

**FISCAL DEFICIT IN NEPAL: ITS SOURCES AND MONETARY  
IMPLICATIONS**

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**1. INTRODUCTION**

Growing fiscal deficit has been one of the underlying causes of distortions in the Nepalese economy. The unbridled increase in government expenditure particularly since 1981/82 accompanied by constantly low level of revenue realisation has been mainly responsible for acceleration in government budget deficit. Budget deficits have been financed by external loans and borrowings from the banking sector. Government budget deficits have created internal and external imbalances through the impact on growth in monetary liquidity. This article tries to analyse the behaviour of government revenue, expenditure and deficit and its implication on monetary growth during the period 1978/79 - 1987/88.

**1. Size of Government Budget Deficits**

Government fiscal deficit has increased tremendously since 1978/79. In absolute terms the amount of deficit which stood at Rs 609.4 million in 1978/79 shot up to Rs 4677.0 million in 1987/88 - a phenomenal increase of 676 per cent during a decade (Table 1). Annual growth rate of deficit, however, does not show any smooth and steady trend. It fluctuated widely between a decline by 2.7 per cent in 1978/79 to an increase by as high as 110 per cent in 1981/82 and 80.5 per cent in 1982/83. Excepting these extremes, the annual growth rate fluctuated between minimum 2.4 per cent and maximum 28.8 per cent. Thus the highest growth rate was observed in the years 1981/82 and 1982/83 and since then the growth rate has subsided to a lower level. In 1987/88 the growth rate came down to 10.0 per cent.

Government deficit as proportion of GDP remained stable at a level of around 3 per cent during 1978/79 to 1980/81. It jumped up to 5.4 per cent and 9.0 per cent of GDP in 1981/82 and 1982/83 respectively. It, however, registered a steady decline from 8.0 per cent of GDP in 1983/84 to 6.9 per cent in 1987/88.

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## 2. Government Revenue

Revenue (including foreign grants) of the government increased steadily from Rs 2411.1 million in 1978/79 to Rs 9427.2 million in 1987/88. It shows a remarkable growth of 291 per cent during a decade. The annual growth trend of government revenue distinctly shows three different phases. During the first phase from 1978/79 to 1981/82 revenue growth rate fluctuated between 11.4 per cent to 22.4 per cent. During the second phase revenue growth rate reached the lowest levels of 7 per cent and 9 per cent in 1981/82 and 1982/83 respectively. During the third phase from 1984/85 to 1987/88 there was a gradual recovery in the revenue growth rate. The growth rate accelerated from 13 per cent in 1984/85 to about 30 per cent in 1987/88. It shows remarkable achievement in the revenue front during the later years of the review period. The relative performance of revenue growth also shows almost the same pattern. From 1978/79 to 1980/81 revenue increased from 10.9 per cent of GDP to 12.0 per cent of GDP. From 1981/82 to 1984/85 revenue growth rate decelerated from 11.9 per cent to 10.9 per cent of GDP while during the last three years revenue turned to a steady uphill path from 11.5 per cent of GDP in 1985/86 to 14 per cent of GDP in 1987/88.

The sources of government revenue can be divided into three major categories, i.e., tax revenue, non-tax revenue and foreign grants (Table 1). Tax revenue contributes the highest share in the total revenue. The average share of tax revenue during the decade under review was 61 per cent with the lowest of 57 per cent in 1979/80 and the highest of 65.1 per cent in 1984/85 (Table 2). Next to tax revenue, foreign grants contributed, on an average, 22 per cent of total revenue, while non-tax revenue contributed about 17 per cent. However, the share of foreign grants shows a slightly downward trend during the later half of the decade particularly since 1983/84 while the share of non-tax and tax revenue reveals an increasing trend during the same period.

The pattern of annual growth rates of tax revenue almost confirms the growth rate of total revenue. During the first three years of the review period (1978/79 to 1980/81) there was a very wide fluctuation in the growth rate from the lowest of 3.5 per cent to the highest of 33.2 per cent. The highest ever growth rate was observed in 1980/81. The growth rate plunged down to a very low level of 8.6 per cent in 1981/82 and it started to pick up again since 1982/83. The smoothly upward trend continued to reach a rate of 31.6 per cent in 1987/88. The growth rates of foreign grants and non-tax revenue, however, did not show a definite trend. The growth rate of foreign grants registered sharp fluctuation between a negative 20 per cent to a positive 61.6 per cent while that of non-tax revenue fluctuated between a negative 10.2 per cent and a positive 62.7 per cent.

### **3. Government Expenditure**

Total expenditure of the government increased tremendously by 367 per cent from Rs 3020.5 million in 1978/79 to Rs 14050.1 million in 1987/88. Expenditure registered a rising trend at different rates, varying from a minimum of 6.6 per cent to a maximum of 31.0 per cent. From 1978/79 to 1982/83 expenditure increased at a higher rate. The highest rates of 31 per cent and 30 per cent were achieved particularly during 1981/82 and 1982/83. In 1983/84 it dropped down to the rock-bottom level of 6.6 per cent after which the growth rate started to accelerate again to reach a level of 22.5 per cent in 1987/88. The relative growth trend shows that during the first five years of the review period total expenditure increased at a higher rate, while during the later half the rate of growth showed a declining tendency. For instance, total expenditure which amounted to 13.6 per cent of GDP in 1978/79 climbed up to a level of 20.7 per cent of GDP in 1982/83 while the amount went up from 18.9 per cent of GDP to 20.7 per cent of GDP between 1983/84 and 1987/88.

Regular (current) expenditure which constituted about one-third of total expenditure during the review period also showed the same tendency of fast increase. In absolute amount the regular expenditure went up by 349 per cent from Rs 1041.7 million in 1978/79 to Rs 4677.1 million in 1987/88. Regular expenditure shows a tendency of uneven annual growth rate. However, the general trend exhibits a rising tendency during the first half of the decade and a falling tendency during the later half. The rate of increase ranged from 11.6 per cent in 1979/80 to 22.2 per cent in 1982/83 during the first half while it declined from 27.8 per cent in 1984/85 to 13.1 per cent in 1987/88 during the second half of the decade. It shows a restraint in regular expenditure during later years of the decade. But as a proportion of GDP, the pattern of regular expenditure shows a different picture. During the years under review it went up almost steadily from 4.7 per cent of GDP in 1978/79 to 6.9 per cent of GDP in 1987/88 except for a slight decline in 1983/84 and 1987/88.

The behaviour of development expenditure, which constituted about two-thirds of total expenditure of the government, indicated a rate of increase higher than that of the regular expenditure which, however, is quite natural in the case of a developing country like Nepal. The absolute amount of development expenditure increased by 376 per cent during the decade from Rs 1978.8 million in 1978/79 to Rs 9428.0 million in 1987/88. The rate of expansion of development expenditure ranged from 3.6 per cent in 1983/84 to 36.5 per cent in 1981/82. During the first five years of the review period the level of expansion was distinctly higher ranging from 9.4 per cent to the highest level of 36.5 per cent. The last two years (1981/82 and 1982/83) recorded particularly highest rate of increase in development expenditure. During the following five years also development expenditure increased substantially but the level of expansion

was definitely under control. After two years of highest expansion, development expenditure grew only nominally by 3.6 per cent in 1983/84 which, however, went up to 27.8 per cent in 1987/88. Development expenditure increased from 8.9 per cent of GDP to 14.8 per cent of GDP during the first five years while it lowered between 12.3 to 14 per cent of GDP during the following five years.

#### **4. Sources of Budget Deficit**

The overview of trend in government budgetary operation demonstrated that government budget deficit has been widening almost every year during the review period. The level of deficit has gone up since 1981/82 and the highest level of deficit (9.0 per cent of GDP) was recorded in 1982/83. Causes of the deficit are also quite clear from the above analysis of trend of government revenue and expenditure. The trend shows that the level of government expenditure has been higher than the level of revenue including foreign grants. The gap between revenue resources and total expenditure has widened significantly during the later years of the review period. Revenue resources of the government, for example, ranged from 11 to 14 per cent of GDP while total expenditure of the government ranged between 13.6 and 20.7 per cent of GDP. It amply demonstrates the fact that the government has not been able to raise resources to meet the growing expenditure. In other words, government has been unable to limit the expenditure in accordance with availability of resources. It has been living beyond its means.

On the revenue side, among the three major sources of government revenue, it is the behaviour of tax revenue which wields overwhelming influence on the movement of total revenue, although foreign grants and non-tax revenue also contributed to the total revenue. Total revenue in turn consists mainly of revenue from tax on foreign trade in the form of customs duty and sales tax.

On the expenditure side, increase in regular expenditure can hardly be controlled by the government. The expansion in government machinery together with compulsion of increment in employees' salary, among others, will rather increase the regular expenditure every year. On the other hand, development expenditure keeps on increasing rather more speedily due to compulsion of expanding infrastructural facilities, social services, economic services, etc., without which economic development will be constrained. In order to explore the underlying causes of government deficit it is necessary to analyse the performance of the Nepalese economy over the years. Budget deficit increased by 28.8 per cent to Rs 785.1 million (3.4 per cent of GDP) during 1979/80. The apparent cause for the increase in deficit was smaller increase in revenue compared to higher rate of increase in government expenditure. Revenue increased by only 11.4 per cent while total expenditure increased by about 15 per cent.

Of the total expenditure also, it is development expenditure which increased at higher rate. The poor performance of the economy during this year is responsible for higher rate of increase in expenditure and lower rate of increase in revenue. During that period owing to a fall in agricultural production by 4.8 per cent due to drought all over the country, GDP, even at current price, increased by only 5 per cent compared with 12.6 per cent in the previous year. Real GDP actually declined by 2.3 per cent. Consequently, tax revenue of the government increased only marginally by 3.5 per cent while revenue from customs duty and income, profit and land tax fell by 3.0 per cent and 7.0 per cent respectively. It was mainly higher receipt from foreign grants which pulled up total revenue resources to some extent. On the expenditure side, although regular expenditure growth was under control, development expenditure surged up due to additional expenses required to meet the shortage of foodgrains and their distribution.

Similarly, budget deficit increased tremendously by 110 per cent and reached a level of 5.4 per cent of GDP in 1981/82 compared to 2.9 per cent of GDP in 1980/81. No abnormal situation was observed during this year. The economy experienced normal growth rate of 3.8 per cent compared to a very high growth rate of 8.3 per cent in the previous year. The main cause for increased budget deficit was greater imbalance in revenue and expenditure of the government. Revenue growth rate slowed down to 11.7 per cent from 22.4 per cent in the previous year while expenditure grew by 31 per cent compared to 18 per cent in the preceding year. Although the growth rates of non-tax revenue and foreign grants were impressive, there was a severe retardation in the growth of tax revenue which went up only by 8.6 per cent compared to 33.2 per cent in the previous year. Revenue from customs duty and sales tax, the major contributors of government tax revenue, increased only marginally while revenue from land tax actually declined by 5 per cent. Of the two major types of expenditures, regular expenditure registered a growth rate of 20.1 per cent over and above the growth rate of 17.1 per cent during the preceding year. The main factor responsible for expansion in regular expenditure was increase in the salary, pension and other benefits of the government employees. The development expenditure marked a major increase of 36.5 per cent which was double the rate of increase witnessed during the preceding year.

During the subsequent year (1982/83) also, there was a phenomenal increase in budget deficit by 80 per cent over the highest ever growth rate of 1981/82. The amount of deficit reached the highest level of 9 per cent of GDP in 1982/83 from 5.7 per cent GDP in 1981/82. The reason for the deficit again was higher increase in government expenditure by 30.2 per cent, unmatched by capacity to raise resources. Revenue increased only by 7 per cent which was lower than

the increase of 11.7 per cent in the preceding year. On the expenditure side, regular expenditure surged up by 22.2 per cent and development expenditure by 33.7 per cent. In the year 1982/83 also, Nepalese economy experienced another shock generated again by adverse weather condition in the form of drought all over the country. Real GDP declined by 3 per cent, of which agricultural sector suffered a setback by 1.1 per cent and non-agricultural sector by 5.8 per cent. As a consequence, total revenue increased by only 7 per cent, of which tax revenue increased by 9.5 per cent and foreign grants by 9.7 per cent, while non-tax revenue declined by 10.2 per cent. Thus it is clear that, although revenue growth was sluggish, government was unable to control the increase in expenditure which resulted in huge fiscal deficit.

The unusual increases in budget deficit during these two years (1981/82 and 1982/83) made the government more cautious in expenditure management in 1983/84. Since this year fiscal policy was directed to raise more revenue and control the expenditure to a sustainable level. Measures to increase revenue included reform in tax administration, broadening the tax base, reform in taxation measures, etc. As a result, revenue, particularly tax revenue, started to show steadily higher growth rates. Government also took measures to control expenditure by curtailing unproductive expenses and increasing the efficiency of project implementation. These measures led to more sustainable budget deficits since 1983/84. In 1987/88 budget deficit stood at 6.9 per cent of GDP.

#### **5. Financing of Budget Deficit**

In Nepal government budget deficits have been financed by external as well as internal loans. The trend of sources of financing the deficits shows that a major part of it has been financed through external loans. External loan financed as low as 32 per cent to as high as 86 per cent of total deficit during the decade (Table 3). Although the share of external finance did not indicate any definite trend, it is quite clear that since 1985/86 it has gone up from 63 per cent to 82 per cent of total deficit. On the other side of the picture, it is evident that during the period under review internal resources financed minimum of 14 per cent to maximum of 68 per cent of budget deficit. But in the later years, share of internal sources has shown a declining tendency. A significant proportion of government deficit has been financed through internal sources of which borrowings from banking system, particularly from central bank, is quite significant.

#### **6. Effects of Monetisation of Deficits on Money Supply**

Total internal borrowings of the public sector moved up at an annual average rate of 21.3 per cent during the decade. The actual growth rate, however, fluctuated

within a very wide margin of 6.3 per cent and 68.2 per cent. A major escalation in internal borrowings was clearly visible since 1981/82. But highest rate of increase of 68.2 per cent was observed during 1982/83 when budget deficit of the government was at the highest peak. The rate of internal borrowing slowed down remarkably since 1985/86. In 1987/88 it came down to the lowest growth rate of 6.3 per cent. The share of government in total borrowing increased remarkably from 56 per cent in 1978/79 to about 78 per cent in 1987/88. Its share moved up substantially to 77 per cent in 1983/84 and remained almost stagnant at that level since then. Conversely, the share of public enterprises in total borrowing has declined from 44 per cent in 1978/79 to 22.2 per cent in 1987/88.

Among the sources of borrowing of the public sector, borrowing from banking system constituted the highest proportion of more than 90 per cent of total borrowing. Borrowing from non-banking system was almost non-existent up to 1982/83. Since 1983/84, as a result of government's deliberate measures to mobilize private sector savings, borrowing from non-banking sources went up to around 5 per cent of total borrowings. Highest share of total borrowings of the public sector has been contributed by the Nepal Rastra Bank (Central Bank). The share of Nepal Rastra Bank ranged from 52.5 per cent in 1980/81 to 62.2 per cent in 1985/86. On the other hand, the share of commercial banks ranged from 35 per cent to 46.7 per cent. The share of borrowing from commercial banks has shown a drastic decline since 1983/84 (Table 4).

Looking from the side of banking system, credit to public sector, ranged between 50 - 60 per cent of total credit. Credit to private sector, therefore, lagged behind credit to public sector every year. The share of credit to private sector declined significantly since 1982/83. Up to 1981/82 private sector credit constituted 38 to 49 per cent of total outstanding credit. But it went down to 32 per cent in 1982/83 and 35 per cent in 1986/87. In 1987/88, however, it increased to 41 per cent of total credit. Of the total credit to public sector higher amount was allocated for the government while lower amount went for public enterprises. The trend of credit allocation shows steadily increasing share of the government in contrast to steadily declining share of the public enterprises.

From the above discussion it becomes clear that public sector borrowings are financed mainly from banking system of which central bank contributes a higher proportion and which is a potent source of monetary expansion in Nepal. The higher correlation between central bank credit to public sector and money supply has become evident from the empirical evidence also. As money supply ( $M_1$ ) is the function of high powered money and money multiplier, if the behaviour of the latter remains stable, the former is the major determinant of money supply.

The behaviour pattern of money multiplier shows that during the first three years (from 1978/79 to 1980/81) it fluctuated between 1.15 and 1.18 and since then it remained almost stable at 1.06 to 1.08. Hence it is the growth rate of high powered money which is more responsible for changes in money supply. Average growth rate of money supply during the decade under study was 16.7 per cent per annum while at the same time high powered money increased at an average rate of 17.3 per cent per year. The main factors which led to increase in monetary expansion have been movements in net foreign assets and domestic credit. For instance  $M_1$  increased by 21.6 per cent in 1978/79 due to increases in domestic credit (22 per cent) and net foreign assets (28.3 per cent). The sole factor for increase in  $M_1$  in 1982/83 by 20.4 per cent was highest ever rate of increase in domestic credit (40.5 per cent) while NFA declined by about 16 per cent. As the movement of NFA depends on external payments situation, it shows erratic trend during the decade. However, the relation between  $M_1$  and NFA can be judged from the fact that in general increase in NFA tends to drive up the money supply and vice versa. But the curve of domestic credit shows a constantly upward trend and hence it has been a permanent source of increase in  $M_1$ . Among the components of domestic credit, the share of public sector credit has been higher than that of the private sector all through the review period.

#### **7. Implication on Monetary Policy**

The expansionary fiscal policy propelled by ambitious development plans of the government resulted in a series of internal and external instabilities in the Nepalese economy. It has been accompanied by frequent jerks due to failure of monsoon which led to shortfalls in agricultural production and subsequently to adverse trade and payments situation and higher inflation.

The internal instability of the economy has been adequately reflected in the inflationary situation experienced by the country during the decade. The country witnessed a higher average annual inflation rate measured in terms of movement in CPI (base 1972/73 = 100) of 10.2 per cent during the decade under review. The year to year actual trend shows that during seven out of 10 years the economy faced a double digit inflation rate, the highest being 16 per cent in 1985/86. The last three years of the decade experienced very high inflation rate which, however, decelerated steadily from 16 per cent in 1985/86 to 11 per cent in 1987/88. The higher rate of inflation occurred in spite of fiscal, monetary and administrative measures taken by the authorities from time to time. The undesirable consequences of persistent run-away inflation on savings, investment, cost of production, capital flows, consumption pattern and social and psychological reactions of the people can not simply be over-emphasized.



Another consequence of expansion in money supply was creation of external disequilibrium which manifested itself in the form of higher trade deficit, enlarged current account deficit and frequent deterioration in overall balance of payments position. In an open economy like that of Nepal which has long open border with a big neighbouring country, monetary expansion naturally boosts up import demand and exerts pressure on balance of payments position of the country. The excessive pressure in balance of payments which has been built up since 1981/82 got released, when the Nepalese rupee was devalued by 14.7 per cent in November 1985. The post devaluation stringent demand management measures which were immediately followed by structural adjustment programme not only arrested the deterioration but also brought remarkable improvement in the overall balance of payments situation of the country. Nevertheless, the current account deficit remained sizeable at 6 per cent of GDP in 1987/88 which was the highest during the decade.

Monetary policy of the country, therefore, has been geared towards achievement of internal and external stability together with higher mobilization of domestic resources. The instruments of monetary policy used for achieving these objectives are as follows:

1. Cash reserve requirement,
2. Imposition of credit ceiling,
3. Margin requirement on import credit, and
4. Interest rate changes.

Nepal Rastra Bank has been using different combinations of these instruments from time to time according to the demand of situation. Among these instruments the most frequently used was imposition of ceiling on expansion of credit. Ceiling was imposed on total credit of the commercial banks in 1978/79 and 1979/80 in order to restrict the expansion of credit due to excessive credit demand from private sector. But the actual credit extension exceeded the ceiling prescribed by the Nepal Rastra Bank. As a result credit deposit ratio increased from 68.5 per cent in July 1978 to 84 per cent in July 1980 while the liquidity position of commercial banks showed a decline to 30 per cent in July 1980 from 39 per cent in July 1979 and 37.8 per cent in July 1978.

Stringent credit ceiling has also been imposed since the devaluation of Nepalese rupee in November 1985. Credit ceilings have been imposed during 1986/87 and 1987/88 as a measure to restrict total credit as well as credit extended to private sector, government and government enterprises. Meticulous follow up has been made in order to keep the credit level within limit. Such

stringent credit control measure coordinated with strict fiscal discipline has to some extent retarded the rate of inflation as the rate of expansion in total credit of the banking system also decelerated steadily from 27.8 per cent in 1984/85 to 14.9 per cent in 1987/88.

Another instrument used particularly since 1980/81 was cash reserve ratio. Cash reserve ratio was raised from 7 per cent to 9 per cent in 1980/81. Liquid assets/deposit ratio (inclusive of the 9 per cent cash reserve ratio) of 25 per cent was imposed in order to bring down the high credit-deposit ratio of 87 per cent in July 1981. The liquid assets/deposit ratio was removed in 1986 but cash reserve ratio of 9 per cent of deposit liabilities has been continued through 1987/88.

Interest rate as an instrument of monetary policy has been used frequently mainly in order to attract private savings to the banking sector, discourage luxury imports and encourage investment in priority and export sectors. Interest rate concessions have been provided for the credit directed towards priority sector and export sector whereas higher rates have been charged for investment in import of luxurious goods and commercial purposes. The Nepal Rastra Bank has been providing concessional refinancing facilities to the commercial banks for their priority sector lending. Commercial banks are required to invest at least 8 per cent of their total lending in priority sector. But in spite of Nepal Rastra Bank's insistence, commercial banks have not been able to invest in priority sector to the desired level.

Another measure which has been frequently taken by the Nepal Rastra Bank to divert the flow of credit to the desired sector has been margin requirement for import credit. Higher margin requirements are imposed for the import of luxury and semi-luxury goods while lower rates are used for the import of essential commodities. In the extreme case a cash margin of 100 per cent was imposed for the import of luxury goods in 1982/83. This measure was directed mainly to safeguard the balance of payments position of the country by discouraging import of luxury and semi-luxury goods.

The Nepal Rastra Bank as a central bank has limited power to control major factors which affect money supply ( $M_1$ ). The main factors which affect money supply are net foreign assets and domestic credit. Movement in net foreign assets reflects the country's overall payments situation and hence is the result of interaction of country's external demand and supply position. Hence this factor is not under the direct influence of monetary policy. Although monetary policy measures in Nepal are aimed at stabilizing external imbalance, it can hardly change the course of movement in net foreign assets. The capacity

of monetary policy to influence the money supply through its direct impact on net foreign assets is, therefore, insignificant.

Domestic credit of the banking system consists of credit to government, public enterprises and private sector. Credit to government is determined by government's fiscal deficit over which the central bank has no direct control. As credit to public enterprises (particularly non-financial) in Nepal is mostly guaranteed by the government it is also beyond the control of monetary instrument. The two sectors together enjoy substantial share of total domestic credit. It indicates, therefore, that a significant portion of one of the important expansionary factors of money supply is beyond the influence of monetary policy measures. The target area of the monetary policy is, therefore, credit to private sector which has very limited impact on money supply ( $M_1$ ).

Monetary policy measures in Nepal are in fact directed towards influencing the total volume and direction of credit to private sector. Monetary instruments like credit ceiling, cash reserve requirement, interest rate changes, margin requirements and credit requirement for priority sector can only change the commercial banks' credit to private sector. However, efforts have been made recently to influence the credit flow to government and public enterprises by imposing ceiling on credit to these sectors. As credit to government and public enterprises is greatly responsible for creating internal and external instabilities, close coordination between fiscal and monetary policy is essential to make the monetary policy more effective.

#### **8. Summary and Conclusions**

Revenue (including foreign grants) of the government increased from 11 per cent to 14 per cent of GDP during the period under review. The last three years showed steadily increasing trend. The major contributors to government revenue have been tax revenue (61 per cent) followed by foreign grants (22 per cent) and non-tax revenue (17 per cent). On the other hand, total expenditure of the government increased from 13.6 per cent to 20.7 per cent of GDP. Both regular (current) and development expenditures increased rapidly. Regular expenditure increased from 4.7 per cent to 6.9 per cent of GDP while development expenditure went up from 9.8 per cent to 14.8 per cent of GDP. As a result, budget deficit widened from 3 per cent to 9 per cent of GDP with a steadily declining trend during the last three years. The main cause of widening government fiscal deficit is inability to raise revenue in comparison with the growing size of expenditure. However, during the last three years of the review period, the government made serious efforts to maintain fiscal discipline as a result of which fiscal deficit remained sustainable.

As regards financing of deficits external loans financed 32 per cent to 86 per cent of total deficit while internal resources financed 14 per cent to 68 per cent during the decade. During later years the share of external loans was higher than that of internal resources.

Total internal borrowings of the public sector increased at an annual average rate of 21.3 per cent during the decade. Of the total borrowings higher amount of about 77 per cent went for government while the remaining share went for public enterprises. Public sector borrowings have been mainly sourced from banking system of which central bank contributed 52.5 to 62.2 per cent and commercial banks contributed 35 to 46.7 per cent. Borrowings from private sector remained insignificant at about 5 per cent of total borrowings of public sector. Public sector borrowing from central bank is a potent source of monetary instability. Money supply ( $M_1$ ) growth is significantly and positively affected by central bank credit to public sector.

The movement of  $M_1$  indicates that it has increased at an annual average rate of 16.7 per cent during the decade under consideration. The main factors leading to increase in money supply have been expansion in net foreign assets and domestic credit which increased at a sustained rate as a permanent source of money supply growth. Among the components of the domestic credit, the share of public sector credit has been higher than that of private sector credit all through the review period.

The expansionary fiscal policy accompanied by frequent short-falls in agricultural production created both internal and external instability in the economy. Monetary policy has, therefore, been aimed primarily at attaining stability in the economy for which the following instruments have been used frequently:

- a. Cash reserve requirement,
- b. Imposition of credit ceiling,
- c. Margin requirement in import credit, and
- d. Interest rate changes.

The effectiveness of monetary policy in regulating the money supply ( $M_1$ ) and controlling the volume and direction of credit depends to a great extent on the degree of coordination between fiscal and monetary policy.

Table 1: Trend of Government Revenue, Expenditure and Deficit

Rs in Million

GDP at Current Price	Revenue*		Regular		Expenditure		Overall		2 as % 3 as % 4 as % 5 as % 6 as %		of 1 of 1 of 1 of 1 of 1					
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)		(11)				
1978/79	22215	2411.1	17.7	1041.7	20.2	1978.8	9.4	3020.5	12.9	609.4	-2.7	10.9	4.7	8.9	13.6	-2.7
1979/80	23351	2685.6	11.4	1162.1	11.6	2308.6	16.7	3470.7	14.9	785.1	28.8	11.5	5	9.9	14.9	3.4
1980/81	27307	3288.1	22.4	1361.2	17.1	2731.1	18.3	4092.3	17.9	804.2	2.4	12	5	10	15	2.9
1981/82	30988	3672.8	11.7	1634.4	20.1	3726.9	36.5	5361.3	31.0	1688.5	110.0	11.9	5.3	12	17.3	5.4
1982/83	33761	3931.7	7.0	1997.1	22.2	4982.1	33.7	6979.2	30.2	3047.5	80.5	11.6	5.9	14.8	20.7	9
1983/84	39390	4285.9	9.0	2273.5	13.8	5163.8	3.6	7437.3	6.6	3151.4	3.7	10.9	5.8	13.1	18.9	8
1984/85	44417	4840.0	12.9	2906.1	27.8	5488.7	6.3	8394.8	12.9	3554.8	12.8	10.9	6.5	12.4	18.9	8
1985/86	50428	5817.4	20.2	3584.0	23.3	6213.1	13.2	9797.1	16.7	3979.7	12	11.5	7.1	12.3	19.4	7.9
1986/87	57828	7260.2	24.8	4135.2	15.4	7378.0	18.7	11513.2	17.5	4253.0	6.9	12.6	7.2	12.8	19.9	7.4
1987/88	67835	9427.2	29.8	4677.0	13.1	9428.0	27.8	14105.0	22.5	4677.0	10	13.9	6.9	13.9	20.8	6.9

\* Includes foreign grants.

Source: Economic Survey 1988/89.

Table 2: Sources of Government Revenue

Rs in Million

Source	1978/79	1979/80	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88
<b>1. Tax Revenue</b>	<b>1476.8</b>	<b>1528.8</b>	<b>2035.7</b>	<b>2211.3</b>	<b>2421.1</b>	<b>2737.0</b>	<b>3151.2</b>	<b>3659.3</b>	<b>4372.4</b>	<b>5752.8</b>
a. Customs Duty	(61.2)	(57.0)	(62.0)	(60.3)	(61.6)	(63.0)	(65.1)	(62.9)	(60.2)	(61.0)
b. Tax on Goods and Services	626.7	608.0	815.8	825.1	760.9	825.9	1064.5	1231.0	1505.7	2214.6
c. Income, Profit & Wealth Tax	142.8	132.6	174.7	209.9	273.6	329.4	341.1	417.5	484.7	643.3
d. Land Tax & Registration Fee	110.3	121.2	178.5	170.0	171.5	212.4	218.6	244.3	284.0	366.9
<b>2. Non-Tax Revenue</b>	<b>334.9</b>	<b>351.2</b>	<b>383.5</b>	<b>468.2</b>	<b>420.5</b>	<b>672.3</b>	<b>765.6</b>	<b>985.2</b>	<b>1602.7</b>	<b>1597.6</b>
	(13.9)	(13.0)	(11.6)	(12.7)	(10.7)	(15.7)	(15.8)	(16.9)	(22.1)	(17.0)
<b>3. Foreign Grants</b>	<b>599.2</b>	<b>805.6</b>	<b>868.9</b>	<b>993.3</b>	<b>1090.1</b>	<b>876.6</b>	<b>923.4</b>	<b>1172.9</b>	<b>1285.1</b>	<b>2076.8</b>
	(24.8)	(30.0)	(26.4)	(27.0)	(27.7)	(20.4)	(19.1)	(20.2)	(17.7)	(22.0)
<b>Total Revenue</b>	<b>2411.1</b>	<b>2685.6</b>	<b>3288.1</b>	<b>3672.8</b>	<b>3931.7</b>	<b>4285.9</b>	<b>4840.0</b>	<b>5817.4</b>	<b>7260.2</b>	<b>9477.2</b>
<b>Rates of Growth</b>										
(a) Tax Revenue	18.7	3.5	33.2	8.6	9.5	13.0	15.1	16.1	19.5	31.6
(b) Non-Tax Revenue	-1.0	4.9	9.2	22.2	-10.2	59.9	13.9	28.7	62.7	-0.3
(c) Foreign Grants	28.4	34.4	7.8	14.3	9.7	-19.6	5.3	27.0	9.6	61.6
(d) Total Revenue	17.7	11.4	22.4	11.7	7.0	9.0	12.9	20.2	24.8	29.8

Figures in brackets show percentages of total revenue.

Source: Economic Survey 1988/89.

**Table 3: Sources of Financing Budget Deficit**

Rs in Million

	<b>Overall Deficit (1)</b>	<b>External Loan (2)</b>	<b>2/1 % (3)</b>	<b>Internal Sources* (4)</b>	<b>4/1 % (5)</b>
1978/79	609.4	390.2	64	219.2	36
1979/80	785.1	534.9	68	250.2	32
1980/81	804.2	693.3	86	110.9	14
1981/82	1688.5	729.9	43	958.6	57
1982/83	3047.5	985.7	32	2061.8	68
1983/84	3151.4	1670.9	53	1480.5	47
1984/85	3554.8	1754.9	49	1799.9	51
1985/86	3979.7	2501.1	63	1478.6	37
1986/87	4253.0	2705.8	64	1547.2	36
1987/88	4677.8	3815.8	82	862.0	18

\* Internal sources include drawdown of cash balance.

Source: Economic Survey 1988/89.

**Table 4: Public Sector Borrowings****Rs in Million**

	From NR Bank		From Com.Banks		From Others		Total Borrowings	
	Amount	%Share	Amount	%Share	Amount	%Share	Amount	(%)
1978/89	1349.0	54.8	1097.6	44.6	17.0	0.6	2463.6	(100)
1979/80	1476.7	56.3	1130.1	43.1	16.7	0.4	2623.5	(100)
1980/81	1490.0	52.5	1326.7	46.7	21.8	0.8	2838.5	(100)
1981/82	1954.4	55.6	1535.4	43.7	25.1	0.7	3514.9	(100)
1982/83	3505.8	59.3	2374.1	40.1	31.4	0.6	5911.3	(100)
1983/84	4216.1	59.6	2528.3	35.8	328.8	4.6	7032.2	(100)
1984/85	5285.3	59.2	3332.5	37.3	307.3	3.5	8925.1	(100)
1985/86	6614.5	62.2	3683.7	34.7	319.2	3.1	10617.4	(100)
1986/87	7390.1	56.1	4292.5	34.9	618.8	5.0	12301.4	(100)
1987/88	7377.6	56.4	5244.7	40.1	454.1	3.5	13076.4	(100)

**Source:** Nepal Rastra Bank, Quarterly Economic Bulletins.



**Table 5: Components of Domestic Credit**

**Rs in Million**

	Credit to Govt	Share in Total Credit (%)	Credit to PEs	Share in Total Credit (%)	Credit to Private Sector	Share in Total Credit (%)	Total Credit	Total Share (%)
1978/79	1129.3	32	1079.9	30	1331.6	38	3540.8	100
1979/80	1258.3	29	1131.0	26	1916.5	45	4305.8	100
1980/81	1262.7	24	1400.6	27	2498.1	49	5161.4	100
1981/82	2061.5	34	1343.4	22	2638.2	44	6043.1	100
1982/83	4089.6	48	1702.2	20	2699.1	32	8490.9	100
1983/84	5028.7	51	1621.8	16	3174.0	33	9824.5	100
1984/85	6492.1	52	2022.2	16	4036.6	32	12550.9	100
1985/86	7495.7	49	2659.3	17	5167.9	34	15322.9	100
1986/87	8712.3	49	2811.1	16	6279.7	35	17803.1	100
1987/88	9259.0	45	2901.6	14	8308.7	41	20469.3	100

**Source:** NRB, Quarterly Economic Bulletins.

**Table 6: Factors Affecting Money Supply**

**Rs in Million**

	<u>N.F.A.</u>	<u>CI. Govt.</u>	<u>CI.P.E.</u>	<u>CI. Pvt.</u>	<u>Others</u>	<u>Money Supply</u>
1978/79	2280.0 (28.3)	1129.3 (17.0)	1079.9 (24.3)	1331.6 (24.3)	3323.9 (26.5)	2504.9 ( 21.6)
1979/80	2231.9 (-2.4)	1558.3 (11.4)	1131.0 ( 4.7)	1916.5 ( 43.9)	3707.3 ( 11.5)	2830.4 (13.0)
1980/81	2414.5 (8.2)	1262.7 (0.3)	1400.6 (23.8)	2498.1 (30.3)	4368.1 (17.8)	3207.8 (13.3)
1981/82	3097.4 (28.3)	2061.5 (63.3)	1343.4 (-4.1)	2638.2 (5.6)	5529.0 (26.6)	3611.5 (12.6)
1982/83	2611.4 (-15.7)	4089.6 (98.4)	1702.2 (26.7)	2699.1 (2.3)	6753.4 (22.1)	4348.9 (20.4)
1983/84	2539.8 (-2.7)	5028.7 (23.0)	1621.8 (4.7)	3174.0 (17.6)	7432.8 (10.1)	4931.5 ( 13.3)
1984/85	1897.6 (-22.2)	6492.1 (29.1)	2022.2 (24.7)	4036.6 (27.2)	8968.7 (20.6)	5480.0 (11.1)
1985/86	2600.0 (37.0)	7495.7 (15.5)	2659.3 (31.5)	5167.9 (28.0)	10893.6 (21.5)	7029.3 (28.3)
1986/87	3059.9 (17.7)	8712.3 (16.2)	2811.1 (5.7)	6279.7 (21.5)	12742.8 (17.0)	8120.2 (15.5)
1987/88	5573.6 (82.1)	9259.0 (6.3)	2901.6 (3.2)	8308.7 (32.3)	16446.3 (29.1)	9596.6 (18.2)

N.F.A. - Net foreign assets

CI.Govt. - Claims on Government

CI.P.E. - Claims on Public Enterprises

CI. Pvt. - Claims on Private Sector

Others include time deposits and capital and other items net,  
which are contractionary factors.

Figures in brackets show percentage change over previous year.

**Source:** NRB, Quarterly Economic Bulletins.