainly occurs due to slow growth of gross domestic product (GDP) as compared to the rate of inflation Sharma, thus, advocates the necessity of the sound budget reflecting the annual plans programs and strategies of the government for the development of the nation (Sharma, 1999).

In spite of the efforts of planned economic development in recent years, most of the underdeveloped countries have failed to achieve a substantial rise in their rate of growth. The world Economic Survey in 1966 has pointed out that it growth rates are to be accelerated; more resources will have to be devoted to investment. Moreover, the task of raising saving levels in low income countries and generating an adequate volume of external purchasing power in countries most of whose export face a relatively unresponsive demand pose a formidable challenge (UN, 1966). The experience of development planning in their economies has also revealed the fact that capital resources alone are not enough for bringing about a satisfactory rate of growth. These countries have become more and more convinced that, as stated in Economic Survey of Asia and Far East, "Improvement in their human resources, in the form of more active participation of the masses in improving the social, economic and political situation and structure of sound planning and policy making of better leadership, organization and administration, of higher incentives in taking risk

and introduction improved production methods and acquiring a sustained and accelerated economic development with a minimum of friction and bottlenecks (UN, 1965)"

Public expenditure is the most important instrument of fiscal policy. These days government expenditure forms a very important part of the total expenditure in the economy and an increase or a decrease in it can cause significant variations in income, output and employment. Any increase in government spending is higher times effect in economy. Similarly, a decline in government spending will get in operation of multiplier in the back ward direction.

The main goal of government is to provide maximum social welfare to the people and economic stabilization. To meet this goal all government is trying to develop their economy and to accelerate economic growth sustainable. The government has been widening its activities in economic and social spheres and is trying to help the country in its economic growth.

The classical economists thought that the public expenditure should be low. Because they did not give importance on the role of the government and they were in the favor of an independent economy without any government interference. But after the great depression of 1930s, Keynes opposed the classic notion and assigns an important role of the government in economic management. He emphasizes the government should increase its expenditure and spend more on public works. So government should increase its expenditure and spend more on public works so that addition resources can be employed and this will remove the depression and unemployment. Hence, with the Keynesian revolution, the scope of public expenditure has been greatly enlarged.

In recent times, public expenditure has increased enormously. The main reason is that the functions of the state have increased manifold. With the concept of welfare state and federal state the government has to provide not only social security but it has also to look at economic stability and economic growth which calls for ever increasing investment expenditure.

In Nepal, after the inception of democratic system in 1951, public sectors activities started to take place prior to that the Rana's family rule prevailed which rarely made an attempt to expand public sector activities with welfare prospective. However the allocation of resource practices were adopted only after period plan started in the country followed by the initiation of Budget (Khanal: 1988)

The main sources of government resources are revenue through taxation. Government either imposes tax to the particular income groups and collects the resources as direct revenue or imposes the tax to production or consumption activities and collects resources as indirect tax, which turn convert public expenditure i.e. distribution income. So, the public expenditure is not only because a direct instrument of economic development but also a prerequisite to increased participation of the private capital in the development process.

Thus, the size of public expenditure has been increasing in the world today. Both the developed as well as under developed countries emphasize the public expenditure on development activities by which the nation can move towards the path of prosperity and welfare state.

1.2 Statement of the Problem

Since 1956, Nepal has started planned process of economic development. But the basic issue of the country has remained the same. There are many causes to create the problems keeping the country in the poor conditions such as, the massive poverty, the political condition, low per capita income, low rate of saving, low rate of investment, low productivity, capital deficiency, population pressure, agriculture dominant economy, low living standard, illiteracy, higher unemployment, technological backwardness, low participation of the private sector, decreasing the rate of foreign aid, lack of better utilization of foreign aid. According to the present content of our country, the main cause to create the problem is internal conflict which had been started since 1996. This ongoing conflict caused the lost of about 15000 lives and billion rupees worth

of physical capital. Besides this direct and explicit cost, there are indirect hidden economic costs, which have reduced the overall growth path of the country that is there has been a lower level of domestic investment, which retards further economic growth and development.

Through the budget speech, every year the government sets the goal of economic development and growth and also announces the strategy and programs to achieve it. The activities of the government are, than, directed towards achieving the targets of the years. After legislating the first annual budget in 1952, this process has become a routine practice in Nepal. However even fifty three years of experience, Nepal has not been able to achieve a satisfactory economic growth. This can be judge from various development indicators. For instance, population below poverty line, literacy rate are still very high, and about forty percent of GDP is covered by agriculture which is still depend on weather.

According to budget and the spending system of the government, there is a deviation in budgeted and the actual spending of the government. The actual public expenditure can be attributed to a few factors. Firstly, resources may not have been allocated realistically, and at times there seems to be very ambitious allocation of the resources. Secondly, the government has not been able to develop the mechanism to utilize the allocated resources to the extent desired on various programs. In practice, the late released of development budget provided only a few months to the government for investment. The government therefore does not have sufficient time to run projects, and implement programs. Another factor for not attaining the target relates to foreign aid. This is because the donor’s couldn’t provide the committed foreign aid to the government. Since the government could not contribute the counterpart fund by itself according to commitment. A large chunk of revenue has been utilized in the repayment of principal and interest, regular expenditures, internal securities and the salaries and other allowances of government employs as regular

expenditure. A very small amount has been left for the development expenditure.

Nepal is certainly a developing country. The economic and social diseases are prevailing in every parts of our country. There is the problem of mass disguised unemployment. People are gradually reaching to the poverty line. There is no option but to mobilize the scarce public resources right direction to achieve a sound and balance growth of all sectors of our economy. In any under-developed country where even the basis infra- structure for economic development have not been created, there is no other way than the act of public expenditure which is responsible to create all the sound bases for economic development public expenditure which is responsible for increasing the rate of economic growth, provides equity and stabilize the economy.

Nepal is characterized by extreme inequalities of income and wealth. Public expenditure tends to lessen them. Expenditure on education, public health and medical facilities helps in human capital formation. Thus public expenditure is one of the most important to instruments for accelerating development in underdeveloped countries. This study tries to find out various measures and possible suggestion which may be helpful in public expenditure of Nepal.

1.3 Objectives of the Study

The basic objectives of this study are to achieve following purposes:

a) To analyze the trend and structure of government expenditure
b) To examine the effect of government expenditure on output (GDP).
c) To suggest the appropriate policy and recommendations.

1.4 Significance of the Study

Public expenditure plays an active role in promoting economic development of underdeveloped countries. It promotes economic development directly by developing social overheads and infrastructure, establishing capital goods industries and providing welfare schemes.

Public expenditure helps in reducing inequalities of income in the country.

Various welfare measures such as free education, health, water etc and numerous social security schemes such as old age pension, medical insurance etc. have helped in reducing inequalities. Public expenditure also plays an important part in reducing regional disparities.

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

1.5 Limitation of the Study

The study is subject to the following limitations

- The study is based on the published secondary data and information and does not attempt to examine the reliability of those data.
- This study covers only the periods 1980/81 to 2006/07 and it's due to the availability of data.
- This study specially covers public expenditure and economic development in Nepal, but it does not study the organizational aspect and other aspects of Nepal's government.

1.6 Organization of the Study

There are seven chapters in the study and each chapter is farther divided into various sub-sections. The first chapter which is the introductionary portion gives a general background of the whole study. The second chapter attempts to literature review. All reviews of literatures are made both in the national and international level as far as possible. The methodology constitutes the third chapter which provides information regarding the types and sources of data used in the study. The forth chapter provides the prominent theories and articles relevant to the subject of the study. The fifth chapter deals with trend and structure of public expenditure which describes the overall trend and

structure of public expenditure of the study period 1980/81 to 2006/07. The trend and structure of public expenditure are analyzed in tables. Chapter Six describes of analysis of effects of government expenditure on GDP. Some models are established to show the effect of government expenditure on output. Chapter Seven describes summary, conclusions and recommendations.

CHAPTER TWO

REVIEW OF LITERATURE

2.1 Introduction

Public sector occupies a significant place to achieve systematic and planned growth especially in the underdeveloped countries like Nepal. Nepal is in the grip of vicious circle of poverty. To get ride of it and accelerate the pace of economic development, a rapid rate of capital accumulation is immediately required. Nepal is heavily dependent upon external resources as well as mobilization of domestic resources for capital formation in the economy.

In modern times, the public expenditure of the government is increasing very rapidly as compared to increase in their income resources. It is due to the rapid increase in the services of the government. It results in deficit in the budget.

There was little attention paid by the classical Economists to the field of public expenditure in economic literature. They thought that the government expenditure is wasteful and that money can be used by private persons than by the government. After the great depression of 1930's, J.M. Keynes brought a new Economic thought Keynes and his follower has expressed that the public expenditure plays a pioneer to achieve the definite ends. Then, this theory arouses the interest of the various Economists in research of the positive theory of public expenditure growth, its pattern and changes.

2.2 International context:

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

Cashin (1995) has developed an endogenous growth model of the influence of public investment, public transfers, and distortionary taxation on the rate of economic growth. The policy implication arising from the paper on government spending, taxes and economic growth are straightforward. Increased government spending on those items that enter private production function as productive public input enhances economic growth. Examples of such productive public spending include investment and (intragenerational and intergenerational) transfer payments, both of which generate positive externalities that raise private investment and thus economic growth. However, the size of the government is limited by the need to fund such public spending by the levying of distortionary taxes, which reduce the marginal return to private capital, and so dampen economic growth. A clear implication of the theoretical and empirical work presented in the paper was the significant trade-offs involved in considering the various contributions of the government to the economic growth of nations.

United Nations (1996) analyzed the role of public expenditure in the provision of social services focusing mainly on education, health, water supply, and sanitation and the housing sector. The United Nations reported that allocation to the education sector continued to constitute the largest share of the government budget devoted to social services in the developing countries of the Economic and Social Commission for Asia and the Pacific (ESCAP) region. In Pakistan, expenditure on education as a proportion of the total public sector expenditure increased from 5.9 percent in 1975 to 7.4 percent in 1993, while in china this proportion increased from 13.8 percent in 1985 to 14.9 percent in 1993. In Nepal, the share of education sector in total development expenditure increased from 14.2 percent in 1986 to 18.7 percent in 1994. A recent World Bank study of the Lao people's Democratic Republic has show that although the percentage of public expenditure on education fluctuated between 1987/88 and 1993/94, expenditure in per capita terms increased steadily from $ 1.09 to $ 13 during the same period.

Expenditure on health services accounts for the second largest share within the social services sector, constituting less than 10 percent of the total government expenditure in

all countries around 1990. The share of the health sector in the total government budget declined from 4.1 to 3.3 percent between 1985 and 1991 in the Philippines. In Nepal, it declined from 4.1 to 3 percent between 1986 and 1994. Further, the survey pointed out relatively low priority given to housing sector in most countries of the region.

Until recently, governments have also accorded a very low priority to water supply and sanitation. However, around 1990, this sub sector received the largest share of funds directed to social services in Hong Kong, India and Maldives and the second largest share in Malaysia, Myanmar, Nepal and Singapore.

Table: 2.1

Central ASIAN Republics: Public Expenditure on Social Sectors and Achievement Indicators:

Countries	Crude Death Rate 1990-1995	Infant Mortality Rate 1990-1995	Life expectancy at birth 1990-1995		Adult Literacy Rate 1990		Public expenditure and social sectors as a percentage of GDP	
			Males	Females	Males	Females	Percent	Year
Armenia	6.5	21	69.5	75.5	99	98	21.4	1993
Azerbaijan	6.4	28	66.5	74.5	98	96	16.9	1992
Kazakhstan	7.5	30	65	73.9	89	98	8.1	1994
Kyrgyzstan	6.9	35	65	72.9	98	94	14.2	1994
Tajikistan	6.1	48	67.3	73	98	97	--	
Turkmenistan	7.5	57	61.5	68.5	99	97	22.4	1991
Uzbekistan	6.2	41	66	72.2	98	96	39.6	1992

Note: The social sector includes education, health and social protection.

Source: Economic and Social Survey of Asia and the Pacific, 1996.

According to Table 3.2, U.N. found that most of central Asian Republics (with the possible exception of Kazakhstan) spent a much higher proportion of their GDP on social services than other developing countries in the region. This resulted in high volume of human resources devoted to social services.

Public expenditure has had a positive impact in terms of bringing about substantial improvements in indicators of achievement in different social sector. However, the survey highlighted a number of issues, which require the urgent attention of policy makers in the region. These include the unacceptably high degree of dispersion in achievements among countries, persistent inequalities within countries, poor quality of services particularly in rural areas and inefficiency in the use of resources.

The survey put forward some actions that require addressing the above-mentioned issues. Among these are improved management, greater attention to equity considerations, the increased allocation of resources to social sectors, recordering of intra-sectoral priorities and the involvement of the private sector, on-governmental organizations and communities.

2.2 Nepalese Context

Singh (1977) analyzed the HMG Revenue, Regular Expenditure and Development expenditure during the period of 1956/57 to 1976/77. He found that HMG budget show that between 1956/57 to 1962/63 (except 1961/62) revenue was not sufficient to meet even regular expenditure. Since 1963/64, however, there has been surplus which has increased over the years but the surplus that has emerged has not been enough to meet development expenditure. Both development and regular expenditure are rising very fast. During the seventies HMG revenue increased from Rs.459 million to Rs.1546 million- an increase of 236 percent. It should be clear that the growth rate of revenue in the present years is slower than that of expenditure. He also found that the ratio of total outlay to GDP was just 2.44 percent in the FY 1954/55, which increased to as high as of 10.57 percent in the FY 1974/75. He also found that development expenditure ratio to GPD increasing form 4.07 percent in FY 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 FY 1974/75.

Basnet (1983) studied the problem of resource gap and analyzes the trend of public expenditure. He found that the growth rate of development expenditure is much higher than the growth rate of regular expenditure of the total expenditure. Economic services alone consume more than 50% of it. He found that the share of total expenditure to GDP has increased from 7.69 percent in 1970/71 to 14.08 percent in 1980/81. The share of regular expenditure to GDP has also increased from 3.04 percent in 1970/71 to 4.68 percent in 1980/81. About 75% to 80% of the total expenditure is allocated always for meeting the requirements of economic services and economic administration and planning.

IDS (1987) have reported that the government expenditure has grown rapidly relative to the country's gross domestic product (GPD). In 1974/75, the share of government expenditure in GDP was only 9.13 per. In 1984/85, this share had increased to 20.11 per. The expenditure on economic services to GDP ratio was the highest for every year. Nevertheless, the most rapid growth as reflected by the data was with respect to the payment of interest. Its share in GDP had increased to 1.21 percent in 1984/85 from 0.20 percent in 1974/75. IDS, moreover, found that a major feature of government expenditure in Nepal was the dominance of current expenditure over capital expenditure. In the absence of effective countervailing forces, the former was expanding at the expense of the latter. The current expenditure, which was only 51.41 percent of the total expenditure in 1979/80, reached 59.24 percent in 1984/85. Except in the year 1981/82 and 1983/84, current expenditure had tended generally to take an upward trend. In 1984/85, current expenditure rose from 56.40 percent of total expenditure in the previous year to 59.24 percent possibly due to a large increase in the salaries of government employees.

Khanal (1988) has come to conclusion that public expenditure in Nepal had increased many folds than the increase in GDP of economy. During the study period, public

Expenditure increased by 8.42 percent per annum on the average where as the GDP increased by 2.04 percent. Regular development and public investment Expenditures increased by 8.66, 8.58 and 9.08 percent respectively. Thus, the trend highlight the fact consumption type of expenditure also expanded at the faster rate and according to growth rate analysis by D. R. Khanal, social services comprising mainly education and health tend to increase at faster then another services like economic, administrative defense etc.

Rana (1988) has analyzed the fiscal system of Nepal during the period 1964/65 to 1986/87. In his study, he has concluded that there has been the constant increasing trend in revenue and expenditure. The trend of increase in regular and development expenditure have created a continuous deficit that has compelled the government to rely excessively upon foreign aid. The amount of deficit has increased rapidly because of a rapid increase in the volume of regular and development expenditures. During the period under review, regular expenditure has increased from Rs. 117.94 millions to Rs. 4307.1 millions to Rs. 8745.5 millions in 1964/65 to Rs. 13052.6 millions in 1986/87. Consequently, a rapid increase in the volume of deficit has been recorded amount into Rs. 157.51 millions in 1964/65 to Rs. 7177.5 millions in 1986/87.

Sharma's research work (1988) has tried to relevant the necessity of serious consideration of public expenditure vis-à-vis the private investment. They have jointly analyzed the crowding out effects of fiscal policy in Nepal from 1974/75 to 1986/87. The study has employed the (ISLM) model to examine the crowding out effects, which simultaneously incorporates product market and money market and consumption, investment, government expenditure, money supply and real interest rate. The tendency for an increase in the government spending or a tax cut, which is implied to reduce investment in the economy, is termed as the crowding out effect. The report has pointed out that in Nepal case, foreign grants and loans and borrowing from the banking sector, which ultimately results in increase in money supply, is the major sources of the rapidly increasing government expenditure. Thus, the traditional channel of crowding through increased (real) interest rate does not work in Nepal due to inflationary consequence of

government expenditure. The empirical results obtained from the test of general model showed that in the consumption function, wealth effect is slightly positive but not significantly different from zero. The marginal propensity to consume (MPC) out of an increase in domestic expenditure is reasonable, the value of R^2 is highly significant and no problem of auto correlation were seen in the analysis of variance. Also in the investment function, the explanatory power of the model was recorded high in a situation where private entrepreneurship is still in the infant stage in Nepal and most investment decisions on the ad hoc basis. The demand for the money function also reveled highly successful results. When special Keynesian model was tasted, the empirical results showed that in the consumption function, the results were more successful than in case of the model with wealth effect. However, in case of investment function, the explanatory power of the model is rather moderate. In money demand function, the same inclusions were derived as in the general model. Thus, the research report has unclouded that the result of both General model and special Keynesian model depict partial crowding out effect of public expenditure in Nepal (Sharma, 1990).

Regarding the Public Expenditure Pattern in Nepal, one thesis had also been written under the Tribhuvan University (T.U) for the completion of master degree by Neeta Shrestha (1986). She comes to conclusions from her analysis that the government had expended during the period of 1951 to 1982, but only with the aid of external sources. On an average at the instant price of 1962/63 the government was spending Rs. 467.07 million yearly. During same period the per capita GDP had increased to Rs. 498.2 million in 1981/82. It was every year per capita GDP was increasing by Rs. 2.7 million and government was spending Rs. 45.4 to increase the same. Thus she suggests that government expenditure had failed to increase the amount of GDP although the former had been increasing every year.

Upreti (1996) analyzed the trend, pattern and impact of public expenditure during the period 1974/75 to 1991/92. He found that the growth of public expenditure in Nepal has taken place rapidly than the growth of GDP of the country. The growth rate of development expenditure is almost equal to the growth of development expenditure. He

found that the larger percent of development expenditure has been covering from foreign aid. This trend highlights that the expenditure pattern in Nepalese economy is unable to create more resources and to get faster economic growth. He concluded that the expenditure on agriculture sector is not friendly to create more employment while more than 8 % employment has been providing from agriculture sector. But on the other hand the higher average growth rate of public expenditure to agriculture sector than non-agriculture sector has become unsuccessful to get more GDP growth rate from agriculture sector.

Lohani, (1993) has analyzed the trend of public expenditure, government revenue and problem of resources mobilization. He has concluded that the public sector is draining the private savings towards unproductive regular expenses instead of channel zing it to wards productive investment in the study period of 1974/75 to 1990/91. In spite of a tremendous increase in the size of the public sector, it has failed to generate surpluses required to finance, generate, and sustain the process of economic development. Nepal's external dependence has risen alarmingly. He has argued that the continuous in the extent of budget without evolving medium and long term investment planning and expenditure programming has delinked planning with annual budgeting for more resources have been allocated to capital items. Both macro and sectoral planning have been found to be weak due to the absence of rigorous cost benefit analysis and program budgeting. Three decade 4 of planning have failed to substantiate a long term perspective plans with a view to maintain consistency among macro and sectoral physical targets on the one hand and ensure necessary to the sect oral programs on the other hand.

Basyal, (1994) has carried out a research about growth of development expenditure of Nepal in different plan periods and sources of financing it. He has underscored the dominance of foreign capital in Nepal's plan financing. During the fifth (1976/80), the sixth (1981/85) and seventh (1986/90) plan periods, foreign grants and loans financed the total development expenditure of the extent of 47.3 percent, 48.1 percent, and 59.5 percent respectively. This has clarified and upward trend in the reliance on foreign

resources and, consequently, the downward share of the revenue surplus in meeting the development expenditure.

Regarding the impact analysis of public expenditure on employment, he has concluded that the expenditure on agriculture sector is not friendly to create more employment. However, interestingly more than 80 percent employment was from agriculture sector. The higher average growth rate of public expenditure to agricultural sector than non-agricultural sector has become unsuccessful to get more GDP growth rate from agricultural sector.

Khadka (1998) has studied the role of public expenditure in economic development of Nepal during the period 1974/75 to 1994/95. The study has estimated the regression models using cross sectional data. The double log transformation models have been used in the study. During the period under consideration, the size of public expenditure has found to be extremely increasing. It has been observed that the internal revenue has mainly helped to increase recurrent and consumption type of expenditures. He has found the high dependence of development expenditure on external resources. The dependence of foreign aid adversely affects the growth rate of the economy through the substantial increase in the capital output ratio. In the study period, the foreign aid has covered 48.5 percent of development expenditure and 31.6 percent of total expenditure on the average. Further, the total public expenditure, regular expenditure and development expenditure have been increased by 18.1 percent, 19.9 percent, and 17.1 percent respectively. He has also pointed out his weakness in both macro and sectoral planning due to the absence of rigorous cost benefits analysis and program budgeting. The donor agencies have predominantly influenced in determining the sectoral programs.

Similarly, Sharma (1999) has also found that the steady growth in public expenditure in the 1980s and in the first half of the 1990s. With an average annual growth of 17.7 present, it has been rising faster than the GDP. Nevertheless, the relative growth in the

public sector has not seen as related to the growth of real per capita income. Instead, it seemed to be affected by the foreign aid given the domestic resource constraint.

For analyzing the problems and prospects of regular and development budget of HMG/Nepal, he has taken help of data from 1979/80 to 1994/95. He found that public expenditure was rising faster than resource mobilization resulting in expanded borrowing to match such expenditure. As much of the government expenditure has been used for noncommercial purpose, and even commercial financing has not generated a surplus for the government, borrowing led expenditure growth forebode a budgetary crisis.

Looking at year-to-year growth, he has found that the regular expenditure has fluctuated less than development expenditure. Whenever public expenditure was curtailed, most of the curtailment came from development expenditure. In the process government expenditure was damped, and implementation of projects was upset affecting the efficiency of public expenditure. This has happened largely because rigidity were being steadily built into regular expenditure, as a result adjustment varying through public spending entailed a high social cost to the economy, by curtailing development expenditure. Thus, he has unclouded, with the growth of regular expenditure, the flexibility or scope of spending policy as a tool for economic management has been drastically limited.

World Bank (2000) on a study under the title “Nepal: Public Expenditure Review” concluded that Nepal is not facing a fiscal collapse rather the fiscal situation is quite stable. This study however showed inefficiency and mismanagement on public spending. Deficiencies in the budget planning, resources allocation and expenditure management process have been found a major factor contributing to low productivity. This study pointed out the institutional weakness for the ineffectiveness of public spending in Nepal. The report concluded that institutional weakness remain probably the most critical set of factors affecting the projective implementation and effectiveness of public spending across sectors in Nepal. This reports present number of suggestions

to improve the effectiveness of public spending. Among which more realistic resource allocation practice, medium term expenditure projections, good governance and transparency, decisive action to formulate an anticorruption agenda, greater local ownership of the public expenditure program, build a partnership between local and central, and public and private, etc are major.

Pradhan and Yadav (2002) in the Role of Saving, Investment and Capital Formation in Economic Development: A Case of Nepal, published in the economic journal Nepal, vol.25, No.4, Oct-Dec 2002, issue No.100 analyzed the regression Gross Domestic Products (GDP_c) on Saving (S_c), Investment (I_c) and capital formation (CF_c) at current prices for 1974/75 to 2000/01 with regression equation: $GDP_c = a+b_1S_c+b_2f_e+b_3cf_e$. The results show the customary strong saving, investment and capital formation effect on GDP. In their equation-I, one rupee increase in saving leads to about Rs. 3.26 increase in GDP at current prices holding other variables constant. The same is noticed to be Rs.4 in equation=II on the other side, one rupee increased in investment results in only Rs. 1.72 increase in GDP, holding saving and capital formation constant. The same is noticed to be Rs. 0.42 in equation-III. Similarly, one rupee increase in capital formation leads to about Rs. 2.52 increase in GDP, holding all other independent variables constant. The same is noticed to be Rs. 4.33 in equation III. The regression equations found by them should that the strong role-played by saving and capital formation and weak role played by investment.

Tenth plan has reviewed the ninth plan. During the ninth plan period, the government expenditure of Rs. 27846.8 crores over the targeted expenditure of Rs. 33279.0 crores at the constant price of 1996/97, created the expenditure gap of 17.4 percent. During the ninth plan period, there has been annual average increase of 9.3 percent in the regular expenditure. The share of the regular side in total expenditure of the plan was estimated to be 43.8 percent, which has actually increased by 9.6 percentage points over the estimation amounting. This substantial increase in regular expenditure has been due to the increase in the salary and pensions of civil servants and on, rise in severity related expenditure especially in the later years of the plan.

During the plan period, the development expenditure had been decelerating by 1.1 percent annually. The share of development expenditure was proposed to be 56.2 percent of the total plan outlay but the unexpected rise in regular expenditure force to limit it to 46.9 percent during the plan period. The targeted expenditure on economic services, infrastructure, social services and miscellaneous (Administrative and contingency) was 29.4, 36.3, 33.4 and 0.9 percent of the development expenditure, respectively. The actual figure turned out to be 22.7, 35.7, 39.9 and 1.7 percent, respectively. The expenditure in unproductive sector especially on miscellaneous heading has exceeded the target, which the expenditure on productive sector like economic services and infrastructures has remained below the target (NPC, 2002).

Pyakuryal (2004), under the study titled "Nepal's Conflict Economy: cost, consequences and Alternatives" asserted that the Nepalese economy has lost its productive capacity to respond to sustained growth following the government expenditure and revenue pattern. He found the ratio of regular expenditure to GDP in FY 1996/97 was 8.6 but increased to 11.5 percent in 2001/02. The revenue during the same period decreased from 7.3 in 1996/97 to 7.0 in 2001/02.Development expenditure also from 9.5 to 7.5 during the same period. Analyzing the pattern, he recommended for contractionary fiscal policy rather the expansionary one during the war period.

Gyawaly (2004) has suggested that budget deficit significantly affects the current account deficit in Nepal. Higher the budget deficit, higher will be the current account deficit and vice versa. The higher spending flow injected by large budget deficit, in the presence of supply bottlenecks at home, is increasing the demand for foreign goods and services and wedding the size of current account deficit.

Raut (2005) has concluded that slow pace of revenue collection compared to expenditure growth is creating fiscal imbalance for which nation has to depend on foreign assistance. Due to the tendency of declining foreign grants and increasing foreign loans, the debt burden of Nepal has been increasing with almost one-third of the

regular expenditure allocated for the debt service. He further points out that if fiscal imbalances increase continuously over the coming year, or debt stock and debt service payments increase emptying Nepal's narrow coffer, there would be problems for earmarking resources for productive projects while complying with the need for maintaining macro economic stability.

2.4 Conclusion

In conclusion, the findings of various researchers largely differ. This is because different researchers examined and analyzed their studies through different aspects. Some are concentrated mainly in social sector, some are in the impact of public spending in various sector and some are concentrated in pattern and growth of public expenditure.

In case of Nepal, a very few empirical studies have been done. The only homogeneous response found in case of world economy and Nepalese economy, has been more or less the increasing trend of public expenditure.

After reviewing relevant literature in the context of Nepal, some conclusions are drawn. These are:

- Increasing trend of public expenditure (from 1956 to 2005),
- Inadequacy of revenue surplus to finance development expenditure so high dependence of development expenditure on external resources,
- Fluctuation of regular expenditure is less than in development expenditure,
- Major chunk of regular expenditure to loan repayment and interest service
  Showing dominance of foreign aid,
- Dominance of foreign capital in Nepal's plan period,
- Upward trend in reliance in foreign resources and downward share of the revenue surplus to meet development expenditure underlines increasing trend of resource gap

CHAPER- THREE

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 stated objectives. Quantitative techniques and analysis are main techniques for the analysis of the data. This study is based on simple regression analysis and tabular analysis.

3.2 Period of Study

The period taken for the study is form FY 1980/81 to 2006/07. The time is designed taking into account the availability of data.

3.3 Definitions of Variables

In this study, the various regressions are run equation has been carried on different format as specified under model title. The variables used in this stud are as follows:

Total expenditure (TE): Total public expenditure or government expenditure has been assumed as public expenditure. The data has been taken out exclusively from the Economic survey.

Output: GDP has been taken as a proxy variable for output. It has been taken exclusively from the Economic Survey.

Agricultural output: Agricultural GDP at factor cost has been taken as proxy variable for agricultural output.

Non- agriculture Output: Non-agriculture GDP at factor cost has been taken as proxy variable for non-agriculture output.

3.4 Specification of Model

The analysis is based on time series date of 27 years covering only the period 1980/81 to 2006/07. Obviously this study period gives more accurate analysis with high degree of freedom. The analysis is based on the evidence put forward by the OLS regression equation. The regression equation has been estimated with the help of Eviews computer programme.

The models used in this study can be summarized as follows:

Model -1

In this model, a change in gross domestic product is regressed with the lagged and unlagged values of total expenditure. The coefficient ℘measures for the lagged and unlagged values of total expenditure.

The model selection follows the trial and error method.

$|\zeta GDP_t = \Im + \wp \zeta TE_t$

$\zeta GDP_t = \Im + \wp \zeta TE_{t-1}$

$\zeta GDP_t = \Im + \wp_1 \zeta TE_t + \wp_2 \zeta TE_{t-1}$

$\zeta GDP_t = \Im + \wp_1 \zeta TE_t + \wp_2 \zeta TE_{t-1} + \wp_2 \zeta TE_{t-2}$

where ζ GDPt = change in gross domestic product of current year.

ζ TEt = change in total expenditure of current year.

ζTE_{t-1} = change in total expenditure of last year.

ζTE_{t-2} = change in total expenditure of two-year lag values.

℘= Regression coefficient

ℑ = constant

Model-2

In the model, a change in agriculture gross domestic product is regressed with the lagged and unlagged values of total expenditures. The coefficient ℘

measures the coefficient for the lagged and unlaggged values of total expenditure. These basically are entitled to trial and error method.

$\zeta AG\text{-}gdp_t = \Im + \wp_1 TE_t$

$\zeta AG\text{-}gdp_t = \Im + \wp_1 TE_{t-1}$

$\zeta AG\text{-}gdp_t = \Im + \wp_1 TE_t + \wp_2 TE_{t-1}$

$\zeta AG\text{-}gdp_t = \Im + \wp_1 TE_t + \wp_2 TE_{t-1} + \wp_3 TE_{t-2}$

$\zeta AG\text{-}gdp_t$ = Change in agriculture gross domestic product.

Model-3

In the model, a change in non-agriculture gross domestic product is regressed with the lagged and unlagged values of total expenditures. The coefficient $\wp$ measures the coefficient for the lagged and unlagged values of total expenditure. The model selection follows the trial and error method.

$\zeta NONAG\text{-}gdp_t = \Im + \wp_1 TE_t$

$\zeta NONAG\text{-}gdp_t = \Im + \wp_1 TE_{t-1}$

$\zeta NONAG\text{-}gdp_t = \Im + \wp_1 TE_{t-1} + \wp_2 TE_{t-1}$

$\zeta NONAG\text{-}gdpt = \Im + \wp_1 TE_{t-1} + \wp_2 TE_{t-1} + \wp_3 TE_{t-2}$

Where, ζ NONAG-gdpt = Change in non-agriculture gross domestic product. However, a note of caution in terms of limited data set, application of limited explanatory variables and low degree of freedom have taken into account while interpreting the result and, therefore, the result found could be taken as indicative only.

3.5 Sources of Data

All the macroeconomic time series data required for the analysis are of secondary source: They are collected mainly through the following sources:

1. Budgetary speeches of different years, Ministry of Finance.
2. Documents and publications about various five years plans-by national planning commission.
3. Statistical pocket books of variables years-by CBS.
4. Economic survey of various years-Ministry of Finance.
5. Quarterly bulletin-Nepal Rastra Bank.
6. Publication of UN-Affiliated agencies.

3.6 Statistical Test of Significance

Coefficient of multiple determination (R^2) is taken as a measure of goodness fit as it shows the percentage of total variation of dependent variable that can be explained by the independent variable of the multiple determinations.

The t-test is performed to identify the significance of an observed sample regression coefficient. F-test is used to examine the overall significance of the model. Durbin Watson (D-W) Test is used to detect serial correlation or auto-correlation.

3.7 Data Analysis Procedure

Simple calculation like ratio, percentage etc. is made with the help of ordinary calculator. SPSS (Statistical Program for Social Science), a computer application program and Excel are used to calculated and analyze the regression equation. It is also used for other mathematical calculation like R^2, Adj. R^2, F-test, t-test, D-W test ect.

CHAPTER FOUR

THEORIES AND PRINCIPLES OF PUBLIC EXPENDITURE

4.1 Introduction

Public finance as defined by The Penguin Dictionary of Economics is a branch of economics concerned with the identification and appraisal of the means and effects of government financial policies. It attempts to analyze the effects of the government taxation and expenditure on the economic situation of individuals and institutions, and to examine the impact on the economy as a whole. It is also concerned with examining the effectiveness of policy measures directed at certain objectives, and with developing techniques and procedures by which that effectiveness can be increased (Bannock,1998). Thus, public finance is the study of the financing of government.

Public finance, field of economics concerned with how governments raise money, how that money is spent, and the effects of these activities on the economy and so society. Public finance studies how governments at all levels - national, state, and local - provide the public with desired services and how they secure the financial resources to pay for these services.

The Penguin Dictionary of Economics defines public expenditure as the spending by general government (public sector). Similarly, government expenditure, as defined by Oxford Dictionary of Economics, is spending by government at any level. It is necessary to net out payments by one level of government to another, for example central government grants to local authorities. Government expenditure consists of spending on real goods and services purchased from outside suppliers; spending on employment in state services purchased from administration, defense and education;

spending on transfers payments to pensioners, the unemployed and the disabled; spending on subsidies and grants to industries; and payment of debt interest (Black,2002).

According to Goode, government expenditures are made to carry out essential functions of administering justice and providing national defense and, in elastic phrase of Adam Smith, to supply certain additional goods and services that are "advantageous to a great society' but that would not be supplied by private enterprises because doing so would not be profitable (Goode,1983).

4.2 Pure Theories of Public Expenditure

The pure theory of public expenditure relates to those principles, which govern the optimal provision of goods[3].Two principles are generally considered in this context. They are ability to pay principle and benefit principle.

4.2.1. Ability To pay Theory

4.2.1.1 Pigou Approach

The use of the ability to pay theory to the determination of the optimum level of public expenditure has received most comprehensive treatment in the hand of Pigou. Singh explains

Pigou's view as the goods and services which are provided by government department and can be sold for fees so arranged as to cover cost of production pose no problem. The amount of resources that should be devoted to this purpose is determined automatically by public demand. Nevertheless, fees can cover neither bulk of non-transfer expenditure of government such defense, civil administration and so forth nor transfer expenditure. Hence, there is no automatic machinery to determine how far expenditure shall be carried; and some other method has to be employed (Singh, 1991).

The optimum amount of government expenditure is determined at the point at which the satisfaction obtained from last rupee spent is equal to the satisfaction lost in respect of the last rupee called upon by government service. Pigou states the condition when government expenditure would be larger. First, the greater is the aggregate income of the community, the larger will be the optimum amount of government expenditure is. Second, under the circumstance where new opportunities for expenditure through government are opened up with no corresponding opportunities for private expenditure, balance between marginal benefit of expenditure and marginal disutility of revenue will be struck at a higher point. Third, given aggregate income and population, greater the concentration of income in the hands of a few rich persons, higher the optimum level of public expenditure. It is because tax scheme can be framed as to raise given revenue with lower marginal sacrifice.

4.2.2 The Benefit Principle

4.2.2.1 Samuelson Approach

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

Samuelson considers the optimal choice between private consumption goods, like bread (X), and public consumption good like an outdoor circus or national defense (G), in a two-man economy (A & B). Since X is a normal private good, it is divisible in consumption: that is, the amount of X consumed by A can not be consumed by B, and conversely. This can formally be stated by the condition that: $X_C + X_b = X$, where X_a and X_b represent the amount of the private good X respectively consumed by A and B.

Since, G is a pure public good, it is not divisible in consumption. The amount of G is equally available for consumption by each person; the total amount of G is in a sense consumed equally by each. This can be stated formally by the condition that: $G_a = G_b = G$, where G_a and G_b represent the amount of G consumed by A and B respectively.

Samuelson further assumes that the tastes of A and B as given and society's production possibility frontier as given. The condition needed for efficiency in a world consisting only of private goods and in a world of private and public good can be stated as follows:

- For efficiency between private goods,

$$MRS^A = MRS^B = MRT$$

- For efficiency between a private good and a public good,

$$MRS^A + MRS^B = MRT$$

Where, MRT is the marginal rate of transformation between X and G and MRS^A and MRS^B are the marginal rates of substitution between X and G for individuals A and B respectively.

In general case for an economy characterized by the existence of public goods, private goods and many individuals, the condition for the optimal supply of public goods is, therefore, that the sum of the marginal rates of substitution must equal the marginal rate of transformation.

$$\sum_{i=1}^{n} MRS_i^{jk} = MRT^{jk}$$

$i = 1 \ldots n$ (the number of individual consumers)

and $j, k = 1 \ldots m$ (the number of commodities)

In other words, if the marginal rate of substitution reflects the marginal benefit that the individual receives from a marginal increase in the quantity of the public good (taking the private goods as *numeraire*), then because everyone consumes the public good the marginal benefits must be summed over all individuals. The increase in total benefit resulting from a marginal increase in the quantity of public good is the sum of individual marginal benefits.

By taking the private good as *numeraire* it is possible to express the optimality conditions for the supply of public good in terms of efficiency prices. By definition $MRS^{A}_{GX} = P^{A}_{G}/ P^{A}_{X}$ and $MRS^{B}_{GX} = P^{B}_{G}/P^{B}_{X}$; furthermore, $MRT_{GX} = MC_G/MC_X$.

Thus:

$$P^{A}_{G}/ P^{A}_{X} + P^{B}_{G}/ P^{B}_{X} = MC_G/ MC_X = MRT$$

Since $$P^{A}_{X} = P^{B}_{X} = P_x$$

i.e., $$(P^{A}_{G} + P^{B}_{G})/ P_x = MC_G/ MC_X = MRT.$$

Setting $P_X = 1$. Then:

$$P^{A}_{G} + P^{B}_{G} = MC_G$$

That is, the Pareto-optimal supply of a public good requires a set of individualized (or personalized) prices for each consumer adding to marginal cost. Samuelson's model for the optimum supply of a pure public good is a general equilibrium model and is concerned to demonstrate the internal logical consistency of the analysis which will determine the existence, uniqueness and stability of set of equilibrium prices for public and private goods.

4.2.2.2 Lindahal- Johansen (L-J) Approach

The approach first used by Lindahl and recently reviewed by Johansen assumes a fixed distribution of income between individuals who consume a private good X and a public good G. he takes the case of two individuals, A and B for simplicity, which when needed can be generalized to Several individuals. The

problem is to determine G that is to be consumed collectively, and the at , shares allocated between A and B.

L-J start off with the usual assumption that each individual has a fixed budget constraint and the usual indifference map between the private good X and public good G. by using the fixed budget constraint L-J are able to transform the usual indifference curves between X and G into indifference curves between X and h (tax share).

By changing tax shares, we can trace out the levels of G that each individual would like to consume, and thus derive demand curve for G for each individual, showing the quantities of the public good G they would prefer at various tax shares. The locus of all efficient consumption points is determined by the points of tangency between the two sets of indifference where the marginal rates of substitution between h and G for A and B are equal. At any point along this contract curve, the sum of A's and B's marginal rates of substitution between X and G equal the marginal rates of transformation. Thus, all points along the curve are efficient consumption points.

The intersection of the two demand curves where the marginal rates of must each be equal to zero and therefore equal to each other is the efficient point since it is on the contract curve; it also is stable since it marks the intersection of A's and B's demand curves.

According to Singh, Musgrave is of the opinion that Johansen's formulation may be considered as a special case of Samuelson's broader framework. However, this formulation is more attractive since it directly deals with the question of tax shares (Singh, 1991).

4.3 Classical View of Public Expenditure

The classical economic theory, It was assume that in private enterprises, competitive economy autocratically ensure that full-employment of resources.

If the resources are already employed, there is no to inter in the economic life of the countries. They believe economic system is based upon the leases-faire policy. The market mechanism was considered a batter method whereby the working of economy could be guided and allocation of the resources could be decided.

Keeping the budget balanced is another important point of classical economists. In the situation of full-employment, if the government increases its expenditure without increasing its revenue this will lead to inflationary rise in prices. This follows from the assumption of full employment. So, that there are no ideal resources willing to be employed. The budget deficit system signifies an increase in the demand for resources on the point of government without private sector being willing to releases resources. Thus, the classical theory point out that every budget deficit is inflationary.

The classical theory thought that the borrowed expenditure is only for productivity proposes. It is necessary for the state to borrow, and then this borrowing must be confined to the financing to productive enterprises. Otherwise borrowing will mean withdrawal resources from their productive use by government.

A debt of government generally represent on opportunity that has been wasted. Hence the government should try to reply its debt as early as possible. Interest in public expenditure followed a decerible downward trend from golden age of political economy till the event of Keynesianism. This trend was outcome of highly normative orientation of public finance which concerned itself mostly with the elusive concept of equity in taxation based on the voluntary exchange theory rather than with the development of substantial positive hypothesis. Besides, it was general opinion that the level and structure of public expenditure is determined politically and thus it is bounded the economist’s proper orbit of the study.

In the short, classical economists had no faith in the government activities. The classical economists can be epitomized as the less government. The better English economists have expressed most government expenditure were as unless and unproductive in public finance tradition. The British economists like Pigou and Dalton had advocated a nation of equalizing the marginal social benefits and marginal social cost. According to this view the main terms of public finance was simply to make the best the bad lot and allocate the burden of taxes as fairly as possible among the members of community.

In early 1950's Samuelson gave higher status to this concept of public expenditure through his article. In his article he tried to give the concept of pure public goods as some things which people desired but which could not be provided through the normal market mechanism. Because the way, the goods and services are provided ensures that they will be equally consumed by all citizens. That is no one can be exclude from enjoying the services provided whether he pays for it or not.

The classical theory public expenditure deals with three separate problems.

a) The requirement for the optimal provision of public goods. B) The demonstration that the private market will fail to provided the optimal amounts of such goods c) the problem of whether political mechanism which perform this task properly can be devised.

2.2 Keynesian View on Public Expenditure.

J.M. Keynes brought the field of public finance as mainstream of economics from periphery of classical economists. He challenged the classical view that private enterprise economy automatically ensures full employment. Similarly, he said that employment depends upon effective demand and there is no

guarantee that there will always be adequate effective demand to generate full employment. Unemployment arises because of deficiency of demand.

If there are unemployed resources, there is no special virtue in keeping the budget small and balanced when resources are unemployed, it is the duty of the state to increase effective demand by increasing its expenditure. In the terms of depression, deficit financing helps to rise the level of employment and output. Similarly during the period of demand deficiency, it is unjustified to tax on consumption, it is essential to raise the level of demand

During the period of depression, appropriate fiscal policy should be adopted to increase demand. In this time, the government can increase its expenditure and spend more on public works so that additional resources can be employed even if it is not a productive process. In the same way, government can give subsidy to producers of mass consumption in order to increase consumption. Thus the evil word 'deficit' can at time of depression be the only remedy in lifting the economy upwards.[8]

On the other hand, the demand is high during inflation. Hence, government should reduce its own expenditure and also should impose heavy tax to cut the level of consumption. Thus in periods of inflation it is better to have surplus budget. According to Keynes the main function of public expenditure if to rise of the level of income and employment in the economy. Keynes also developed the theory of expansionary and concretionary effect. In almost all the developing countries the percent of budget deficit is high. This high budget defect rate leads to the paid expansion of government expenditure, which will have expansionary effect. In order to lesson the budget deficit the government is compelled to raise the tax rate affecting the welfare of poor people. If the government lowers the tax rate then it will not be in a position to meet the growing expenditure so the government will have to think about meeting the expenditure through foreign sources or by reducing expenditure. The better

action will lead to concretionary effect. In this way, he brought public finance form periphery to the mainstream 'nonetheless' Keynes id not try to the theory of public expenditure growth as such.

2.3 Wagner's Hypothesis

Adolph Wagner, a famous German fiscal theorist believes that there is a functional cause and effect relationship between the growth relative growths of public sector. Presenting his famous law, 'Las of increasing state activities' Wagner write comprehensive comparison of different countries and different time shows that among the progressive people, with which along we are concerned, an increasing regularly takes place in the activities of the central and local government. These increases in both intensive and extensive, the central and local government is constantly undertaken new function while they perform both old and new function of more efficiently completely.[10] According to Wagner "relative growth of the government sector was an inherent characteristic industrializing economics".

He point out the growing importance of the government activities and expenditure as an inevitable future of progressive state. His law was based on historical facts Wagner concentrates on demand side of public expenditure and play down the importance of the revenue as constraint of public expending.

Wagner has divided public expenditure into two parts a) expenditure on internal and external security b) culture and welfare which implies health, transport, education, banking, and like. Expenditure for external security increases in the growth economy as a nature of use of force by the state from simple aggression to prevention of attack and used sophisticated weapons. Similarly, the expenditure for internal security would increases due to greater function between economic units and urban people.[11]

Wagner study was based upon the historical trend of public expenditure. He gives his ideas on the basis of experiences of long time series and cross-

sectional comparison greater in the part by him and any other economists. He explained both demand and supply side of public sector activities and explained how they interest changing production and marketing arrangements affect and are affected by social organization in two ways. A) Organization with economic system change to accommodate new production and marketing arrangement and B) social and political organization change to accommodate a new social relationship among person. One requirement of first are gory of change is that the public sector doesn't certain function, which facilitate implementation of the production and marketing techniques. As the mentioned, those functions may include relation or public production a certain material goods. Industries such as basic fuels and metals, transportation and, communication and banking exhibit those characteristics are create important external economics. In the second category organization and expenditure requirement arise from new social patterns, including urbanization, specialization of labor and centralization of administration in both private and public activities. Similarly, the effect of those growing interdependencies is higher relative resources allocation of public sector. Those changes in the infrastructure of social organizational requirements, thus enabling even higher relates of economic change.

There are various factors responsible for increasing of public expenditure. They are:

a) Increasing activities in state:

In a modern era, the role of government has been increasing. The government is known as welfare government instead of police government. Education public health, housing and medicine facilities and the public recreation are the common example for the government involvement. In the developing is another importance responsibility of government. To utilize unemployed resources and labor for faster economic growth is also the duties of welfare governments. Hence more and more public expenditures are resorted to perform those activities.

b) Technical change:

Technological change is a factor that plays to increases the government expenditure. Technical change may be such as to increase the relative importance of goods whose benefits are largely or internal. Government must therefore provide such goods. The invention of internal combination engine resulted in the rise of automobile industry. This leads to an increasing demand for travel and so for highway.

c) Growth of population and urbanization:

The growth of population and urbanization is responsible for the rise in government activities. The process of urbanization activities should maintain by government and government should provide the security and protection for the people and properly of the new city. This put the additional responsibilities upon the government. The increased population and population of the new urban areas demand food, other essential commodities, public health, education sanitation and other. So to maintain and fulfillment of the demand of the people government needs huge amount, which in term, increases the government expenditure.

d) Rising of the prices:

Public expenditure has been increasing in countries of the world due to rising trend of prices. The continuous rise in prices has two effects. Firstly, the government has to pay higher price for goods and services which it has to buy. Secondly, it has to find larger financial resources to meet its growing expenditure.

e) War and preparation of war:

War is the most important factors for increasing government expenditure in these are major factors responsible for growth of public expenditure. Besides, other various factors may play in the important role in the expenditure growth. They are evolution of democracy, economic development change in attitude of government, world depression and role of economic planning.

In the most of countries, expenditure for national defense accounts is half of total expenditure. The invention and development of new and new war weapon technology is also the cause of public expenditure growth.

2.4 Peacock-Wiseman Hypothesis:

Peocock and jack Wiseman advanced this hypothesis of the growth of public expenditure in the study of public expenditure in Great Britain during the period 1890-1955. It stresses the time pattern of public expenditure trends and highlights the facts that the increase in public expenditure does not follow any smooth and continuous trend but the increase in public expenditure occurred in step like manner or in the jerks. During this period some social or other disturbance takes pace which shows need of increased expenditure as the existing public revenue could meet the situation. However, the approach of the hypothesis is made of three separate concepts. They are:

i) Displacement Effect
ii) Inspection Effect
iii) Concentration Effect

Using empirical data of British economy after 1890 to 1955, they observed that the relative growth of the British public sector has occurred in a step like rather

than on a continuous growth basis. Government fiscal policies have risen step by step to successive new plateaus during the period of studies. The social crisis or disturbances such as war and depression cause the previous lower tax and expenditure to be replaced by new, higher budgetary levels. After the social crisis ended, the new tax tolerance which have emerged make the society willing to support a heavier tax burden than it previously had. Thus there is no strong motivation to return to the lower pre crisis level of taxation.

Associated with this displacement effect is the inspection effect, which helps to perpetuate the higher level of public expenditure, forced on the public sector institution at the time of emergency. The inspection effects refers to the phenomenon where by as a direct consequences of the social emergency, public expenditure comes to encompass within it's purview economic and social activities which might have been the province of private sector concern prior to the period of crisis. Further owing to technological advances concomitant to social disturbances, new goods are apt to come to existence through the public sector and which have no previous allocation history. In the secular growth of public expenditure in Great Britain Peacock and Wiseman also discovered the influence of another factor, which they call the concentration effect. This process takes place when the expenditure particularly on transportation and communication is centralized through Government's larger involvement.

In nutshell, Peacock-Wiseman Hypothesis of public expenditure trend is more convincing than the Wagner's expanding state activities hypothesis. It dos not claim to be an immutable economic law or principle but tries to point out some pivotal characteristics of the growth pattern in the industrial set up. Here, it must be remembered that there is natural course of advancement and structural changes in the economy, which in turn leads to constant and systematic expansion in the pubic expenditure, Similarly, urbanization, population expansion, and awareness of the civil right coupled with awareness of state government towards duty leads Peacock and Wiseman still is still relevant in

the context of developing economies and does not isolate all the relevant cases at work.

2.5 Critical Limit Hypothesis:

Colin Clark put forth what he calls the ‘critical limit’ hypothesis regarding tax tolerance. Colin Clark based his hypothesis on the interwar data of several western countries. He has 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 remains in balance. Public expenditure beyond a stipulated level will cause inflation only if there does not exist initially sufficiently unused capacity to the increased demand and if the additional public spending over the capacity level of output is not compensated by the reduction in private spending to release resources necessary to meet the requirements of increased public expenditure.

Theory holds that by increasing taxes and restricting credit, it is possible to cut down expenditure of the private sector and thereby to accommodate increased public expenditure by releasing sources from private use. Therefore, when it asserted that public expenditure beyond a specified limit will generate inflation, it seems to imply that reduction of private expenditure on account of personal consumption and private investment is either possible or undesirable. If any of theses contentions is conceded, it will be true that additional public expenditure will cause inflation in the economy.

2.6 Displacement Hypothesis:

With the help of British long time series data on public expenditure, Peacock and Wiseman developed a hypothesis which is generally called the ‘displacement effect’. Khanal puts this hypothesis as during the period of social

upheavals like was the public expenditure is displaced from the old level and never returns to the prewar level (Khanal, 1988).

From an empirical analysis of the data on public expenditure for the British economy, they were able to establish that the relative growth of the public sector expenditure in that country had occurred on a ‘step like’ pattern rather that a “continuous growth” pattern. It was during period of emergency or of major social distribution such as war and depression that most of the upward steps in public expenditure had occurred. These emergencies created a displacement effect by which the previous lower expenditure (and tax) levels were displaced by new and higher levels of expenditure. However, this expenditure was not reserved once the emergency ended. Rather, new levels of “tax tolerance” appeared which continued to sustain the new and heights of expenditure reached earlier. In the face of society’s acceptance of the new and higher volume of “taxable capacity,” there was no strong motivation for a return to the pre-emergency period of lower level of taxes and expenditure.

According to them, social upheavals like war displace public expenditure through two effects. The first is inspection effect. This refers to the plan phenomenon whereby, as a direct consequence of the social emergencies, public expenditure comes to encompass within its purview economic and social activities, which might have been the province of crisis. Further, owing to technological advances that are concomitant to social disturbance, new goods are apt to come into existence through the public sector and which had no previous allocation history. Furthermore, war and other social disturbances frequently force the people and the government to ‘inspect’ the adequacy of the majors higher to undertaken to meet problems which would have been considered as trivial but which assume importance and urgency owing to the disturbance, and continuity priority attention even after the period of disturbance.

The second is the concentration effect. This concept refers to the evolution expenditures undertaken at different levels of government and their tendency to be concentrated in the central government. According to Khanal, this process takes place when the expenditure particularly on transportation and communication is centralized through government' larger involvement. This usually happens when a country is experiencing economic growth (khanal, 1988).

CHAPTER- FIVE

TREND AND STRUCTURE OF PUBLIC EXPENDITURE

5.1 Introduction

Before the unification of Nepal by king Prithvi Narayan Shah, Nepal was divided into various states. After unification the Ronas came to rule the country as a feudal system. During the Rana regime she had closed economy and there was no relation with the rest of the world. After the inception of democratic system in 1951, Nepal came into the main stream of the world economy. To initiate the development process, budgetary and planning system were started in 1952 and 1956, respectively.

In The year 1956 the crucial for the Nepalese economic development as it witnessed onset of a comprehensive planning process in the country. From then on wards there have been tremendous increase in the size of the public sector. The phenomenal increase in the size of public expenditure is, thus due to the intensive development efforts made by government through the comprehensive planning process in the country. The factors responsible in expanding public sector activities in the economy can be summarized through two distinct approaches. One of the increasing demand pressures for public services due to the increasing level of money income and population growth and its subsequent impact on the density of population and urbanization. As the population growth rate in Nepal is very high this has augmented the problem of providing education, health and other basic minimum needs services. At the same time, due to the existence of predominant subsistence agricultural sector, public sector is compelled to make larger investments in infrastructural and other industrial development to reduce more pressure on the subsistence sector and provide more employment opportunities else-where in the economy. Another is the supply factor private sector in the

Nepalese economy is not well developed. So the public sector has to play a double role. On the one side it has to be directly involved in the production process and on the other side it has to evolve such programs which can help to stimulate the private sector in participation development activities.

5.2 Trend in Public Expenditure

Public expenditure figures, presented in the table (5.1), show the steadily increasing trend of expenditure programs. Development component has increased faster than regular until 1998/99then after regular component began to accelerate. There have found a series of eccentric trends in public expenditure since the restoration of democracy in the country.

Nepal formulates budget basically under the traditional budgetary approach, which gives more emphasis on the expenditure side; practice is to divide total budgetary expenditure under two major heads viz. regular expenditure and development expenditure. The first is smaller to that of recurrent expenditure adding nothing to the capital stock though it may lad to the Positive marginal productivity on the individuals and some time to the economy through the aggregate demand function. Second, on the other hand, is basically the capital expenditure, which is supposed to add to the stock of capital (including that of human capital). Beside that, functional classification, like economic service, social service, defense, general administration etc. is one of the criteria of budgetary management. In the context Nepal major public expenditure categories come under economic service, social service, loan repayment and interest payments etc. The more often practice that is to divide the expenditure under the regular and development expenditure are presented above. Moreover, the regular expenditure has surpassed the development expenditure as against the accepted fiscal norms. Second, on the other

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Table 5.1
Trend on Aggregate Level of GDP, AG-GDP, NONAG-GDP, TE, RE and DE

Rs. in Million

FY	Total (GDP)	Agriculture (GDP)	Non Agriculture (GDP)	Total Expenditure (TE)	Regular Expenditure (RE)	Development Expenditure (DE)
1980/81	27307	15510	11797	4092.3	1361.2	2731.1
1981/82	30988	17715	13273	5361.1	1634.3	3726.8
1982/83	33761	19082	14697	6979.2	1997.2	4982.1
1983/84	39390	22570	16820	7436.6	2272.8	5163.8
1984/85	44441	22761	21680	8394.8	2906.2	5488.6
1985/86	53215	27136	26079	9797.2	3583.9	6213.3
1986/87	61140	30623	30517	11502	4123.6	7378
1987/88	73170	36755	36415	14050	4622.1	9428
1988/89	85831	42572	43259	18005	5676.5	12328.7
1989/90	99720	50470	49250	19670	6672.2	12997.5
1990/91	116127	55268	60759	233549.8	7574.1	15979.5
1991/92	144933	65156	79777	26418.2	9905.4	16512.7
1992/93	165350	70090	95260	30897.7	11484.2	19413.6
1993/94	191596	80589	111007	33597.4	12409.2	21188.2
1994/95	209976	85569	124407	39060	19265.1	19794.9
1995/96	239388	96896	142492	46541.6	21561.2	24980.5
1996/97	269570	108785	160785	50723.7	24181.2	26542.6
1997/98	289798	112495	177303	56118.3	27174.4	28943.3
1998/99	330018	132373	197645	59579	31047.7	28531.3
1999/00	366251	145131	221120	66272.5	34523.3	31749.2
2000/01	393566	151059	242507	79835.1	45837.3	33997.8
2001/02	444052	166090	277962	80072.3	48863.9	31208.3
2002/03	473545	172802	300743	84006.1	52090.5	31915.6
2003/04	517993	186125	331868	89442.6	55552.1	33890.5
2004/05	566579	199368	367211	102560.5	61686.4	40874
2005/06	623083	211010	412073	112074.7	67017.8	43871.4
2006/07	691559	228677	462882	133604.6	77122.4	56482.2

Source: Various Issues of Economic Survey, MOF, GON.

In the above table in 1980/81 the total expenditure was Rs. 4092.3 million, which reached Rs. 23549.8 million and in 1990/91 around 5.7 fold more. It reached the amount Rs. 133604.6 million around 5.6 folds more, in the 2006/07 comparing in 1990/91. Regular expenditure also increased from Rs. 1361.2 million in the FY 1980/81 to Rs. 77122.4 in

the FY 2006/07. Development expenditure exceeds the regular expenditure till 1997/98 than after it lesser than regular expenditure. In FY 1993/94 it has decreased by the amount Rs. 1393.3 million from the previous year. In FY 1997/98, the development expenditure amounting 412.6 million has again been decreased registering the negative change over previous year. But in FY 2006/07, development expenditure has increased Rs. 12610.8 million form the previous year's figure.

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

Table 5.2

Total Regular & Development Expenditure as % of GDP (at current price)

Rs. in Million

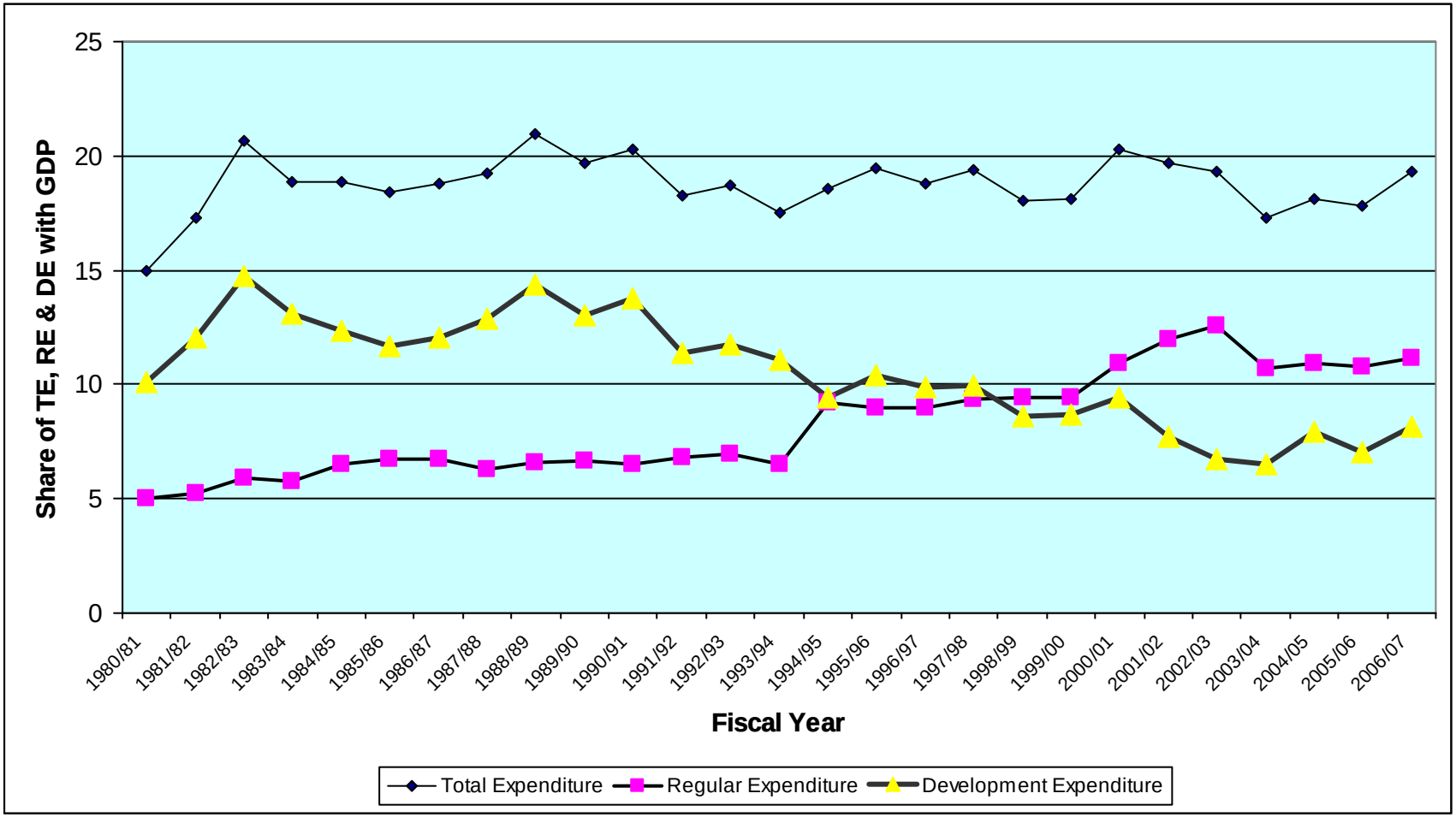
FY	Total Expenditure	Regular Expenditure	Development Expenditure
1980/81	14.99	4.98	10
1981/82	17.30	5.27	12.03
1982/83	20.67	5.92	14.75
1983/84	18.88	5.77	13.11
1984/85	18.89	6.54	12.35
1985/86	18.41	6.73	11.68
1986/87	18.81	6.74	12.07
1987/88	19.20	6.32	12.89
1988/89	20.98	6.61	14.36
1989/90	19.72	6.69	13.03
1990/91	20.28	6.52	13.76
1991/92	18.23	6.83	11.39
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	9.98
1998/99	18.05	9.41	8.64
1999/00	18.09	9.43	8.66
2000/01	20.3	10.9	9.4
2001/02	19.7	12.01	7.7
2002/03	19.3	12.6	6.7
2003/04	17.26	20.72	6.54
2004/05	18.1	10.9	7.9
2005/06	17.84	10.8	7.04
2006/07	19.31	11.15	8.16
Average	18.76	8.22	10.54

Source: Various Issues of Economic Survey, MOF, GON

Table 5.2 shows that total expenditure is least in the beginning of the study period; it is only 14.99% of GDP. It has not change in relation to GDP from the early 1990s to early millennium. It has remained constant instead around the average of 18.76% during the period under review. There is positive change from the FY 1980/81 to FY 1982/83 and reached 20.67%. In the fiscal year 1988/89, it reached maximum of 20.98. In the fiscal year 1990/91 the share was 20.28% while in the FY 2006/07 it goes down to 19.31%. However, remarkable changes are in case of regular expenditure and development expenditure. In FY 1980/81, regular expenditure as percentage of GDP was just 4.98%, which reached to 6.52% in 1990/91 and to 11.15%, nearly three fold in the FY 2006/07. The case of development expenditure is just opposite. Development expenditure as % of GDP was only 10.01%, which reached as higher as of 14.75% ever highest share, in 1982/83 which comes down to the figure of 8.16 in FY 2006/07.

During the study period, the growth rate of regular expenditure is higher than the development expenditure. It clearly indicates that government consumption type of expenditure is increasing faster than development expenditure or investment expenditure. This shows that the government is going towards non-productive activities.

The Figure 5.1: Percentage Share of TE, RE and DE with GDP



Source: Various Issues of Economic survey, MOF, GON.

The above figure shows that the percentage share of public expenditure with the GDP is increasing trend till the fiscal year 1982/83 and reaches maximum of 14.75% for the development expenditure and 20.67% for the total expenditure. The share of these expenditures decreases for some years then again increases and reaches once again maximum to 20.98% for the total expenditure and 14.37% for development expenditure. The development expenditure decreases the following years and drops to 6.54% of GDP in the FY 2003/04. In the FY 2006/07, the development expenditure is 8.16% of GDP. Where as regular expenditure increases substantially in all the study period and reached to 11.15% of GDP in the FY 2006/07. Which is very alarming situation for the management of the fiscal system.

Thus, the table 5.2 again justifies that fact of increasing regular expenditure and decreasing development expenditure. Decrease in total expenditure, as a ratio of GDP may be justifiable under the context of liberalization and privatization. The expansion of private sector and limiting the government activities from the production of commercial goods will certainly reduce the share of public expenditure in GDP simply because contribution of public enterprises is supposed to add to GDP decline. However, the increasing share of regular expenditure and decreasing that of development expenditure are really alarming sign for developing economy like nepal. Against the background of lower growth rate of the revenue than 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. Development expenditure must be raised immediately in order to meet the goals set by periodic plan. Only then rational of government expenditure will be justified with welfare prospective. For the last nine years, development expenditure have dropped compared to the regular expenditures. The challenge ahead is to maintain macro-economic stability by rationalizing the regular expenditure, streamlining development expenditure to highly productive sectors, broadening the tax base and reducing the size of deficit financing.

Table 5.3, compares the share of total government expenditure, regular expenditure and development expenditure to country's gross domestic product (GDP). It gives more precise and meaningful picture. This table pictures the scenario where all information has been expressed as percentage of GDP (at current price).

Table 5.3

Nominal Total Expenditure, Regular Expenditure, Development Expenditure and Percentage Distribution

(Rs. in million)

FY	Total Expenditure (TE)	Regular Expenditure (RE)	Development Expenditure (DE)	Percentage Distribution (RE and DE as % of TE		
				RE	DE	Total
1980/81	4092.3	1361.2	2731.1	33.30	66.70	100
1981/82	5361.1	1664.3	3726.8	30.50	69.50	100
1982/83	6979.2	1997.2	4982.1	28.60	71.40	100
1983/84	7436.6	2272.8	5163.8	30.60	69.40	100
1984/85	8394.8	2906.2	5488.6	34.60	65.40	100
1985/86	9797.2	3583.9	6213.3	36.60	63.40	100
1986/87	11501.0	4123.6	7378.0	35.90	64.10	100
1987/88	14050.1	4622.1	9428.0	32.90	67.10	100
1988/89	18005.0	5676.5	12328.7	31.50	68.50	100
1989/90	19670.7	6672.2	12997.5	33.90	66.10	100
1990/91	23553.6	7574.1	15979.5	32.20	67.80	100
1991/92	26418.2	9905.4	16512.7	37.50	62.50	100
1992/93	30897.7	11484.2	19413.6	37.20	62.80	100
1993/94	33597.4	12409.2	21188.2	36.90	63.10	100
1994/95	39060.0	19265.1	19794.9	59.30	50.70	100
1995/96	46541.6	21561.1	24980.5	46.30	53.70	100
1996/97	50723.7	24181.1	26542.6	47.70	52.30	100
1997/98	56118.3	27174.4	28943.3	48.40	51.60	100
1998/99	59579.0	31047.7	28531.3	53.60	46.40	100
1999/00	66272.5	34523.3	31749.2	53.70	46.30	100
2000/01	79835.1	45837.3	33997.8	57.41	42.59	100
2001/02	80072.3	48863.9	31208.3	61.02	38.98	100
2002/03	84006.1	52090.5	31915.6	62.00	38.00	100
2003/04	89442.6	55552.1	33890.5	62.10	37.90	100
2004/05	102560.5	61686.4	40874.0	60.14	39.86	100
2005/06	112074.7	67017.8	43871.4	60.43	38.57	100
2006/07	133604.6	77122.4	56482.2	57.72	42.28	100

Source: Various Issues of Economic Survey, MOF, GON.

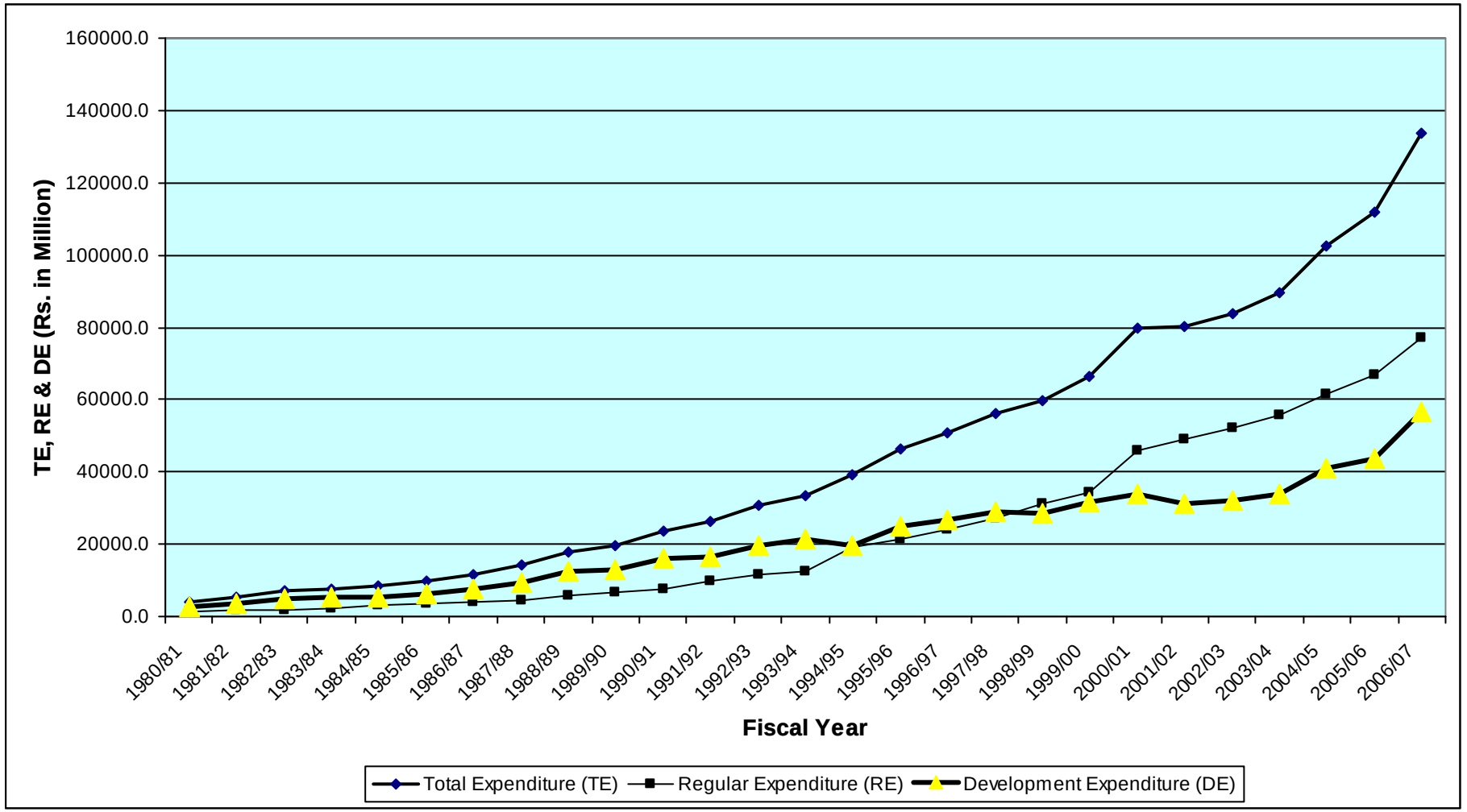
The above table 5.3 reflects the amount of regular, development and total expenditure during the study period. In 1980/81, the total expenditure was only Rs. 4092.3 million that amounted up to Rs. 19669.7 million in 1989/90 and in the fiscal year 2006/07, it reached Rs. 133604.6 million. This clearly depicts the study and increasing trend of public expenditure in Nepal (before and after the restoration of democracy). Table 5.3 also tells about the percentage share of regular and development expenditure in the total expenditure. In 1980/81, the percentage share of regular expenditure to total expenditure was 33.3% which were 33.9 at 1989/90. However, small fluctuations are seen in the share of regular expenditure to total expenditure, the average overall share during 1980-1990 over around 33 percent of total expenditure. Hence, during the early 10 years period under consideration, the average overall share of development expenditure was 67 percent (MOF, 1999)

Nevertheless, in the second half of the study, the picture is reversed. The overall pattern shows decreasing development expenditure. That is, more resources have been devoted for recurrent expenses rather for accumulations of capital. In FY 1990/91, the share of regular expenditure to total expenditure was 32 percent, which reached to 58 percent in the FY 2006/07 while the development expenditure has decreased from 68 to 42 percent during the same period. It is from the fiscal year 1998/99 the regular expenditure started surpassing the development expenditure (MOF, 2004).

In FY 2006/07, development expenditure increased by 3 percent against that of FY 2005/06 totaling 56 billion. In the ratio of regular and development expenditure, tendency of regular expenditure to

rise continued through FY 2006/07. In terms of ratios, regular expenditure was 60.43 percent and 39.57 percent in FY 2005/06. In FY 2006/07, regular expenditure ratio decreased to 57.72 percent while that of development expenditure increased 42.28 percent (MOF, 2008).

Fig. – 5.2: Trend in Total, Regular and Development Expenditure



Source: Various Issues of Economic Survey, MOF, GON

Figure 5.2 is drawn based on 5.3. Figure- 5.2 clearly shows that the unique trend of the public expenditure. Before 1998/99, the share of development expenditure was greater than regular expenditure in total expenditure. After then (after 1998/99) regular expenditure exceeds development expenditure. The figure 5.2 leads to several important aspects of Nepalese public expenditure structure. First is that government goal to meet major social objective of poverty alleviation is overshadowed by the increasing share of regular expenditure. The bulky resources 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 country when private sector is at infancy. However, the government has failed 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. The urgency is felt for the political commitment of reforms in public expenditure management as well as in resources allocation practices.

5.2.1 Regular Expenditure:

This category is in the consumption type of expenditure and therefore it includes recurring type of expenditures. Regular expenditure is made of various components. The main components are general administration, social service, economic service, loan repayment and interest, etc. under the heading of miscellaneous; other (not mentioned above) smaller components are included.

Table 5.4
Regular Expenditure

(Rs. in million)

FY	Defense	Total Expenditure on Adm**	Foreign Service	Social Services	Economic services	Interest Payment	Misc*	Total Regular Expenditure
1980/81	258.9	348.7	38.8	210.2	110.1	227.6	166.9	1361.2
1981/82	282.8	402.3	50.1	249.6	130.5	264.5	254.5	1634.3
1982/83	392.4	503.3	52.4	320.4	165.7	310.3	252.6	1997.1
1983/84	453.6	531.2	54.8	36.05	174.6	497.6	199.8	2272.8
1984/85	507.9	607.1	62.3	410.6	199.4	689.3	429.6	2906.2
1985/86	606.2	787.6	71.6	493.1	232.3	1028.3	264.8	3583.9
1986/87	712.4	929.1	93.7	508.2	286.0	1205.2	38.9	4123.6
1987/88	768.3	992.2	106.9	562.0	289.6	1444.2	458.9	4622.1
1988/89	898.7	1068.7	150.8	634.9	351.4	1729.6	742.3	5676.5
1989/90	1027.2	1327.2	152.1	716.1	423.8	2285.9	739.9	6672.2
1990/91	1151.4	1629.0	183.4	742.6	374.8	2417.4	1075.7	7574.1
1991/92	1489.0	2150.9	230.0	999.0	548.7	3800.1	676.7	9905.4
1992/93	1723.6	3292.4	310.1	1269.3	586.1	4584.5	618.1	11484.1
1993/94	1877.4	2527.7	329.6	1352.8	605.3	4871.1	845.3	12409.2
1994/95	2001.3	2607.2	376.7	4441.6	1353.9	6088.5	2195.7	19265.1
1995/96	2126.4	3285.9	385.0	5375.0	1533.5	6732.9	2123.2	21561.9
1996/97	2357.6	3899.4	440.4	5909.1	1738.2	7558.9	2277.5	24181.1
1997/98	2582.8	4161.3	482.1	6993.1	1889.9	7707.7	3357.3	27174.4
1998/99	2994.8	4712.7	607.4	7376.9	2167.9	8738.1	4450.2	31047.7
1999/00	3482.1	5247.8	672.6	8327.9	2224.8	10072.0	4496.1	34523.3
2000/01	3457.2	6816.9	587.8	15366.3	4899.9	4697.8	10659.6	45837.3
2001/02	5264.8	8792.9	668.5	16953.1	5795.1	5770.3	6299.4	48863.9
2002/03	6168.3	8901.8	709.7	18886.9	5078.5	6621.8	5657.3	52090.5
2003/04	6629.6	8938.2	710.2	20808.5	5512.8	6543.9	6568.2	55552.1
2004/05	8580.3	10065.8	794.2	23208.8	7167.8	6218.0	7275.5	61686.4
2005/06	9706.0	11407.7	826.0	25382.6	7529.8	6158.7	5224.0	67017.8
2006/07	10128.9	14199.7	846.8	29497.6	8384.8	6140.0	7900.5	77122.4

Source: Economic survey of various years and quarterly economic bulletins of NRB.

Note: ** Total expenditure on administration includes expenditure on constitutional bodies, general administration, revenue administration, economic administration & planning and judicial administration.

Table 5.4 exhibits the composition of regular expenditure under different heads. These categories have again been divides into different sub categories, which are not mentioned here in the table. Table 5.4 shows public expenditure on loan repayment and interest payment is lower than general administration till the fiscal year 1981/82 but it occupies the higher amount than other categories than after. This has registered the highest amount with amount with in the all FY compared to other these alone claims at an annual average of 25.62% more than one fourth of total regular expenditure incurs within the period. The share of loan repayment and interest payment reaches up to 39.90% in the FY 1992/93 which is not lower than 26% of total regular expenditures.

Next categories with substantial amount are the expenditure on social services. The expenditure on social services increases in all the years but it drops very low in 1983/84 which is only 36.05 million. This has, in an average a share of nearly 30% of total regular expenditure. Defense expenditure is the third major category which itself has remained as the center of gravity among the total regular expenditure. In the initial years, its share on total regular expenditure is very high more 19.0%, which decreases in the middle years and registers an average of 12%. But data reveals that there is an increasing trend in defense expenditure in the latter years of the analysis.

The analysis of data reveals that expenditure for administration (constitutional bodies, general, judicial, economic, revenue etc.) all assert nearly one fourth of the total expenditure, of which expenditure on foreign services is substantial expect than general administration. The expenditure on revenue administration and the

economic planning contains very normal share of total expenditure reaching Rs. 846.8, Rs. 1001.2 and Rs. 663.3 in 2006/07. Though the expenditure on revenue administration and economic planning administration increased in absolute terms in the subsequent years but still had little share over total regular expenditure in 2006/07 of 1.29% and 0.86% respectively while the share of constitutional organs, foreign service and defense on the same year is 1.13%, 1.12% and 13.13% respectively all being higher than those two. Allocation on economic services is quite lower than other categories. Expenditure under miscellaneous heading on the other hands has a remarkable bearing on the total regular expenditure.

The highest share of loan repayment and interest payment shows that block of resources is devoted for the maintenance of public enterprises and goes back to the donor countries. Ironically these public institutions have been suffering heavy loses every year adding extra burden to the government. This category also consists of the loan and interest payment of foreign aid. Under the background of low productivity of foreign aid, the opportunity cost of loan and interest payment of low productivity of foreign aid, the opportunity cost of loan and interest payment my be higher indeed. Another important aspect is that a substantial amount is allocated for the salaries, wage categories (e.g. general administration, foreign services, constitutional organs, judicial organs etc.) which have left a little amount for other categories like social services expenditure, economic services expenditure and mainly for the organization and management. In effect, allocations for operations and maintenance activities in the regular budget have been highly inadequate. For the last three years, development expenditure has dropped compared to

the regular expenditures. The challenge ahead is to streamling development expenditure to highly productive sectors, broadening the tax base, and reducing the size of deficit financing.

5.2.2 Development Expenditure

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

Table 5.5

Development Expenditure

Rs. in million

FY	Constitutional organization	General Administration	Economic Adm. & Planning	Social Services	Economic services**	Miscellaneous	Total
1980/81	-	0.7	30.0	572.5	2101.0	26.9	2731.1
1981/82	-	2.9	14.4	1059.6	2556.0	93.9	3726.1
1982/83	-	7.9	20.2	1540.3	3287	126.7	4982.1
1983/84	-	13.0	15.4	1493.5	3542.5	59.4	5163.8
1984/85	-	11.9	5.2	1501.2	3717.0	353.3	5588.6
1985/86	-	10.3	4.0	1699.9	4414.6	84.5	6213.3
1986/87	-	18.4	4.0	2036.3	5168.6	150.7	7378.0
1987/88	-	24.4	5.9	2433.3	6751.7	212.6	9427.9
1988/89	-	35.0	10.1	3309.2	8241.1	732.8	12328.2
1989/90	-	14.3	10.8	3973.2	8200.7	798.7	12997.7
1990/91	-	11.3	83.3	3569.3	11893.3	422.2	15979.4
1991/92	-	13.8	39.3	5040.3	11063.3	356.1	16512.8
1992/93	-	29.0	18.7	7245.5	12111.5	8.9	19413.6
1993/94	-	31.3	19.5	7104.1	13841.4	191.9	21188.2
1994/95	-	33.5	31.6	6224.8	12852.7	652.3	19794.9
1995/96	-	41.6	33.2	7612.7	16982.7	310.3	24980.5
1996/97	-	34.5	17.3	9281.3	17054.7	154.8	26542.6
1997/98	3.6	46.4	19.3	10323.5	17900.2	650.9	28943.9
1998/99	28.5	79.2	20.5	10265.4	17324.4	813.3	28531.3
1999/00	26.6	108.1	28.6	12406.2	18648.6	531.3	31749.2
2000/01	19	965.8	17.4	8489.0	17745.1	643.2	27879.5
2001/02	11.9	838.0	7.3	7927.5	13562.1	1755.5	24102.6
2002/03	16.8	518.3	3.7	7050.9	12561.0	875.6	21026.3
2003/04	36.8	578.1	8.9	7135.2	13129.0	172.1	21060.1
2004/05	37.7	883.6	24.2	7940.7	15394.9	435.3	24716.4
2005/06	96.1	1181.7	20.3	10151.8	14797.1	13.6	26260.6
2006/07	45.3	4512.0	26.2	15529.3	17938.6	223.1	38274.5

Note: ** Economic services include communication, transportation and electricity.

Source: Economic Survey of Various years and quarterly economic bulletin of NRB.

Table 5.5 shows that the development expenditure has divided into different functional groups. In the fiscal year 1980/81, the expenditure under economic service was Rs. 2101 million which reached Rs. 11893.3 million in 1990/91 and Rs. 17938.6 million in FY 1990/91 and Rs. 17938.6 million in FY 2006/07. The highest amount spent under this head was in FY 1999/00 amounting to Rs. 18648.6 million. Social service expenditure shows some ups and downs in different fiscal year. In 1980/81 the expenditure made under this heading was Rs. 572.5 nearly three fold less than the expenditure on economic service on the same fiscal year. This amount had reached to Rs. 1699.9 million in FY 1985/86 and it has reached Rs. 15529.3 million in FY 2006/07. The highest amount however spent on social service was Rs. 10151.8 million in 2004/05. This amount however increases to Rs. 15529.3 million in the following FY. Expenditure incurred under miscellaneous heading is also significant. In the initial period of this study the expenditure this head was small but increased in the latter period. Except the 1992/93, the amount allocated under this head was significantly higher than other categories like constitutional organs. Table 5.5 exhibits some special characteristics. It is seen that social services expenditure and economic service expenditure hold a large share in total development expenditure. The expenditure on administrative reforms side such as spending on constitutional organ, general administration and economic administrative and planning command some amount on development expenditure signifying the reforms process on the administrative side. These factors will contribute in realizing the efficient and good governance within 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. It is necessary to give sight into different component of social service and economic service expenditure, which hold a large share in total development expenditure in order to have precise picture on development expenditure.

Table 5.6

Development Expenditure under Social and Economic Service

Rs. in million

	Social Service			Economic Service					
	Education	Health	Drinking water	Agriculture	Forestry	Industries	Communication	Transport	Electricity
1980/81	285.6	97.7	73.2	257	89.3	123.2	30.8	601.3	653.2
1981/82	412.3	152.8	107.5	468	185.4	266.5	49.2	744	382.2
1982/83	604.6	216.3	241.9	668.6	228.1	373	74.3	802.2	443.3
1983/84	678.6	199.8	220.9	547.1	234.5	651.3	97.2	746.8	653
1984/85	644.2	254.8	201.6	703.6	290.4	347	90.4	923	504.9
1985/86	879.4	255.9	228.3	856.2	365	397.5	89.5	717.1	1035.4
1986/87	1036.5	309.2	274.2	681.7	388.4	377	139.8	986	1239.2
1987/88	1226.8	385.2	236.3	928.9	449.6	604	519	1214.6	1924.7
1988/89	1458.8	616	469.3	1016.2	556.7	554.3	374.7	1857.2	2003.4
1989/90	1479.8	393.8	617.4	1183.5	547.2	1049	128.4	1590.1	2087.6
1990/91	1716	366.8	538.5	1534.6	460.1	1751.5	56.7	1979.5	1363.1
1991/92	2395.2	537.2	1334.4	1276	884.3	2427.2	116	2381	1414.4
1992/93	3465	600.2	1821.4	2077.2	928.8	1085.6	474.7	2844	2229.1
1993/94	3822.1	560.5	1073.6	2300.3	966.5	648	437.6	3363.2	2312.2
1994/95	1453.6	858.5	1102.2	2639.4	408.4	27.2	1517.8	3010.6	1764.9
1995/96	1791	915.5	1206.3	2224	378.7	306	1151.7	5968.5	3210.2
1996/97	2356.2	1621.2	1327.1	1189.6	463.8	363.5	1095.9	5305.2	4447.3
1997/98	2037.1	2076.1	1670	2144.3	410.4	477.1	1188.4	5619.9	4707.7
1998/99	1641.3	1677.2	1866.8	1926.2	480.5	289.4	466	5111.3	4811.3
1999/00	2573.7	2126.7	2423	2089.5	519	833.9	282.5	4695.4	5537.9
2000/01	1224	913.1	1898.3	552	292.7	132.4	263.3	5168.6	6715.5
2001/02	1103	899.3	1418	505.4	376	125.6	256.6	4429.6	4371.9
2002/03	940.7	159.3	1669.9	187	373.7	425.1	1680.1	3664.9	3831.6
2003/04	1003.4	142.2	2065.8	160.2	459.8	40.5	356.5	3959	4746.2
2004/05	1260.4	409.3	1440	217.5	410.7	23.5	536.8	4149.6	7219.1
2005/06	1609.6	948.2	1949.8	265.4	148	31	283.6	4178.1	6256.4
2006/07	1604.9	1185.5	3182.7	1374.2	152.5	91.2	251	6382.1	5450
	41725.5	19331	30918	30902.2	11767.15	14385.1	12083.8	84760	82460

Source: Economic Survey of various years and quarterly economic bulletin of NRB.

Tables 5.6 consider only important sub components of social services and economic services. Table 5.6 exhibits that education; health and drinking water are the important component of social service expenditure. Education under social service expenditure claims a largest share in this expenditure. This alone is an average command 25.61% of total social service expenditure during the period taken for the study. The average share of health and drinking water was 11.86% and 18.97% respectively during the same period. In the FY 1980/81, expenditure under education was Rs. 285.6 million and in the FY 1990/91 expenditure under education was Rs. 1716 million, which reaches Rs. 1604.9 million in FY 2006/07. Similarly, the expenditure on health and drinking water was Rs. 97.7 and Rs. 73.2 million respectively on FY 1980/81, which increases amounting Rs. 1185.5 and Rs. 3182.7 million in 2006/07; both increases by substantial amount. Moreover the spending on health has increased surpassing the spending on health. Table 5.6 exhibits that the rate of change in drinking water and health is more than that of education from the initial year to last year of study period.

Expenditure under different component of economic service reveals different pattern of them, transportation occupies a larger share in the expenditure under this head. This expenditure had increased from Rs. 601.3 million in the FY 1980/81 to Rs. 6382.1 million which was nearly 10.62 times from FY 1980/81 to 2006/07. In FY 2006/07, the ever-highest amount of the period taken for the study, Rs. 6282.1 million is spent under this category.

The spending on agriculture has many ups and downs, for some period it is increases but in the other period it is decreases. It decreases nearly half in the FY 1996/97 but it increases in the

subsequent years. This reveals the fact that government is not keen to implement the agriculture prospective plan, which is the master plan of the agricultural development of the country.

Electricity occupies the third major sector of expenditure in the economic services, which has been considered as the major prospects of the country's development. The expenditure on forestry, industry and communication have occupies smaller amount. They ranges from Rs. 89.3, Rs. 123.2 and Rs.30.8 million in the FY 1980/81 to Rs. 152.5, Rs. 91.2 and Rs. 251 million in the FY 2006/07.

These figures on table 5.6 do not reveal any surprising figures. Under the assumption of infant private sector and democratic governmental set up justifies the need of large of resources to be allocated under the social services and economic services. The real debate however should be the productivity of such spending under the different components of social and economic services. Accordingly, there is the need of inter sector comparison to guarantee the high yield so that the society's major objective of poverty alleviation can be achieved with in the desired period.

To get precise information, growth rate of total expenditure and its component, major functional categories have been carried out and analyzed.

5.3 Public Expenditure Growth Rate

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

Table 5.7

Growth Rate of Total, Regular, Development Expenditure and Share of Public Expenditure in GDP

Rs. In Million

FY	Total Expenditure	Regular Expenditure	Development Expenditure	Share of Public Expenditure in GDP
1980/81	-	-	-	-
1981/82	31	20.06	36.46	17.3
1982/83	30.18	22.2	33.68	20.67
1983/84	6.55	13.81	6.29	18.88
1984/85	12.89	27.87	13.2	18.89
1985/86	16.71	23.32	18.75	18.41
1986/87	17.4	15.06	27.79	18.41
1987/88	22.16	12.09	30.77	19.2
1988/89	28.15	22.81	5.42	20.98
1989/90	9.2	14.1	5.4	19.72
1990/91	19.7	16.4	22.9	20.28
1991/92	12.2	27.3	3.3	18.23
1992/93	17	13.7	17.6	18.69
1993/94	8.7	6.3	9.1	17.54
1994/95	16.3	58	(-) 6.6	18.6
1995/96	19.3	12.7	26.2	19.44
1996/97	9	10.8	6.3	18.82
1997/98	10.6	12.1	9	19.36
1998/99	6.2	37.4	(-) 1.43	18.05
1999/00	11.2	11.4	11.28	18.09
2000/01	20.5	28.8	16.75	20.3
2001/02	0.3	6.6	(-) 15.06	19.7
2002/03	4.9	6.6	(-) 9.8	19.3
2003/04	6.5	6.6	3.3	17.26
2004/05	14.7	11	18.4	18.1
2005/06	8.1	8.6	8.3	17.84
2006/07	20.48	15.1	28.7	19.31
Average	14.1	21.36	12.07	

Source: Various Issues of Economic Survey and Quarterly Economic Bulletin of NRB.

The growth rate of total public expenditure on the FY 1981/82 was 31 percent. There was maximum growth rate in FY 1981/82, which became 31 percent whereas there is 20.48 percent growth rate in FY 2006/07. Similarly, regular expenditure in the beginning of the study period was 20.06%. It increased to 27.30% in FY 1991/92 to ever highest growth rate in FY 1994/95 of 58.00%, which was substantially higher than the decade's average of 21.36%. 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.

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, 2002/03. In FY 1981/82 there was 36.46 percent of growth rate in development expenditure is occurred which was the highest growth rate achieved during the period of analysis. Similarly there was a growth rate of 8.3 percent in FY 2005/06, which drastically has increased positive growth of 28.70 percent in FY 2006/07. The corresponding share of public expenditure is lower in comparison with those of many other developing countries; even then public sector has steadily emerged as a powerful source of economic management and development.

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 expenditures 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

Table- 5.8

Growth rate of Regular Expenditure Categories (major functional categories)

Rs. in Million

FY	General Administration	Defense	Social Service	Economic Services	Loan Repayment & Interest
1980/81	-	-	-	-	-
1981/82	15.68	9.23	18.74	18.53	18.63
1982/83	29.63	38.76	28.37	26.97	19.64
1983/84	8.23	15.6	(-) 88.75	5.37	62.08
1984/85	17.35	11.97	1038.97	14.2	36.29
1985/86	25.41	19.35	20.09	16.5	50.29
1986/87	17.76	17.52	3.06	23.12	17.39
1987/88	13.96	7.85	10.59	1.26	20.47
1988/89	20.5	16.97	12.97	21.34	19.36
1989/90	13.1	14.3	12.79	20.6	32.46
1990/91	22.52	12.09	3.7	(-)11.56	5.62
1991/92	29.05	29.32	34.53	46.4	57.73
1992/93	19.25	15.76	27.06	6.82	20.1
1993/94	4.62	8.92	6.58	3.28	6.46
1994/95	11.54	6.6	228.33	123.67	25.3
1995/96	18.39	6.25	21.01	13.27	10.39
1996/97	13.25	10.87	9.94	13.35	12.09
1997/98	11.14	9.55	18.35	8.73	2.07
1998/99	14.46	15.95	5.49	14.71	13.54
1999/00	12.58	16.27	12.89	2.62	15.02
2000/01	53.57	9.51	30.67	(-)26.69	3.54
2001/02	23.48	53.66	22.68	16.8	17.49
2002/03	2.74	17.16	11.1	-12.36	14.75
2003/04	-1.4	7.47	10.15	8.55	-1.17
2004/05	12.29	29.42	11.53	30.02	-4.9
2005/06	20.21	32.95	9.64	2.68	-9.53
2006/07	19.52	4.35	16.21	11.35	0.08
Average	16.63	16.2	56.92	14.72	17.15

Source: Economic Survey of Various Years and Quarterly Economic Bulletin of NRB/N.

Table 5.8 shows the growth rate of major functional categories of regular expenditure. The average growth rate of economic services and social services are 14.72% and 56.92%. These both categories have experienced negative growth rate also in some fiscal years. For example, the growth rate of social services has registered negative growth rate in one fiscal year 1983/84. Likewise, the negative growth rate of economic service was experience during the FY 1990/91, 2000/01 and 2002/03. The highest growth rates during the period under study in the social services observed in the FY 1984/85 of 1038.97 percent. The highest growth rate however has been achieved under the category of general administration followed by the defense. These two have average growth of 16.63% and 16.20% respectively; exceeding the economic service growth rate. Loan repayment and interest payment category has registered the average growth rate of 17.15 percent.

From the table presented the growth rates highlight that the spending on the social service ad economic service, which is most desirable with respect to societal objective of poverty alleviation, should be increased. The growth rate of general administration may signify the institutional reform process for the efficient bureaucracy system. However, because of the fact that, as noted in the pattern in pubic expenditure, the bulk of spending is done on the salaries and wage categories, this trend however does not correspond to the reforms process. At the same time, the growth rate of defense falsifies the hypothesis that there have been explosive rise in security expenditure during the late 1990s. On the other hand, the trend reveals that there is also persistent growth in the initial years of democracy. Social and economic service spending are the most

desirable because they include the human development dimension and economic growth promoting agents. They are of particular important because they signify the importance of government under democratic set up by providing basic (economic) needs to the people.

Table- 5.9
Growth Rates of Development Expenditure Categories (Major Functional Categories)

FY	Constitutional Organ	General Administration	Economic Administration and Planning	Social Services	Economic Services	Miscellaneous
1980/81	-	-	-	-	-	-
1981/82	-	278.9	(-)56.1	85.1	21.7	219.2
1982/83	-	142.6	24.9	45.4	28.6	20.2
1983/84	-	54.7	(-)28.3	(-)3.0	9	(-)55.9
1984/85	-	(-)12.1	(-)67.6	0.5	1	471
1985/86	-	(-)24.3	(-)32.8	13.2	22	-79.1
1986/87	-	58.5	(-)11.2	19.8	17.1	58.3
1987/88	-	18.6	31.9	19.5	30.6	26.2
1988/89	-	28.9	53.9	36	22.1	209.8
1989/90	-	(-)63.1	(-)3.4	20.1	(-)0.5	-1.6
1990/91	-	(-)27.8	604.8	(-)10.2	45	-51.7
1991/92	-	2.4	(-)60.5	41.2	(-)7	-29.3
1992/93	-	90.2	(-)56.9	43.8	9.5	-97.7
1993/94	-	0.5	(-)2.9	(-)2.0	14.3	1907.8
1994/95	-	0.5	52.1	(-)12.4	(-)8.9	219.1
1995/96	-	15.1	(-)2.6	22.3	34.7	-55.9
1996/97	-	(-)22.7	(-)51.4	21.9	0.4	-53.5
1997/98	-	29.4	7.3	11.2	5	304.4
1998/99	626.4	56.6	(-)2.5	(-)0.6	(-)3.2	14.7
1999/00	-10.8	30.5	33.4	20.9	7.6	-37.6
2000/01	-53.5	14.7	568.5	3.8	13.2	403.2
2001/02	2	90.1	(-)53.6	(-)38.4	(-)35.8	-24.5
2002/03	-35	(-)62.3	(-)66.7	(-)11.1	(-)7.4	-50.3
2003/04	11-.04	11.53	140.54	1.2	4.5	0.16
2004/05	2.45	52.85	171.9	11.3	17.3	17.36
2005/06	154.9	33.73	(-)16.11	27.8	-3.9	6.24
2006/07	(-)52.86	281.8	29.06	52.97	21.23	45.75
average	27.87	39.99	44.65	15.56	9.56	125.4

Source: Economic Survey of Various Years and Quarterly Economic Bulletin of NRB/N.

Among the development expenditure categories, the higher growth rate has been obtained for miscellaneous services and constitutional organs. Economic administration and planning accounts for moderate increase in average growth rate and the same is of general administration. As shown in table 5.9, miscellaneous services are rising at a faster rate (125.4 percent per annum) than other services. The expenditure on general administration and economic administration and planning increased at a rate of 40 and 45 percent per year, respectively during 1980/81 to 2006/07 period. During the same period, a growth rate of 15.56 percent in social services and 9.56 percent per year in economic services in observed.

Table- 5.10

Growth Rate of Social Services Categories

FY	Education	Health	Drinking Water
1980/81	-	-	-
1981/82	44.36	56.4	46.86
1982/83	46.64	41.56	125.02
1983/84	12.24	(-)7.63	-8.68
1984/85	(-)5.07	27.53	-8.74
1985/86	36.51	0.43	13.24
1986/87	17.86	20.83	20.11
1987/88	18.36	24.58	-13.82
1988/89	18.91	59.92	98.6
1989/90	1.44	(-)36.07	31.56
1990/91	15.96	(-)6.86	-12.78
1991/92	39.58	46.46	147.8
1992/93	44.66	11.73	36.5
1993/94	10.31	-6.61	-41.06
1994/95	(-)61.97	53.17	2.66
1995/96	23.21	6.64	9.44
1996/97	31.56	77.08	10.01
1997/98	(-)13.54	28.06	25.84
1998/99	(-)19.43	-19.21	11.78
1999/00	56.81	26.8	29.79
2000/01	8.17	-7.26	-0.65
2001/02	(-)1.03	-4.85	-27.41
2002/03	(-)14.71	-82.28	17.76
2003/04	6.66	-12.02	23.7
2004/05	25.6	187.8	-30.3
2005/06	27.7	131.7	35.4
2006/07	-0.29	25.02	63.23
Average	13.72	23.81	22.43

Source: Quarterly Economic Bulletin (Various issues) Nepal Rastra Bank and Economic Survey of Nepal of Various Years.

Table 5.10 shows the growth rate of different categories of social service spending. These categories include mainly education, health and drinking water. There are many ups and downs in all the categories. Table 5.9 shows that all categories under social services spending have negative growth rate in some years. Education sector has average growth rate of 13.72 percent during the period 1980/81 to 2006/07. The highest average growth however is under the health sector which registered average growth rate of 23.81 percent. Drinking water sector has also growth rate of 22.43 percent in an average. The highest growth rates achieved in these sectors are 56.81% in education in the FY 1999/00, 187.8% in health in FY 2004/05 and 147% in drinking water in 1991/92.

Table 5.11

Growth rate of Economic Services Categories

FY	Agriculture	Forestry	Industry & Mining	Communication	Transportation	Electricity
1980/81	-	-	-	-	-	-
1981/82	82.1	107.61	116.31	59.74	23.73	-41.49
1982/83	42.86	23.03	39.92	51.02	7.82	15.99
1983/84	-18.87	2.81	74.61	30.82	-6.91	47.3
1984/85	28.61	23.84	-46.72	-7	23.59	-22.68
1985/86	21.69	25.69	14.55	-1	-22.31	105.07
1986/87	-20.38	6.41	-5.16	56.2	37.5	19.68
1987/88	36.26	15.76	60.21	271.24	23.18	55.32
1988/89	9.34	23.82	-8.23	-27.8	52.91	4.09
1989/90	16.46	-1.71	89.25	-65.73	-14.38	4.2
1990/91	29.67	-15.92	66.97	-55.84	24.49	-34.7
1991/92	-16.85	92.2	38.58	104.59	20.28	3.76
1992/93	62.79	5.03	-55.27	309.22	19.45	57.6
1993/94	10.74	4.06	-40.31	-7.81	18.26	3.73
1994/95	14.74	-57.74	-95.8	246.85	-10.48	-23.67
1995/96	-15.74	-7.27	1025	-24.12	98.25	81.89
1996/97	-46.51	22.47	18.79	-4.85	-11.11	38.54
1997/98	80.25	-11.51	31.25	8.44	5.93	5.78
1998/99	-10.17	17.08	-39.34	-60.79	-9.05	2.27
1999/00	8.48	8.01	188.15	-39.38	-8.14	15.1
2000/01	11.48	-7.73	-56.01	-13.63	14.05	23.04
2001/02	9.96	31.74	58.81	11.19	-15.63	-35.49
2002/03	-62.99	-0.61	238.45	554.75	-17.26	-11.21
2003/04	-14.33	23.03	-90.47	-78.78	-7.99	22.27
2004/05	35.76	-10.67	-41.97	50.57	4.84	52.1
2005/06	22	-64	31.9	-47.2	0.7	-13.3
2006/07	41842	3.04	194.1	-11.5	50.35	-12.88
Average	27.25	9.57	53.5	48.48	10.85	13.44

Source: Quarterly Economic Bulletin (Various Issues), Nepal Rastra Bank and Economic Survey of Nepal of Various Years.

Table 5.11 presents the growth rate of different categories under economic services spending. The major categories under this heading are agriculture, forestry, industry and mining, transport, communication, electricity etc. Table 5.10 shows some obvious trend reflecting the nature of economic services development with in the economy. There are fluctuations from year to latter year, the average figures have attempted to present overall trend on the economic service categories. It can be seen that the lowest average growth so far maintained is under the category of transportation. The highest average growth rate is under industry and mining followed by, communication and agriculture, electricity and forestry.

The above Table leads to several consequences regarding the economic development of the country. The low growth rate cum massive poverty can be attributed as the significant consequences of under funded agriculture sector. While at the same time, the highest growth rate under industry and mining sectors support the nation of private sector led liberalization policy with in the country. This has given impetus to the fact the secondary sector is expanding contributing to the process of economic development in the country. Investment in the electricity and communication still hold higher average growth rate than agriculture.

Table 5.12
Sources of Financing Public Expenditure

Rs in million

FY	Total Revenue (TR)	Foreign Aid (FA)	Internal Borrowing (IB)	Percentage Share on Total Expenditure of			FA as % of Development Expenditure
				(TR)	(FA)	(IB)	
1980/81	24.19	1562.2	250.0	59.1	38.2	6.1	57.2
1981/82	26.79.5	1723.2	500.0	50.0	32.1	9.3	46.2
1982/83	2841.6	2075.9	1000.0	40.7	29.7	14.3	41.7
1983/84	3409.3	2547.5	1576.8	45.8	34.3	21.2	49.3
1984/85	3916.6	2678.3	1799.9	46.7	31.9	21.4	48.8
1985/86	4644.5	2674.0	1403.4	47.4	37.5	14.3	59.1
1986/87	5975.1	3990.9	1644.7	52.0	34.7	14.3	54.1
1987/88	7350.4	5892.6	1130.0	52.3	41.9	8.0	62.5
1988/89	7776.9	7347.0	1330.0	43.2	40.8	7.4	59.6
1989/90	9287.5	7935.0	2150.0	47.2	40.3	10.9	61.1
1990/91	10729.9	8421.5	4552.0	45.6	35.8	19.3	52.7
1991/92	13512.7	8460.7	2078.0	51.1	32.0	7.7	51.2
1992/93	15148.4	10714.2	1620.0	49.0	34.7	5.2	55.2
1993/94	19580.8	11557.2	1820.0	58.3	34.4	5.4	54.5
1994/95	24575.2	11249.4	1900.0	62.9	28.8	4.9	56.8
1995/96	27893.1	14289.0	2200.0	59.9	30.7	4.7	57.2
1996/97	30373.5	15031.9	3000.0	59.9	29.6	5.9	56.6
1997/98	32937.9	16457.1	3400.0	58.7	29.3	6.1	56.9
1998/99	37251	16189.0	4710.0	62.5	27.2	7.9	56.7
1999/00	42893.8	17523.9	5500.0	64.7	26.4	8.3	55.2
2000/01	48893.6	18797.4	7000.0	61.2	23.5	8.8	50.7
2001/02	50445.5	14384.8	8000.0	63.0	18.0	10.0	45.7
2002/03	56229.8	15885.5	8880.0	66.9	18.9	10.6	54.7
2003/04	62331	18912.4	9597.4	69.7	21.1	10.7	55.8
2004/05	70122.7	23657.3	7743.7	68.4	23.1	7.6	57.9
2005/06	72282.1	22041.8	3732.8	64.5	19.7	3.3	50.2
2006/07	87712.2	25854.3	11856.8	65.7	19.4	8.9	45.8
Average				56.3	30.2	9.7	53.9

Source: Economic Survey, 1998/99 and 2006/07 MOF

In the above table 5.12 shows the Foreign aid as percentage of development expenditure is very high. In an average, foreign aid as percentage of development expenditure has been financed by foreign aid thus; the analysis of data reveals that the expanding public sector size has been maintained either through the internal resource mobilization efforts or through the increasing in flow of foreign resources.

CHAPTER-SIX

AN ANALYSIS OF THE EFFECT OF GOVERNMENT EXPENDITURE

6.1 Introduction

In the developing countries, like Nepal private sector is not well development. So, the government expenditure increases with its increasing activities. When market works perfectly, price mechanism will solve the basic economic problems of what, how and whom to produce. Government intervention, however, does not necessarily provide guarantee that society will benefit from such action. Government failure may be as common as market failure. Tight budget, high cost of raising revenue (particularly the administrative and distortion costs of taxation) and a multiplicity of claims on the public purse dictate that government activity demonstrates its ability to add tangibly to the economy. Expecting countries with low capacity and few resources to undertake more complicated redistributive functions such as providing social safety nets (health care and retirement) could be a tall order to fill. Improving government performance requires, among other 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 effect of total government expenditure on output can be analyzed by establishing some models such as by analyzing the relationship between GDP and total government expenditure, relationship between agriculture GDP and total government expenditure and relationship between non-agriculture GDP and total government expenditure.

6.2 Relation between GDP and Total Government Expenditure

The relation examines the effect of government on output (GDP). Ordinary Least Square (OLS) method is applied to estimate the relevant regression equations. Various statistical tests like t-test, F-test, DW-test, R-squared, Adjusted R-squared are used to verify the relationship. While estimation the

equation lags structure is also considered. Let us consider the following equations:

(i) ζGDP_t = 115430.8 + 2.424 ζTE_t

Standard Error	(45143.63)	(0.616)
t-statistics	2.557	3.933
R^2	0.382	
$\bar{R}^2$	0.357	
F-test	15.466	
DW-test	0.826	

(ii) ζGDP_t = 136592.6 + 2.318 ζTE_{t-1}

Standard Error	(47071.99)	(0.674)
t-statistics	2.902	3.440
R^2	0.33	
$\bar{R}^2$	0.302	
F-test	11.83	
DW-test	0.704	

(iii) ζGDP_t = 65267.36 + 1.832 ζTE_t + 1.733 ζTE_{t-1}

Standard Error	(46303.55)	(0.586)	(0.606)
t-statistics	1.410	3.125	2.859
R^2	0.53		
$\bar{R}^2$	0.489		
F-test	12.962		
DW-test	0.601		

(iv) ζGDP_t = 35576.616 + 1.509 ζTE_t + 1.451 ζTE_{t-1} + 1.366 ζTE_{t-2}

Standard Error	(47677.231)	(0.566)	(0.579)	(0.587)

t-statistics	0.746	2.668	2.505	2.326
R^2	0.609			
$\bar{R}^2$	0.553			
F-test	10.894			
DW-test	0.509			

In this models change in Gross Domestic Product is regressed on lag change in Total Government Expenditure.

Equation (i) shows that there is a positive relationship between change in GDP and change value of TE. The intercept term (~) is 115430.8 which indicate that GDP_t would be 115430.8 if the independent variable TE_t is zero. The result shows that value of the coefficient ( ) of TE_t is 2.424, which explain that one unit increases in TE_t causes GDP_t would increase by 2.424 units. The R squared and Adjusted R square values lying around 0.357 reveals the fact that about 35 % change in GDP_t is explained by the change in Government Expenditure. F statistics also supports for the overall fitness of the model which is about 15.466. The value of DW is moderate.

Equation (ii) shows that, there is positive relationship between change in GDP and change in one year lag value of TE. The intercept term (~) is 136592.6 which indicate that GDP_t would be 136592.6 if the independent variable TE_{t-1} is zero. The result shows that value of the coefficient ( ) of TE_{t-1} is 2.318, which explain that one unit increases in TE_{t-1} causes GDP_t would increase by 2.318 units. The R squared and adjusted R squared values are lower than before F statistics supports for the overall fitness of the model which is about 11.83. The DW value is 0.704 which suggests that there is possibility of first order positive autocorrelation. So, a new model has been estimated as shown in the following paragraph.

Equation (iii) shows that there is a positive relationship between change in GDP and change in total government expenditure and one year lag value of change in total government expenditure. The intercept term (~) is 65267.36

which indicate that GDP_t would be 65267.36 if the independent variable TE_t is zero. The result shows that value of the coefficient ( ) of TE_t is 1.832, which explains that one unit increases in TE_t causes GDP_t would increase by 1.832 units keeping TE_{t-1} constant. Adjusted R squared values lying around 0.489 revels the fact that about 48 % change in GDP is explained by the change in total government expenditure, which is higher than the previous equation. F statistic also supports for the overall fitness of the model which is about 12.962. The DW value of 0.601 suggests that there is possibility of first order autocorrelation. So, that, a new model has been estimated and shown in equation iv.

Equation (iv) shows that there is positive relationship between change in GDP and change in TE of current years, one year lag and two years lag values. The intercept term (~) is 35576.616 which indicate that GDP_t would be 35576.616 if the independent variable TE_t is zero. The result shows that value of the coefficient ( ) of TE_t is 1.509, which explains that one unit increases in TE_t causes GDP_t would increase by 1.509 units keeping TE_{t-1} and TE_{t-2} constant. Adjusted R squared values lying around 0.553 revels the fact that about 55 % change in GDP is explained by the change in Government Expenditure, which is higher than previous equation of the model. F statistics supports for the overall fitness of the model which is about 10.894. The DW value of 0.509 suggests that there is no positive autocorrelation. Insignificant coefficient of TE_{t-2} indicates that the model is over fitted.

Further, government multiplier is estimated.

6.3 Relation between Agricultural GDP and Total Government Expenditure

(i) ζ AG-GDP_t = 51453.821 + 0.814 ζ TE_t

Standard Error	(14969.491)	(0.204)
t-statistics	3.437	3.981
R^2	0.388	
$\bar{R}^2$	0.364	

F-test	15.851
DW-test	0.851

(ii) ζ AG-GDP$_t$ = 58826.382 + 0.778 ζ TE$_{t-1}$

Standard Error	(15515.23)	(0.333)
t-statistics	3.792	3.502
R^2	0.338	
$\bar{R}^2$	0.311	
F-test	12.263	
DW-test	0.718	

iii) AG-GDP$_t$ = 35085.084 + 0.610 ζ TE$_t$ + 0.583 TE$_{t-1}$

Standard Error	(15197.537)	(0.192)	(0.199)
t-statistics	2.309	3.169	2.931
R^2	0.539		
$\bar{R}^2$	0.499		
F-test	13.463		
DW-test	0.620		

iv) AG-GDP$_t$ = 25967.930 + 0.499 ζ TE$_t$ + 0.486 ζ TE$_{t-1}$ + 0.490 ζ TE$_{t-2}$

Standard Error	(15581.333)	(0.185)	(0.189)	(0.192)
t-statistics	1.667	2.702	2.569	2.344
R^2	0.616			
$\bar{R}^2$	0.561			
F-test	11.237			
DW-test	0.536			

In these models change in agricultural GDP is regressed on change in total government expenditure.

Equation i) shows that there is positive relationship between change in agricultural GDP and change value of TE. The intercept term (~) is 51453.821 which indicate that ζ AG-GDP$_t$ would be 51453.821 if the independent variable TE$_{t-1}$ is zero. The result shows that value of the coefficient ( ) of TE$_{t-1}$ is 0.814, which explain that one unit increases in TE$_{t-1}$ causes ζ AG-GDP$_t$ would increase by 0.814 units. The R squared values lying around 0.388 revels the fact that the change in ζ AG-GDP$_t$ is explained by some other insignificant factors rather than change in total government expenditure. F -statistics also small which is 15.851. The DW value strongly supports the model which is 0.851 suggest that there is no autocorrelation.

Equation (ii) shows that, there is positive relationship between change in agricultural GDP and change in one year lag value of TE. The intercept term (~) is 58826.382 which indicate that ζ AG-GDP$_t$ would be 58826.382 if the independent variable TE$_{t-1}$ is zero. The result shows that value of the coefficient ( ) of TE$_{t-1}$ is 0.778, which explain that one unit increases in TE$_{t-1}$ causes ζ AG-GDP$_t$ would increase by 0.778 units. The R squared values are improved than before which is around 0.561. F statistics supports the overall fitness of the model which is about 15.851. The value of DW is moderate. So, a new model has been estimated as shown in the following paragraph.

Equation (iii) shows that there is a positive relationship between change in agriculture GDP and change TE and one year lag value of change in TE. The intercept term (~) is 35085.084 which indicate that ζ AG-GDP$_t$ would be 35085.084 if the independent variable TE$_t$ is zero. The result shows that value of the coefficient ( ) of TE$_t$ is 0.610, which explains that one unit increases in TE$_t$ causes ζ AG-GDP$_t$ would increase by 0.610 units keeping TE$_{t-1}$ constant. The R squared and Adjusted R squared values lying around 0.561 revels the fact that about 56 % change in ζ AG-GDP$_t$ is explained by the change in total

government expenditure, which is higher than the previous equation. F statistics also supports the overall fitness of the model which is about 13.463. The DW value of 0.620 suggests that there is no autocorrelation.

Equation (iv) shows that there is a positive relationship between change in agricultural GDP and change in current years last years and two years lag values of TE. The intercept term (~) is 25967.930 which indicate that ζ AG-GDP_t would be 25967.930 if the independent variable TE_t is zero. The result shows that value of the coefficient ( ) of TE_t is 0.499, which explains that one unit increases in TE_t causes ζ AG-GDP_t would increase by 0.499 units keeping TE_{t-1} and TE_{t-2} constant. The R squared and value lying around 0.616 revels the fact that change in Agricultural GDP_t is explained by some insignificant factors rather than lag values of public explained by some insignificant factors rather than lagged values of public expenditure. F statistics is also small. The DW value of 0.536 suggests that there is no autocorrelation. Insignificant coefficient of change in TE_{t-2} indicates that model is over fitted.

6.4 Relationship between Non-Agricultural GDP and Total Government Expenditure

To examine the relationship between total Government Expenditure and Non-Agriculture GDP linear regression models are estimated. Following equations verify the effects of change in total government expenditure on change in Non-Agriculture GDP.

i) NON-AG-GDP_t = 63988.364 + 1.610 ζ TE_t

Standard Error	(30312.106)	(0.414)
t-statistics	2.111	3.890
R^2	0.377	
$\bar{R}^2$	0.352	
F-test	15.133	
DW-test	0.808	

ii) ζ NON-AG-GDP_t = 77761.264 + 10540 ζ TE_{t-1}

Standard Error	(31683.382)	(0.453)
t-statistics	2.454	3.397
R^2	0.325	
$\bar{R}^2$	0.297	
F-test	11.538	
DW-test	0.693	

iii) ζ NON-AG-GDP$_t$ = 30189.912 + 1.222 ζ TE$_t$ + 1.150 ζ TE$_{t-1}$

Standard Error	(31285.679)	(0.396)	(0.410)
t-statistics	0.965	3.085	2.809
R^2	0.522		
$\bar{R}^2$	0.489		
F-test	12.573		
DW-test	0.588		

iv) ζ NON-AG-GDP$_t$ = 9614.196 + 1.009 ζ TE$_t$ + 0.965 ζ TE$_{t-1}$ + 0.916 ζ TE$_{t-2}$

Standard Error	(32315.900)	(0.383)	(0.393)	(0.398)
t-statistics	0.298	2.632	2.457	2.310
R^2	0.602			
$\bar{R}^2$	0.545			
F-test	10.583			
DW-test	0.493			

In these models change in Non-Agricultural GDP is regressed on lag change in total government expenditure.

Equation (i) shows that there is a positive relationship between change in NON-AG-GDP and change value of TE. The intercept term (~) is 63988.364 which indicate that NON-AG-GDP_t would be 63988.364 if the independent variable TE_t is zero. The result shows that value of the coefficient ( ) of TE_t is 1.610, which explains that one unit increases in TE_t causes NON-AG-GDP_t would increase by 1.610 units. The R squared value lying around 0.377 reveals the fact that about 37 % change in NON-AG-GDP_t is explained by change in total government expenditure. F statistics also supports the overall fitness of the model which is about 15.133. The DW value of 0.808, suggests that there is possibility of first order positive autocorrelation. So that, a new model has been estimated and shown in equation (ii). Equation (ii) shows that, there is positive relationship between change in NON-AG-GDP and change in one year lag value of TE. The intercept term (~) is 77761.264 which indicate that NON-AG-GDP_t would be 77761.264 if the independent variable TE_{t-1} is zero. The result shows that value of the coefficient ( ) of TE_{t-1} is 10540, which explain that one unit increases in TE_{t-1} cause NON-AG-GDP_t would increase by 10540 units. The R squared and Adjusted R squared values are lower than before. F statistics of the model is small, which is about 11.538. The DW value is of 0.693 suggests that there is possibility of first order positive autocorrelation. So, a new model has been estimated as shown in the following paragraph.

Equation (iii) shows that there is a positive relationship between change in non-agricultural GDP and change in TE and one year lag value of change in TE. The intercept term (~) is 30189.912 which indicate that ζ NON-AG-GDP_t would be 30189.912 if the independent variable TE_t is zero. The result shows that value of the coefficient ( ) of TE_t is 0.778, which explain that one unit increases in TE_t causes ζ NON-AG-GDP_t would increase by 0.778 units keeping TE_{t-1} constant. The R squared value lying around 0.522 revels the fact that about 52 % change in ζ NON-AG-GDP_t is explained by the change in total

government expenditure, which is higher than the previous equation. F statistics also supports for the overall fitness of the model which is about 12.573. The DW value of 0.588 suggests that there is possibility of first order positive autocorrelation. So, a new model has been estimated as shown in the equation (iv).

Equation (iv) shows that there is a positive relationship between change in non-agricultural GDP and change in current years values of TE but is negative to the last year's values of TE, which is not expected. Again, it is positive to the two years of TE. The intercept term (~) is 9614.196 which indicate that ζ NON-AG-GDP$_t$ would be 9614.196 if the independent variable TE$_t$ is zero. The result shows that value of the coefficient ( ) of TE$_t$ is 1.009, which explains that one unit increases in TE$_t$ causes ζ NON-AG-GDP$_t$ would increase by 1.009 units keeping TE$_{t-1}$ and TE$_{t-2}$ constant. The R squared value is lying around 0.602 revels the fact that about 60 % change in non-agricultural output (GDP) is explained by the change in total government expenditure, which is higher than the previous equation, F statistics also supports the overall fitness of the model which is about 10.583. The DW value of suggests that there is no autocorrelation.

6.5 Concluding Remarks

From the above analysis it is found that there is a positive relationship between the aggregate levels of GDP and total expenditure. Over the study period of years (1980/81 to 2006/07) it is found that government expenditure is also responsible for increasing both agricultural GDP as well as non-agricultural GDP.

CHAPTER –SEVEN

SUMMARY, CONCLUSION, MAJOR FINDINGS AND RECOMMANDATIONS

7.1 Summary

Government expenditure programs are the main viable source 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 structure of public expenditure and effects of government expenditure on GDP during the period 1980/81 to 2006/07. The trend and structure of public expenditure threaten the fiscal discipline and management. There are many factors giving rise to the increasing trend of regular expenditure on output is analyzed by establishing some models. The output or GDP originated in the economy is separated into agricultural and non-agricultural sectors. The changed structure of GDP and total expenditure of lagged values are taken for the study to make the data consistent.

7.2 Major Findings

- In the study period, the trend of public expenditure has been increasing. In the beginning of the study period, the increasing trend of development expenditure is greater than regular expenditure but after the FY 1998/99 the regular expenditure has been increasing until the last study period.
- Moreover, the regular expenditure has surpassed the development expenditure as against the accepted fiscal norms. In 1980/81 the total government expenditure was Rs.4092.3 million, which reached Rs. 133604.6 million in the fiscal year 2006/07. Regular expenditure also increased from Rs.1361.2 million in 1980/81 to Rs.77122.4 in fiscal year 2006/07. Development expenditure exceeds the regular expenditure until 1998/99, than after it is lesser than regular expenditure. This shows that

government spends more on regular activities than on development activities. The regular expenditure exceeds the development expenditure because in these years government spends more on the defense and on management of administration.

- 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 whereas general administration, interest payment and loan repayment and defense claim a large share over regular expenditure. However, the threat to the societal objective of poverty alleviation has been caused from high burden of defense expenditure, loan repayment and general administration expenditure. Data reveals that expenditure for administration (constitutional organs, general, judicial, revenue etc) all assert nearly one fourth of the total expenditure, of which expenditure on Foreign Service is substantial except than general administration. Not least, the rapid growth of regular expenditure on later years of 1990s can attributes to the increasing expenses on defense. But ironically the situation offers no hope of peace in the country. Another important aspect is that a substantial amount is allocated for the salaries, wage categories (e.g. general administration, foreign services, constitutional organs, judicial organs 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 activates in the regular budget have been highly inadequate. The overall pattern, thus, corresponds to the fact that public expenditure is mainly diverted to the consumption type only instead of capital expenditure.

- For the analysis of effect of government on output, there regressions models have been established. In model first, change in gross domestic product is regressed on lagged and unlagged values of change in total

Government Expenditure. The different parameters (R-squared, Adjusted R-squared, F-statistics, DW test etc.) support the model and found that the total government expenditure significantly affects the aggregate level of GDP. In model two, the change in agriculture gross domestic product is regressed on change in total government expenditure of lagged and unlagged values. In this case also, it is found that the change in agricultural GDP is significantly affected by the change in total government expenditure. In model three, the change in non-agricultural GDP is regressed on lagged and unlagged values of change in total government expenditure. By the analysis of this model, it is found that the non-agricultural GDP is also significantly affected by the total government expenditure. Hence, there is positive impact of government expenditure on aggregate level of GDP, agricultural GDP and non-agricultural GDP or output growth.

- Regarding the impact of analysis, a public expenditure on employment is positive relationship. This means when the government increases expenditure labour force also increases in economy and when labour force increases employment automatically increases. But the case of production, some time the impact of expenditure on production is positive relation and negative too. When government expenditure on public utility services such as education, medical services, cheap housing facility, transport and communication will increase the efficiency of people to work. This lead production into increase. On the other hand, when the government expenditure on luxury goods such as cinema, film studio, fashion will decrease the ability of the people to work and it will lead to harmful effect on production.

- The trend structure and effect of public expenditure on output during the period under review shows 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 excessive dependence on foreign aid especially foreign loan will certainly pull the country to the debt trap in the long run.

7.3 Conclusions

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 overriding 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 annual budget for rapid expansion of economic and social infrastructure leads to the increase in government expenditure.

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 involves in the decision making. So many difficulties are created in the implementation and completion of the projects.

7.4 Recommendations

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

- It is found that a substantial part of internal resources are utilized in financial consumption type of expenditure under the regular expenses. In effect, it has left very little resources 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 or luxuries consumption i.e. car, T.V., etc. which stock the capital, which help to promote the

capital accumulation process. In overall, development expenditure must be increased.

- 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, economic valuation of alternative investment of defense expenditure must be considered. 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 had should be allocated to social and economic sectors with high multiplier effect.
- The reforms packages on fiscal front were launched from the early years of reforms started in the country, those reforms process, however, did not correspond to expected result as such. The efforts were primarily centered to rationalize government expenditure. However, the large public spending on the general administration and debt service are the clear indication of failure of reforms process. Thus there must be taken appropriate measures that signify reforms process to rationalize the overall government expenditure as well as the expenses on general administration, debt service payment etc.
- In depth cost benefit analysis of alternative investment of public resources is needed. Resources must be diverted to the areas with high yield contributing to pro-poor based economic growth. For this, there must be coordination between period plan and annual budget.
- Analyzing of revenue and expenditure as the ratios of GDP shows higher ratio for total expenditure than that of revenue, signals adverse impacts on the economy in the long run. For the four years, development expenditures have dropped compared to regular expenditures. The challenge ahead is to maintain macro-economic stability by rationalizing the regular expenditure, streamlining

development expenditure to highly productive sectors, broadening the tax base, and reducing the size of deficit financing.

- Government expenditure is the main tool to increase the overall output of the nation. So, government has to increase the development expenditure to the long run projects for the stead increase in the GDP.
- Development projects are facing impediments due to violence and terrorist activities. Therefore, an integrated and coordinated mechanism needs to be set up between security agency and a concerned ministry in order to carry out security measures and development expenses and productivity has become a challenge to the government.
- Enlarging problem of resource gap will certainly create problems to our economy. So, attention should be paid to checking the unnecessary increase in resource gap. The major part of development budget is fulfilled by foreign aid. The donor agencies also interfere in the decision making. Over dependence on the foreign loan can further create resource problem in the near future. Government should only take foreign loan for productive purposes that have high revenue possibility.
- The pattern of public expenditure should be rearranged. The budgetary classification should be done according to the productivity nature of different sectors. The trend of classifications budget should be changed, it should be properly classified and planning of expenditure should be realistic as well as comprehensive.

Appendix-A

Total GDP, Agricultural GDP, Non-Agricultural GDP and Total Expenditure

Year	GDP	AG-GDP	NON-AG_GDP	TE
1980/81	27307	15510	11797	4092.3
1981/82	30988	17715	13273	5361.1
1982/83	33761	19082	14697	6979.2
1983/84	39390	22570	16820	7436.6
1984/85	44441	22761	21680	8394.8
1985/86	53215	27136	26079	9797.2
1986/87	61140	30623	30517	11502
1987/88	73170	36755	36415	14050
1988/89	85831	42572	43259	18005
1989/90	99720	50470	49250	19670
1990/91	116127	55268	60759	233549.8
1991/92	144933	65156	79777	26418.2
1992/93	165350	70090	95260	30897.7
1993/94	191596	80589	111007	33597.4
1994/95	209976	85569	124407	39060
1995/96	239388	96896	142492	46541.6
1996/97	269570	108785	160785	50723.7
1997/98	289798	112495	177303	56118.3
1998/99	330018	132373	197645	59579
1999/00	366251	145131	221120	66272.5
2000/01	393566	151059	242507	79835.1
2001/02	444052	166090	277962	80072.3
2002/03	473545	172802	300743	84006.1
2003/04	517993	186125	331868	89442.6
2004/05	566579	199368	367211	102560.5
2005/06	623083	211010	412073	112074.7
2006/07	691559	228677	462882	133604.6

Rs. in Million

Source: Various Issues of Economic Survey, MOF, GON.

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