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Application of Instruments of Fiscal Policy in Nepal

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Abstract

Fiscal policy is an important component of government policy to bring high, broad based and sustainable economic development. Budget, taxation, public expenditure and public debt are the instruments of fiscal policy and these instruments are not using appropriately, effectively and efficiently in the context of least developed countries so that they trapped as a low-income nation. In Nepalese context, government of three-layer formulating and implementing budget to mobilize national, provincial and local level resources and to follow the norms of decentralization. The ratio of capital expenditure in relation to recurrent expenditure is high indicator of low economic development in the coming years. In eleven months of fiscal year, only 50 percent of the development expenditure can utilize is the symbol of gloomy situation of our economy. Regarding to tax base and rate, it has some regressive nature so that collection of tax became difficult task. People are interested to evasive tax due to administrative hurdles and its poor utilization policy. Resources can divert into productive sector due to better public expenditure policy. Government of Nepal can utilize the resources of its citizen on the basis of the trust of government. Ultimately better fiscal policy can pave the way for higher, sustainable and broad-based economic growth rate. We can graduate our nation in the list of developing nation by 2030 as well as can fulfill sustainable development goals.

Keywords: Fiscal, development, taxation, domestic resources, public debt

Introduction

Government policy is an important instrument that can bring adjustment in micro and macro-economic variables. Fiscal and monetary are two policies of the government and the uses of these instruments depend on the condition of an economy. Fiscal policy is a powerful instrument of government control after 1930s. Tax, budget, public expenditure and public debt are the instrument under fiscal policy. Budget is the economic manifesto of income and expenditure of government of a year. Surplus, balance and deficit are three

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types of budgets popular all over the world. In Nepal like least developed countries, deficit budget is an important instrument to bridge the fiscal mismatch. Similarly, tax is the compulsory payment toward the support of government. Direct tax is taken as superior as indirect tax in the sense that the burden of direct tax falls equally, exploit to the poor section of society. Public expenditure is a powerful instrument that can influence the distribution of income and wealth in society. The government fails to spend their given income in their priorities sectors; it is categorized under failure government. The role of public debt is prominent in Nepalese economy because government cannot mobilize domestic resources due to poor tax capacity of its citizen. One’s expenditure is another income so that government should spend more. Fiscal deficit can be bridged with the help of public debt and it is useful for appropriate and efficient utilization of human and natural resources.

Fiscal policy was popular when there was a great depression in the world. In 1930s-decade, supply does not create its own demand so that say’s law of market became failure that demand and supply did not bring automatically adjustment in economic variables. Only monetary policy unable to control all these fluctuations since monetary policy was regulated on the basis of full employment of human and natural resources.

Macroeconomic management should contribute to higher economic growth without disturbing the macroeconomic stability, which is essential for attaining sustained higher level of economic growth. Sound macroeconomic management would also improve the external sector competitiveness of the economy on a sustainable basis, a precondition for reducing the external sector vulnerability of the economy. Balance of payments crises and foreign debt problems are often caused and aggravated by imprudent fiscal policy the solution of which would involve some combination of cutting public spending and raising additional revenue, thereby freeing resources for export and debt servicing. With increased fiscal expansion or fiscal deficit, current account deficit widens and the level of government debt in proportion to GDP increases accordingly. Unsustainable fiscal deficit would encourage capital flight which would deteriorate the debt problem (Basyal, 2006).

Objectives of the Study

The major objective of this research paper is to study the role of fiscal policy in Nepal. The specific objectives of the study are:

- To analyze the nature of fiscal policy of Nepal.
- To explore the impact of fiscal policy related variables on total revenue collection of Nepal.

Review of Literatures

Seligman (1908), asserted an important idea put by the Mercantilists on fiscal principle. The Mercantilists idea was that men should be taxed according to the benefits they received from the state. The duty for the state is to protect the nation, it requires expenditure and it comes from taxation. Petty, the first English writer on fiscal attitude forwarded, "it is generally allowed by all those men should contribute to the public charge but according to the share and interest they have in the public place; that is according to their Estate and Riches. In general, the Mercantilists put the idea of fiscal operation on the benefits the people received and the test for benefit should be expenditure.

According to Lerner (1951), the volume of employment depends on the rate of spending. He has given more important on expenditure side of the fiscal policy. There are five elements in the total spending of an economy. They are consumption by the individuals, consumption by the government, investment by the individuals, investment by the government and investment by the private individuals. Any policy for full employment has to work on one or multiple of these five elements which make up the total spending on currently produced goods and services. In addition, he mentioned the government's three fiscal weapons for fighting deflation. By increasing government expenditure directly for own purchases or indirectly to spend money for social security's benefits to people who will spend it and less taxes from the individuals so that they can spend more.

Lipsey & Steiner (1978), there is little doubt that, when appropriately used, fiscal policy can be an important tool for influencing the economy. In the heyday of fiscal policy in 1940s, 1950s and 1960s, many economists thought that the economy could be adequately regulated solely by varying the size of the government's deficit or surplus. That day is now past, although a few "pure fiscalists" are still to be found. The role of fiscal policy in the economy and its employment by the economists are increasing day by day. When Milton Friedman said, "we are all Keynesian now", he was referring to the general acceptance of the view that the government's budget is much more than just the revenue and expenditure statement of a very large organization. Whether we like it or not, the very size of the government's budget inevitably makes it a powerful tool for influencing the size of the GNP and total amount of employment in the economy.

The IMF approach emphasizes, that "fiscal space can be defined as the availability of budgetary room that allows a government to provide resources for a desired purpose without any prejudice to the sustainability of a government's financial position" (Heller 2005:). The desired purpose of the fiscal policy is very important where the government can arrange resources and there is fiscal space for it.

Sloman (2006) in his analysis of the relative merits of changing government expenditure and changing taxes, has given the opinion, "changing government expenditure has the advantage that it affects aggregate demand directly and has a bigger multiplier effect. Changes in government expenditure can be more specifically targeted than changes in taxation. For example, government expenditure can be directed to regions of high employment or to the specific sectors, such as transport. Taxes cannot be used so selectively. Therefore, the most effective tool of fiscal instruments for a specific purpose is becoming public expenditure.

Karimi and Khosravi (2010) have studied the impact of monetary and fiscal policies on economic growth in Iran using autoregressive distributed approach to co-integration between 1960 and 2006. The empirical evidence shows the existence of long-run relationship between economic growth, monetary policy and fiscal policy. In conclusion, they found that a negative impact of exchange rate and inflation as proxies for monetary policy, but a positive and significant impact of government expenditure on growth.

'It should also be noted that public sector "institutions" are also likely to affect economic growth. For example, Persson and Tabellini (1992) outline a theory that relates different political incentives and political institutions to growth. They conclude that income inequality is “bad” for growth in democracies, while land concentration is bad for growth everywhere.

Relatedly, there is much empirical work that suggests that factors such as the number of local governments, the presence of tax and expenditure limitations (TELs), and the political composition of the governing party affect (and are in turn affected by) fiscal policies.

Babalola and Aminu (2012) investigated the impact of both fiscal revenue and expenditure on economic growth in Nigeria. They classified the fiscal expenditure into productive and unproductive government expenditure while direct income tax was used as a proxy for distortionary fiscal revenue. In order to avoid spurious estimates, the unit roots of the series were verified using Augmented Dickey-Fuller (ADF) technique after which co-integration was conducted. The error correction models were also estimated to determine the short-run dynamics. The result in the analysis is that there is long-run positive impact of productive government expenditure on economic growth. Unexpectedly, distortionary revenue positively influenced economic growth. The analysis recommends improvement in government expenditure on health, education and economic services, as components of productive expenditure, to boost economic growth.

Methodology

The main objective is to present the empirical strategy employed by the government in fiscal instruments after the restoration of democracy in Nepal. Opinions expressed by experts and politicians are taken into analysis in the time of completion of objective. The study is based on annual data on different fiscal years.

The study is descriptive, analytical as well as explorative in nature. So, it utilizes quantitative data collected from secondary sources. The research is based on data of economic surveys published from ministry of finance, Nepal.

Quarterly Economic Bulletins (NRB), Banking and Financial Statistics (NRB), Government Finance Statistics (NRB), Economic Surveys (MOF, GON); National Accounts of Nepal (CBS), Statistical Year Book of Nepal (CBS); Statistical Pocket Book (CBS); International Monetary Fund and World Bank Data sheet were the major sources of data and information for the study.

Data and Methods

This study is related to analyze the trend and structure of fiscal instruments in Nepal. The analysis was based on secondary data from economic surveys of Nepal published by ministry of finance. Regarding to the fulfillment of above listed objectives, various studies from the side of scholar has taken as key sources. Thereafter, data has been managed and systematized on the basis of their nature in this research work. Data of various years were used to explore the condition of tax, public expenditure, budget and public debt. All these instruments were compared with the economic growth of Nepal. It is basically focused on the role of these instruments to obtain economic objectives of fiscal policy. It is also compared and linked with the international theories to the Nepalese actual situation. Descriptive method was used to analyze the variables in this article.

Result and Discussion

On the basis of data, it is cleared that the entire fiscal instrument used according to its norms. Deficit budget is the key sources of income to the Nepalese government. The trend of budget deficit is increasing in the sense that the recurrent expenditure of Nepalese government is increasing. When budget deficit is analyzed of FY 2073/74 and FY 2074/75, budget deficit has increased by 129.93 percent. Such a huge deficit is a indicator of fiscal imbalance and it should be limited in a desirable range.

Table 1

Trend of Budget Deficit in Nepal (Nine Month Comparison)

Fiscal Years	Government Income (In Crores)	Percent Change	Budget Deficit (In Crores)	Percent Change
2073/74	36669.7	-	3346.34	-
2074/75	45212.13	23.8	7694.92	129.93
2075/76	45460.61	0.55	8629.12	12.25

Sources. Financial control general office, 2075

According to government data, deficit budget is increasing in Nepalese context. Government income is not increasing rapidly when it is compared with the budget deficit.

Budget deficit in Nepal to its gross domestic product (GDP) was equal to 8.90 percent in 2018. Government budget in Nepal averaged – 3.50 percent of GDP from 1999 AD until 2018 AD, reaching all time high of 0.90 percent of GDP in 2014 AD and a record low of – 8.90 percent of GDP in 2018 AD (Trading Economics, 2019).

In the one hand budget deficit is increasing and on the other, recurrent expenditure is increasing. When deficit budget is financed through internal and external debt and it is used for recurrent expenditure, it will not be productive to a nation.

Figure 1

Trend of Government Income and Budget Deficit

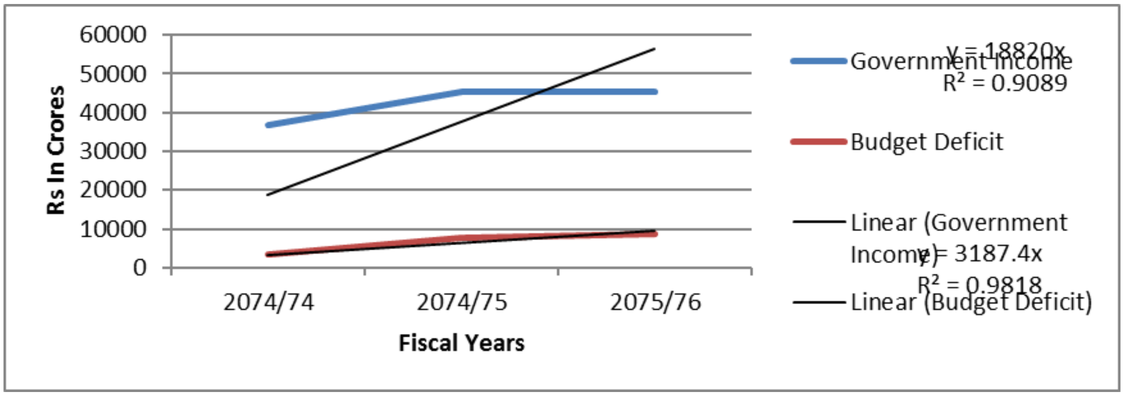


Figure 1 shows that government income increased but at slower pace while budget deficit is increasing at rapid rate. If the situation continues, keeping fiscal balance is not a easy task to the concerned authorities. When trend lines were drawn, it is cleared that budget deficit is increasing in approximately at same pace but government revenue is at lower rate.

According to Keynesian economics, a rise in the budget deficit during a recession is a good instrument to combat with recession. During a recession, there is fall in private sector spending and increase in budget deficit stimulates economic activities. In this situation, it is useful to increase effective demand in an economy. However, a budget deficit during a boom period will be harmful to some extent in the sense that it may reflects on rise in price as well as it drives out private investment. Similarly, it is also important to analyze whether the deficit is used in recurrent or capital expenditure. All other things remaining same, if the government deficit is used to invest in capital expenditure, it might improve the productive capacity and employment scenario of the economy.

Taxation as a Fiscal Instrument in Nepal

Tax is a compulsory payment toward the support of government and people have no expectation of return from that payment. Tax can be used to make equal distribution of income and wealth in the society so that human and natural resources may allocate appropriately, efficiently and effectively. Taxable capacity of Nepalese people is low due to low level of income. Nepal itself is in the trap of vicious circle of poverty so that revenue collection through direct taxes is daunting task. The base of tax is increasing in Nepal since very small transaction is also in the threshold of permanent account number (PAN).

The last few months have seen the problems in taxation intensifying after local governments began increasing the existing tax rates and imposing several new taxes. From levying taxes on street vendors, sale of cattle, movement of citizens, re-introduction of the long-abolished scrap and octroi taxes, alongside multifold increases in government service fees and surcharges, (which many see as ridiculous and irresponsible of the local bodies), a lengthy list of recently surfaced tax related problems from across the country can be prepared (Sharma, 2018).

In several areas across the country, members of the business community and general people alike have taken to the streets to protests the tax hikes and imposition of new tariff rates. Birgunj Metropolitan City, for instance, revoked the imposition of taxes on scrap goods, the sale of petroleum and the raised business registration fees after the Birgunj Chamber of Commerce and Industry (BCCI) organized a mass protest (Sharma, 2018).

The Nepali business fraternity had long feared that the problem of double taxation would spiral out of control after the country started practicing the federal system of governance. This fear has now become a reality. Recently, cement producers in the Argakanchi found themselves in a difficult position when one of the municipalities in the district-imposed taxes on every sack of produced cement as well as clinker, in a clear breach of the tax collection jurisdiction implemented by the Ministry of Federal Affairs and General Administration (MoFAGA). As per the guidelines, local bodies are entitled to levy tax on business transactions only once a year in their jurisdictions (Sharma, 2018). Trend of total revenue and their share on GDP can be presented as;

Table 2

Trend of Total Revenue and Their Share on GDP

Fiscal Year	Share of GDP in %		Total Revenue	Budget deficit on GDP (In %)
	Tax Revenue	Non- TaxRevenue		
2070/71	15.9	2.25	18.15	-1.94
2071/72	16.71	2.34	19.05	-3.81
2072/73	18.69	2.7	21.29	-3.09
2073/74	20.71	2.07	22.78	-7.1
2074/75	21.76	2.22	23.98	-10.46

Sources: Economic Survey, 2019

Table 2 revealed that share of tax revenue increasing year after year. However, the share of non-tax revenue is less or more constant. Budget deficit on GDP is increasing which is the big obstacle in the field of rapid economic development. Revenue collection from the side of state is not satisfactory. It can be presented in a diagram as;

Figure 2

Trend of Total Revenue and Their Share on GDP

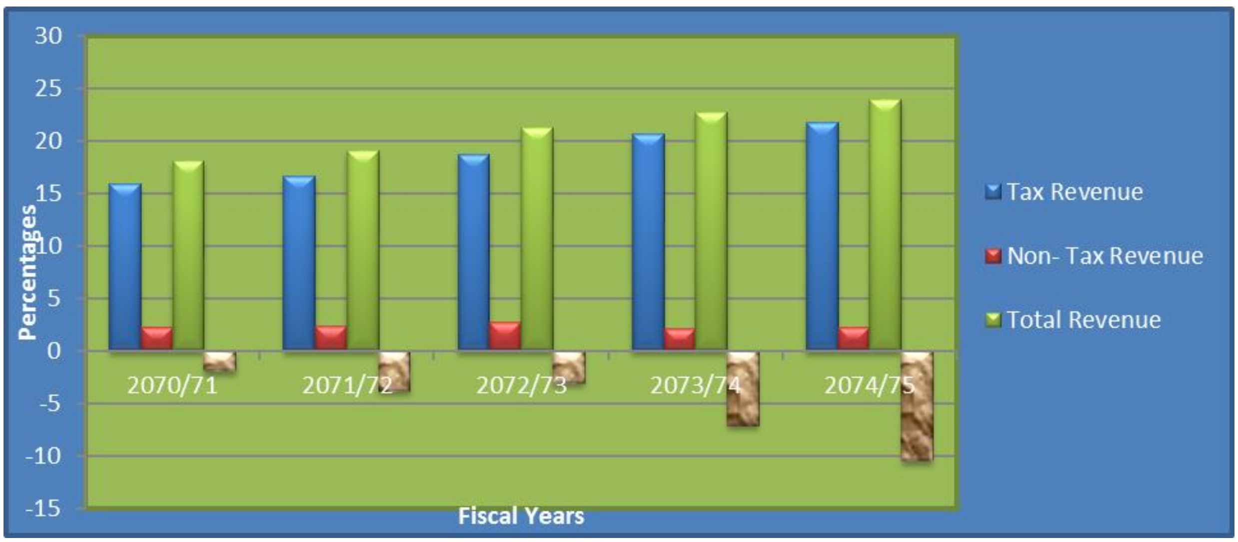


Figure 2 depicted that the share of tax revenue is increasing and the share of budget deficit is increasing. It is not a healthy fiscal indicator and should be managed timely. Fiscal deficit became more rampant with the introduction of federal system in Nepal.

Public Expenditure as a Fiscal Instrument

It is an important fiscal tool popularly exercised by concerned authorities all over the world. It became more popular and effective when the concept of welfare government was realized in the globe. According to classical economists, that government is ideal which collect least revenue from its citizen implies that they had least expenditure. In their thinking, government is irrational and individual is rational regarding to the utilization of available resources. After the great depression of 1930s, the concept had totally changed. The role of this instrument became prominent thereafter.

There are so many theories on public expenditure. Classical economists gave less attention on public expenditure on economy. They gave narrow view that the government should not make interfere in the general activities. They advocated the laissez-fair policy. They suggested that government should reduce their expenditure, they believed on the existence of the full employment in the economy and there is no need of government intervention (Acharya, 2016).

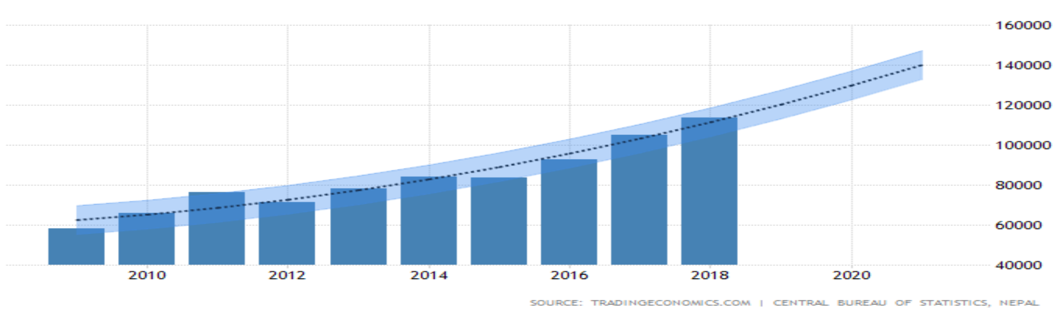
But later, after the Great Depression of 1930's, many economists suggested that the government must intervene in the economy. A moderate level of government intervention is necessary to run the economy smoothly. Hence, the analysis of public expenditure in different time period and theories are examined. That can be divided in to the classical view, Keynesian view, Neo-classical growth model, Endogenous growth model, Peacock and Wiseman hypothesis, Colin Clark hypothesis, Baumol"s hypothesis, and Stanly Please hypothesis (Acharya, 2016).

Public expenditure is the expenditure made by public authorities' i.e., central government and other local bodies to fulfill the demand of the people. It is for protecting the citizens and for promoting their economic and social welfare. Public expenditure is one of the instruments through which government influence economic variables. Public expenditure to carry out essential functions of administrating justice and providing national defense and to supply certain additional goods and services that is advantageous to a welfare society but that would not be supplied by private enterprises because doing so would not be profitable (Goode, 1984). Moreover, most of the government is spending money in the economy in the different sector. Basically, it is divided in to two categories that are current expenditure and development expenditure. Current expenditure is the regular government expenditure that is useful to run the day-to-day administration of the country. The development expenditure is one that is useful for the infrastructure building, providing different services in the education, health, agriculture etc. And, public expenditure is an important instrument of the state policy to make control over the economy of the state (Sharma, 1999).

In the context of Nepal, public expenditure is increasing. In this pattern, recurrent expenditure is increasing rapidly when it compared with development expenses. One expenditure is the sources of others income so that government try to optimize their level of public expenditure especially in the field of capital formation. The trend of public expenditure can be presented as;

In the time of analyzing the trend of public expenditure, government Spending in Nepal increased to 113731 NRs Million in 2018 from 104989 NRs Million in 2017. Government Spending in Nepal averaged 65645.63 NRs Million from 2000 until 2018, reaching an all-time high of 113731 NRs Million in 2018 and a record low of 35785 NRs Million in 2000.

When public expenditure is projected, its trend can be presented in the diagram as;



Public expenditure is increasing but the sources of income are weakened because poverty is rampant in Nepal. If increased income is not used in the field of productive sectors, then it may reflect on inflation.

Public Debt as an Instrument of Fiscal Policy

Public debt is an important source of government financing not only for underdeveloped but also for developing countries. Public debt fulfills resource gap of country required for development of nation. Government expenditure is ongoing process although its revenue is in surplus or deficit. If government revenue is in surplus position, there is no need of additional fund but if it is in deficit, government needs to borrow fund either internally or externally to meet its expenditure. Mostly in the case of underdeveloped and developing countries, external debt has greater role because in such countries people don't have capacity to fulfill country's budgetary deficit. As domestic resource is incapable of meeting deficit, foreign aid and debt are required for meeting the expenditure (Karna, 2019).

However, there are various views regarding public debt. Some economist view that public debt is good for short run as it gets necessary fund to invest in required economic growth. Whereas some view it as dangerous in long run because in long run, it may lead country in other's hand. Some economist views it as safe way for foreigners to invest in country by buying bond which is much safer than Foreign Direct Investment (FDI). It is considered as much safer because purchasing at least 10% interest in countries' company, business or real state is less risky than investing in Countries Company through stock market whose overall profit is ruined by investing company. Further, if public debt is used in productive sector, it improved living standard of people as people enjoys benefit from improved and advanced road and bridges, education and jobs, transportation and communication and so on. But, FDI only provides job opportunities to limited number of people and benefit from it is enjoyed by other investing countries. Though, debt is important and useful in many aspects, there are some aspects in which it lags behind. Generally, investors measure the level of risk by countries GDP - countries total economic output. Debt to GDP ratio acts as an indicator, how likely country can pay off its debt. And a country with high debt lags behind in further investment (Karna, 2019).

Public debt is an important source of government financing basically in the Least Developed Countries like Nepal where there is acute shortage of resources to finance public expenditure. So, they need to borrow. However, in modern world, not only for LDCs but also for Developed Countries, public borrowing is becoming an important technique of government finance along with other source of revenue e.g. tax and non-tax of revenue. Public debt comprises of both internal and external sources of government. Internal source includes borrowing from internal sources and banking sector whereas external source includes foreign loan, grants and borrowing from bilateral and multilateral agencies. Taxation is the most important source of government financing to build up socio economic infrastructure such as health education, transportation, communication etc. for economic development. But it is quite impossible to raise adequate fund through taxation in underdeveloped countries because of poor tax payable capacity of the people. The only way to collect the needed fund is public debt. (Katuwal, 2017).

It shows that government borrowing and annual growth rate from the period of 2002/2003 to 2015/2016. It is shown that government borrowing has been increased from Rs.13426.8 million to Rs. 67983.1 million and was estimated to be Rs. 182964.7 million in FY 2015/2016. External borrowing also increased from Rs. 4546.4 million to Rs. 25615.6 from FY 2002/2003 to 2014/15 and was estimated to be Rs. 94964.7 in FY 2015/16. However, in FY 2015/16, the share of external debt was estimated to be more than the internal debt.

External borrowing became the way to bridge the fiscal gap. In the case of Nepal, where taxpaying capacity of people is too low because of low per capita income, external debt plays vital role to fulfill the resource gap. Foreign loans basically from multilateral agencies like World Bank, ADB, IFD having long maturity period has great contribution in development and other activities.

The total outstanding public debt was Rs. 627.79 billion in mid of March, 2017. Out of this domestic debt was 38.1 percent and foreign debt was 61.9 percent respectively. In the period of first eight month of fiscal year 2016/17, total foreign aid commitment was Rs. 212.04 billion which was higher by 35.76 percent compared to corresponding period of previous fiscal year. Out of total foreign aid, 21.5 percent share was of grant and 78.5 percent of loan (Karna, 2019).

The trend of public debt can be analyzed on the basis of a table;

Table 3

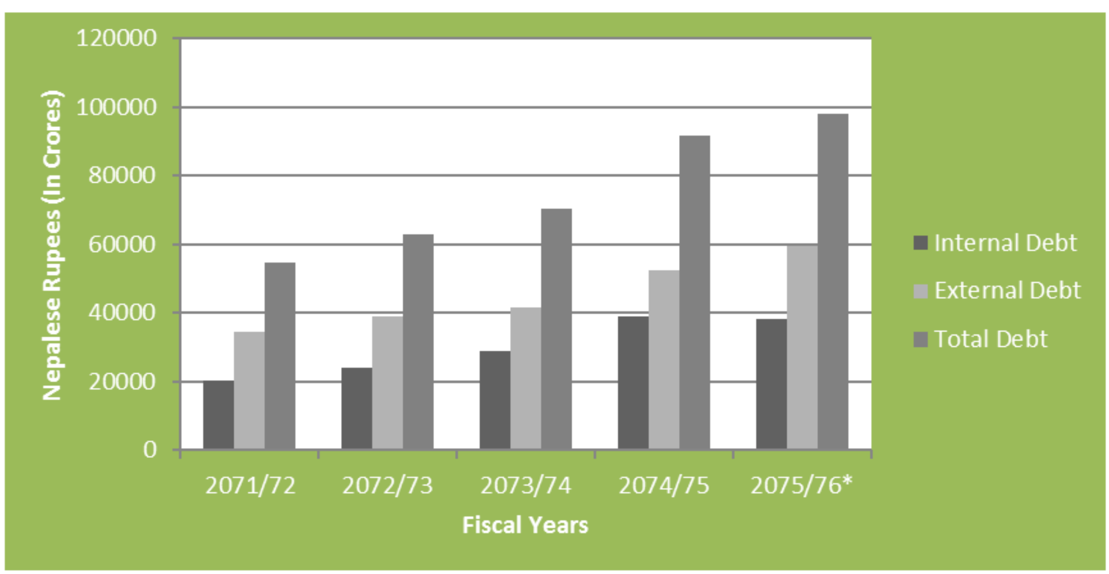
Trend of Internal, External & Total Debt in Nepal (In Crores)

Fiscal Year	Internal Debt	% Change, **	External Debt	% Change, **	Total Debt	% Change, **
2071/72	20165.68	-	34326.18	-	54491.86	-
2072/73	23902.9	118.533	38876.28	113.255	62779.18	115.21
2073/74	28858.18	120.731	41397.88	106.486	70256.06	111.91
2074/75	39116.15	135.546	52535.12	126.903	91651.27	130.45
2075/76*	38358.85	98.064	59485.81	113.231	97844.66	106.76

*Sources: Financial Control General Office & Nepal Rastra Bank, 2075 * = Falgun(Nine Month of FY 2075/76), ** is calculated from author on the basis of given data.*

It is clear that the trend of public debt in increasing. The share of debt is increasing in the sense that its expenditure is increasing. Public debt is the way to bridge the gap between revenue and income of a country.

Figure 4



Trend of Internal, External & Total Debt in Nepal (In Crores)

Figured 4 cleared that public debt regularly increasing and external debt has a lion share on total public debt. Public debt has been using to fulfill recurrent expenditure so that it has a negative impact on national economy. In nine month of FY 2075/76, the size of public debt had already crossed the data of previous year.

Conclusion and Recommendations

Fiscal instrument is an important component to attain fiscal stability in the world. A country can choose any of the instruments (tax, budget, public expenditure and public debt) according to the condition of that economy. A rise in the budget deficit during a recession is a good instrument to combat with recession. During a recession, there is fall in private sector spending and increase in budget deficit stimulates economic activities by increasing effective demand. In this situation, it is useful to increase effective demand in an economy. However, a budget deficit during a boom period will be harmful to some extent in the sense that it may reflects on rise in price as well as it drives out private investment. Similarly, it is also important to analyze whether the deficit is used in recurrent or capital expenditure. All other things remaining same, if the government deficit is used to invest in capital expenditure, it might improve the productive capacity and employment scenario of the economy. It is depicted that the share of tax revenue is increasing and the share of budget deficit is increasing. It is not a healthy fiscal indicator and should be managed timely. Fiscal deficit became more rampant with the introduction of federal system in Nepal. Public expenditure is increasing but the sources of income are weakened because poverty is common phenomena in Nepal. If increased income is not used in productive sectors, then it may reflect on inflation. External borrowing became the way to bridge the fiscal gap. In the case of Nepal, where taxpaying capacity of people is too low because of low purchasing power, external debt plays vital role to fulfill the resource gap.

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