



NEPAL
ECONOMIC
FORUM

nefsearch

December 2015, Issue 8



A SPECIAL REPORT ON THE NEPALI BUDGET

UNDERSTANDING TRENDS AND IMPLICATIONS

OVERHAULING THE BUDGET PROCESS AND ASSESSING EFFICACY

THE NEPALI BUDGET

Understanding Trends and Implications

1. BUDGET IN NEPAL'S CONTEXT

Budgeting in Nepal is an annual breakdown of periodic plans (previously five-yearly, currently interim three-yearly). The government sets the necessary programs; such as improving investment climate to create jobs and provide necessary subsidies and concessions for agricultural, industry and services development, to accomplish

national goals and objectives defined by the periodic plan; such as poverty reduction, attaining a certain growth rate, reducing unemployment, etc. Nepal's budget also includes a projection of the next fiscal revenue collection, government expenditure, and actual progress report up to the tenth month of the current fiscal year.¹

Emerging economies have increasingly been utilizing the budget as a tool for economic and social development. However, Nepal has struggled in effectively formulating and deriving results out of the budget; with prime issues surrounding implementation, allocative inefficiency and inadequate spending capabilities.

An official budget is a legal document appropriating funds for a series of plans. A country's budget addresses the interest of diverse stakeholders' (taxpayers, private businesses, investors, etc.) and subsequently incorporates a wide range of concerns (investment environment, taxations, macroeconomic provisions, etc.). Extending beyond the practice of equating revenues and expenditures, the budget is a representation of the country's yearly financials with a firm strategic outline of plans where resources are allocated based upon set objectives.

1.1. Formulation of Budget

Prior to 1991, the formulation process was entirely a centralized top-down approach with the King having the final verdict. After 1991, budget formulation evolved to include a top down approach for central government and a bottom up approach for local government.

1.1.1. Top Down Approach

In the top down approach, the Nepal Planning Commission (NPC) provides the necessary notifications on plans and programs to various ministries which in turn disseminate the information to departments and district offices.

1.1.2. Bottom Up Approach

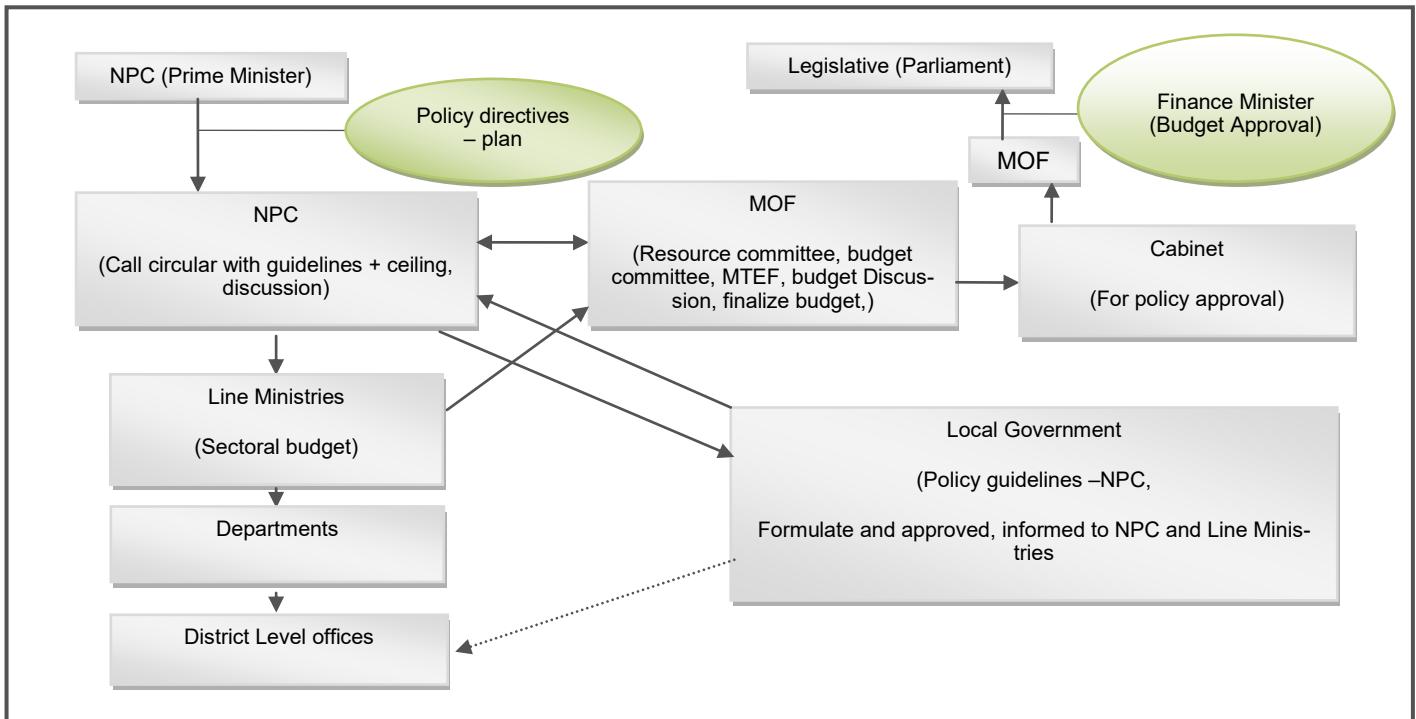
In the bottom-up approach, the NPC sends guidelines on district level plans and programs to the District Development Committee (DDC) which

The process of formulating a budget includes political, managerial, planning, communication, and most importantly financial dimensions. The budget further encompasses a host of plans, their development, implementation, and evaluation in delivering various public services and build up capital assets; such as physical infrastructure, equipment and machineries, etc.

Table 1: Timeline of Budgetary Reforms in Nepal

Year	Reforms
Pre 1951	<ul style="list-style-type: none"> No distinction between the state and rulers i.e. the Rana regime Priority given to revenue collection and maintenance of law and order over developmental work.
1951 – 1955	<ul style="list-style-type: none"> Formal practice of budgeting introduced after the end of the Rana regime Not as scientific and precise due to minimal statistical information and lack of accurate data; due to the lack of a bureau to collect facts. Main sources of revenues were land revenues, sale of timber and other forest products, and excise duties, whereas expenses mostly on general civil administration and defense.
1956 – 1970	<ul style="list-style-type: none"> Initiation of Five Year Development Plan, and foreign aid begins. Incorporation of social and economic objectives in development plans. Panchayat system enforced Economic reorganization through formation of National Planning Council Functional budget classification introduced: <ul style="list-style-type: none"> * Developmental budget - Economic Administration and Planning, Social Services, Economic Services, and Miscellaneous. * Regular Expenditure - Constitutional Bodies, General Administration and Planning, Administration, Foreign Services, Social Services, Economic Services, Defense and Miscellaneous.
1970 – 1990	<ul style="list-style-type: none"> Developmental expenses centered on rural infrastructure development and poverty reduction Centralized form of development introduced Marked by high regional disparity, and minimal public participation Expansion of governmental institutions.
1990 – 2000	<ul style="list-style-type: none"> Economic liberalization and reforms especially in regard to trade, finance and the manufacturing sector, marking the dawn of private ownership Political revolution Encouragement of private sector participation Encouragement of people's participation in the formulation of development plans Improved revenue collection.
2000 - Current	<ul style="list-style-type: none"> Introduction of Medium Term Expenditure Framework (MTEF), a three year framework of public expenditure Implementation of recurrent and capital classification Introduction of Immediate Action Plan (IAP). Implementation of the Three Years Interim Plans (TYIP). Changed the existing functional classification structure to: <ul style="list-style-type: none"> * General Public Services, Defense Services, Public Order and Safety, Economic affairs, Environmental Protection, Health, Recreation Culture and Religion, Education, and Social Protection.

Figure 1: Budget Formulation Cycle



Source: Budget Formulation in Nepal: Practices and Weaknesses, Bijaya Acharya Adhikari

is further passed down to the Village Development Committees (VDC) and Municipalities. The VDCs and Municipalities then hold village/ town council meetings to discuss and prepare sector wise development programs and projects with ward offices and NGOs/ consumers, after which the proposed plans are sent back to DDC. The DDC then holds meetings with district offices and finalizes district budget and priorities, which is then sent to the NPC and the ministries.

Once finalized, the budget for upcoming fiscal year is presented in the legislature by the Finance Minister towards the end of the current fiscal year.

2. HISTORICAL TRENDS IN THE BUDGET:

2.1. Observable Occurrences

One strikingly observable occurrence in the budgeting practice of Nepal is the host of recurrent projects and objectives. Since the early 90s some priorities, such as agricultural development, investment climate improvement, Private-Public Partnership, governance and infrastructure development, among others, have remained the same. Some of the reasons behind this are listed below:

2.1.1. Prolonged Objectives

Given the extended continuation of certain projects under particular themes, the government's inability to complete projects within the set timeframe appears

to be the most probable cause. Projects often tend to run into implementation difficulties, facing delays due to political instability and corruption. Furthermore, inadequate feasibility studies, complicated administrative authorization processes, procurement and allocative inefficiencies tend to create added problems.² As a result, a similar set of objectives often gets passed onto subsequent budgets with the same set of projects.

One such example is the Melamchi Water Supply Project (MWSP) which was sought as a social provision in water supply, and as a long-term solution for persistent water shortage problems in Kathmandu valley. The initial vision of this project dates back to 1998, although it was only in 2000 that the government

achieved a breakthrough in terms of funding requirements. The Asian Development Bank (ADB) and Government of Nepal along with seven other multilaterals gathered NPR 47.2 trillion (USD 631.8 billion),³ which then facilitated the launch of the project in 2001. The project was unable to gain momentum as conditional requirements were unmet, corruption charges emerged, and funds were misused; which further led to a major restructuring in 2008 with hopes of completion in 2014. Unfortunately, the target remains unmet. Looking back, the government has been pushing this project for over a decade, allocating additional funds but with negligible outcomes. The project is still underway with hopes of completion in mid-April 2016.

Development of physical infrastructure, which is considered to be of top priority in improving investment climate, has met with the same fate. Another such example is the Kathmandu-Terai Fast Track Road project which has been on the cards for over a decade, but has been mired by controversies and inactivity. Apart from these, recent projects also do not particularly show encouraging signs. These examples therefore demonstrate the trend of prolonged projects and consequently unmet objectives. As of now, the feasibility study for West-Seti Hydropower Project has been delayed, plans for construction of second international airport proposed at Nijgadh have not taken off beyond completion of feasibility study and demarcation of boundaries, and the Postal Highway construction has fallen short of its target.

4

2.1.2. Persistent Challenges and Copy-Paste Strategies

A quick comparison of the challenges faced by the economy more than a decade ago with current times displays the extent of progress; or lack thereof, that the economy has achieved. The stark similarities in past and present challenges can readily be observed from the prevailing circumstances, as well as the budget documents illustrated in Table 2, which shows that the same set of challenges have persisted throughout the years with no real progress in any of these areas over the past fifteen years. Moreover, strategies employed by the government to meet these challenges have also remained identical.

For instance, most public enterprises have recorded losses since their inception. To curb these losses, the government's approach has been limited to Private-

A similar set of objectives often gets passed onto subsequent budgets with the same set of projects.

Public Partnership (PPP), which has remained ineffective.⁵ Since enacting the Privatization Act in 1994, the government has been opting for various PPP models including sales of assets and business, sales of shares, leasing out, management contract, and liquidation. Despite the government's attempts, lack of sufficient restructuring prior to the announcement for privatization, bureaucratic complexities and delays, lack of manual with clear guidelines and specific time bound targets along with political instability and opposition from powerful interest groups have been attributed for the failure of PPP.⁶ Extrapolating instances such as these, the whole of the budget therefore fits

Table 2: Comparison of the prevalent challenges in FY 2000-01 and 2015-16

2000-01	2015-16
Low agricultural productivity due to inadequate irrigation facility and agricultural inputs, and traditional technology.	Inability to raise agricultural productivity, increasing agricultural input imports.
Slackness in investment and industrial sectors.	Weak infrastructure.
Negative growth in public enterprises.	Weak performance of public enterprises.
Cumbersome governance – inability to enhance public resource management.	Ineffective administration mechanism system.
Complicated public expenditure management.	Allocative inefficiency – higher allocations to non-productive sector than productive sector.
Lack of institutional capability and stagnant implementation.	Inadequate absorptive capacity of the government, poor implementation.

Source: Ministry of Finance Budget speech 2000/01 and 2015/16

into this copy/paste technique⁷ such that one can easily forecast budget provisions. This persistent scenario has been the ultimate testament for stagnant implementation and thus, recurring projects and objectives.

2.1.3. Inability to Materialize Long Term Vision

Whether the budget encompasses necessary plans and programs with a long term objective is itself up for debate, and the plans and programs that do appear to be based upon a long term vision seem unable to materialize into significant outcomes. The introduction and realization of a long term vision—as a guiding factor—is an essential part of planned development for any nation. In the context of Nepal, the periodic plans have focused on improving two things:

- **Economic growth** – By increasing productivity and employment, developing infrastructure, and promoting industry, commerce and trade.
- **Fostering a prosperous society** – By reducing poverty, inclusive development both in terms of class and gender, improving literacy and health, and closing the income gap.

These broad objectives are said to be incorporated in the yearly budget. However, despite having more than six decades of planned development, little has been achieved in terms of long-term progress.⁸ For instance, agricultural development plans such as the Agriculture Perspective Plan, have failed to achieve objectives of increasing agricultural growth and modernization. Likewise, the attempt at reviving the manufacturing sector through the

Industrial Development Perspective Plan has also failed as the industrial sector's contribution to GDP has continually declined. Meanwhile the Public Private Partnership approach has also proved to be ineffective, and investments (though rising) have also remained under utilized along with persistently poor infrastructure. Overall, of the few long term objectives that have been framed, most have largely remained unmet.

2.2. Implementation Lags

As mentioned earlier, prolonged objectives of the government, persistent challenges and inability to materialize long term vision, all point to a substantial flaw in the budgeting practice – the inability to implement projects.

2.2.1. Root Causes for Inadequate Implementation

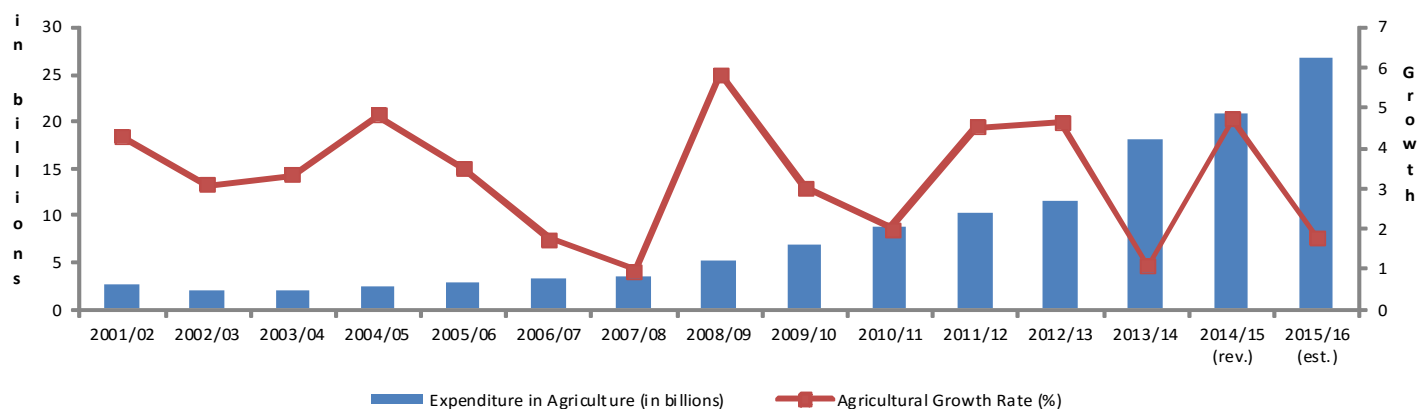
It is evident that inadequate implementation has had detrimental effects in terms of the inability to fulfill objectives and on the progress of the economy as a whole. This is especially pronounced with regards to capital spending, as trends indicate that actual capital expenditure is less likely to meet the allocated expenditure. Multiple reasons have been identified for weak capital spending as illustrated in Table 3.

The MWSP for instance provides insights into the implementation difficulties in project execution. Despite the concept being identified in 1998, it was not until 2008 that serious dedication was given. During this ten year gap, despite the government

Table 3: Reasons for Low Capital Spending

Bureaucratic Hassles
<ul style="list-style-type: none"> • Delays in project approval • Weak inter and intra ministry coordination
Structural Issues
<ul style="list-style-type: none"> • Limited capacity of sector ministries (Planning & Implementation) • Lack of strong pipeline of projects ready for implementation • Legislation hurdles (procurement & maze of processes dictated by various acts and policies)
Political Instability
Low Project Readiness / Allocative Inefficiency
<ul style="list-style-type: none"> • Lack of ready detailed design • Hassles in land acquisition • Frequent staff turnover • Lack of feasible procurement plans • Weak capacity of contractors • Weak contract management

Figure 2: Expenditure Allocation in Agriculture vis-à-vis Agriculture Growth Rate



Source: Ministry of Finance Redbook and Economic Survey

sourcing NPR 47.2 trillion (USD 631.8 billion) through partnerships with various multilateral and bilateral agencies, the project was engulfed in controversies. World Bank, one of the partners, retracted from funding as the conditions for private sector participation went unmet and the government was unsuccessful in engaging private sector investors. Three additional partners also withdrew financial support citing political unrest and instability, and leaving a gap of NPR 13.5 trillion (USD 180.7 billion).

Further, corruption allegations led to delays in project planning and execution. In 2008, ADB, one of the main partners, sought to restructure the project which subsequently led to the initiation of construction work only in 2010; even though contractors were hired in 2009.⁹ The project exceeded its five year completion deadline stipulated for 2013.

In this respect, it should also be mentioned that the honesty in construction by the contractors also plays a significant role in the final outcome of

the project. For instance, the contracted entity for the project had only dug 6.5 km out of the planned 27.5 km tunnel in three years, leading to contract termination in September 2012 which led to further delay in construction work.^{10 11}

2.2.2. Insignificant Outcomes

Despite continuous prioritization of certain objectives such as economic growth, fostering a prosperous society, and all sectors receiving increased subsequent funding, the outcome of these projects continue to remain insignificant.

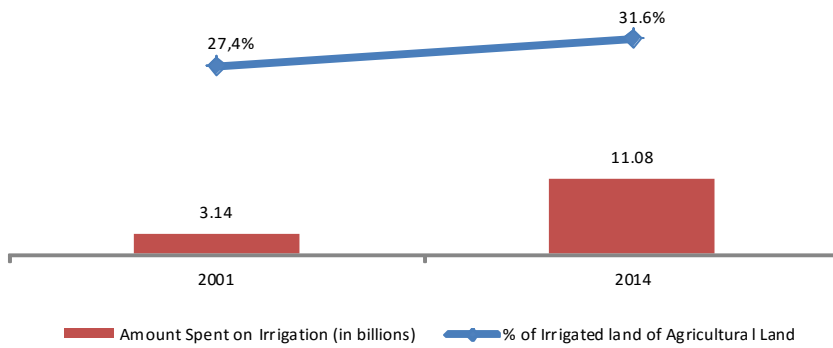
Agriculture Sector

For instance, the yearly national budget has been prioritizing agricultural commercialization and productivity under the broader objective of agricultural development for over two decades, which also is the largest budgeted sector in every national budget. However, despite a ten-fold increase in budget allocation for this sector; from an average of NPR 2.6 billion (USD 25

million) between 2001 and 2008 to estimated NPR 26.64 billion (USD 256 million) in FY 2014-15, the agriculture growth rate has remained erratic for the same duration, going as low as 0.97% in FY 2007-08 and as high as 5.8% the very next year.

This erratic nature of growth has been casually blamed upon weather conditions regardless of the billions of amount spent specifically towards facilitating growth - especially through increased allocations in irrigation as well as acquisition of fertilizers; the two primary factors influencing productivity besides climate. With total irrigated land growing at a sluggish pace; a mere 4% increase in irrigated land as opposed to over 250% increase in budget allocations for irrigation since 2001, and minimal growth in crop yields; which signifies low productivity, slowest among the South Asian nations like Bangladesh, India and Pakistan,¹² it is not surprising that the average growth for 2005-2015 rests at a dismal 3%.

Figure 3: Budget Allocation in Irrigation Compared with Percentage of Irrigated Land



Source: World Bank indicators and Ministry of Agricultural Development yearbook 2014

Investment Climate

Similarly, with regards to investment climate, despite gaining continual priority the situation remains unfavorable as numerous deterrents still persist. For a developing nation like Nepal, productive sectors are considered to be an ideal investment sector; in that the economy can start mass producing various goods alongside also generating employment opportunities. However, despite the increasing number of industries and

growing inflow of foreign investment especially towards manufacturing sector, the contribution of this sector to GDP continues to remain the lowest over the last decade. The average contribution to GDP for the past 10 years i.e. between FY 2004-05 to FY 2014-15 was stuck at 16.3%, while the growth rate rests at 2.9%. Moreover, compared to other developing economies, Nepal still has the lowest FDI flow; ranking 175 out of 182 countries in the FDI Potential Index.¹³

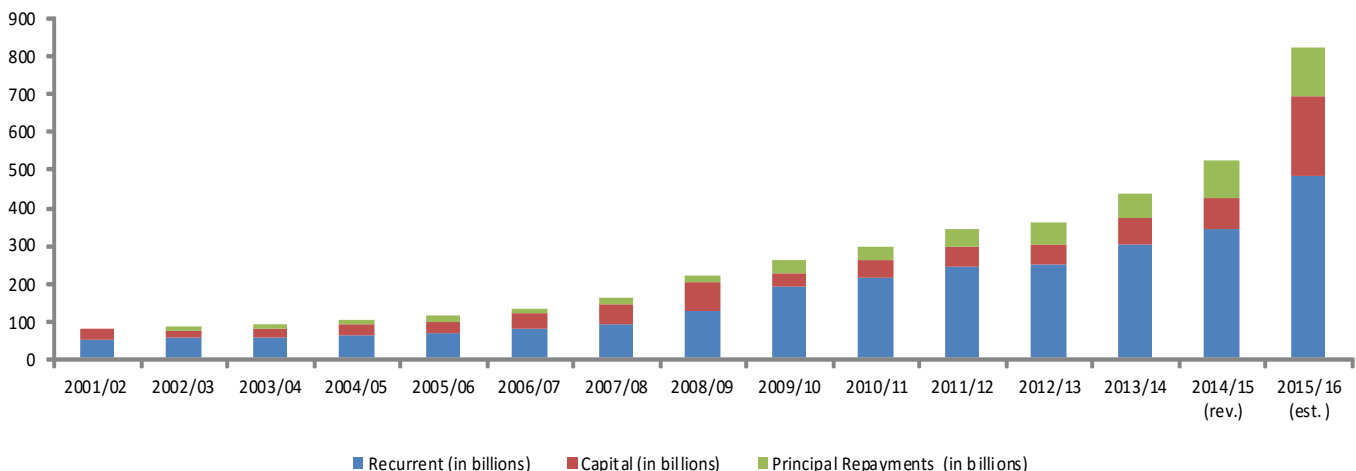
2.3. Expenditure Patterns

Despite increased allocations in subsequent budgets, the budget formulation process suffers from allocative inefficiencies and inadequate spending capability of the government both in terms of quality and quantity.

2.3.1. Increasing Recurrent Expenditure

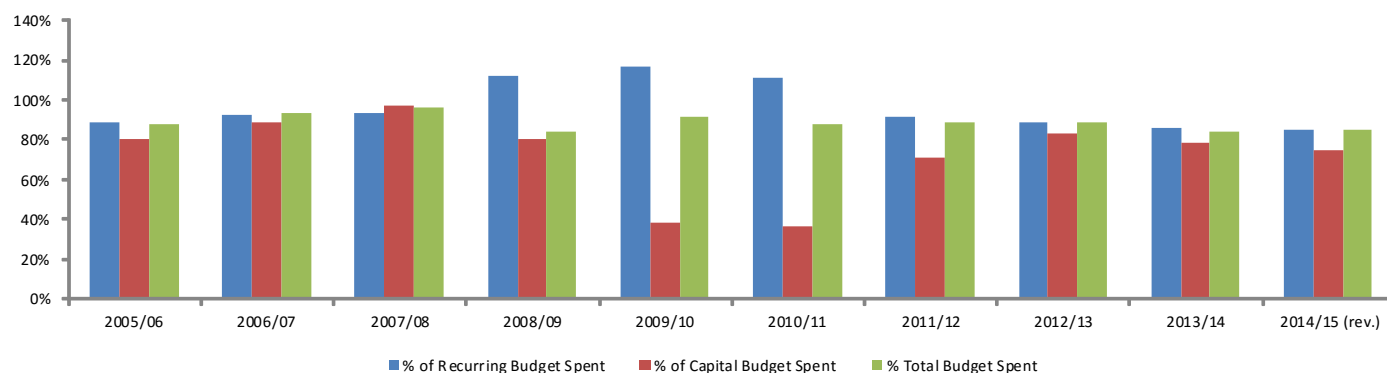
The expenditure pattern for the last 15 years shows an alarming tendency wherein the recurrent expenditure has been on a constant rise as can be seen in Figure 4. This points out to the fact that most of the expenses have been allocated towards wages, rents, and other recurring costs, which may include development project expenses of previous years; wherein if development projects extend beyond their deadline, the additional costs keep accumulating on recurrent expenses - for instance transportation costs, operational costs, etc. It was observed that the recurrent expenditure grew at an average of 16.7% from FY 2002-03 to FY 2015-16, higher than the capital expenditure (11.2%) as well as total expenditure (15.8%).

Figure 4: Trend in Government Spending



Source: Redbook, Ministry of Finance

Figure 5: Actual vs. Estimated Spending Rate



Source: Author calculations based on Ministry of finance Redbook

A drastic shift can further be noted where the average share of recurrent expenditure to total expenditure hiked to 70% post FY 2008-09 from around 60% in the previous years. Consequently, the share of capital expenditure has almost halved from 30% to 15% in the same duration. The highest allocated recurrent expenses during FY 2015-16 comprised of grants to local bodies and social services (42.7%), compensation to employees (21.5%) and social sector provisions (14.2%). This indicates the ballooning recurrent expenditures, significantly

altering the allocations in capital expenditure.

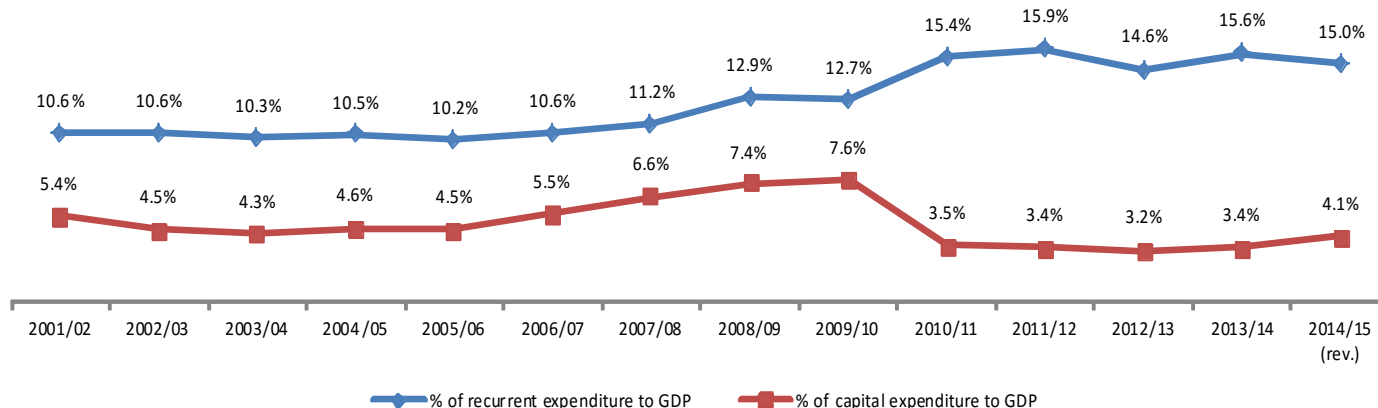
2.3.2. Inadequate Capital Allocation and Spending Capability

While accommodating for the huge recurrent spending, the expenses for development activities through capital spending have been compromised. The statistics show that the share of capital expenditure to GDP has fallen from 7.6% in FY 2009-10 to an estimated 4.1% in FY 2015-16. Similarly, looking at the actual and estimated expenditure

gap in Figure 5, it has been found that capital spending is significantly more likely to fall short of its targeted expenses. The average gap between actual and estimated recurrent expenditure, between FYs 2002-03 and 2015-16, figures at 11.3% whereas the gap rests at 27.5% for capital expenditure.

In fact, between FY 2008-09 to FY 2010-11, the actual recurrent expenditure overshoot the estimated amount by almost 13% on average; conversely, the gap in capital expenditure for the same duration

Figure 6: Percentage Share of Expenditure in GDP



Source: Ministry of Finance Economic Survey 2014/15

While accommodating for the huge recurrent spending, the expenses for development activities through capital spending have been compromised.

grew by a staggering 48.4%. On a side note, the principal repayments are seen to be rising, signifying repayments of, and reductions in public debt. However, such repayments have been covered through allocations which could have been aimed towards capital expenditure.

Multiple reasons have been identified for such lackluster capital allocation and spending. The government cited failure to bring a full budget in the beginning of the fiscal year, and state of ambiguity on budgetary issues as the major factors for the decline in capital allocation.¹⁴ Additionally, delays in execution of procurement process combined with weak planning and implementation capacity have affected capital spending. According to ADB, the prime reason for low capital spending (which is especially notable in the last five years) has been attributed to the lack of project readiness, such as delays in project design, land acquisition, and establishment of project management offices.¹⁵

Overall, this shows that the government has spent significant effort in catering to the non-productive sectors as opposed to productive sectors. For a developing nation, like Nepal, with poor infrastructure and high instances of unemployment, the growth of productive sector is pivotal to achieve progress, and with it the desired level of employment, improved infrastructure and increased investments.

Table 4: Fiscal Deficit Trends

Fiscal Year	Total Expenditure (in NPR billions)	Total Revenue (in NPR billions)	Deficit (in NPR billions)	Deficit (% of GDP)
Avg. 1990-2000	43.27	25.48	-13.70	6.28
2001/02	80.07	57.13	-22.94	5.70
2002/03	83.99	67.55	-16.43	3.80
2003/04	89.43	73.60	-15.82	3.50
2004/05	102.55	84.50	-18.04	4.00
2005/06	110.88	86.10	-24.77	3.40
2006/07	133.59	103.49	-30.09	3.60
2007/08	161.35	127.94	-33.41	3.60
2008/09	219.66	169.85	-49.80	3.70
2009/10	259.68	218.49	-41.19	3.20
2010/11	295.36	245.74	-49.62	3.60
2011/12	339.16	287.98	-51.18	3.40
2012/13	358.63	333.92	-24.71	1.50
2013/14	435.05	396.31	-38.95	2.00
2014/15	618.10	514.82	-103.28	4.86
2015/16	819.46	587.90	-231.56	-

Source: Ministry of Finance Economic Survey 2014/15 and Dr. Govinda Bahadur Thapa

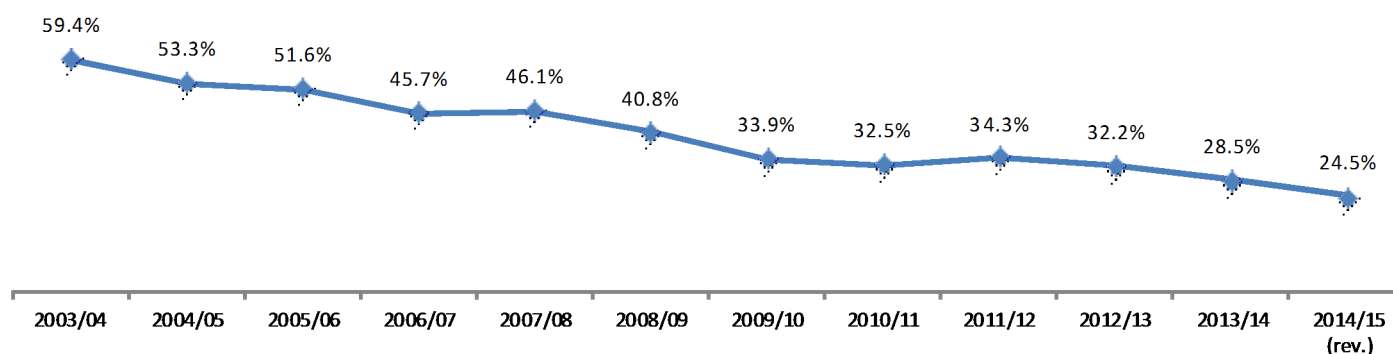
2.4. Fiscal Deficit

When expenses exceed revenues, the budget incurs a fiscal deficit. Fiscal deficit is an increasingly common phenomenon in developing countries and Nepal has been incurring a fiscal deficit right from the early budgeting years.

Although incurring fiscal deficit has become a trend, the level of deficit has varied every year and does not exhibit a definite pattern. However, the recent

deficit, as a percentage of GDP, has lowered in comparison to the 1990s. One of the reasons for the decreasing deficits is said to be the introduction of International Monetary Fund's Enhanced Structural Adjustment Facility (ESAF) in 1994; where liberalization was promoted giving more functions to the market, which required macroeconomic stability thus leading to level maintenance of deficits. The deficit continued to decline wherein Nepal even resorted to sacrificing

Figure 7: Outstanding Debt Per GDP



Source: Ministry of Finance Economic Survey 2014/15

growth in order to maintain stability by slashing down developmental expenditures in the years where revenue collection fell short of the target.¹⁶

In recent times, public debt i.e. accumulation of fiscal deficits, has shown a declining trend, which suggests that the government has been paying off due loans; though at the cost of development activities. Although debt burden gets lowered, cutting capital spending further stagnates the growth in an economy which is already struggling with inadequate infrastructure. Given that public debt of around 40% is considered fiscally sustainable, the economy has enough fiscal space to push public borrowing which is currently hovering at 24.5%. As per a report by ADB, a growth rate of 7% per annum is achievable from FY 2017-18 to FY 2024-25, given that borrowing is gradually raised to 40.6% of the GDP target.

The recent deficit, as a percentage of GDP, has lowered in comparison to the 1990s.

3. HIGHLIGHTS OF NEPAL BUDGET FY 2015-16

The latest budget for FY 2015-16, was published in July 2015 which seems to markedly differ in terms of prioritization compared to previous budgets. The top priority of the current budget has shifted to relief, rehabilitation and reconstruction due to the earthquakes in the first half of 2015, which adversely affected the industrial and services sector. However, the objective of the national budget has remained more or less the same and still focuses on fostering economic growth, reducing poverty through increasing employment opportunity, constructing physical infrastructures, reforming governance and taking measures to improve investment climate; simultaneously, giving continuity to previous plans and programs.

The previous budget had expected a GDP growth rate of 5%, which dropped to 3.04% after the earthquake; whereas, inflation increased from less than 7% to 7.4% as of the 11th month of the previous fiscal year led by the supply-side

strain i.e. rising wages and increase in imports. In the current budget, the estimated GDP growth was 6% with inflation targeted below 8%. However, given the shortage of essential commodities affecting agriculture, industry and services, the growth and inflation target is unlikely to be met.

3.1. Changes in Budget Allocation

In terms of allocation, the overall budget amount increased by an incredible 56.7% from the previous revised budget of FY 2014-15 to an estimated NPR 819.4 billion (USD 7.87 billion). This has been accounted for primarily by the surge in capital expenditure towards reconstruction activities. Capital allocation significantly rose by 141.2% to NPR 208.87 billion (USD 2 billion). Such an increase could be viewed as a step in the positive direction to correct the prevalence of poor infrastructure and inadequate spending; though the government's ability to spend the allocated amount must improve.

Although the increase in capital expenses appears favorable (as more amount is likely to be geared towards developmental activities as opposed to recurrent

Table 5: Budget 2015-16 Allocation to Function-wise Heads

Classification	Allocation (in NPR billions)
General Public services	243.95
Defense	37.49
Public order and safety	39.22
Economic Affairs	289.25
Environmental protection	15.15
Housing and community amenities	26.98
Health	41.33
Recreation culture and religion	4.73
Education	98.64
Social Protection	22.67
Total	819.45

Source: Ministry of Finance Redbook 2015/16

expenses), the real challenge is to maintain the trend in future budgets. The likelihood of this happening, nonetheless, is doubtful as the hike might just be a short term anomaly brought about by the earthquake where various damaged governmental offices had to be relocated or rebuilt, increased civil construction works (repairing roads, building shelters) had to be undertaken, and capital contingency was available.

3.2. National Reconstruction Authority

With respect to the reconstruction activity following the earthquake, the budget proposed the formation of a National Reconstruction Authority (NRA) to oversee reconstruction work. Within NRA, the “National Reconstruction Fund” is expected to finance the expenses, which shall be collected through internal and external

sources like tax revenues and donations, and a “Reconstruction Bond”, where investor loans the money to the government for a defined period of time at a variable or fixed interest rate, in order to enhance ownership and participation of the general public. As of the current budget, the fund amounts to NPR 74 billion (USD 711.5 million) which has further been segregated for various purposes such as housing, public buildings, archaeological structures, among others. However, despite the appointment of the CEO, the NRA could not begin operation as the ordinance that created it missed the deadline for passage through the parliament. This prompted the bill to be registered again causing more delays. Until NRA becomes operational, the NPC has been assigned the responsibility of reconstruction works.

Besides NRA, provisions up to NPR

200,000 (USD 1923) for those willing to construct their damaged houses on their own, under specified norms, has also been made available. Moreover, special housing loans at 2% concessional interest for house rebuilding purposes has also been introduced. In terms of businesses a provision has been made to establish an Economic Rehabilitation Fund to provide refinancing facility and interest subsidy for the sectors affected by the earthquake.

3.3. Projects

Apart from reconstruction activities, provisions for several big projects, old and new, have been made in the current budget. For instance, multiple road infrastructural development projects have been initiated and carried forward including the Kathmandu-Terai Fast Track Road, East-West highway four lane upgrade, Terai-Madhes based Postal Road, Humla/Dolpa connecting road and Mid-hill highway, along with several other corridor expansions and localized road expansions.

Likewise, large hydropower projects such as Upper-Tamakoshi has been given continuity with the aim of completion within two years, whereas the construction of Tanahu hydropower and

Four months into FY 2015-16, capital expenditure has barely exceeded 4%. Historical trends on capital expenditure show that a major chunk of capital allocations gets utilized only in the last

trimester.

CAPITAL SPENDING HABITS

Four months into FY 2015-16, capital expenditure has barely exceeded 4%. As of early November 2015, a total of NPR 7.6 billion (USD 73 million) has been utilized, of the estimated NPR 208.8 billion (USD 2 billion) allocated for capital expenditure.¹⁹ This meager capital expenditure in the early stages of the fiscal year is one of the marked characteristics of the government's spending habit. Historical trends on capital expenditure show that a major chunk of capital allocations gets utilized only in the last trimester.²⁰ The final trimester alone accounts for an average of 70% of capital expenditure utilization. At the end of the fiscal year, the actual capital expenditure seldom exceeds 80%. As a result, development projects often face significant delays in execution leading to difficulties in meeting their objectives and overshooting deadlines - further making projects prone to haphazard conduct. Consequently, the chain effect builds up as additional resources get dedicated to the incomplete projects year after year, adding to the already burgeoning recurrent expenses. The MWSP can be taken as a fitting case example.

The major reasons for the persistently low capital spending have been identified as:

- Within allocation inefficiency, the Ministry of Finance has identified the abundance of projects and donor issues as a hindrance to quick disbursement. Additionally, unfulfilled pre-requisites, such as land acquisition, designing, etc., prior to budgeting for construction works are also noted as barriers to disbursement of capital.
- Implementation problems include hassles in public procurement process, poor performance of contractors and quality of work, and ineffective monitoring. Similarly, the socio-political imbalance also falls among the major impediments to capital disbursement.
- Apart from these, delays in program approval, budget authorization, and preparation of financial statements and audits, along with frequent turnover of key project staff and absence of elected local authorities are also seen as adding to the obstructions in capital expenditure.

In the current fiscal year, the challenges to capital budget utilization appear especially pronounced. Although the long awaited constitution was formed soon after the earthquake, the promulgation led to aggravation of the Terai-Madhes protests subsequently causing border blockade. As a result, the nation plunged into political and economic turmoil which has further disturbed the already poor capital expenditure disbursement and utilization. Few of the challenges currently being faced include:

- National Reconstruction Authority (NRA) which was expected to carry out the rebuilding works of damaged infrastructures after the April Earthquake is yet to be constituted due to political disagreements and the ongoing political unrest and there has been no headway with regards to passing the reconstruction bill in the parliament. Seven months after the earthquake, the NRA still remains shrouded in controversy. Given that the NRA accounts for a considerable portion of the capital expenditure, the delays in its operation would very likely delay capital spending.
- Construction is halted at major hydropower projects such as Upper Tamakoshi, Rasuwagadhi along with four other power-plants due to the lack of gasoline and construction materials. Consequently, some of these projects are expected to be delayed by at least a year.²¹
- Reports of disruptions in road construction projects have begun to crop up.²² The shortage in requirement of petroleum products to operate heavy equipment and transport has ceased progress in construction works.

Nonetheless, the full extent of the obstruction caused by the economic turmoil on capital expenditure is ambiguous given the government's eleventh hour approach on its spending; all the while, instances of obstructions in on-going projects are likely to increase, especially in those requiring construction works. However, with the current fiscal year being dubbed as "budget implementation year", various efforts have been made to increase implementation such as simplifying program approval and authorization process, discouraging approval of new program in middle of fiscal year, and reallocating funds to performing projects if projects fail to use at least 50% of their allocated funds in the first eight months of the fiscal year, among others. Given the prevailing economic crisis, genuine implementation of these efforts would be pivotal in appropriating the time and resources currently being lost, and ensuring effective utilization of the capital budget.

Budhi Gandaki hydropower has been initiated. The Melamchi Drinking Water project is also expected to conclude within two years. Apart from these, provisions for expansion of transmission lines have been provided, upgradation of Gautam Buddha Airport to regional international airport has been given

continuity with the hopes of completion within two years, and large irrigation projects have been undertaken with the hope that operation can start within five years.

Despite new plans and continuation of old ones, the struggle for the government

indubitably lies in implementation. Although the current fiscal year has been termed as the "Budget Implementation Year", realization of such an ambition hinges on the outcomes of the plans as the days go by.

RECOMMENDATIONS & OUTLOOK

The current trend in Nepal's budgeting practices paints a disappointing picture in terms of current as well as future growth and development. The prevalence of unmet challenges and prolonged objectives coupled with bleak outcomes jarringly gaps at implementation inefficiencies, whereas the increasing recurrent expenses followed by largely inadequate capital spending points to compromised development.

Though revenue collection has shown increasing effectiveness, the crux of the matter is entirely on spending, and ensuring that the spent amount delivers a substantial outcome. The government, in this aspect, has fallen disastrously behind. In this regard it becomes imperative for the government to get a different perspective on the purpose of the budget, its objectives and the ensuing plans and programs for the short as well as the long term, especially if it hopes to graduate from least developed country status in 2022 and to a middle income country in 2030. Given the existing issues, few recommendations have been listed below to curb the prevalent inefficiencies in formulation and implementation of the budget:

PRE-PONE BUDGET PREPARATION DATE

The Budget should ideally be ready by mid-May so that proper allocations and approvals could be finalized by mid-July. This will avoid the current problem of the budget being tabled in July, approved around September and then spending beginning three months into the fiscal year.

DOVETAIL LONG TERM PLANS

For the budget to be an effective tool for socio-economic

development, it must incorporate and interconnect long-term plans. The budget needs to strategize projects through prioritizing and developing additional long term visions; unlike the current practice of budget formulation which is largely a document in isolation.

RESTRUCTURE PUBLIC PROCUREMENT

The procurement process has to be re-designed to ensure capital budget implementation such that the process is streamlined; as this alone has been delaying the process by 3 to 4 months in the prevailing circumstances.

RECTIFY BUREAUCRATIC HASSLES

The presence of bureaucratic hierarchy involved in authorization and budget disbursement have been known to cause delays especially with practices such as requirement of multiple official sanction letters. These processes should be managed such that the process runs efficiently while ensuring accountability and transparency.¹⁷ Moreover, rectifications should be made on other inefficiencies such as - absence of a clear organizational structure, weak linkage with Public Expenditure and Financial Accountability (framework for strengthening public expenditure system) and non-implementation of the public act regulations, as identified by a framework on public procurement i.e. Public Procurement Strategic Framework Phase I.

INSTITUTIONALIZE CAPITAL SPENDING

This is a straight forward approach based on basic common sense. First, the plans like feasibility studies, project designs, procurement methods, etc. are to be finalized.

Following this, the capacity of the government officials is to be improved through technical and institutional support. Finally, the procurement practices are to be improved through trainings of staffs at Public Procurement Management Office.²

EMPHASIZE ON PRODUCTIVE SECTORS

The government needs to address the purpose of the budget, which for the most part appears to be a tool to distribute income - with higher allocations in social sectors as opposed to productive sectors. The current practice of distributive economics must be transformed such that the allocation of resources facilitates productive sectors while ensuring that education and health; among other social sectors, get adequate support. For this to occur, cost ineffective projects and programs with poor impact must be dropped.

Nepal is currently at a transitional phase having just formulated a new constitution. While treading new grounds, the government is bound to come across several issues including, but not limited to, formulating federal budgets, allocations, and the setting of long, medium and short term strategies. In keeping up with the changes, the process of budget preparation needs a complete overhaul where policy issues and issues relating to revenue and expenditure needs to be segregated. Further, the process should be made transparent by requesting information via internet and other platforms. Moreover, the reasons for amendments should be clearly stated, so that it is understandable that the changes were not made at the behest of business syndicates and cartels.

The revamping of budget formulation and execution should also be in tune with the new federal structures, such that coherency is maintained among the objectives of the states and the center. Similarly, the allocations in resources are likely to change as per the states, as various resources will strictly be limited according to demarcations. This further highlights the issues in revenue sources, collection and spending. Looking ahead, these issues, among many others, will need to be carefully addressed.

MINIMIZE DISINCENTIVES

In order to attract private sector investment, the deterrents; which primarily include poor infrastructure such as transportation and energy, and rigid labor laws, must be thoroughly addressed. But perhaps the most significant of deterrents i.e. political instability—the presence of which has foiled attempts to build public-private partnerships¹⁸ and has affected the smooth functioning of industries—should end.

CONTAIN RECURRENT EXPENDITURE

The increasing recurrent expenditure must be contained in order to free up fiscal space for capital development, according to ADB. In order to achieve this, the government must identify unwanted projects, make necessary cuts in social obligations, and most importantly find alternatives for public enterprises which appear to raise costs significantly year after year.

ENDNOTES

1. Bijaya Acharya Adhikari, "Budget Formulation in Nepal: Practices and Weaknesses", Ministry of Finance Nepal, July 2009, <http://goo.gl/lwScgD>
2. Shalinta Sigdel, "CAPITAL BUDGET: Hard To Spend", New Spotlight, September 2014, <http://www.spotlightnepal.com/News/Article/CAPITAL-BUDGET-Hard-To-Spend>
3. As per the average exchange rate of 2001 where 1 USD = 74.7 NPR
4. Keshab Poudel, "Economy: Back on Agenda", New Spotlight, March 2014, <http://www.spotlightnepal.com/News/Article/ECONOMY-Back-On-Agenda>
5. Rudra Pangani, "Privatization plan hits snag as ministers put differing views on PEs", Republica, December 2014, http://myrepublica.com/portal/index.php?action=news_details&news_id=88133
6. Ram Prasad Ghimire, "Privatization of Public Enterprises in Nepal: Expectations and Achievements", 2004, http://www.researchgate.net/publication/257142347_Privatization_of_Public_Enterprises_in_Nepal_Expectations_and_Achievements
7. Arthabeed, "Beyond Budgets", Nepali Times, July 2006, <http://nepalitimes.com/news.php?id=12192>
8. Dinesh Chandra Devkota, "Nepal Needs Long Term Vision.", New Spotlight, July 2012, <http://www.spotlightnepal.com/News/Article/-Nepal-Needs-Long-Term-Vision->
9. Chris Freeman, NabinKhanal, WaqasSatti, Abhinav Upreti, and Grace Webster, "Melamchi Water Supply Project", Duke University, March 2014, https://faculty.fuqua.duke.edu/~charvey/Teaching/663_2014/Pancha/Melamchi_case.pdf
10. "Melamchi's tunnel vision", The Kathmandu Post, December 2014, <http://kathmandupost.ekantipur.com/news/2014-12-23/melamchis-tunnel-vision.html>
11. Chandan Sapkota, "Nepal's economic outlook for FY2015 and FY2016", Blog, March 2015, <http://sapkotac.blogspot.com/2015/03/presentation-nepals-economic-outlook.html>
12. Rizwanul Islam, "Nepal: Addressing the Employment Challenge through the sectoral pattern of growth", ILO, April 2014, http://www.ilo.org/wcmsp5/groups/public/---asia/---ro-bangkok/---ilo-kathmandu/documents/publication/wcms_245652.pdf
13. Ratnakar Adhikari, "Foreign Direct Investment in Nepal", SAWTEE, http://www.sawtee.org/Research_Reports/R2013-01.pdf
14. Ministry of Finance, "Economic Survey 2012/13", Government of Nepal, http://mof.gov.np/uploads/document/file/Eco%20survey%20English%202012-13_20130818033004_20140724075921.pdf
15. "Adequate space to ramp up borrowing: ADB", The Himalayan Times, September 2015, <http://thehimalayantimes.com/business/adequate-space-to-ramp-up-borrowing-adb/>
16. Dr. Govinda Bahadur Thapa, "Deficit Financing: Implications and Management", NRB, http://www.nrb.org.np/ecorev/pdf/files/vol17_art2.pdf
17. Shalinta Sigdel, "CAPITAL BUDGET: Hard To Spend", New Spotlight, September 2014, <http://www.spotlightnepal.com/News/Article/CAPITAL-BUDGET-Hard-To-Spend>
18. RudraPangani, "Privatization plan hits snag as ministers put differing views on PEs", Republica, December 2014, http://myrepublica.com/portal/index.php?action=news_details&news_id=88133
19. "Daily Budgetary Status as of 2072-07-19 (05 Nov 2015)", Ministry of Finance – FCGO, Government of Nepal, November 2015. <http://www.fcgo.gov.np/wp-content/uploads/2072-07-19.pdf>
20. Baikunth Aryal, "Capital Expenditure and Lower Disbursement in Development Projects", Ministry of Finance, Government of Nepal, April 2014. http://www.mof.gov.np/uploads/document/file/NPPR%202014_20140423124306.pdf
21. Sanjeev Giri, "Fuel crisis hits construction of hydropower projects", The Kathmandu Post, November 2015. <http://bit.ly/1QIkdW9>
22. "Shortage disrupts upgradation of Manthali-Ramechhap road", The Himalayan Times, November 17, 2015.

