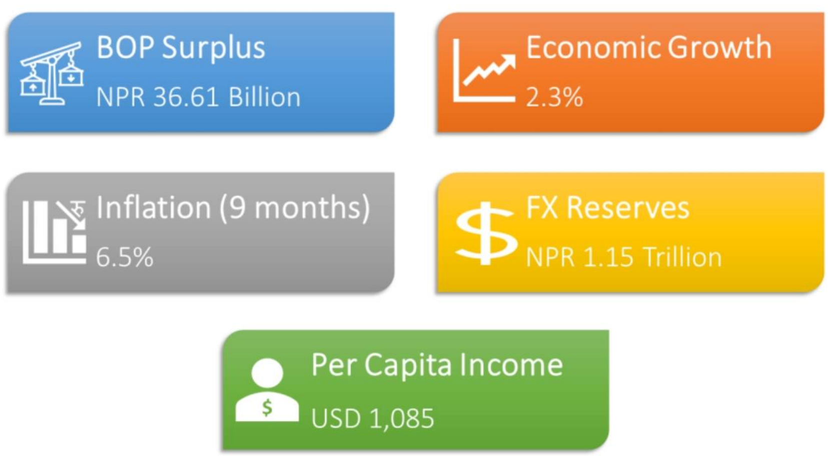
Nepal Budget 2077/78
Unexciting programs defined by incremental but essential improvements

1. Macroeconomic Highlights

Nepal's macroeconomic outlook is like the past few years with the same systematic deficiencies and behavior patterns. Dependence on remittance is still quite high (annual remittance is equal to 25.4% of GDP[1]) which drives a consumption culture (National Consumption is 81.9% of GDP[2]) The export to import ratio while improving is still 12.5[3] (compared to 15.5 the last fiscal) which shows there is still a tremendous imbalance in the national accounts. The GDP growth for the FY stood at 2.3% as opposed to 7% as targeted by the previous budget mainly owing to COVID-19's impact.

Similarly, Inflation Stood at 6.5% against a target of 4.5%. On the back of more prudent policies and a sudden drive in refined palm oil exports, Exports saw an increase of 12.9% whereas there was a 7.5% decrease in imports, which helped reduce the Trade Deficit and helped maintain a BOP Surplus of NPR 36.61 Billion. As a result, FX reserves grew by 11.25% to NPR 1.15 Trillion. These improvements along with growth in output of various sectors helped increase the per capita income of the country by 5% to USD 1,085. Overall, despite effects of COVID-19, the macroeconomic indicators still point towards a positive outlook on the surface.

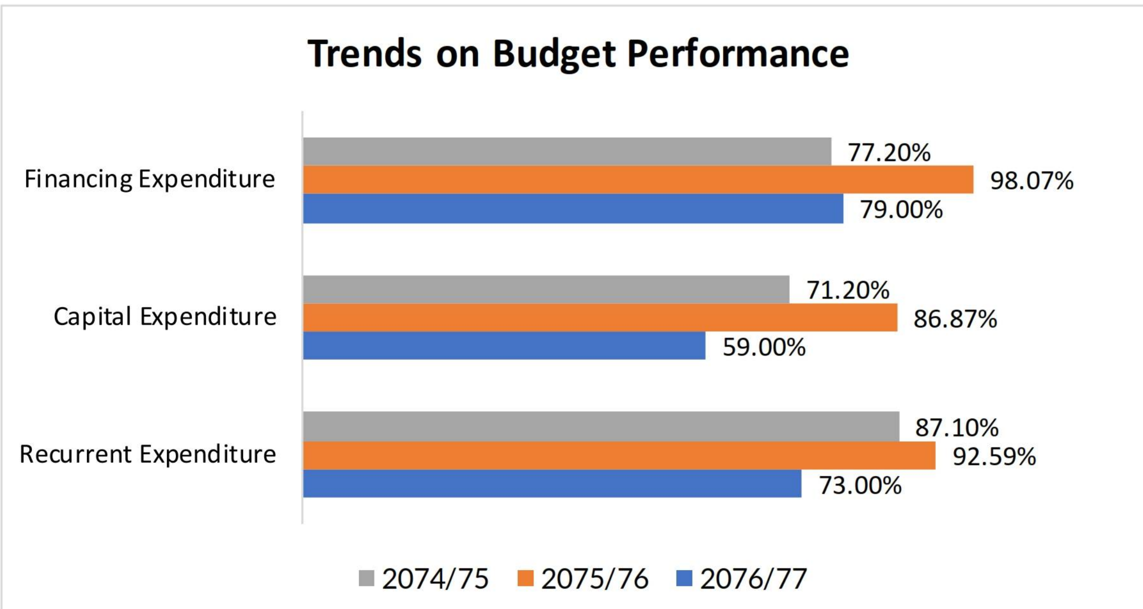


[1] Economic Survey 2076/77, MOF
[2] Economic Survey 2076/77, MOF
[3] Macroeconomic Update, NRB

2. Budget Performance (2076/77)

With regards to the performance, the budget for FY 2076/77 continued the trend of ballooning recurrent expenditure vis-à-vis total expenditure observed since 2063 B.S. However, owing to the pandemic and inefficient mechanism, only 70% of the budgeted expenditure (NPR 1.07 Trillion) is projected to be made in the FY.

Recurrent, Capital and Financing Expenditures are projected to be 73.3%, 58.6%, and 78.8% of their respective allocated budgets. Total Tax collection stood at NPR 827 Billion (74.4% of targeted amount). It can be clearly seen that budget performance has suffered greatly because of the pandemic and inefficiencies on part of the government to spend as per planned.



Access to financial system has improved with almost 1,000 new branches of BFIs being established and insurance coverage has extended from 5.6 Million to 7 Million Individuals. Provision of compulsory PAN has increased the scope of taxation as 1.13 Million Taxpayers registered for a PAN in the last FY. FDI commitments have also jumped up significantly to NPR 1.43 Trillion with NPR 155 Billion and NPR 29.82 Billion worth of FDIs being approved for the FY by Nepal Investment Board and Department of Industry, respectively.

3. Budget Overview

In continuation of the practice of presenting an Annual Budget for Nepal which Began In 2008 BS with a total Budget of NPR 52.53 Million Against a Revenue of NPR 30.62 Million was carried out for FY 2077/78 by honorable finance minister Dr. Yuvaraj Khatiwada on 15th Jestha, 2077 BS (28th May, 2020 AD). The Budget for the FY is NPR 1.47 Trillion against Tax Revenue of NPR 889.62 Billion. As Tax Revenue is not sufficient to cover the total projected expenditure, Foreign Aid worth NPR 60.52 Billion, Foreign Loan of NPR 299.50 Billion and Internal Debt of NPR 225 Billion are to be sourced to fulfill all financial obligations under the budget. The budget intends to achieve an economic growth rate of 7% in the FY.

Headings	Amount (Billion NPR)	Percentage Composition
Expenditure		
Recurrent	948.94	64.35%
Capital	352.91	23.93%
Financial Provisions	172.79	11.72%
Total	1,474.64	
Revenue/Receipts		
Tax Revenue	889.62	93.63%
Foreign Grants	60.52	6.37%
Total	950.14	
Projected Budget Surplus (+)/Deficit (-)	-	
Projected Deficit Financing	524.50	
Foreign Loans	299.50	57.10%
Internal Borrowing	225	42.90%

It can be clearly observed that since the Tax Revenue is only able to cover around 61% of the expenditure need for the budget, there is a deficit of around 39% equating to NPR 524 Billion, which is expected to be covered through Foreign Grant worth NPR 60.52 Billion (4.1%), Foreign loans worth NPR 299.50 Billion (20.3%) and Internal Borrowing of NPR 225 Billion (15.26%). The planned increase in foreign and internal borrowing are substantial as there has been a sources crunch for the budget in the current FY due to the pandemic. However, these exhibit a substantial jump in borrowing for the nation and hence their efficacy will be a cause for concern.

A. Objectives:

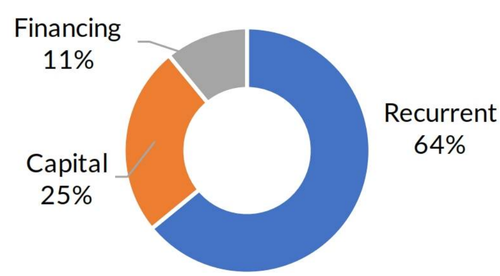
i. Easing and safeguarding the daily life of public by preventing the infection of contagious and all kinds of disease.
ii. Utilizing all means, resources, opportunities, and abilities to achieve immediate economic recovery and continuing the momentum of development.
iii. Increasing the state's fiduciary role by fulfilling the people's welfare and rights.
iv. Through development of social, economic, physical infrastructures making an empowering, sustainable, prosperous economy.

B. Priorities:

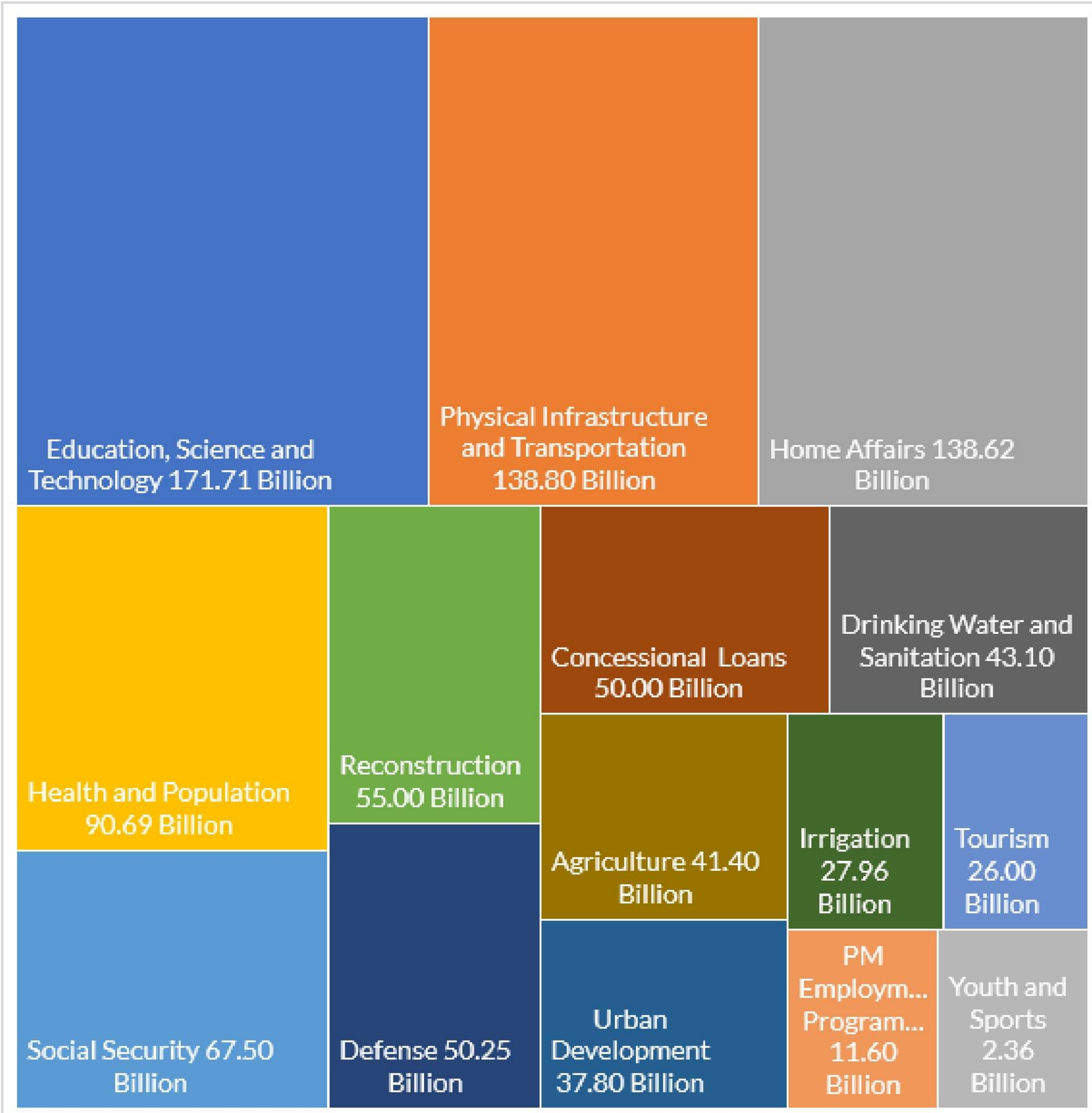
i. Improving the scope of health services, establishment and improvement of health infrastructures, and development of health manpower to safeguard the public from all kinds of health hazards including COVID 19, and to make qualitative health s ervice easily accessible to the masses.
ii. Re-establishing the discontinued production and exports value chains due to steps taken to control and prevent the Corona virus and recovering the affected sectors including agriculture, industries, tourism, and construction.
iii. Work and employment opportunities for the public, food safety, safe housing, long-term social safety, and conservation.
iv. Focus on development projects that can provide immediate return and that can be completed within the coming year.
v. Development and establishment of social, economic, and physical infrastructures related for qualitative practical education, extension of information technology, basic drinking water amongst others.
vi. Federation implementation, qualitative and accessible public services, and accountable and transparent governance improvement.

C. Expenditure Distribution

Recurrent Expenditure for the FY is budgeted at NPR 948.94 Billion, Capital Expenditure is Budgeted at NPR 352.91 Billion and Financial Management Expenditure is budgeted at NPR 172.79 Billion.



Sectoral Distribution of the budget for various specific areas is as follows:



As can be seen, the total tax revenue of the nation now cannot support even its recurrent expenditure which is a very worrying sign as we now basically have to borrow money just to keep the nation running as it is. There is an urgent need to cut unnecessary expenses which has not been forthcoming with the budget.

D. Implications

The major implications of the budget for various specific areas are as follows:

Health

Health sector has seen an increase in funding owing to the COVID-19 pandemic and the realization that our healthcare system is not able to handle even a small-scale outbreak of disease. Hence,

i. Budgetary provisions for establishing at least one infectious disease hospital in all provinces with a capacity of 50 Bed and another hospital in the capital with capacity of 300 Bed. This will be supplemented by having at least 250 ICU Beds in all hospitals in the national and provincial capitals.
ii. Establish small scale hospital in 272 local levels with 5-15 beds is also going create some economic opportunities while improving the quality of life for which Budget has been allocated of NPR 14.25 Billion.
iii. Facilities such as motivational allowance, health insurance of NPR 0.5 Million for front line health workers is intended to improve motivation levels.
iv. Provision of mandatory health Insurance for all in three years and earmarking of funds for covering 40% of total population for this year as a social security measure is sure to improve access to health but questions remain over integration with private hospitals. This has been allocated a Budget of NPR 7.5 Billion
v. Policy measures for establishing a Centre for Disease Control and Food and Drug Administration will modernize the health system greatly and is a welcome addition.
vi. Allocation of NPR 6 Billion to ensure availability of all medical equipment/resources required for the control and prevention of the CORONA virus and establishment of the necessary infrastructure for the same.

General Relief Measures

i. Refinancing Fund worth NPR 100 Billion to provide subsidized loans at 5% to COVID-19 affected SME and Cottage industries, manufacturing industries, Hotel and Tourism Enterprises was introduced to ensure cost of financing is low during these difficult times for hard hit industries which will help them recover faster in the long run.
ii. Payments for Social Security of employees of registered organizations during lockdown to be covered by government (recovery following normalization) for easing cash flow restriction and allowing for payment of remuneration to employees.

iii. Elimination of Demand Charge of Electricity for Industries with a 50% discount for electricity use during off-peak hours when electricity demand is very low. Provides relief to industries affected by the pandemics.

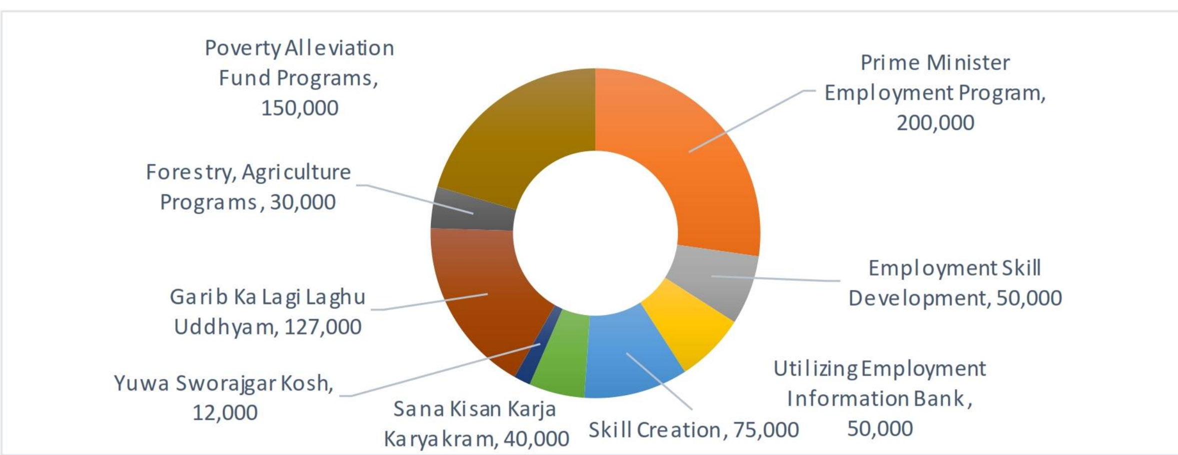
iv. Individual Daily wage workers not involved in local, province, or federal level, “Kam ko Lagi Khadyanna” program to be provided relief worth ¼ of Minimum Wage during Lockdown Period.

v. Provision to facilitate return of Nepalis stranded in foreign countries due to unemployment or lapsing of VISA/Licenses.

Labor, Employment, and Social Security

Jobs and employment creation programs planned with their respective investment and aimed Job Creation for Individuals and Returnee migrant workers are as follows:

Program	Employment Creation	Investment (In Billions NPR)
Prime Minister Employment Program	200,000	11.6
Employment Skill Development	50,000	1
Utilizing Employment Information Bank	50,000	1
Skill Creation	75,000	4.34
Sana Kisan Karja Karyakram	40,000	-
Yuwa Sworajgar Kosh	12,000	-
Garib Ka Lagi Laghu Uddhyam	127,000	-
Forestry, Agriculture Programs	30,000	-
Poverty Alleviation Fund Programs	150,000	19
Total	**734,000**	**36.94**



Travel and Tourism

i. Reduction in Aviation Fuel Tax and other taxes and service charges which reduces operating cost of airlines.
ii. Tax break of 20% for tourism related industries for the FY which for the time can help manage their cash flows.
iii. Keeps the door open for tourism holiday and extensive internal tourism in the FY after the resolution of current pandemic to uplift the tourism industry.
iv. One province one tourist destination is continuation for similar type of programs in the past but can add value if executed properly.
v. An allocation of NPR 1.26 Billion has been made for the identification of novel tourism opportunities and development of tourism infrastructures, in coordination with the private sector.

SMEs

i. Specialized fund worth NPR 50 Billion for providing subsidized loan at 5% to SMEs and Corona Affected Tourism Industries for covering operation costs and employee remuneration has been established to ensure companies can continue to operate above the red in these difficult times.
ii. In line with government policy of supporting small enterprises tax rebate of 75%, 50% and 25% to SMEs and Cottage industries with total revenue up to NPR 2 Million, NPR 2-5 Million and NPR 5-10 Million respectively.
iii. Extension of tax-free operation to 7 years for new SMEs from 5 years and 10 years from 7 years for those driven with women at the helm.

Agriculture

i. Provision of minimum support price for agricultural produce from this FY will ensure better prices for farmers and encourage them to produce more.
ii. Innovation fund worth 500 Million for funding new types of projects in various areas including agriculture.
iii. Establishment of pocket sectors for specific agricultural products in 250 local levels to promote specialized agriculture and reduce oversupply.
iv. Provision of paying premiums after production of crops for farmers will improve access to insurance to farmers who do not have necessary capital to insure their products otherwise.

v. Textile based agricultural produce that have higher economic value and can create employment opportunities such as silk, cotton, and wool to be provided grants.
vi. Government will support production and export of cash crops and medicinal herbs to improve balance of trade.
vii. Continuity of grants for fertilizers and sugarcane farmers so that production is cheap, and farmers can benefit through it and keep on producing.
viii. Discount on Taxes and Duties and subsidies for import of raw materials and instruments/machinery used in agriculture intended to encourage agricultural production.

Industries

i. Establishment of new industrial villages in 130 locations alongside new commercial roads to promote greater industry and productivity.
ii. 25% Tax Discount up to 5 years of establishment for Industries being established in the new industrial villages to promote the industrial villages as destinations for investment which will help drive planned industrialization.
iii. Improvement in Hedging Regulation can open newer industries to FDI as risk bearing mechanism becomes present.
iv. Refinancing Fund will be helpful in ensuring large industries can meet operational capital requirements.
v. Change in tariffs for Raw material against finished industrial goods with tariffs for raw materials being made cheaper to encourage value addition within the nation and increase further productivity.

Financial Sector

i. Policy for encouraging mergers of BFIs has been continued but with no additional financial incentives, this will not spur further M&As.
ii. Time extension for loan payment and insurance premiums is implicitly and explicitly endorsed with restructuring of concessional interest rates loans at 5%, and up to 50% of securitization and business insurance premium to be given as grant and assistance; Allocation of NPR 13.96 Billion has been made for the same.
iii. Digitization and cashless economy to be encouraged and the implementation of national payment gateway will facilitate the same.

iv. Provision for Interest Capitalization maybe upcoming with monetary policy based on the prevailing situation at that time. BFIs not benefited as expected by budget with NPAs expected to worsen and income to fall.
v. Automation of Stock Market and start of commodity trading with a fully-fledged Commodities Exchange should improve market conditions and drive better growth as access becomes better and more stability is provided as a result.
vi. Introduction of stock dealer is expected to play a stabilizing role with increased institutional investment in the capital markets.
vii. The Debenture market is expected to mature due to formulation of supportive policies and frameworks for trading.

Tax Implications

i. Increase in import duties of various agricultural produce to promote better domestic consumption and discourage import of agricultural produce.
ii. Small taxpayers can pay taxes online and get tax clearance which improves tax administration.
iii. Provision on tax discount on lump sum payment for pension schemes that get added to Social Security fund (6% to 15% on final claim amount) introduced to make switching to SSF lucrative.
iv. Contributions made by any person to Government, province or state level Corona infection, prevention, control, and treatment Fund shall be deductible from income tax.
v. For FY 2077/78, wages provided to the Labor not having PAN to the extent of NPR 3,000 shall be Tax deductible expenses.
vi. Most concessions and exemptions previously granted to special industries (Manufacturing Industries) are now also granted to Tourism Industries (excluding casinos).

Impactful Provisions

i. Nepal to become energy self -sufficient in the coming FY as 1300+ MW to be added to national grid and promote energy trading.
ii. Contract and temporary employees in government institutions to be enrolled in SSF to improve its goodwill and reach.
iii. Continuation of work in projects of national pride and similar infrastructure projects with addition of Mahakali Irrigation project as that of National Pride Project.

iv. No change in tax slab for individuals and no change to salary of civil servants in the budget.
v. Day time tiffin program extended to all districts and expected to benefit many children and improve retention rate in schools.
vi. Cost of Social Security has reached 67.5 Billion which is 4.6% of total budget and will need restructuring in future for sustainability.
vii. Various skills development and employment programs to manage internal unemployment and people who might be back home due to COVID-19 from abroad.
viii. Digitization of 10 Million records of citizens to move towards national ID Card in three years for better governance and data tracking.
ix. Anti-dumping regulation will be implemented to discourage imports of substandard FMCG products and supervision will be strengthened to control fake FMCG products and for quality control.
x. Tax breaks on certain industrial raw materials.
xi. Continuation of provision of land bank from previous budget, where land can be taken in lease to establish large projects.
xii. Establishment of satellite cities around Kathmandu valley for better urbanization and improved quality of life.
xiii. Tax discounts for Telecommunication companies and Medicine companies as they are essential in these trying times to keep people healthy.
xiv. Deduction in various allowances of civil servants is done more as a token measure in favor of actual restructuring and cost reduction.
xv. Establishment of 39 border check outposts and regional airbase for Nepali army to improve border security and national security.

Change in Taxes and Charges

i. Health hazard tax: 25 paisa per unit of cigarette, 50 paisa per unit of cigar, NPR 40 per kg of tobacco, khaini, gutkha.
ii. Education service fee for Foreign exchange for students availing foreign currency for education fee shall be charged 2%, banks and financial institutions collecting such Education service fee shall deposit the same with the inland revenue office within 25th of the next Nepalese month.
iii. Infrastructure development tax: NPR 10 per liter of petrol and diesel on import at customs point.
iv. Pollution control fee: NPR 1.5 per liter of petrol and diesel sold and distributed within Nepal.

v. Additional Road Construction Tax on the import and registration of vehicles, 5% (for electric vehicles) to 8% on 4-wheeled vehicles, and from NPR 15,000 (Scooters up to 155 cc) to NPR 20,000 to two wheelers based on engine displacement size.

vi. Casino Royalty of NPR 40 Million and 10 Million on use of modern equipment and machinery.

Changes in Customs and Excise Duties

Increase in Customs Duty

Description	Previous Rate	Revised Rate
All Motor Parts	15%	20%
Refrigeration Equipment	15%	20%
Parts for Refrigeration Equipment	15%	20%
Gold Plating Powder (Per 10 gram)	NPR 75	NPR 85
Gold Plating on Platinum (Per 10 gram)	NPR 6,500	NPR 8,500
Faux Pearl, Incomplete faux precious stones, and cosmetics such as Tika, Chura, Pote	15%	20%
Small statues, Decorative Objects made of ceramic/mud	10%	15%
Blocks Used in Construction	15%	20%
Seeds	10%	15%
Spices	10%	15%
Tea, Coffee	10%	15%
Alcoholic raw materials used for producing wine, brandy, whisky, rum, gin, and vodka (Per Liter)	NPR 1,200	NPR 1,500
Chemical Fertilizer	0%	5%
Organic Produce	5%	10%
Film Development Materials	15%	30%
Polymer Based Objects/Utilities	15%	30%
Fevicol/Binding Agents	15%	20%
Ropes, Fibers	10%	25%

An increase in the customs duty for seeds and chemical fertilizer is indicative of a disjoint policy for the promotion of agriculture in the country. While the budget is focused on modernization of agriculture for improvement employment and increase economic activity, it seems counterintuitive to increase tax burdens on agricultural raw materials especially when local alternatives are rare and cannot assure adequate quality. However, this might also be indicative of a push to promote local production of raw materials for agriculture which would help local institution compete better with cheaper foreign counterparts. Nonetheless, there could have been other policy initiatives such as tax discount or grants to encourage the same without needing to add to the capital requirements for cash strapped farmers.

Decrease in Customs Duty

Description	Previous Rate	Revised Rate
Chocolate and raw materials for cake	40%	30%
Flour, Soy Powder	20%	15%
Inner wear, cotton clothes, Track suit and jerseys	20%	5%
Cloth based headgear for women	20%	5%
Electrical Equipment and Parts	15%	5%

Changes in Excise Duty

Description	Previous Rate	Revised Rate
Fresh Chilled Fish, Meat packing materials	-	5%
Forzen/ Powdered Packed Meat Products	-	5%
Fresh/Powdered Khajur, Chokada, Grapes, Mango	-	5%
Sugar Molasses/ Bheli (Per Quintal)	-	NPR 125
Vegetables/Fruits preserved in Vinegar, Acetic Acid	-	10%
Pan Masala without Toabcco Leaves (Per Kg)	-	NPR 650
Tobacco Leaves with stem.	-	NPR 95
Slate Rock	-	5%
Lead Acid	-	5%

Change in Excise/Custom Duty for EVs

<table>
<tr><th rowspan="2">Description</th><th colspan="2">Previous Rate</th><th colspan="2">Revised Rate</th></tr>
<tr><th>Excise</th><th>Customs</th><th>Excise</th><th>Customs</th></tr>
<tr><td>Hybrid Vehicles</td><td>10%</td><td>Nominal</td><td>60%</td><td>80%</td></tr>
<tr><td>Pure Electric</td><td></td><td></td><td></td><td></td></tr>
<tr><td>Three wheelers</td><td rowspan="5">10%</td><td rowspan="5">Nominal</td><td>5%</td><td>30%</td></tr>
<tr><td>50 KW</td><td>30%</td><td>80%</td></tr>
<tr><td>50 to 100 KW</td><td>40%</td><td>80%</td></tr>
<tr><td>100 to 150 KW</td><td>50%</td><td>80%</td></tr>
<tr><td>150 to 200 KW</td><td>60%</td><td>80%</td></tr>
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200 to 300 KW		70%	80%
More than 300 KW		80%	80%
Other		60%	80%

The sudden increase in customs and excise duties for electric vehicles showed a significant departure from past policies of keeping tariffs and duties low to encourage proliferation of EVs in the country specially at a time where Electricity Production is finally going to exceed aggregate demand. The new tax formula has raised the total tax to between 120-140% which would price battery cars higher than a petrol or diesel car of the same size.

The shift seems to be driven primarily by the high cost of EVs as opposed to ICE vehicles which are expensive for customers on the back of huge custom and excise duties but do not affect national account significantly besides their tax contributions. Large imports of EVs would thus affect the gradually improving Import to Export Ratio and more importantly put pressure on FX reserves which is sure to experience a decline due to falling Remittance Numbers and Tourist Expenses on the back of the pandemic. Another rationale might be behind the proliferation of expensive EVs that are classified by the government as luxury goods instead of basic amenities and would thus warrant in premium due to the same. However, it is highly likely that the government could be pushing for manufacturing and assembly of EVs in Nepal opposed to import through the policy as the availability of cheaper electricity can be the drives for creation of good market for EVs in Nepal.

Key Takeaways

With the impact of COVID-19 and policy measures put in place to control its spread, Nepal's Economy faces a huge challenge akin to or greater than that experienced following the Gorkha Earthquake of 2015. The additional caveat being that besides affecting domestic industries hard, this pandemic has resulted in a direct impact on remittance coming into the country and presents a prospect of reverse migration of workers to the country. These are both scenarios Nepal has not been privy to since remittance income started playing a major role in the national economy some two decades ago.

This is further compounded by a major impact on majority of private enterprise with mobility limited tremendously and overall consumption declining on the back of stay at home measures. Hospitality and Travel related businesses are the worst hit with tourist numbers hitting almost zero in the last month as all travel within and beyond the country at a standstill since the lockdown measures took hold more than two months ago. The financial sector is also feeling the effects of a drop in interest rates (Mandatory Rebate) for loans to businesses directly affected by the pandemic which is beginning to show in their finances.

Hence, there was an expectation that the new budget would introduce substantial measures to help ailing private businesses and the financial sector. And while certain measures such as the increment of the refinancing fund, concessional loans for covering employee expenses alongside tax breaks and discounts on electricity charges were instituted , covid-19 related measures mostly pertained to increasing funding for the health sector, additional focus on employment generation, and tax breaks for travel and hospitality as well as SMEs. While these were good measures providing relief to the affected businesses, larger private institutions and BFI's did not experience significant relief as opposed to SMEs which the budget catered more towards. However, the monetary policy which is due in two months can be expected to be provide additional relief for BFIs and banked businesses if the current situation persists.

Completion of credit rating of Nepal, alongside amendments in hedging regulations, introduction of stock dealer company in the stock exchange and the prospect of Electricity self-sufficiency and trade as well as the completion of post-earthquake reconstruction point to a positive outlook for the nation. The growth in number of taxpayers is substantial owing the policy of mandatory PAN and the budget has effectively endorsed the Millennium Challenge Compact as being operational without conclusion of its ratification in parliament.

Overall, the budget addresses the basics and carries on with the socialist government policy of favoring smaller enterprises and measures for health service improvement and creation of employment which the budget makes good strides towards. There are few exciting programs and most projects are extensions of running budgeted programs. Besides the inclusion of Mahakali Irrigation Project as national pride project, all other infrastructure projects are carried over from the last budget. In this regard, the budget is functional and not flamboyant and has made necessary tweaks to improve key policy initiatives such as the SSF; Therefore while the lack of "perceived game changing projects" may not be in line with the governments past policies; A functional and incremental budget during tough times is not necessarily nonideal.