4 NEPAL

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4.1 Introduction

4.1.1 Topography and Environment

A. Location

Nepal is a small country with an area of 147,181 sq. kms. Surrounded by Tibet in the north and India in the south, east and west. The country stretches between 80°4’ east to 88°12’ east longitude and between 26°22’ north to 30°27’ north latitude. It is about 885 kilometers long from east to west and 193 kilometers wide from north to south on an average. It has the shape of an elongated rectangle.

Nepal is a landlocked country. It has no coastal border and is surrounded on all sides by foreign landmass. Its nearest access to the sea is only through India at a distance of about 1,170 kilometers from the border.

B. Physical Division

Nepal can be divided into three geographical regions from south to north: (1) Plains region known as Terai, (2) Hills region known as Pahad’ and (3) Alpine region known as the Himalayas.

a) Plains Region

The plains region known as Terai covers an area of 25,020 sq. kms. about 17% 0f the total area of the country. It gradually rises from a height of 70 feet above sea level to about 1,000 feet along the foothills. The plains region is rich in agricultural and forest resources. Because of its agricultural abundance, it has come to be the most important region of the country.

b) Hills Region

The hills region known as Pahad covers an area of 100,080 sq.kms. about 68% of the total area of the country. It gradually rises to a height of 10,000 feet above sea level.

c) Alpine Region

The alpine region known as the Himalayas covers an area of 22,081 sq. kms. , about 15% of the total area of the country. It consists of high Himalayan Mountains, snowpeak and high Himalayan valleys and rises to the Mt. Everest height of 29,028 feet above sea level.

C. Riverine Division

There are numerous rivers in the country that has their origin in the Himalayas. Based on drainage area, there are three principal riverine divisions from east to west: (1) Kosi basin in the east, (2) Gandak basin in central Nepal, and (3) Karnali in the west.

D. Climate and Rainfall

Nepal has a wide variation in climate. Variation in climate corresponds to variation in altitude. Nepal can be roughly divided into three climate zones in the following manner:

a) Hot and Humid Zone

The Terai plains region has a hot and humid climate with temperature up to 100^0F in summer. The area between 200 feet to 2000 feet above sea level is extremely hot and humid more or less tropical in nature. Temperature declines with increasing altitude. In the higher parts of this region up to 3000 feet above sea level, there is sub-tropical type of climate, which is less hot and humid.

b) Temperate Zone

The hills region up to an altitude of 10000 feet above sea level is characterized as a Temperate Zone from climatic point of view. Lower parts of this region are warmer than higher parts. Temperature hardly rises above 70^0F along the Mahabharat range even during summer season, except in some valleys where it reaches up to 80^0F at times.

c) Cold and Alpine Zone

The area above 10000 feet above sea level is characterized as a cold and alpine zone from climatic point of view. In the lower part of this zone up to an altitude of 15000 feet above sea level, maximum temperature hardly exceeds 55^0F even in summer with minimum winter temperature almost equal to freezing point. The climate above the snowline is frigid with perpetual snow.

It has rightly been said that one can choose one's climate in Nepal all the year round. When it is hot in the Terai, it is temperate in the hills and cold in the mountains.

4.1.2 Development Region and Administrative Division

In order to ensure balanced development in various parts of the country, Nepal has been divided into five development regions. For Administrative purposes, Nepal has been divided into fourteen zones and seventy-five districts.

4.1.3 Agriculture in Nepal

A. Importance

Nepal is an agricultural country. Importance of agriculture becomes evident from following facts:

a) Source of employment: Agriculture is the predominant source of employment in Nepal. According to the 1991 census, 81.22 % of economically active population of Nepal are employed in agriculture. If agricultural dependence components of other sectors are considered, employment in agriculture substantially exceeds this figure.
b) Source of national income: Agriculture is the predominant source of Nepal's national income. Agricultural sector generates about 56.03 % of the country's national income.
c) Source of food: Nepal annually produces about 4.9 million metric tons of foodgrains, including rice, wheat, maize, millet, and barley. Food requirements of the country are fulfilled by agricultural production. As, population increases the importance of agriculture as supplier of food will also go on increasing.
d) Agriculture supplies feed and fodder to livestock population. Agricultural byproducts from farmland serve as feed and fodder for livestock.
e) Source of industrial raw materials: Nepal has numerous dehiscing and edible oil extracting plants, jute factories, sugar factories, cigarette factories and floor mills. Agriculture is the source of raw materials for all these industries.
f) Source of exportable items: Nepal exports agricultural products including livestock, foodgrains cash crops ginger cardamom, jute, tea, fruits and vegetables. Almost about 70 % of Nepalese exports consist of agricultural commodities.
g) Agriculture sector is the most important sector of investment. From the commencement of first plan period in 1956, substantial amounts have been allocated for agriculture.

B. Features

Subsistence farming, food crop predominance, regional variation, scanty irrigation, small holdings, dual ownership, unequal distribution of land, low productivity, and seasonal employment are the features of Nepalese agriculture.

C. Agricultural Crops

a) Food crops

Principal food crops of Nepal are paddy, maize, wheat, millet and barley grown in various parts of the country.

b) Cash crops

Principal cash crops of Nepal are oilseeds, jute, sugarcane, tea, tobacco, and potato grown in various parts of the country in the hills and the plains.

4.1.4 Characteristic of Nepalese Economy

Nepal is one of the least developed among developing countries of the world. The following are the characteristics of Nepalese economy.

A. Widespread Poverty

Nepalese people are very poor. About 49 % of the total population of Nepal are estimated to be steeped in absolute poverty.

B. Rapid Population Growth

According to the census of 1991, Nepal has a population of 18,491,097. It consists of 9,220,974 males and 9,270,123 females. In 1971 Nepal had 11,556 thousand people and the rate of population growth during the decade was 2.o7 % per year. The figure rose to 15,023 thousand in 1981. This meant an annual growth rate of 2.66 %. The growth rate during the 1981-91 decade was equal to 2.08 % per year, since population increased to 18,491 thousand.

C. Low Income Level

Per capita income is very low and inadequate in Nepal, not exceeding US $ 200 equivalent per year. Nepal has the lowest per capita level, even lower than of Bhutan and Bangladesh. This accounts for the inability of Nepalese people to fulfil ever their dire basic needs.

D.

Nepalese economy is overwhelmingly dependent on agriculture. Over 80 % of Nepalese people derive their livelihood from agricultural sources. The agricultural sector generates over 50 % of total national income of Nepal. It provides about 80 % of raw materials required for the industrial sector. Exports of agricultural commodities constitute about 70 % of total exports from Nepal. Income from agricultural sources accounts for a major portion of government revenue.

E. Lack of Industries

Nepal's industrial sector is still in its infancy. Contribution of industrial sector to national income is only 6.4 % of total employment. This reveals the primary nature of Nepalese economy.

F. Dependence on Foreign Aid

Nepal's dependence on foreign aid is increasing. Foreign aid disbursement to Nepal from bilateral and multi-lateral sources which was equal to Rs. 382.9 million during the first plan period (1956-1961), amounted to Rs. 478.3 million during the second plan period (1962-1965), Rs. 919.8 million during the third plan period (1965-1970), Rs. 1509.1 million during the fourth plan period (1970-1975), Rs.4240.9 million during the fifth plan period (1975-1980), Rs. 10585.2 million during the sixth plan period (1980-1985), and Rs. 23978.4 million during the seventh plan period (1985-1990). During non-plan years, Nepal received a foreign aid disbursement of Rs. 23191.6 million. Thus, Nepal has so far received a total foreign aid Rs. 65286.2 million. The figures for various plan periods reveal Nepal's mounting dependence on foreign aid.

4.2 Overview of Macroeconomic Activity and Fiscal Position

4.2.1 International Environment

A. Macroeconomic Activity

Nepal's economic growth during the 1970s barely kept pace with population growth. Heavy regulation of industry and imports and reliance on a large and inefficient public enterprise sector discouraged private initiatives and undermined efficiency. Efforts in the early 1980s to accelerate economic growth through expansionary fiscal policies led to considerable macroeconomic instability. In the mid-1980s, Nepal embarked on a program of structural

Table 4.1 Nepal's Political and Economic Chronological

Year	Event
Later 18th century	Gorkha's king Shaha unified Nepal and established the Gorkha Dynasty.
1846	General Rana seized the power through the coup. Start of regency by the Rana clan
1950	Signing of an India Nepal Peace and Amity Agreement. Also signing of a trade and commerce agreement.
1951	Restoration of Royal Rule (King Tribhuvan). Establishment of parliamentary cabinet system but conflicted with the king.
1956	Start of the First five-year Plan (1956/57-1960/61).
1959	Promulgation of a constitution.
	General election (Feb.).
	Nepali Congress Party B.P. Koirala Cabinet formed (May).
1960	The king dismissed the cabinet, dissolved the parliament, suspended the constitution, and arrested politicians (Feb.)
	India Nepal Trade and Transit Agreement signed (Sep.).
	Start of the Second Three-year Plan (1962/63-1964/65).
1962	Promulgation of a new constitution, start of the panchyat system.
1965	Start of the Third Five-year Plan (1965/66-1969/70).
1970	Start of the Fourth Five-Year Plan (1970/71-1974/75).
1975	Start of the Fifth Five-Year Plan (1975/76-1979/80).
1978	The India Nepal Trade and Transit Agreement was separated into a Trade Agreement and a transit Agreement and signed.
1980	National referendum on the panchyat system (54.8% approved May).
	Constitution revised.
	Start of the Sixth Five-Year Plan (1980/81-1984/85).
1983	Renewal of the India Nepal Trade and Transit Agreement.
1985	Start of the Seventh Five-Year Plan (1985/86-1989/90).
	IMF loan (16-month stand by agreement). Implementation of an economic stabilization policy.
1987	Start of the First Structural Adjustment Policy (IMF's SAP 3 years, also IDA and ADB loans)
	New Industrial Enterprise Act.
1989	Rupture of the trade and transit agreement negotiations with India. Start of "economic blockade" (March).
1990	Due to the mounting demand for democratization, the king announces to compromise (April).
	An interim cabinet established until general election (K.P. Bhattrai of the Nepali Congress Party became Prime Minister).
	Restoration of the India Nepal relations. End of the "economic blockade" (June).
	Promulgation of the new constitution (shift from the panchyat system to a multiparty democratic system Nov.)
1991	General election. Nepali Congress Party's G.P.Koirala cabinet formed (May).
	Nepalese Rupee devaluated by 17% against US $ (July).
	Trade and Transit agreements with India signed (Dec.).
1992	Start of the Eighth Five-year Plan (1992/93-1996/97).
	Promulgation of the Village Development Committee Law, City Development Committee Law, and District Development Committee Law. Introductions of

	universal suffrage in local assemblies as well (April). Introduction of the Second Structural Adjustment Policy (IMF's ESAP also IDA and ADB loans). As part of law development for liberalization, promulgation of the 1992 Industrial Enterprise Act and the 1992 Foreign Investment and Technology Transfer Act (Nov.).
1994	A nonconfidence motion against Prime Minister Koirala, who dissolves the Parliament (July). General election. Communist Party of Nepal/United Marxist and Leninist (CPM/UML) became the leading party and Mon Mohan Adhikary formed cabinet (Nov).
1995	Nonconfidence motion against the Adhikary cabinet. The Nepali Congress party, the National Democratic Party and the Fraternity Party forms a Coalition Government (Sep.). Joined states of the South Asian Association for Regional Cooperation (SAARC) in the South Asian Preferential Trade Area Dec.
1996	Start of the Agricultural Perspective Plan (1996-2015).
1997	Nonconfidence motion against the Coalition Government (Prime Minister Ser Bahadur Deuba). The National Democratic Party (Prime Minister Lokendra Bahadur Chand) and CPM/UML form a Coalition Government (March). Nonconfidence motion against Chand cabinet. The National Democratic Party again (Prime Minister Surya Bahadur Thapa) and Nepali Congress form a Coalition Government (Oct.).

adjustment supported by the IMF and IDA. While this program helped achieve macroeconomic stabilization, only limited progress was achieved in structural reforms.

Political changes in 1991, which led to the election of a democratic government with a strong commitment to economic reforms and economic liberalization in India over past five years reinvigorated economic reform in Nepal. Major efforts were made in liberalizing trade and industrial policies and rationalizing the foreign exchange regime. Over the past five years quantitative restrictions have been abolished and the import, tariff structure has been greatly simplified. The industrial licensing system for domestic investment was eliminated, except in a few areas that continue to be restricted for security, health and environmental reasons, and regulations for foreign investment were greatly simplified. Some progress was made in privatizing public enterprises; 11 out of 62 public enterprises have been privatized, 3 public enterprises amalgamated and 3 have been abolished. The exchange rate was unified and made fully market- determined, and full convertibility was achieved for all current transactions, well ahead of neighboring countries. The government also took steps to strengthen public resource management and streamline the civil service. A major tax reform program was launched; domestic sales and excise taxes were simplified with a view to the full implementation of a VAT in fiscal year 1997/98 (VAT implemented from 16th of Nov. 1997), the tax base was expanded, and tax administration has been considerably strengthened. The government also undertook a public expenditure review and some programs and projects were canceled or merged, while budget allocations for the essential social sector programs were increased significantly in fiscal years 1993,1994, 1995 and 1996. These reforms contributed to significantly improved economic performance in a number of areas i.e. private sector led, current account deficit declined, sharp decline in inflation, stimulation in private investment, expenditure control etc.

B. Trade Balance

Nepal imports finished goods, machinery and transport equipment, chemicals and drugs, mineral fuels and lubricants, animal and vegetable oil and fat, crude materials, tobacco and beverage, food and live animals e.t.c. Nepal's exports to foreign countries are also classified according to import categories. However, relative position of the categories in composition of exports is different.

Nepal's imports substantially exceed exports. This means deficit balance in Nepal's trade with foreign countries. The deficit has been mounting every year.

During the last 22 years, Nepal's trade deficit has been growing with exports increasing with the rate of 12.5 % per annum and imports registering an 18 % growth rate. During FY, 1994/95-

trade deficit rose to Rs 47627.9 million, an increase by 47.6 % leading to serious rise on trade deficit as compared to the previous fiscal year. Of this, deficit with India rose by 19.1 % to Rs. 17422.1 million. During the same period, trade deficit with third countries rose by 17.1% reaching Rs. 30205.8 million. The rise on the trade deficit with the third country was due to decline in export and substantial increase in import. India is the most important trading partner of Nepal as clearly experienced during the trade and transit deadlock of 1988/89.

Nepal's external trade position continues to be highly unfavorable in spite of the many reforms introduced by the government from time to time. There has been substantial diversification in trade over the years with India. Nepal's dependence on India for essentials, however, continues unabated. Because of the highly unfavorable trade balance, the overall deficit has been growing at the rate of 20.1% during the last 21 years. Various distortions have also suffered in the economy due to the highly unfavorable balance of trade. Trade reforms have been implemented under the Structural Adjustment Program (SAP) using such measures as the licensing system, the Open General License (OGL) passbook system and auctioning of import licenses for commercial items. The following graph shows Nepal's exports and imports during fiscal year 1986/87 to fiscal year 1995/96.

Nepal's main export products are manufactured goods and miscellaneous products, which comprise around 86% of the total, export amount. Most of them are textile products such as carpet and garments. Nepal has the following the structural problems in its export.

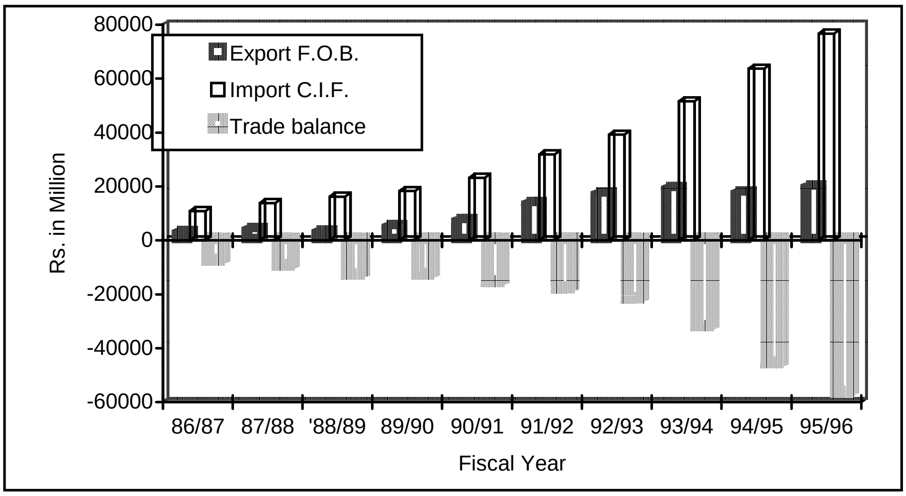
- Dependence of the textile products on imported raw materials.
- Limited export partners.
- Lack of other conspicuous export products.

Import of capital and consumer goods has been growing with the economic growth. Especially, import of manufactured goods has been increasing. The following table shows the trends of trade (share of items).

C. States Current Account Balance

Nepal's current account deficits accounted for 7.89% of GDP in FY 1990/91 it however started to improve supported by revenue from favorable exports and service revenue and growth of private remittance. In FY 1993/1994, it decreased 4.02% of GDP as same level in the early 1980s. The current account balance deteriorated again in FY 1994/95 due to the continuous growth of imports and decrease of exports. Loans and grants account for around 20-25% of the total fund inflow from overseas. Nepal is still dependent on aid-inflow. However, at present, inflow of public external capital are relatively stable so that Nepal has realized a certain equilibrium on the balance of international payments. In addition, foreign currency reserves of

Figure 4.1 Direction of Foreign Trade



Source: Economic survey 1996/97 HMG/N Ministry of Finance.

Table 4.2 Trends of Trade (share of items)

Headings	89/90	90/91	91/92	92/93	93/94	94/95
Export F.O.B.(Million rupee) (Share)	5156.2	7387.5	13706.5	17266.5	19293.4	17639.2
Food	12.06%	13.35%	14.17%	10.79%	6.03%	9.11%
Beverage, tobacco	0.08%	0.15%	0.09%	0.07%	0.06%	0.14%
Raw materials	4.76%	4.23%	3.19%	3.08%	2.24%	2.89%
Minerals, fuels	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Animal and vegetable oils	0.39%	2.74%	1.18%	1.02%	0.72%	1.47%
Chemicals and drugs	0.22%	0.24%	0.14%	0.17%	1.10%	1.69%
Manufacturing products (incl. carpets)	51.76%	58.37%	55.14%	59.64%	56.56%	53.76%
Machinery, transportation equipment	0.00%	0.00%	0.00%	0.01%	0.03%	0.21%
Miscellaneous (incl. Garments)	30.82%	20.92%	26.09%	25.21%	33.25%	32.73%
Others	0.00%	0.00%	0.00%	0.01%	0.00%	0.00%
Import C.I.F.(Million rupee) (Share)	18324.9	23226.5	31940	39205.6	51570.8	63679.5
Food	8.77%	7.84%	9.23%	7.71%	7.92%	7.85%
Beverage, tobacco	1.25%	1.11%	0.90%	1.20%	0.71%	0.92%
Raw materials	8.57%	8.67%	10.69%	10.14%	6.05%	5.98%
Minerals, fuels	8.27%	9.80%	11.41%	9.78%	9.38%	7.18%
Animal and vegetable oils	2.60%	3.19%	2.51%	2.77%	2.83%	3.14%
Chemicals and drugs	15.41%	13.14%	14.45%	13.43%	10.75%	11.57%
Manufacturing products	27.64%	25.62%	26.93%	29.67%	37.13%	38.75%
Machinery, transportation equipment	20.68%	25.79%	18.45%	19.64%	19.46%	19.75%
Miscellaneous	6.81%	4.83%	4.85%	5.58%	5.59%	4.84%
Others	0.00%	0.01%	0.58%	0.08%	0.18%	0.02%

Source: economic survey 1995/96 HMG/N Ministry of Finance.

Nepal have maintained a stable level of seven to eight months of the monthly import amount in 1990s. The following table shows Nepal's trade and current account balance situation.

D. Exchange Rate and Exchange System

Nepal Rastra Bank (central bank of Nepal) regulates and controls foreign exchange operations. It reserves the sole right to deal in and authorize other agencies to deal in foreign exchange at rates fixed from time to time. The government is required to secure advice from Nepal Rastra Bank in order to promulgate and implement foreign exchange control regulations.

Exchange rate of Nepalese currency fluctuates specially due to external factors. Exchange rate of Nepalese currency with American dollars and other convertible currencies is affected because of fluctuation of exchange rate of American dollar with other convertible currencies and fluctuation of exchange rate of non-convertible currencies with U.S. dollar. The value of Nepalese currency is decreasing in terms of U.S. dollar (Figure 4.2).

4.2.2 Domestic Environment

A. Economic Growth

Nepal has not been able to achieve economic growth despite a series of development plans since 1956 and an increasing trend in foreign aid. The poor performance of the agricultural sector has been further accentuated by rising population pressure on land and limited resources. Nepal had a per capita income of US $ 200 per annum in 1995, which was the lowest among the Asian countries. However, the annual GDP growth rate per capita during ten years from 1985 to 1994 was 2.9% recording a high performance compared with 1.1%, which is the average growth rate for low-income countries. Due to the depression of the agricultural sector, the real GDP growth rate for FY 1995 decreased to 2.9%. However, a high growth rate of 6.1% achieved in FY 1996. The Nepalese economy in the 1990s has been generally expanding supported by strong growth of the industrial and service sectors (Figure 4.3).

It is a matter of satisfaction that the broad-based growth rate of GDP has been encouraging during the FY 1995/96. Nevertheless, tremendous efforts are needed to attain sustainable and high economic growth rate and maintain its continuity in future. High rate of economic growth and sustainable development would be achieved only if Nepal could make her economy competitive with the development of agriculture sector and creation of adequate infrastructures. Integration of Nepalese economy into the mainstream of regional and global economy is also equally important. The following tables show composition of GDP and comparison of tax GDP

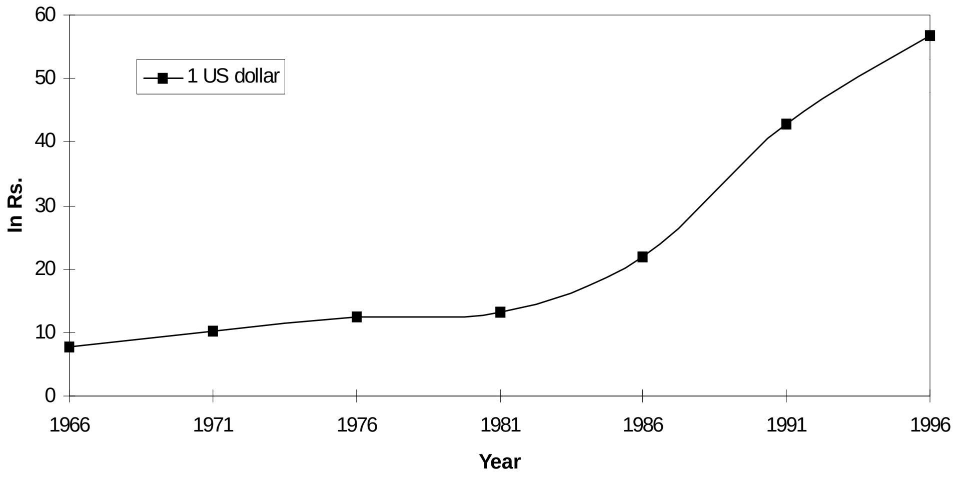
Table 4.3 Trade and Current Account Balance Situation

(Rs. in million)

Headings	1990/91	1991/92	1992/93	1993/94	1994/95
Trade balance	-15852.40	-18361.40	-21973.50	-32312.70	-47647.70
Balance on goods and Services	2691.50	3893.10	5064.40	17476.50	23565.20
Net current transfer	3661.20	4294.30	6937.30	6809.00	10708.80
Current account balance	-9499.70	-10074.00	-9971.80	-8027.20	-13373.70
Current account balance % of GDP	(-7.89)	(-6.73)	(-5.81)	(-4.02)	(-6.09)

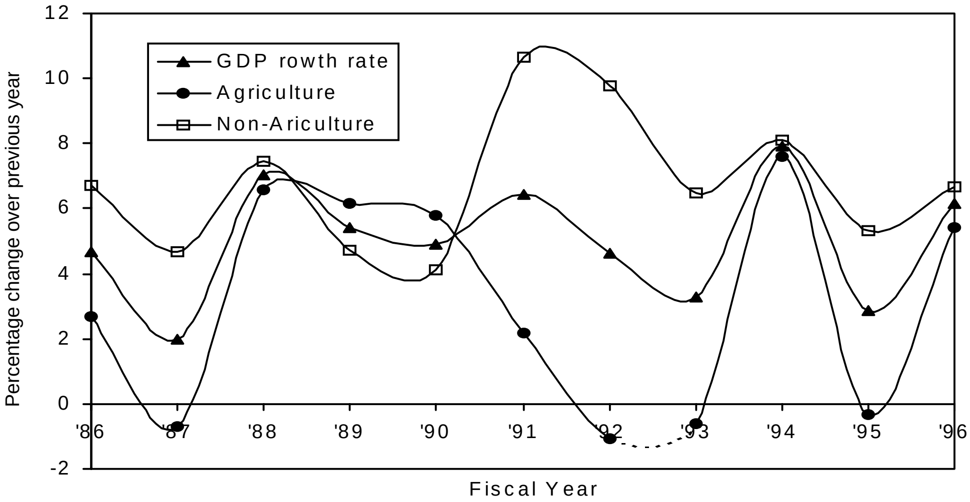
Source: Economic survey Ministry of Finance HMG/N.

Figure 4.2 Exchange Rate of Nepalese Rupee against US Dollar



Source: International Financial statistics year book 1996.

Figure 4.3 Trend in GDP Growth Rate



Source: Economic survey 1996/97 HMG/N Ministry of Finance.

ratio with some developing countries (Table 4.4, 4.5).

B. Monetary Policy

Economic stability is a necessary prerequisite in context of achieving higher economic growth through liberal, open and private sector friendly economic policy. Nepal's monetary policy is also directed accordingly. The monetary policy needs to be executed by maintaining proper balance between the poverty alleviation through institutional credit. As the main thrust of Nepal's current monetary policy has been to maintain economic stability, targets were set in terms of net internal borrowing by the government, net internal asset of Nepal Rastra Bank, additional credit to be borrowed by the government from banking sectors, etc. However, despite the efforts to limit the borrowing with target, HMG/N has borrowed more than targeted. Consequently, maintenance of stability in price, balance of payments and foreign exchange reserve through monetary control has been a somewhat difficult exercise although there has not been a substantial expansion in aggregate monetary figures.

C. Money Supply

The ratios of M1 and M2 to GDP have consistently been increasing since the mid 1970s reaching to 15.01% to 36.86% respectively, in 1995. The ratio of M2 to GDP is not low compared with its ratio of other south Asian countries. Expansion of money supply has been supported by increase of time deposits so that the financial market has steadily been improving. Time deposits have drastically grown particularly since the economic liberalization process advanced in 1990. The following figure (Figure 4.4) shows the trends in money supply.

Examining the factors for expansion of money supply (M2) from the aspect of assets, M2 as mainly grown by expansion of net external assets in the 1990s. However, the share of net external assets in total assets started to decrease in 1995. Focused on domestic credits, as the fiscal deficits have been decreasing since the end of the 1980s, credits to the government and public sector have gradually been decreasing. On the other hand, credits to the private sector have rapidly increased in the 1990s and reached to 40% of the total assets in 1995. It can be seen that the financial market has deepened by the development of activities of private enterprises since the economic liberalization program has fully implemented. The following figure (Figure 4.5) shows the trends of assets.

D. Fiscal Position

Table 4.4 Composition of GDP (origin)

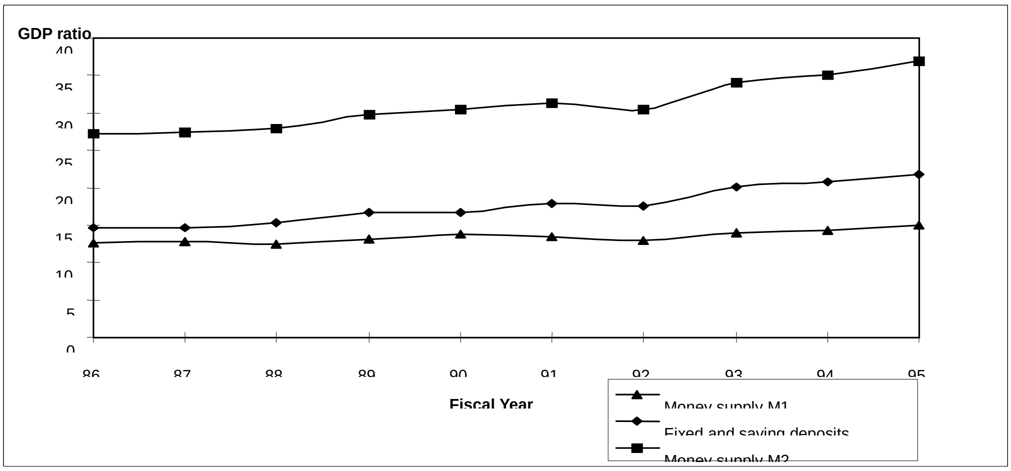
Origins of gross domestic product	% of Total				
	1990/91	1991/92	1992/93	1993/94	1994/95
Agriculture, forestry & fishing	47.47	44.89	43.19	43.07	41.73
Mining and quarrying	0.45	0.47	0.46	0.46	0.46
Manufacturing	6.28	7.93	8.15	8.49	8.41
Electricity, gas & water	0.77	0.79	0.69	0.68	0.70
Construction	9.26	9.53	9.68	9.56	9.67
Trade, hotels etc	10.52	10.65	10.97	11.03	11.30
Transport and communications	6.55	6.81	7.15	7.15	7.55
Finance and real estate	9.46	9.52	9.75	9.61	9.90
Social services	9.23	9.42	9.95	9.95	10.28
GDP at factor cost	100.00	100.00	100.00	100.00	100.00

Table 4.5 Composition of GDP (components)

Components of gross domestic productr	% of Total				
	1990/91	1991/92	1992/93	1993/94	1994/95
Private consumption	81.22	80.16	77.79	77.31	79.42
Government consumption	9.21	7.87	8.69	8.02	8.22
Gross fixed capital formation	18.92	19.34	21.75	21.10	21.91
Change in stocks	1.91	2.81	1.39	1.31	1.54
Exports of goods & non- factor services	11.82	15.79	18.06	23.87	24.29
Imports of goods & non-factor services	-23.08	-25.97	-27.67	-31.61	-35.38
GDP at market price	100.00	100.00	100.00	100.00	100.00

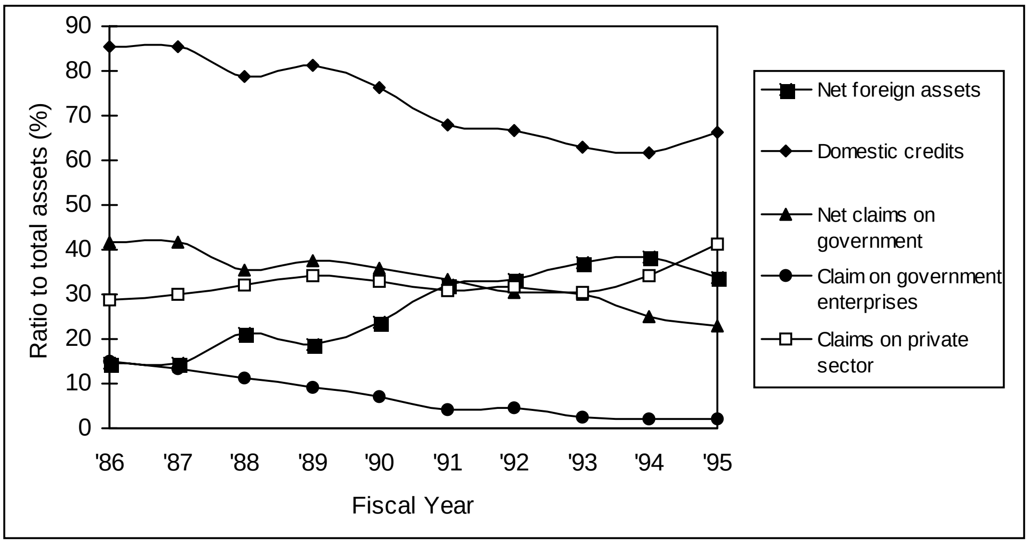
Source:The Economist Intelligence Unit Limited 1997.

Figure 4.4 Trends in Money Supply



Source: Economic survey 1995/96 HMG/N Ministry of Finance.

Figure 4.5 Trends of Assets



Source: Economic survey 1995/96 HMG/N Ministry of Finance.

Along with the process of people becoming sovereign and continuous expansion of investment in context of rising expectation of people, Nepal is passing through a difficult challenge of resource not getting mobilized accordingly. Public finances of Nepal face the structural problems such as constant revenue shortage, expenditure in excess of financial capacity, and weak administrative management. They have resulted in large financial deficits and dependence on foreign aid. For the Nepalese government, reduction of the fiscal deficits has become one of the most important issues to be resolved for stabilizing its economy. The government has mainly reduced expenditure since the early 1990s, and has made improvements in the revenues side by introduction of several measures for increasing the tax revenue. Therefore, the fiscal deficits decreased to 6.9% of GDP in FY 1995/96. However, Nepal has not been able to reduce the expenditures drastically due to political factors such as change of government during 1994-1997 (Table 4.1 above) period. Also there are many issues to be improved in the revenue side. Therefore the fiscal deficit is expected to increase again (Figure 4.6, 4.7).

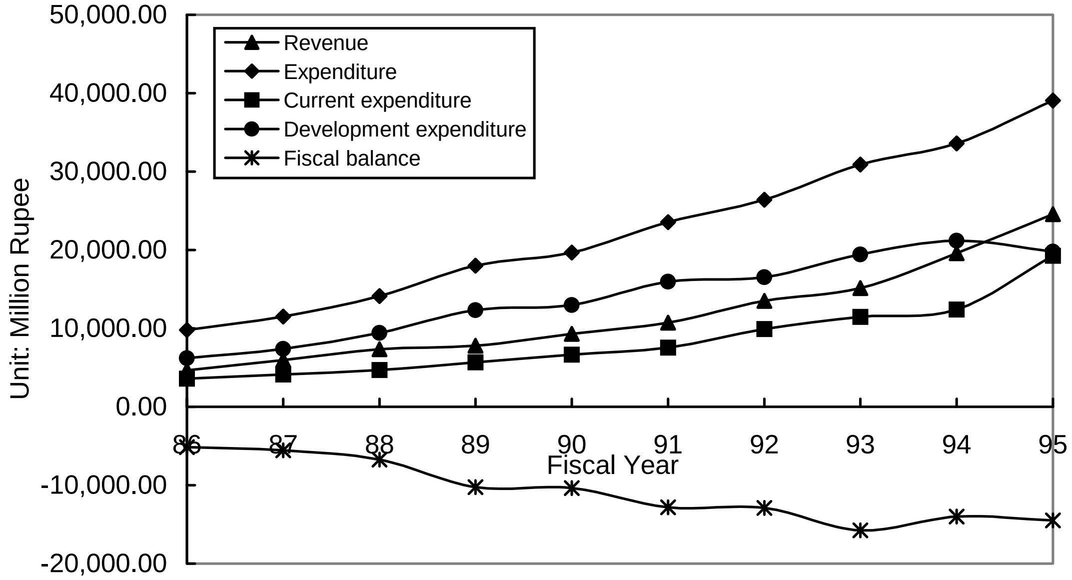
Despite control in expenditures, the government expenditures have reached at a level of about 20 % (1989) of GDP, whereas revenue mobilization has not crossed the level of 12 % of GDP. In this context, budget deficit has to be met through mobilizing external and internal loans.

The discrepancies between investment and savings, trade and balance of payments, and revenue and expenditure have made the country's financial precarious. Government expenditure has been growing at an unsustainable rate in view of the week productive base and fragile revenue system. Expenditure grew at an average annual rate of 18.6% during the period 1974/75-1996/97 current (regular) and development expenditures in 1974/75 were US$ 54.7 million and US$ 1 billion respectively.

Resource allocation in the public sector had been very inefficient during the previous regime. Investments were made without the due consideration of the financial or economic viability of the projects and the economy's capacity to sustain them. The rapid increase in regular expenditure and share of consumption in development expenditure has created many distortions in the economy.

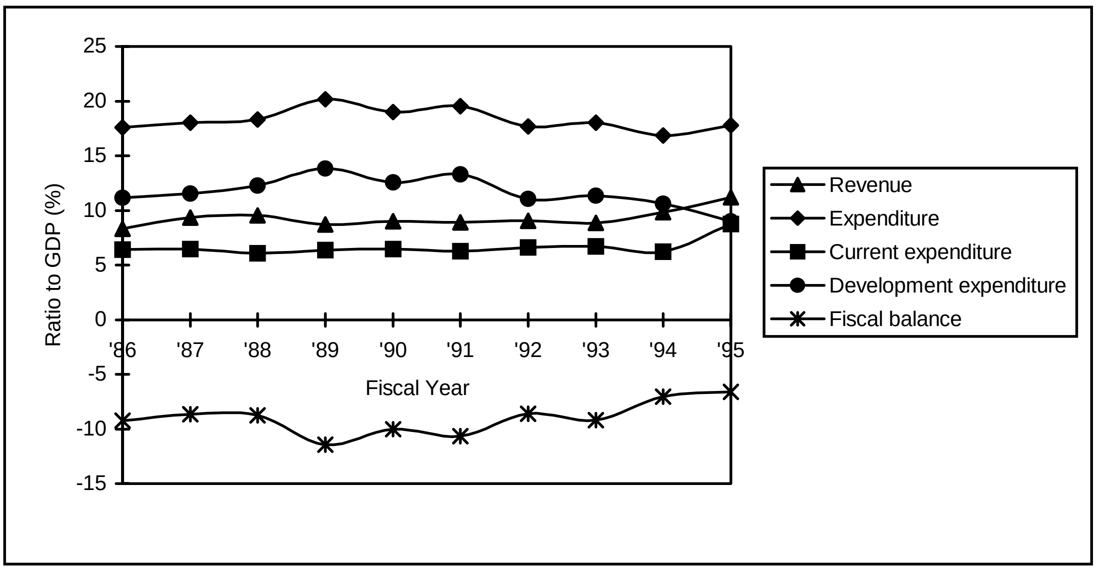
The country depends heavily on imports for revenue, over half of the total revenue collection. However, the majority of the people remain outside the tax net including high-income individuals and businesses that benefit most from government facilities. Thus, government revenue does not relate to the volume of economic activity while fiscal policies remain ineffective in directing the course of economic development. In spite of the many revenue facilities enjoyed by the industrial sector, its contribution to government revenue has been insignificant. Without effective fiscal instruments, the government has had to depend increasingly on the more accessible foreign assistance and loans to finance its increasing

Figure 4.6 Trends in Public Finance



Source: Economic survey 1995/96 HMG/N Ministry of Finance.

Figure 4.7 Trends in Public Finance (% of GDP)



Source: Economic survey 1995/96 HMG/N Ministry of Finance.

expenditure. The total outstanding debt reached US$ 2398 million in 1995, while it was US$ 205 million in 1980. The total outstanding debt was 10.4% of GDP in 1980 and 53.3% in 1995.

Fiscal revenue remained at around 9% of GDP from the later 1980s, but have sharply increased since FY 1994/95 and reached 11.1% of GDP. However the fiscal revenue has constantly been short in Nepal and has remained at lower level compared with other south Asian countries (Table 4.6). The people under poverty line accounted for 49% of the total population (FY 1990/91) and most of the people live in rural areas so the tax revenue base is weak. In the Nepalese tax revenue structure, the ratio between indirect and direct taxes is around 8:2. Customs and sales taxes in particular take large shares of the indirect tax revenue (Table 4.7).

The following Tables (4-7,8,9,10) show the revenue structure of Nepal for the period of FY 1980/81 to FY 1995/96.

The public finances will play major roles in the development of the Nepalese economy, so the increase of tax revenues is a matter of urgent. Measures such as introduction of the Value Added Tax (VAT) will be indispensable for establishing a stable tax base.

E. Foreign Aid

Foreign aid has been playing an important role in the development effort of Nepal. Foreign aid is received in form of bilateral and multilateral grants and loans. The bilateral aid to Nepal has been provided in the firm of grants (including technical cooperation). The share of grants in the total bilateral aid amount was 94.6% in the first half of 1980s (1980-84). During this period annual average grant amount reached US $ 98.5 million. In the later 1980s, IMF and World Bank led Structural Adjustment Program started, which greatly increased the bilateral aid. In the first half of 1990s (1990-94) the annual average grant amount continued to increase by 31% compared to the preceding period and reached to US $ 229.8 million. It was because Japan and Scandinavian countries rapidly increase the aid to Nepal since the later half of the 1980s. The growth of grant disbursement from major DAC countries except Japan and Scandinavian countries has been slowing.

In terms of multilateral aid, loans accounted for around 72% of the total amount (1990-94 average). In particular, highly concessional loans by the two international agencies namely the World Bank and the ADB account for two-thirds of the total amount.

In terms of sectors, the loan extended around 80% has been disbursed in economic infrastructure projects. Since 1976, the loans to the agriculture and forestry sector and the power sector have consistently accounted for over half of the total amount. The World Bank and the ADB have both given a priority to power sector. Japan has also directed 51% of its loan

Table 4.6 Tax GDP Ratio Among some South Asian Association for Regional Cooperation (SAARC) Countries

Year	Tax GDP ratio		
	'93	'94	'95
Bangladesh	11.1%	11.3%	11.6%
Bhutan	22.2%	18.9%	19.2%
India	16.3%	16.5%	15.3%
Pakistan	18.2%	18.7%	18.2%
Sri Lanka	19.7%	19.0%	20.8%
Nepal	8.8%	9.8%	11.1%

Source: World Development Report 1993,1994,1995.

Table 4.7 Composition of Revenues

(Revenues in millions Rs and shares of total government financing %)

Types of Revenue	Revenue in millions Rs and share of total government financing (%)							
	1980/81	1985/86	19990/91	1991/92	1992/93	1993/94	1994/95	1995/96
Customs %	815.8	1231.0	3044.3	3358.9	3945.0	5255.0	7018.1	7300.0
	19.28	12.66	12.84	13.97	14.35	15.94	18.33	16.11
Tax on consumption or production %	866.7	1766.5	3763.4	4921.5	5681.3	7261.2	8792.6	9684.7
	20.48	18.17	15.88	20.46	20.67	22.03	22.97	21.38
Domestic Excise %	242.2	558.7	1200.2	1414.3	1452.8	1592.5	1657.3	1944.3
	5.72	5.75	5.06	5.88	5.29	4.83	4.33	4.29
Sales tax(domestic and import) %	537.7	985.9	2026.1	2840.7	3438.2	4693.1	6031.7	6431.3
	12.71	10.14	8.55	11.81	12.51	14.24	15.76	14.20
Others %	86.8	221.9	537.1	666.5	790.3	975.6	1103.6	1309.1
	2.05	2.28	2.27	2.77	2.88	2.96	2.88	2.89
Land Revenue and Registration %	178.5	244.3	540.0	636.1	754.9	833.1	971.8	1202.5
	4.22	2.51	2.28	2.64	2.75	2.53	2.54	2.65
Tax on Property, Profit and Income %	174.7	417.5	829.7	959.1	1281.3	2022.1	2823.5	3669.0
	4.13	4.29	3.50	3.99	4.66	6.14	7.38	8.10
Total Tax Revenue	2035.7	3659.3	8177.4	9875.6	11662.5	15371.4	19606.0	21856.2
%	48.11	37.64	34.50	41.06	42.44	46.64	51.22	48.24
Other Revenue	383.5	985.2	2552.5	3637.1	3485.9	4209.4	4915.2	6144.1
%	9.06	10.13	10.77	15.12	12.68	12.77	12.84	13.56
Total Revenue	2419.2	4644.5	10729.9	13512.7	15148.4	19580.8	24521.2	28000.3
%	57.17	47.77	45.27	56.18	55.12	59.41	64.06	61.80
Foreign Grants	868.9	1172.9	2164.8	1643.8	3793.3	2393.6	2876.7	4100.0
%	20.53	12.06	9.13	6.83	13.80	7.26	7.51	9.05
Foreign Loans	693.3	2501.1	6256.7	6816.9	6920.9	9163.6	9052.7	11000.0
%	16.38	25.73	26.40	28.34	25.18	27.80	23.65	24.28
Domestic Loans	250.0	1403.4	4552.7	2078.8	1620.0	1820.0	1776.2	2000.0
%	5.91	14.44	19.21	8.64	5.89	5.52	4.64	4.41
Total Government Financing	4231.4	9721.9	23704.1	24052.2	27482.6	32958.0	38280.8	45305.6

Source: Economic Survey 1995/96 HMG/N Ministry of Finance.

Table 4.8 Revenues as A Share of GDP

Types of Revenue	Revenues as a share of GDP %							
	1980/81	1985/86	19990/91	1991/92	1992/93	1993/94	1994/95	1995/96
Customs	3.0	2.2	2.5	2.2	2.3	2.6	3.2	2.9
Tax on consumption or production	3.2	3.2	3.1	3.3	3.3	3.6	4.0	3.9
Domestic Excise	0.9	1.0	1.0	0.9	0.8	0.8	0.8	0.8
Sales tax(domestic and import)	2.0	1.8	1.7	1.9	2.0	2.4	2.7	2.6
Others	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Land Revenue and Registration	0.7	0.4	0.4	0.4	0.4	0.4	0.4	0.5
Tax on Property, Profit and Income	0.6	0.7	0.7	0.6	0.7	1.0	1.3	1.5
Total Tax Revenue	7.5	6.6	6.8	6.6	6.8	7.7	8.9	8.7
Other Revenue	1.4	1.8	2.1	2.4	2.0	2.1	2.2	2.5
Total Revenue	8.9	8.3	8.9	9.0	8.8	9.8	11.2	11.2
Foreign Grants	3.2	2.1	1.8	1.1	2.2	1.2	1.3	1.6
Foreign Loans	2.5	4.5	5.2	4.6	4.0	4.6	4.1	4.4
Domestic Loans	0.9	2.5	3.8	1.4	0.9	0.9	0.8	0.8
Total Government Financing	15.5	17.4	19.7	16.1	16.0	16.5	17.4	18.1
GDP in Millions Rs	27307	55,734	120,371	149,485	171,386	199,216	219,580	249,896

Source: Economic survey 1996/97 HMG/N Ministry of Finance.

Table 4.9 Revenue from Customs

(RS in million)

Headings	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96
Imports	2752.6	2795.2	3178.0	4356.0	5840.1	6246.5
Exports	78.5	114.7	140.7	427.0	332.5	149.9
Indian Excise Refund	211.7	447.4	623.5	460.4	837.5	899.9
Others	1.5	1.6	2.8	11.6	8.0	31.1
Total	3044.3	3358.9	3945.0	5255.0	7018.1	7327.4

Source: Economic Survey 1995/96 HMG/N.

Table 4.10 Tax on Property, Profit and Income

(RS in million)

Headings	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96
Income tax from public enterprises	162.2	171.1	255.3	534.1	860.2	1144.5
Income tax from semi public enterprises	2.7	5.3	2.6	2.1	0.0	0.0
Income tax from private corporate bodies	0.0	6.5	9.5	19.7	440.1	563.9
Income tax from Individuals	531.2	617.9	800.7	1184.8	1293.1	1470.1
Income tax from remuneration	49.9	54.7	56.7	83.8	118.4	133.1
Urban house and land tax	0.2	22.3	16.7	8.4	34.2	87.2
Vehicle tax	23.9	45.4	63.3	41.4	54.0	70.7
Tax on interest	37.8	19.5	73.4	96.7	111.6	119.8
Other taxes	21.8	16.4	3.1	51.1	0.0	0.0
Total	829.7	959.1	1281.3	2022.1	2911.6	3589.3

Source: Economic surveys 1995/96 HMG/N.

Table 4.11 Tax on Consumption and Product of Goods and Services

(RS in million)

Headings	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96
Industrial product	1199.6	1414.1	1452.4	1592.2	1657.3	1944.3
Liquor contract	0.6	0.2	0.4	0.3	0.0	0.0
Sales tax	2026.1	2840.7	3438.2	4693.1	6031.7	6431.3
Entertainment tax	39.4	38.3	53.1	112.2	91.1	100.4
Hotel tax	115.6	191.3	223.4	219.1	229.1	284.2
Air flight tax	173.4	177.9	205.7	270.7	278.2	311.1
Contract tax	173.3	213.3	293.0	356.5	505.2	613.4
Road & bridge maintenance tax and others	35.4	45.7	15.1	17.1	0.0	0.0
Total	3763.4	4921.5	5681.3	7261.2	8792.6	9684.7

Source: Economic Survey 1995/96 HMG/N.

Table 4.12 Foreign Aid Commitment by Major Sources

(in million Rs.)

Source	1990/91	1991/92	1992/93	1993/94	1994/95
1.Bilateral	**3494.9**	**7643.2**	**12650**	**7402.3**	**9744.8**
Grant	2734.4	7643.2	12386	7267.1	9670
Loan	760.5	_	264	135.2	74.8
2.Multilateral	**2170.5**	**13440.9**	**7876.7**	**5769.9**	**3132.1**
Grant	35.5	417.9	3611.7	158.9	1496.8
Loan	2135	13023	4265	5611	1635.3
3.Total	**5665.4**	**21084.1**	**20526.7**	**13172.2**	**12876.9**
Grant	2769.9	8061.1	15997.7	7426	11166.8
Loan	2895.5	13023	4529	5746.2	1710.1

Source: Financial comptroller General office HMG/N.

Table 4.13 Foreign Aid Disbursement by Major Sources

(in million Rs.)

Source	1990/91	1991/92	1992/93	1993/94	1994/95
1.Bilateral	**2939.9**	**3597.3**	**3638.5**	**2627.1**	**5050.2**
Grant	1337.1	1207.5	2330.9	2044.2	4332.9
Loan	1602.8	2389.8	1307.6	582.9	717.3
2.Multilateral	**3050.1**	**4203.1**	**5597.1**	**8930.1**	**7260.7**
Grant	292.9	323.5	943	349.4	665.8
Loan	2757.2	3879.6	4654.1	8580.7	6594.9
3.Total	**5990**	**7800.4**	**9235.6**	**11557.2**	**12310.9**
Grant	1630	1531	3273.9	2393.6	4998.7
Loan	4360	6269.4	5961.7	9163.6	7312.2

Source: Financial comptroller General office HMG/N.

Table 4.14 Foreign Aid Disbursement by Sector (share)

(Grants)

Headings	Year			
	76-'80	81-'85	86-'90	91-'95
Agriculture, irrigation, forestry	17.60%	23.80%	13.60%	18.60%
Transportation	48.10%	24.60%	18.20%	25.40%
Electricity	8.80%	14.80%	22.40%	8.60%
Telecommunications	0.40%	1.60%	9.00%	6.50%
Commerce and industry	7.90%	4.70%	5.70%	3.30%
Social sector	16.50%	29.30%	28.60%	39.60%

(Loans)

Headings	Year			
	76-'80	81-'85	86-'90	91-'95
Agriculture, irrigation, forestry	22.20%	35.20%	33.20%	34.90%
Transportation	18.50%	13.40%	10.70%	16.40%
Electricity	39.60%	21.90%	32.40%	18.50%
Telecommunications	2.90%	4.20%	3.50%	5.10%
Commerce and industry	7.60%	15.20%	8%	14.10%
Social sector	9.20%	9.70%	12.00%	12.50%

Source: Economic survey HMG/N Ministry of Finance.

commitments until the end of 1995 in this sector. On the other hand, both the World Bank and the ADB since the late 1980s have been increasing the lending to the social sector. The following tables show Nepal's foreign aid commitment and disbursement by major sources.

Distribution of foreign aid by type

The loans extended to Nepal by sector, over half the amount has consistently been extended to the agriculture, forestry sector and the power sector since 1976 (Table 4.14).

4.2.3 Income Tax System

A. Background

Income tax is based on income. The main objective of income tax is to collect revenue and reduction of unequal distribution of income in society. Income is the key element of ability to pay, so tax based on income can be accumulated with tax payer's economic condition thus it is called progressive and modern tax. Experience shows that importance of tax system would be increased after completing the process of economic development, educational expansion, and increase in tax awareness, and strengthening tax administration. In Nepal, income tax system was started as a tax on business, profit and remuneration tax in 1960. In 1963, it was levied in all the sources of income. After that, there were various amendments in tax law in different time.

Nepal currently levies four different types of income taxes, viz., individual income tax, corporate income tax; house rent taxes and interest tax. Of these taxes, individual income tax is levied at three rates, i.e. 10, 20, 25 % (1997/98 budget speech) and corporate tax is levied on public enterprises, public and private limited companies and partnership firms at the rate of 25 %.

House rent is taxed at both central level and local level. The local level house rent tax, however, is ineffective. The central level house rent tax and interest tax are withheld at the rate of 15 and 5 % respectively, and the tax withheld is the final tax in the case of both taxes. Tax is also withheld on a wide range of other income, such as wages 10%, contract 2.5%, commissions 10%, any supplies over Rs.60,000 at the rate of 2% and meeting allowances 10%.

B. Major Issues

The existing Nepalese income tax system suffers from several limitations. There is a lack of clear and explicit definitions of income tax liabilities and administration procedures. Administrative practices are very poor as well. On the one hand, the income tax act gives far-reaching powers to the authorities (such as penalties and tax assessment by best judgement of tax authorities), but on the other hand, it is incomplete in specifying the tax structure and administration. This has resulted in the taxation of income becoming ad hoc and arbitrary. Negotiated tax settlements have become common practice. In addition, the tax base is small and an insufficient effort has been made to widen it, resulting in a situation where the relatively few who are caught within the net suffer a disproportionately high tax burden and all the compliance costs. Hence, the deep concerns of the current taxpayers about the inequalities and inefficiencies of the income tax system and the desire for its reform have emerged. Such a tax system can also be expected to be ineffective in raising revenues and to cause major distortions in business behavior with high costs to the economy. The following are the some major issues of the income tax system in Nepal.

a) Low revenue yield

Tax yields in Nepal are generally low. Customs duties rise only 3 % of GDP, other indirect taxes on consumption or production about 4 %, and overall tax revenues between 8 % and 9 % of GDP in recent years. Income tax revenues are remarkably low reaching only 1.0 % to 1.5 % of GDP in recent years (Table 4.8 above). While Nepal has a predominantly small farmer agricultural sector economy and a large informal sector, including many small traders, even if only 20 % of GDP was effectively taxable at a rate of 15 % the revenue yield would be 3 % or double the current yield.

b) Sources of Tax Base Erosion

--- Legislated nontaxable income sources

Under Income Tax Act 1974 (ITA) as amended through 1993, a number of sources of income are made fully or partially non-taxable or even receive subsidies.

- Agricultural income is exempt from income tax. Currently this removes some 41 % of GDP from the tax base.
- Dividends are exempt.
- Pension and gratuity income is not taxed, and in addition, contributions are deductible from income, and the investment income earned on the contributions is free of tax.
- Life insurance income is not subject to tax in the hands of policyholder.
- Interest income is only taxable at 5 % except when received by banks or other financial institutions.

--- Industrial incentives

The following are some of the major income tax breaks facilities offered:

- Cottage industries irrespective of the size of the industry receive an indefinite tax holiday. National accounts estimate the cottage industry to have a gross value added of some Rs. 4.4 billion or about 2 % of GDP.

- Profits earned through exports is exempt from income tax.
- With a few exceptional subsectors, five year tax holidays are awarded to manufacturing industries, mining industries, and energy, forest and agro based industries, and prescribed tourism, service and construction industries. Additional two-year tax holidays are awarded to (a) national priority industry (b) manufacturing agro and forest based industries using 90 % local raw materials (c) enterprises employing 600 or more persons.
- Industries receive: (a) 5 percentage point tax rate cut on each rate bracket; (b) 5 percentage point tax rate cut if listed on the stock exchange and have widely held shares; (c) one third acceleration in depreciation rates allowed under ITA; and (d) rebates ranging from 10 % up to 60 % of the tax otherwise payable for establishing in sites ranging from relatively developed to remote areas.
- Investment deductions are provided to industries as follows: (a) 40 % additional investment deduction for 25 % capacity expansion, or diversification, or the development of an ancillary industry or technology modernization; (b) 50 % additional investment deduction for an approved pollution control process or equipment and (c) 100 % expensing of up to 10 % of gross profit spent on technology or product development or efficiency improvement.

Except the above issues there are some complains on: penalty structure and administrative practices, legislative and administrative procedures and practices, and appeal system.

C. Income Tax Administration in Nepal

Several departments within the Ministry of Finance are directly related to tax administration. They are Income Tax, Customs, Value Added Tax, Revenue Investigations, and Revenue Administration Training Center. A Director General heads each. To have an effective tax system all departments must work together and complement each other. The income tax department does receive some basic import data from customs, which is entered into the computer and used when making assessments. This is a labor-intensive operation because the paper documents are sent from customs to the income tax department where they are entered into the computer database.

The income Tax Department has total 42 tax offices located throughout the country. Each office maintains returns filed at that office. A Chief Tax Officer or a Tax Officer heads each office. The Income Tax Department is responsible for collecting the following taxes: Income, Entertainment, Hotel, Air Flight, Contract, and Urban House and Land Taxes. Out of 21 million people, there are only about 0.2 million-income taxpayers.

D. Assessments

There are basically three ways income tax is assessed; self-assessment, committee assessment and additional assessments made by tax officers. Committee assessments are used for small taxpayers. Self-assessment is used by large businesses such as registered public companies and firms. Committee assessments are made by a Small Taxpayer Assessment Committee composed of a tax officer, customs officer, VAT officer, and a representative of the village development committee or municipality, and the local chambers of commerce and industry. Small Taxpayer Assessment Committees assess the income of taxpayers with net income below Rs 70,000 per year. Self-assessment was implemented some three years ago (FY 1994/95) for the large taxpayers. It is viewed by the business community as a failure and by the tax department as reasonably successful. No implementing instructions or guidelines have been provided to the tax officers. They continue to reassess nearly all self-assessments. Business now pay large sums of money to get their records audited (statutory audit as well as tax audit), returns prepared and filed with the department. After incurring this expenses there has been no change in the process used to by the tax department. The businesses expected, and rightly so, that there would be a random audit of self-assessment returns. However, the business now sees self-assess and pay. The belief in the business sector is that if one tries to follow the rules the end results is that they are harassed and penalized, while those outside the system continue to pay no tax.

The tax system of Nepal (basically self assessment system) suffer from two related problems: a large informal sector (primarily concentrated in agriculture and trading) and weak traditions and laws in accounting, bookkeeping and record-keeping standards and requirements. The income tax should be clear on the requirements for different types and sizes of business. As a general requirement, however, all business should be required to issue invoices and receipts. Without this basic requirement, it is difficult to enforce either direct or indirect taxes, or to judge the sizes of business. Penalties for failure to issue invoices and keep records are required. Clearly, however, judgement has to be exercised in imposing penalties. The more established an enterprise in terms of fixed places of business, stocks of goods, numbers of persons employed, etc., the stricter the enforcement should become. The credit or invoice method VAT has at it’s a core requirement for all registered businesses to issue VAT invoices. The income tax should make the maximum use of this requirement and have invoice requirements that are consistent with those of the VAT.

Nepal does not have national accounting standards and only some 110 of the over 6,000 auditors licensed by the Auditor General are qualified Chartered Accountants.

Current Tax Rates

i. Companies and Partnership: 25 %

ii. Individuals:

Taxable income:

up to Rs. 40,000	10 %
Next Rs. 25,000	20 %
Over Rs. 65,000	25 %

(Less at least 5 percentage points for registered industries)

Basic exemptions:

Single	Rs.30, 000
Joint	Rs.40, 000

For employees: employment expenses deduction: lesser of 15 % of income or RS. 7,500 deduction

Rate reductions: Industries (nearly all industries excluding financial and trading service and non-energy utilities) receive: (i) 5 percentage point tax rate cut on each rate bracket; (ii) 5 percentage point tax rate cut if listed on stock exchange and have widely held shares.

An advance income tax of 5 % is levied on all importers who do not have an income tax registration certificate. This tax is also levied on all imports from Tibet and imports, which enter through the Tribhuvan International Airport. An advance income tax of 2.5 % is levied on the imports of specified agricultural products.

4.3 Conclusion

While analyzing different aspects of economic situation, it has become necessary to continue the policy of structural reform while maintaining macro-economic stability. If economic stability could not be continued and maintained, the economic structure will be disturbed and finally there will be far reaching counter productive effects in the economy. Achieving higher and sustainable economic growth rate, containing inflation and maintaining fiscal balance is the need of the day.

Fiscal imbalance, which has remained a great challenge for economic stability, has necessitated undertaking effective policy measures to avoid such imbalances. While analyzing all aspects regarding how much the government can depend on the current sources of revenue, what measures should be undertaken to mobilize additional resources, what should be done to improve public expenditure management etc., the objective should be to attain fiscal on a permanent basis.

Nepal's level of export is very low and export trade is confined only to limited number of product and a few countries. Emphasis should be given on spending up of the growth of export and diversifying trade both countrywide and commoditywise.

Nepal's GDP saving rate is also very low as compared to most of the developing countries. Investment can not expand without an increase in the saving rate. It is imperative to increase the share of saving in GDP by enhancing investment for the socio-economic development of the country. In order to rise the present saving rate of GDP, it is necessary to create favorable environment.

There has not been any significant progress in the living standards of people comprising almost 90 % of the population residing in the rural areas. This is due to pay more attention in this aspect. It has been necessary to develop institutional capability of mobilizing resources and making investment at rural level to increase agricultural production, create additional employment opportunities, expand investment on rural sector and generate maximum return from such an investment.

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