

Trend and Pattern of Public Expenditures in Nepal

*Sohan Kumar Karna**

Abstract

This paper aims at assessing the impact of public expenditures on overall economy and offers the opportunity for effective utilization of limited public resources and improvement of the ruined condition of the economy. It is expected to become more rigorous, informative and systematic in analysing policy implications, estimating parameters needed for future projection, designing policy outlook, and explaining the public expenditure growth.

Introduction

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

Nepal has completed more than fifty years of its budgetary history. This period is not sufficient to change the poor economic condition of this country but this period would be very significant to lead the economy into the progressive path of economic development. Though Nepal embarked on economic development very late, only in the 1950s and since the considerable public resources development with not worthy progress has been initiated in many areas. Government spending on an average is high. Nevertheless, there is considerable evidence that a large amount of these resources has been misspent, which led the incidence poverty around 31% (NLSS, 2003/04) particularly in rural areas where 85.80% of people live (CBS, 2005). The country can ill afford waste of its scarce resources. In addition to poor use of public resources, Nepal has also been unable to implement a policy framework conducive to high level of economic growth. Although a brief period of economic reforms led to a significant acceleration of economic growth to about 5.6% in the early 1990s and since then the growth rate has decelerated to 3.9% in the mid-to-late 90s, 2.8%

* Dr. Karna is Associate Professor at Central Department of Economics, TU, Kathmandu, Nepal. This article is based on the author's Project Report titled "Study on the Impact of Public Expenditures in Nepal" supported by Prof. Dr. Tara Pad Chaudhari and Achyut Nath Upreti Research Fund, Central Department of Economics, Tribhuvan University, Kirtipur, Kathmandu.

in FY 1998/99, negative (-0.6%) in FY 2001/02, 2.3% in FY 2002/03, 3.4% in FY 2003/04, and 2.4% in FY 2004/05. This nosedive growth trend would have improved had a suitable budgetary policy implemented. Especially after the restoration of democratic set up in the country, growth pattern of public expenditure seems to be unsatisfactory.

Trend and Pattern of Public Expenditures

In Nepal, the history of government budget is of very recent origin. It was introduced for the first time in the country in 1952 after the overthrow of the Rana regime. However, it is notable that the budget presented by the first elected government in 1958/59 is considered as the first scientific budget of Nepal, which was divided into two components: regular budget and development budget. Because of the lack of an efficient mechanism till 1958, the budget preparation had to be based on rough estimate. In 1959, a new accounting system was devised which was further revised and improved in 1963. This new accounting system gradually introduced all over the country has been facilitating the preparation of the budget by providing the necessary financial data at the appropriate time.

During the 1970s and 1980s foreign aid occupied significant role in Nepalese budgetary system. The government adopted the policy of borrowing from internal and external sources for financing budgetary deficit. Since 1980 loan assistance proportion began to increase and grants decreasing.

Trends of Public Expenditures in Nepal

Public expenditure in each successive plan has increased tremendously in Nepal as has been depicted in Table 1. The growth of public expenditure is mounting very fast. On the average, it stands at the range of 11.2 percent in between 1990/91 and 2004/05. Total governmental expenditure in 1990/91, was Rs 23549.8 million, which reached Rs 102560.4 million in 2004/05.

Growth rate of public expenditure surpassed the growth rate of real and nominal GDP, which were 4.0 percent and 14.1 percent respectively. But the massive inflow of external capital of 40 percent in an annual average and high growth of public expenditure are not seen as related to the growth of per capita income.

Structure of Public Expenditures

There is fluctuating percentage share of regular and development expenditure. The fact witnessed in the study reveals that the general trend is increasing in the share of regular expenditure and decreasing share of development expenditure in total, whereas in percentage of GDP, the share of development expenditure rather remained constant and slowly and consistently increasing regular expenditure surpassed it since 1998/99.

Looking back at growth records, regular expenditure shows less fluctuation than the

Table 1: Public Expenditure Growth and its Determinants (Rs in Million)

Year	T E	Growth	Nominal GDP	Growth	Real GDP	Growth	Revenue	Foreign aid
1990/91	23549.8	-	116127	-	174908	-	10729.9	8421.5
1991/92	26418.2	12.2	144933	24.8	183371	4.6	13512.7	8460.7
1992/93	30897.7	17	165350	14.1	188780	2.9	15148.4	10714.1
1993/94	33597.4	8.7	191596	15.9	204397	7.6	19580.8	11557.2
1994/95	39060.0	16.3	209976	9.6	209976	2.7	24575.2	11249.6
1995/96	46542.4	19.2	239388	14	221930	5.4	27893.1	14289.0
1996/97	50723.7	9.0	269570	12.6	233040	4.8	30373.5	15031.9
1997/98	56118.3	10.6	289798	7.4	240816	3.3	32937.9	16457.0
1998/99	59579.0	6.2	330018	13.0	251758	4.5	37251.0	16189.0
1999/00	66272.5	11.2	366251	11.9	267096	6.1	42893.8	17523.9
2000/01	79835.1	20.5	393566	7.4	280106	4.9	48893.6	18797.4
2001/02	80072.2	0.3	406138	3.2	279169	0.3	50445.5	14384.8
2002/03	84006.1	5.0	437546	7.7	287689	3.1	56229.8	15885.5
2003/04	89444.2	6.4	474919	8.5	298023	3.6	62331.0	18912.4
2004/05	102560.4	14.6	508651	7.1	305244	2.4	70122.7	23657.3
Average		11.2		14.1		4.0		

Note: TE=Total Expenditure. Year 1994/95 taken as the base year for real GDP from 1990/91 onwards.
Source: Economic Survey, MOF, 2003/04; 2004/05; 2005/06.

development expenditure. Growth rate of regular expenditure is positive every year but growth rate of development expenditure is found to be negative in some fiscal years particularly, 1994/95, 1998/99, 2001/02, and 2002/03.

In the fiscal year 1990/91, the percentage share of regular and development expenditure were 32.1 and 67.9 and the share in this fiscal year also shows that regular expenditure gave a nosedive to its minimum 32.1 percent and development expenditure raised to its maximum 67.9 percent. But this situation reversed in the later phase. In the fiscal year 2002/03, regular expenditure expanded to 65.4 percent of total as development expenditure contracted to the 34.6 percent of total (Table 2). Similarly, in the FY 2003/04, recurrent expenditure expanded to 62.1 percent of total, capital expenditure contracted to the 25.8 percent of the total, and the principal repayment was 12.0 percent followed by 60.1 percent, 26.6 percent, and 13.2 percent for recurrent expenditure, capital expenditure, and the principal repayment respectively in the FY 2004/05 (MoF, 2006).

Table 2: Trend and Pattern of Regular and Development Expenditures and GDP with their Growth Rate

Year	Regular Expenditure				Development Expenditure			
	Amount (Rs in Million)	Growth	% of TE	% of GDP	Amount (Rs in Million)	Growth	% of TE	% of GDP
1990/91	7570.3	13.5	32.1	7.2	15979.5	22.9	67.9	15.2
1991/92	9905.4	30.8	37.5	6.8	16512.8	3.3	62.5	11.4
1992/93	11484.1	15.9	37.2	5.8	19413.6	17.6	62.8	11.5
1993/94	12409.2	8.1	36.9	6.5	21188.2	9.1	63.1	11.1
1994/95	19265.1	55.2	49.3	9.2	19794.9	-6.6	50.7	9.4
1995/96	21561.9	11.9	46.3	9.0	24980.5	26.2	53.7	10.4
1996/97	24181.1	12.1	47.7	9.0	26542.6	6.3	52.3	9.8
1997/98	27174.4	12.3	48.4	9.4	28943.9	9.0	51.6	10
1998/99	31047.7	14.3	52.1	9.4	28531.3	-1.4	47.9	8.6
1999/00	34523.3	11.2	52.1	9.4	31749.2	11.3	47.9	8.7
2000/01	42769.2	23.9	53.6	10.9	37065.9	16.7	46.4	9.4
2001/02	48590.0	13.6	60.7	11.9	31482.2	-15	39.3	7.7
2002/03	54973.0	13.1	65.4	12.6	29033.0	-7.7	34.6	6.7
Average		18.1	47.6			9.4	52.3	

Source: Economic Survey, MOF, 2003/04; 2004/05; 2005/06.

The expenditure heads till FY 2002/03 were classified as regular and development. Since FY 2003/04, such expenditures have been classified as recurrent, capital, and principal repayment expenditures, which are also increasing every year.

Regular Expenditure (Recurrent Expenditure)

The regular or current expenditures are appropriated and designated as the current outlays on public consumption and revenue expenditures, which create no productive assets such as salaries of employees. It includes expenditures on goods and services like wages and salaries, pensions, interest payments, subsidies, and other current transfers, etc. It is made up of from various components. Among of the main functional components under various heads are constitutional organs, general administration, revenue and judicial administration, defence, social services, economic services, loan repayment and interest, loans and investment, and miscellaneous. The pattern of regular expenditure has been presented in Table 3 into various functional components.

Table 3: Pattern of Regular Expenditure (Rs in Million)

Year	TRE	COE	GAE	DE	SSE	ESE	LRIE	LIE	Miscellaneous
1990/91	7570.3	191.2 (2.5)	1180.4 (15.6)	1151.4 (15.2)	742.6 (9.8)	374.8 (5.0)	2407.4 (31.8)	10 (0.1)	1512.5 (20.0)
1991/92	9905.4	282.7 (2.2)	1534.3 (15.5)	1489 (15.0)	999 (10.1)	548.7 (5.5)	3797.1 (38.3)	3 (0.0)	1251.6 (12.8)
1992/93	11484.1	169.7 (1.5)	1816.5 (15.8)	1723.6 (15.0)	1269.3 (11.0)	586.1 (5.1)	4560.5 (39.7)	24 (0.2)	1334.4 (11.7)
1993/94	12409.2	204.4 (1.6)	1900.5 (15.3)	1877.4 (15.1)	1352.8 (10.9)	605.3 (4.9)	4855.1 (39.1)	16 (0.1)	1597.7 (13.0)
1994/95	19265.1	214.8 (1.1)	2119.8 (11.0)	2001.3 (10.4)	4441.6 (23.0)	1353.9 (7.0)	6083.3 (31.6)	5.2 (0.0)	3045.2 (15.9)
1995/96	21561.9	234.9 (1.1)	2509.7 (11.6)	2126.4 (9.8)	5375 (24.9)	1333.5 (7.1)	6715.5 (31.1)	17.4 (0.1)	3049.5 (14.3)
1996/97	24181.1	471 (2.0)	2842.3 (11.7)	2357.6 (9.7)	5909.1 (24.4)	1338.2 (7.2)	7527.2 (28.3)	31.7 (0.1)	3304 (13.8)
1997/98	27174.4	353.5 (1.3)	3158.8 (11.6)	2582.8 (9.5)	6993.3 (25.7)	1889.9 (7.0)	7682.8 (28.3)	24.9 (0.1)	4488.4 (16.5)
1998/99	31047.7	384.2 (1.2)	3615.6 (11.6)	2994.8 (9.6)	7376.9 (23.8)	2167.9 (7.0)	8723 (28.1)	15.1 (0.1)	5770.2 (18.6)
1999/00	34523.3	431.5 (1.2)	4070.4 (11.8)	3482.1 (10.1)	8327.9 (24.3)	2224.8 (6.4)	10032.8 (29.0)	39.2 (0.1)	5914.6 (17.1)
2000/01	42769.2	438.2 (1.0)	6258.4 (14.6)	3813.4 (8.9)	10882.2 (25.4)	1631.1 (3.8)	10388.4 (24.3)	10 (0.0)	9347.5 (22.0)
2001/02	48590.1	569.5 (1.1)	7728.0 (16)	5859.8 (12)	13350.5 (27.4)	1905.1 (4)	12205.2 (25.1)	12.6 (0.0)	5170.5 (10.6)
2002/03	54973.0	825.4 (1.5)	7818.2 (14.2)	7381.5 (13.4)	13749.0 (25.0)	2048.1 (3.7)	16181.3 (29.4)	2.0 (0.0)	5128.6 (9.3)

Note: TRE= Total Regular Expenditure; COE=Constitutional Organs Expenditure; GAE=General Administration Expenditure; DE= Development Expenditure; SSE= Social Service Expenditure; ESE= Economic Services Expenditure; LRIE=Loan Repayment and Interest Expenditure; LIE= Loan and Investment Expenditure.

Source: Economic Survey, MOF, 2003/04; 2004/05.

After analysing the table, it is found that regular expenditure has increasing trend and its growth is very high. In the 9th plan period, nearly 80 percent of the total revenue was consumed by regular expenditure. Of the total expenditures in FY 2004/05, the largest amount expenditure, i.e. Rs 23208.8 million, was spent on social services. Similarly, other main current expenditures were made on general administration (Rs 8226.3 million), on

defence (Rs 8580.3 million), and on economic services (Rs 7167.8 million). The expenditure on payment of interest was Rs 6218 million (MoF, 2006).

Development Expenditure (Capital Expenditure)

Expenditures on development refer to those development activities of the government, which are linked with the expansion of capital formation, social welfare, etc. It includes the expenditure on the development of economic, social and other sectors. The development expenditures are appropriated and designated to add the productive capacity or the capital stock of the country, which would raise the 'level of living' of the people expressed in dishes of health, food consumption and nutrition, education, employment and condition of works, housing, social security, clothing, recreation. Thus, the development expenditures are supposed to create productive assets like irrigation, skilled manpower, i.e. expenditure on capital account, which lead to rise in total and per capita income, widely diffused among occupational groups and among regions. The process is accompanied by structural change, narrowing gaps in productivity among sectors and regions and improved education and health resulting to an increase in substantial amount of investment and technological progress.

The main functional components of development expenditure include general administration, revenue and fiscal administration, economic administration and planning, social services, economic services, defence, and miscellaneous. Allocated budget for distinguished components has been presented in Table 4.

It is evident from Table 4 that economic services constitute the largest item, accounting for 74.4 percent of total development expenditure followed by social services 22.3 percent in 1990/91. The figure of ES for 2004/05 was 56.3 percent (Rs 15394.9 million) followed by SS 29 percent (Rs 7940.7 million) (MoF, 2006).

Reviewing the pattern of expenditures from 1990/91 to 2004/05, one thing stands out clearly: there has been steady and perceptible shift in the composition of expenditures towards current transfers and subsidies, interest and grant payments and all have higher growth rates than other heads of expenditure. This growth pattern is somewhat unexpected in the relatively early stage of economic development, when the provision of capital goods and creation of overhead capital normally get precedence over other heads.

Table 4: Pattern of Development Expenditure (Rs in Million)

Year	TDE	GAE	EAP	SSE	ESE	ME
1990/91	15979.4	11.3	83.3	3569.3	11893.3	422.2
1991/92	16512.8	13.8	39.3	5040.3	11063.3	356.1
1992/93	19413.6	29.0	18.7	7245.5	12111.5	8.9
1993/94	21188.2	31.3	19.5	7104.1	13841.4	191.9
1994/95	19794.9	33.5	31.6	6224.8	12852.7	652.3
1995/96	24980.5	41.6	33.2	7612.7	16982.7	310.3
1996/97	26542.6	34.5	17.3	9281.3	17054.7	154.8
1997/98	28946.8	46.4	19.3	10323.5	17900.2	657.4
1998/99	28531.3	79.2	20.5	10265.4	17324.4	841.8
1999/00	31749.2	108.1	28.6	12406.2	18648.6	557.7
2000/01	37065.9	127.2	196.2	12872.7	21114.3	2755.5
2001/02	31482.2	250.1	94.1	11530.3	17452.0	2142.3
2002/03	29033.0	98.8	37.7	12188.8	15591.3	1116.4

Note: TDE= Total Development Expenditure; GAE=General Administration Expenditure; EAP= Economic Administration and Planning Expenditure; SSE= Social Service Expenditure; ESE= Economic Services Expenditure; ME=Miscellaneous Expenditure.

Source: Economic Survey, MOF, 2003/04; 2004/05; 2005/06

Factors Contributing to the Growth of Regular Expenditure

Regular or non-plan expenditure has increased faster than development expenditure in recent years. Whenever public expenditure is curtailed, much of the curtailment comes from development expenditure. In the process, government investment was dampened, and implementation of projects was upset, affecting the efficiency of public expenditure. This happened largely because rigidities are 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. The regular expenditure was 32.1 percent of total expenditure in 1990/91, reached to the highest 65.4 percent in 2002/03, and 60.1 percent in 2004/05 (Table 2). The increasing dominance of regular expenditure over development expenditure is attributed to the following reasons.

Debt servicing is the fastest growing regular expenditure. Over staffing in government offices and temporary recruitment in development projects are increasing. To fulfil the recruitment of technical manpower in the country, government invites trained and efficient

manpower from abroad paying them high salary and allowance, which flattens the size of regular expenditure. Overestimation of development expenditure always shortfall in actual term, which tends to occur more in development items, thereby, increasing the proportion of regular expenditure in total expenditure. Huge amount of money spent on subsidies to public enterprise is growing year to year. Government liabilities on subsidy mounted not only on account of its policy of subsidizing but also because of large leakage and insufficiency in the enterprises. "When the unit cost of subsidized product goes up on account of mismanagement and malpractices, the government maintains, the government maintains the same degree of relief to the beneficiaries of subsidies through higher amount of expenditure" (IDS, 1987). The government does have capital budgeting system to its development budget, so its development budget also contains a large proportion of regular expenditure items that are not scrutinized.

The increasing trend of recurrent expenditure as a proportion of GDP ultimately leads to a gloomy picture for the developing countries like Nepal. It has multidimensional impact on development process of the country. Such notable impact include as follows:

The grant component of foreign assistance is declining against loan component. The mounting burden of external debt and servicing is the fastest growing expenditure. Huge amount of recurrent expenditure creates big constraints amidst the process of domestic resource mobilization, which compels the economy to depend on foreign assistance. Fastest growing recurrent expenditure leads to the inflationary situation in the country.

Factors Contributing to the Growth of Development Expenditure

There is significant growth in development expenditure as reflected from the Table 2. Factors contributing to the growth of development expenditure are as follows:

Due to largely under develop capitalistic sector in the economy, government has to play its role not only in expansion of infrastructure, which is necessary to induce private sector but also in the expansion of directly productive activities such as manufacturing. It causes ultimately an increase in development expenditure. The government has to increase the development as well as the regular expenditure to maintain the services and activities in pre inflation level.

Concluding Remarks

The conclusion drawn is that though attempts were made to improve the budgeting system but the government could not be succeeded in this respect. Through the various budget speeches, all the time have expressed the need for revenue administrative reform, yet in reality very ill performances have been observed and experienced. Public expenditure growth had taken place rapidly than the increase in gap of the country. During the period 1965-81, the public expenditure was increased by 8.42 percent per annum on the average as against the gross domestic product by only 2.04 percent (Khanal, 1988).

The portion of development expenditure is higher than RE in the initial years, which are favorable from economic point of view, but in the later years RE growth rate has far surpassed to the growth rate of DE employing consumption type of expenditure expanded rapidly which reflects poor scenario of Nepalese economy. The major portion of revenue is diverted for debt servicing resulted in reduction of expenditure on development activities.

Following recommendations are made which can be helpful for effective utilization of limited public resources and improvement of the ruined condition of the economy -

Reforms in public expenditure management have been, without doubt, the most important for the successful implementation of PRSP. Critical actions in this area included prioritizing all development expenditures (through the MTEF) on the basis of PRSP priorities; and providing adequate funding for high priority activities.

For this purpose, a realistic medium term expenditure framework was adopted, projects/ programs were ranked in to three categories (P1, P2 and P3), and 190 projects/activities which were considered low priority were either dropped or merged (Dahal, 2006). Unproductive expenditures should be controlled by right sizing the number of ministries/ departments/organisations and civil servants.

Staggering magnitude of contingencies expenses e.g. Rs 2.0 billion under recurrent expenditure and Rs 8.3 billion under capital expenditure is conspicuous. The public expenditure freeform should be to accelerate the delivery of the benefits to the rural poor through better targeting of expenditures. Government should focus its scarce resources on core priority areas where such resources can be optimally utilized.

Government should increase the proportion of productive investment and allocate efficiently unlike its past "hit and miss" policy. Thus, major reforms in planning and budgeting are required. More emphasis has to be given to the quick yielding and highly pay off production-oriented program. Zero-base budgeting system should be implemented in order to reduce unnecessary costs incurred hither to.

Utilization and scope of subsidies should be properly analyzed and unnecessary subsidies should be cut off. The process of privatization should be accelerated. The ownership of public enterprises including least and profit making should be transferred to private sector. Maintain the government deficit within a certain limit by redesigning budget in order to improve supply side efficiency.

The following recommendations made by Public Expenditure Review Commission, 2001 should be implemented to create conducive fiscal environment for sustainable growth of the economy. For example, streamlining and rationalizing the role of the government, ministries and departments, delegating and eliminating functions to increase public focus on key public goods and services should be the followed. Prioritising development programs through: a) establishment of more rigorous criteria for project selection and funding; b) identification of project to be cut, merged or given greater resource allocations; and c) use of project implementation performance system to allocate resources should be encouraged.

A five-year expenditure prioritization framework that seeks to increase public savings,

provides for debt servicing, contain the wage bill and rationalize defence and police expenditure should be identified and implemented. Administrative cost control systems through setting up of clear expenditure norms should be strengthened. Finally, financial management and internal auditing system should be improved.

References

- Central Bureau of Statistics (2004). *Nepal Living Standards Survey 2003/04*. Kathmandu: Central Bureau of Statistics.
- Central Bureau of Statistics (2005). *Statistical Year Book of Nepal*. Kathmandu: Central Bureau of Statistics.
- Integrated Development Studies (1987). *Financing Public Sector Expenditure in Nepal*. Kathmandu: Integrated Development Studies.
- Khanal, D.R. (1988). *Public Expenditure in Nepal*. Kathmandu: Ratna Pustak Bhandar.
- Ministry of Finance (2004). *Economic Survey, 2003/04*. Kathmandu: Ministry of Finance.
- Ministry of Finance (2005). *Economic Survey, 2003/04*. Kathmandu: Ministry of Finance.
- Ministry of Finance (2006). *Economic Survey, 2005/06*. Kathmandu: Ministry of Finance.