

A Study On Performance Of Public Expenditure In Nepal

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INTRODUCTION

Classical economists favored least government interference in the general activity of the economy. They argued that the large amount of government expenditure was wasteful and that private persons could use resources better. After the Great Depression of 1930, Keynes developed a new model in public expenditure in which public expenditure plays a vital role creating employment and investment opportunity in the economy. Keynes and his followers, then, strongly put forward their views in favour of government expenditures arguing that the government expenditure is an important responsibility in achieving the definite ends. The theories of public expenditure, thereafter, aroused the interest of the various economists into the positive of public expenditure growth, its pattern and changes over time.

After 1980, the world economy has turned towards the policies of economic liberalization and globalization. Since then, privatization has been given due importance for reforming economic distortions in the world economy. Government's participation in total national economic activities has been given less priority. As a result, the role of private sector has become significant for economic growth and efficiency.

The Nepalese economy came into the mainstream of the world economy in 1951 after the end of autocratic Rana regime. Nepal entered into planned economy since 1956 and the Ninth Plan is almost completed. The ongoing Ninth Plan has set some policies in the area of public expenditure management including, a) a limit on overdraft to government by the Nepal Rastra Bank at one billion rupee, b) implementation of three-year rolling budget for development projects, c) continuation of privatisation of public enterprises and elimination of subsidies d) and seeking the approval of budget by the parliament before the beginning of the fiscal year (National Planning Commission 1998). However, the link between the plan and the annual budget has been weak.

As a developing country, Nepal still requires more resources for different sectors to fulfil the increasing demand for various activities such as building infrastructure, maintaining social services, managing general expenditure of the government, launching development activities. Colin

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Clark is of opinion that government activities up to around 25 percent of the aggregate economy are desirable in developing and inter-war countries (Brown and Jackson 1978). Due to the increasing demand for investment from various sectors of the Nepalese economy, the size and magnitude of public expenditure has been increasing at a rapid rate. However, the tax base is very limited in Nepal due to several constraints such as weak administration, agro-based economy and absence of agricultural taxation, and lower industrial output. It, therefore, is not an easy task to strike a balance between the increasing demand for investment and limited resources.

The government budget has two main components - resources and expenditure. Resources primarily comprise the revenue followed by foreign cash grants and loans. Public expenditure affects private demand and also influences aggregate supply (IMF 1991). It comprises of regular expenditure and development expenditure. The classification of public expenditure into regular and development expenditure is generally known as budgetary classification. As economic classification, it is normally said to be, consumption and capital expenditure of the government.

Nepal embarked upon financial reform program since mid-1980s through a structural adjustment program. After the political change in 1990, the country moved toward market-friendly economy by accelerating the pace of economic liberalization and has been giving priority to the privatization of public enterprises. However, the private sector is still not well developed. The public sector, therefore, has both responsibilities: one, it has to be directly involved in the production, and two, it has to stimulate the private sector to participate in various economic activities.

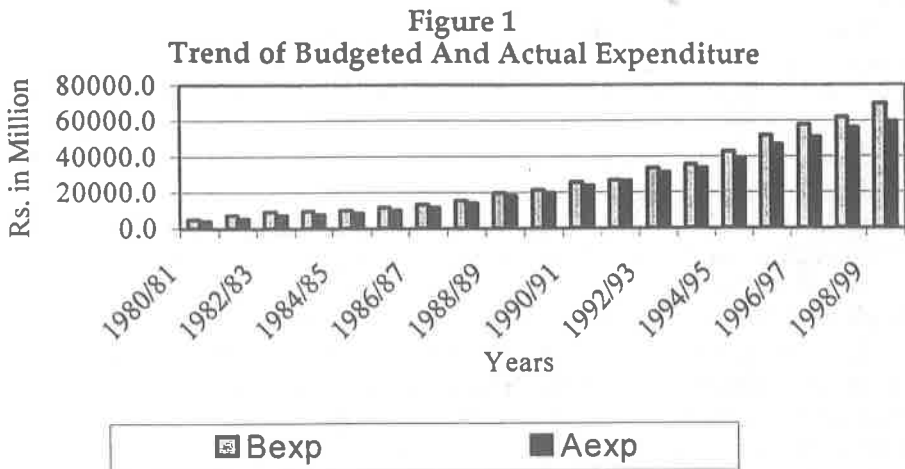
The study of the performance of public expenditure helps better to understand the real situation of Nepalese economy to some extent and also assists in the preparation to develop further policies to reform fiscal weaknesses. In this regard, it seems relevant to analyze the scenario of public expenditure in Nepal. Viewed from this background, the main objectives of this paper are : (i) to analyze the performance of public expenditure in the Nepalese economy, and (ii) to outline some policy implications.

PERFORMANCE OF PUBLIC EXPENDITURE

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, then, directed towards achieving the target of the year. After legislating the first annual budget in 1952, this process has become a routine practice in Nepal. However, even fifty years of experience, Nepal has not been able to achieve a satisfactory economic growth. This can be judged from various development indicators. For instance, the rate of economic growth has been

less than the targeted rate in every plan period; population below poverty line and rate of illiteracy are still very high; and about 40 percent of GDP is covered by agriculture which is still dependent on weather.

Figure 1 depicts a deviation in the budgeted and the actual spending of the government. The existing gap between targeted and 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 a very ambitious allocation of the resources. Secondly, the government has not been able to develop the mechanism to utilize the allocated resources to the



Source : Budget speech of respective years, MOE/HMG/N.

extent desired on various programs. In practice, the late release of development budget (sometimes even during the second half of the year) provides 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 so because the donors could not provide the committed foreign aid to the government since the government could not contribute the counter part 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 employees as regular expenditure. A very small amount has been left for the development expenditure. Foreign aid has, therefore, a large share in development expenditure during period from 1980/81 to 1998/99 it went up from 31.7 percent in 1982/83 to 62.5 percent in 1987/88 (Table 1). This higher share has a significant impact on the expenditure pattern of the Nepalese economy. This denotes that while there is always lack of

resources in Nepal, the government has responsibility to invest in various sectors, even in infrastructure. In other words, the budget (particularly its development component) is over-programmed. Owing to political pressures to incorporate new projects, resource estimates have been too optimistic, and the budget has been formulated at levels, which are not consistent with the actual availability of resources. As a result, there are too little resources for too many projects. Moreover, the link between budget allocation, actual spending and associated outputs has not been clearly established in the Nepalese context.

Table 1
Estimated And Actual Foreign Aid

FY	Estimated Foreign aid	Actual Foreign aid	Percent of actual to estimated Foreign aid	Rs. in million
				Foreign aid as percent of development expenditure
1980/81	2048.4	1562.2	76.3	57.2
1981/82	31.88.1	1723.2	54.1	46.2
1982/83	3628.0	2075.9	57.2	41.7
1983/84	3440.0	2547.5	74.1	49.3
1984/85	4216.4	2678.3	63.5	48.8
1985/86	4542.2	3674.0	80.9	59.1
1986/87	5937.5	3990.9	67.2	54.1
1987/88	6602.2	5892.6	89.3	62.5
1988/89	8890.2	7347.0	82.6	59.6
1989/90	9992.0	7935.0	79.4	61.1
1990/91	9626.8	8421.5	67.5	52.7
1991/92	11828.5	8460.7	71.5	52.7
1992/93	14974.2	10714.2	71.6	55.2
1993/94	15609.6	11557.2	74.0	54.5
1994/95	15798.7	11249.4	71.2	56.8
1995/96	18811.8	14289.0	76.0	57.2
1996/97	20351.2	15031.9	73.9	56.6
1997/98	21569.8	16457.1	76.3	56.9
1998/99	25503.8	16189.0	63.5	56.7
1999/00	27219.5	17523.9	64.4	55.2

Source : Respective Budget Speeches and Economic Survey, MOF/HMG/N.

Table 1 exhibits that on an average only 72.7 percent of estimated foreign aid during 1980/81 to 1999/2000 period has been utilized. This low performance in receiving and utilizing foreign aid is one of the reasons for the weak implementation of development programs and the presence of a

significant gap between actual and budgeted expenditure of the government, particularly development expenditure.

Analysis of the government budgetary operation and expenditure pattern reveals the limitations in supervising the process of public expenditure. Similarly, the amount of utilization of allocated resources can be one way to assess fiscal soundness and the discrepancy between economic target and attainment.

Input-output model is one of the appropriate models for judging the performance of public expenditure, however, due to data constraint, it is difficult to employ this model in assessing the degree of deviation in relationship between targeted and actual public expenditure. Nevertheless, the deviation of actual outlay from its budgeted value may be one of the simplest but desirable methods in evaluating the performance of public expenditure.

In this context, an attempt has been made for testing the performance of the public expenditure with the help of simple t-statistic under the following hypothesis :

$$H_0: X_1 - \bar{X}_1 = 0$$

$$H_1: X_2 - \bar{X}_2 > 0$$

Where,

\bar{X}_1 = mean of budgeted expenditure

\bar{X}_2 = Mean of actual expenditure.

The following formula has been considered in conducting the t-test:

$$t = \frac{\bar{X}_1 - \bar{X}_2}{S} \sqrt{\frac{n_1 n_2}{n_1 + n_2}}$$

Where, S = standard deviation.

Standard deviation is calculated with the help of the following formula

$$S = \sqrt{\frac{\sum (X_1 - \bar{X}_1)^2 + \sum (X_2 - \bar{X}_2)^2}{n_1 + n_2 - 2}}$$

Where,

$n_1 + n_2 - 2$ is degree of freedom.

Table 2
Results of t-statistics Test

Headings	Results
1. Regular Expenditure	0.135670
2. Development Expenditure	0.831952
3. Total Expenditure	0.486056

The result from t-statistic test (Table 2) does not reject the hypothesis at 5 percent level that statistically there is no significant difference between budgeted and actual public expenditure in practice. Even if a variation exists, this may be due to insignificant factors. However, to reinforce the result of this finding F-statistics has also been employed by adding 14 more observations (1966/67 to 1979/1980) in both budgeted and actual expenditures, the hypothesis has been formed as :

$$H_0 : X_1 - \bar{X}_1 = 0$$

$$H_1 : X_2 - \bar{X}_2 > 0$$

Where,

\bar{X}_1 = mean of budgeted expenditure

\bar{X}_2 = Mean of actual expenditure.

F-test has been performed under the consideration of following formula :

$$F = \frac{S_1^2}{S_2^2}$$

$$\text{Where, } S_1^2 = \frac{\sum (X_1 - \bar{X}_1)^2}{n_1 - 1} \quad \text{and} \quad S_2^2 = \frac{\sum (X_2 - \bar{X}_2)^2}{n_2 - 1}$$

(S_1 = standard deviation of budgeted expenditure and S_2 = standard deviation of actual expenditure; n_1 = number of observations of budgeted expenditure and n_2 = number of observations of actual expenditure).

The result of F - test also failed to reject the null hypothesis at 5 percent level that there is no significant deviation in the targeted and the actual expenditure of the government during the study period. Therefore, all the hypothesis tests failed to reject the null hypothesis, hence, the expenditure pattern is not discouraging in the Nepalese fiscal system. Regarding the regular expenditure, on average more than 90 percent of the budgeted expenditure was spent. Despite some problems such as leakage

due to corruption and wastage due to lack of co-ordination among various project implementing agencies, delay in project completion as a result of an increasing number of projects without adequate resources have been noticed in the spending pattern of development expenditure as indicated earlier. This is also not a major problem according to the result of the hypothesis tests as shown in Figure 1. Although the spending capacity of the government is not very poor, this may be an indication for risk in the future. The findings of the study may work as a warning to the government and advising it to accord more attention to fiscal management and to improve efficiency by reducing various types of distortions and failure.

Table 2
Results of F-test After Adding More Observations

Headings	Results
1. Regular Expenditure	1.74849154
2. Development Expenditure	1.352425
3. Total Expenditure	1.235054069

Being a developing country, Nepal requires more resources to spend in different sectors. Although there does not exist wide variation between budgeted and actual government expenditure in Nepal, the country is not able to enjoy desirable growth. As such, some important questions can now arise: Is the allocated budget sufficient for spending in Nepal? How much budget would be required for achieving desirable outcome from the Nepalese economy? Is the present pattern and trend of investment appropriate for the coming years as well or should it be reviewed and improved for investing efficiently? A further research seems necessary along these lines in the future to make government expenditure sound, efficient and productive in order to attain the desirable results.

CONCLUSION

The growth of public expenditure in Nepal is taking a rapid tempo. This may be due to both demand-side effects and supply side factors in the economy. The growth of revenue is lower than that of government expenditure during the study period leading to widening resources gap. The increasing share of foreign aid, especially foreign loan, in development expenditure for bridging resources gap affects the economy adversely in the long run by forcing repayments of large amounts as principal and interest payments.

The government lacks the strong commitment, clear vision and sufficient assessment necessary to choose programs and to allocate budget for them in Nepal. This increases the gap between budgeted and the actual government expenditure. Although this deviation is not statistically a problem at the present, this may be an indication for a growing problem in

the future, if sufficient measures are not taken to reduce this gap now. At present, the result of the study indicates either the allocation of resources is not sufficient or the allocated resources are not used efficiently. On the basis of these conclusions actions to be taken for utilisation of scarce resources can be suggested as follow :

- The government should focus its scarce resources on core priority areas where such resources can be optimally utilized.
- More local ownership of government expenditure programs should be promoted for improving the effectiveness of public spending. This demands actions from both the government and the donor agencies/countries. The government, for instance, will have to take the principal role in designing, financing and implementing the development programs as well as aid-coordination itself. It has to decide what its own development programs and priorities are, and request the donors to support such programs. When donor aid is not in parallel with its priorities and program objectives, the government must reject such 'donor-driven' aid. All of this requires building up of institutional capacity and a greater degree of self-financing/self-reliance through stronger efforts to mobilize revenues, which could take a lot of time. Donors should support this process.
- Analogous efforts should also be exerted with regard to fully government-financed programs also. In order to improve effectiveness, it is necessary to establish greater linkages between institutions at the center and those at local levels and to develop partnerships involving the private sector, NGOs and other stakeholders.
- It is necessary to ensure greater realism in resource forecasting in order to control the development budget and minimize the waste of resources associated with overprogramming. Estimates of revenue, aid inflows and the size of the development budget should be parallel with recent performance and reasonable expectations. All of this has to be combined with strengthening the project screening appraisal capacity in the National Planning Commission and the line ministries.
- Some measures could be undertaken to strengthen expenditure management and control: (a) the mid-year budget review process could be utilized to reevaluate resource outlook during the year to make expenditure adjustments in a more systematic manner; (b) to protect priority projects from any resource shortfall, a core program of priority projects could be formulated and fund disbursement to projects must be in accordance with the core program; (c) improvement is required in expenditure reporting by spending units both with regard to punctuality and report quality; and (d) there is a need to strengthen the capacity for monitoring expenditures as well as physical progress of projects at various levels of the government.

- The role of donors also need to be changed from providers of 'supply-driven' aid, implementers of projects, and suppliers of expensive technical assistance to facilitators who will provide financial and technical support that correspond to the country's needs and priorities in a way that promotes local ownership, institution building and longer term sustainability. Donors will need to accept the consequences of expenditure rationalization (for example: downsizing, canceling poor projects, and limiting new project for some time, among others), and remodel their own aid programs to suport only those projects which fit the country's needs.

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