GLOBAL CRISIS, POLICY CHANGES AND THEIR IMPACT ON NEPAL'S FINANCES AND TAXATION POLICIES:

BRIEF ASSESSMENT

National Campaign for Education Nepal (NCE Nepal)

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Global Crisis, Policy Changes and Their Impact on Nepal's Finances and Taxation Policies: Brief Assessment

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Published Date:
June 2023

Support:

Design and Production: Pentagram Pvt. Ltd.

CONTENTS

01

INTRODUCTION

Today the world is facing deepening crisis[1] in several fronts through multiple channels. At a time when world was confronting with devastating impact of COVID-19 and worsening climate crisis, the Russian invasion of Ukraine has fuelled socio-economic crisis further.

The most important consequence of the war in Ukraine is that the loss of life and humanitarian crisis is mounting along with displacement and forced migration of millions of people. The adverse economic consequences of the war have been highly pervasive across the globe. The most sufferers have been the developing countries in general and least developed countries (LDCs) in particular[2]. Though the magnitude of medium to long term socio-economic impact is still uncertain which, to greater extent, will depend on the duration of the war as well as coordinated policy responses, the threat of recession[3] in the global economy is growing with likely more severe adverse implications on the developing and LDCs to revive their COVID-19 damaged economies and move ahead toward accomplishing the SDGs within the stipulated time. Amidst triple crises—pandemic, climate and war-the fragmentation of the world economy into geopolitical blocs[4], intensified rivalries, diversion of resources to the war and unilateral policy moves of some of the dominant advanced countries added by protectionist tendencies and de-globalization practices are posing more challenges to cope with the swelling multiple crises. Notwithstanding some of the new or extended support schemes by the multilateral agencies to the most affected developing and LDCs alike with new trusts on policy shifts in the post pandemic period[5], refocus on austerities though in a different way amidst multiple fragilities, weak or lack of policy coordination at the global level and danger of resource outflows are adding downside risk and threat to the economies of most of developing and LDCs.

In such an adverse global outlook, unfavorable policy environment and threat of prolonging of war, LDCs like Nepal may face more difficulties to overcome from the looming bigger crisis in the economy and move ahead towards bringing economic prosperity in the country and fulfilling the SDGs commitments within stipulated time. Nepal has also committed to graduate Nepal from LDC category to the developing one by 2026 which if materialized by ensuring sustainability would be a milestone for the SDGs. Noticeably, this calls for a big jump in per capita income and rapid progress in access to health and quality education apart from minimizing economic and environmental vulnerabilities. Therefore, ascertaining of likely adverse implications of global crisis and policy changes on the Nepali economy focusing on financial flows and taxation policies would be crucial from short to long term policy standpoints in these areas.

In this paper below, at first a brief examination on the ongoing global crisis, policy changes and their broad impact on the global economy with focus the developing and LDS is made. An assessment on their impact on the Nepali economy in general and financial flows and taxation policies in particular follows this. The probable implications on the education budget of Nepal is also apprehend in the same section. Last section is devoted to present the lessons to be learned and way forward.

[1]The World Bank President has termed today's crisis as development crisis. See Malpass 2022.

[2]Most of the recent global economic forecasts by showing bleak prospects of most of the developing and least developed countries corroborate this. See, for instance, UN 2022 and IMF 2022.

[3]Studies examining more exclusively the impact of war reveal more pervasive impact of war than earlier assumed (See World Bank 2022 and OECD 2022). Consequently, there are continuous downward revisions of the forecasts. For comparisons see 2022 April and October forecasts of the IMF. Grounded on the worsening short to medium term outlook of the global economy, a World Bank study indicates on the possibility of recession in the global economy in foreseeable future. See Cerdeiro, Kothari and Chris Redl 2022.

[4]Very recent IMF study shows that how economic fragmentation will impact the global economy in general and economies of the Asia and Pacific countries in particular. See Georgieva 2022.

[5]Certain policy shift of the multilateral agencies is evident in the post pandemic period since they focus on green, resilience and inclusive development (GRID). Similarly, in the post pandemic period some new funding schemes to the low income countries have been introduced.

02

GLOBAL CRISIS, POLICY CHANGES AND IMPACT

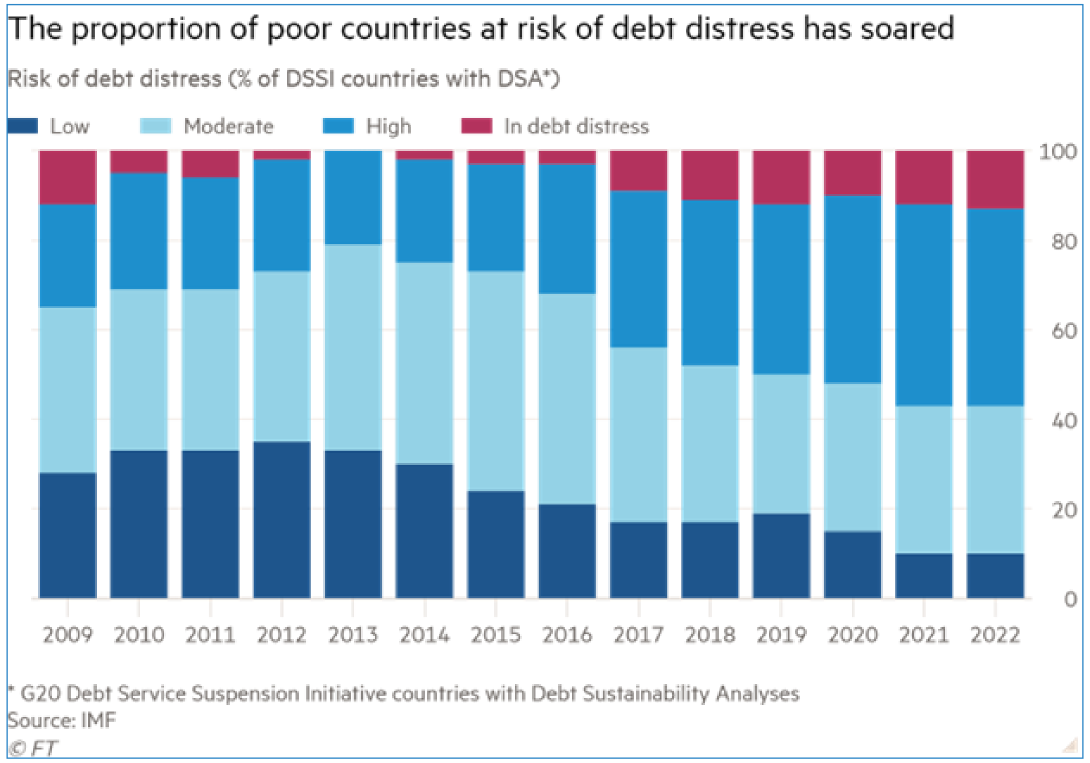
Prior to the Russian invasion in Ukraine, the world economy was gradually picking up. From 3 percent negative growth in 2020, there was a positive growth of 6 percent on the average in 2022 with rising hopes of speedy recovery in the global economy[6]. However, despite such a positive development from the overall growth perspectives, countries were still facing problems in many other critical fronts in the aftermath of COVID-19 pandemic. As a result of massive fiscal stimulus introduced through quantitative easing, ultra loose monetary and credit policies as well as other means used to cope with health, humanitarian and economic crisis simultaneously[7] added by disrupted supply chains, developed countries were struggling with mounting inflationary pressures and rise in debt outstanding markedly[8].

Now an explosive situation has emerged in both developed and developing countries in the debt front as a result of massive rise in both public and private-sector debt. In the private sector, mounting of debt includes that of households (such as mortgages, credit cards, auto loans, student loans, personal loans), businesses and corporations (bank loans, bond debt, and private debt), and the financial sector (liabilities of bank and nonbank institutions). In the public sector, it includes central, provincial, and local government bonds and other formal liabilities as well as implicit debts such as unfunded liabilities from pay-as-you-go pension schemes and health-care systems. It is reported that globally total private- and public-sector debt as a share of GDP rose from 200 percent in 1999 to 350 percent in 2021. The ratio is estimated to be 420 percent across advanced economies and 330 percent in China now. In the United States it is estimated to be around 420 percent which is higher than during the Great Depression and after World War II. Worse, these developments are coinciding with the return of stagflation (high inflation alongside weak growth)[9].

In the low-and middle-income countries' the debt levels have reached to a 50-year high. With soaring inflation, rising interest rates, and the strengthening US dollar, their debt-service burdens are compounding leading to upholding of crisis in several countries of the developing world. It is reported that there are 53 highly vulnerable countries that have either defaulted on their debts or are at high risk of debt distress[10]. According to the World Bank Debt Report 2022, nearly 60 percent of all emerging and developing countries have become high-risk debtors. Kristalina Georgieva managing director of the IMF has stated[11] that about 15 per cent of low-income countries are already in debt distress and an additional 45 per cent are at high risk of debt distress. Among emerging markets, about 25 per cent are at high risk and facing default-like borrowing spreads. Sri Lanka, Ghana and Zambia are already in default. This year may prove devastating for the developing world, as more and more countries find themselves engulfed in debt crises. Several (Lebanon, Sri Lanka, Russia, Suriname, and Zambia) are already in default.

More worryingly, in recent years not only the level of debt has increased phenomenally but also the structure of the debt has also changed dramatically with fuelling of debt servicing liability. For instance, the graph presented below shows that in between 2000 and 2021, the share of public and publicly guaranteed external debt of low and lower-middle income countries (other than that held by IFIs) owed to bondholders jumped from 10 to 50 per cent, while the share owed to China rose from 1 to 15 per cent. At the same time, the share held by the 22 predominantly western members of the Paris Club of official lenders fell from 55 to 18 per cent. Such a composition apart for escalating the debt servicing liability has also additionally complicated the problem of debt restructuring.

Graph 1: Proportion of Poor Countries at Risk of Debt Distress



6 See latest October forecasts of IMF 2022. See also IMF forecasts of 2021 (April and October) for comparisons.

7 Studies show that in the developed countries the fiscal stimulus was in the neighborhood of one forth of GDP compared to 3 to 5 percent of GDP in most of LDCs and developing countries respectively.

8 How the bdebt problem has augmented in both developed and developing countries see World Bank 2022 b.

9 Large number of global, regional and country level studies carried out to examine the COVID-19 corroborates this. Emerging problems of resource gap in the LDCs especially from the point of SDGs is exhaustively discussed in UN 2022 and 2019. Similarly, the UNCTAD study shows that the gap in financing to achieve SDGs (for instance ending poverty and halting climate change), would be in the order of $17.9 trillion for the period 2020-2025. It adds that this puts the current annual gap at $3.6 trillion, excluding the effects of the Ukraine war.

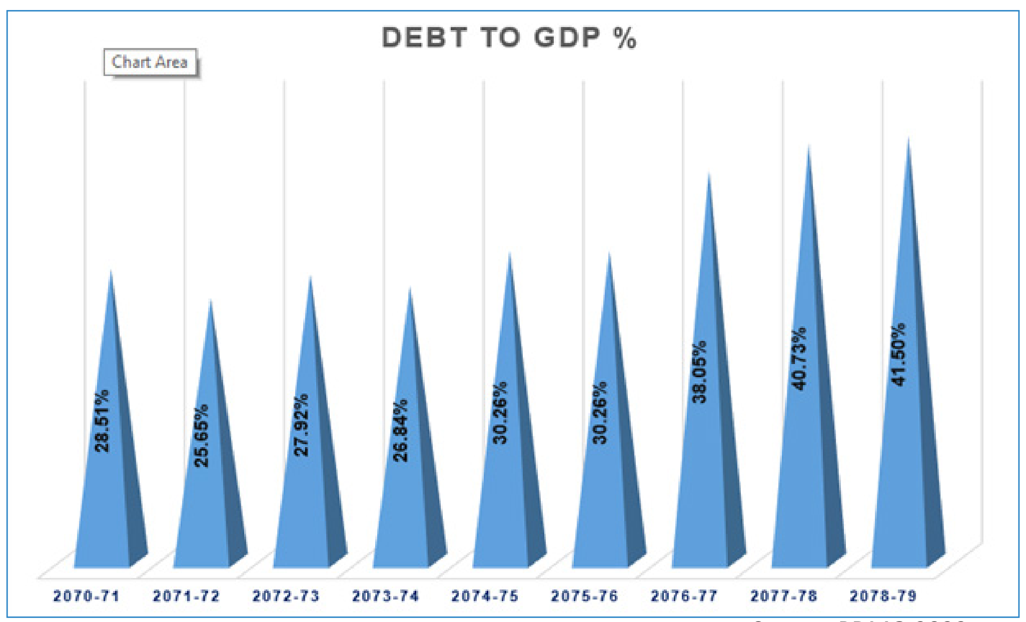
10 Still this is a more positive outlook in view of number of studies including the World Bank 2022 indicating a threat of recession in 2023. Prior to the G20 meeting in Bali the IMF also warned that the economic situation could deteriorate more than what were shown in the October forecast.

11 See IMF 2022 October forecasts. Moreover, as per the assessment of the IMF prior to the recent G20 meeting held in Bali, Indonesia, Jakarta there is a threat of further deteriorating of the economies of G20 countries.

A survey based on 107 countries shows that increased government spending coupled with decreased revenues from exports, remittances and taxes throughout the pandemic has left majority of low-income countries in debt distress or at moderate to high risk. It adds that with debt levels growing faster than revenues, many countries are increasingly spending higher proportions of their budgets on servicing debt rather than investing in public services and infrastructure. It indicates that in 2020 one- third of the low- and lower middle-income countries spent more on servicing external debt than they did on education. It based on the World Bank's Macro Poverty Outlook data on interest payments combined with the Education Finance Watch 2022 data on government spending on education through 2020 points out that fiscal space in low and lower middle income countries will be constrained by the debt in the coming years as a result of reduction in the space for education and other social sector funding. It further points out that with debt payments climbing to nearly 10 percent of national budgets on average across low-and lower middle- income countries by 2024, ambitions for education spending to reach 20 percent of the budget may become further out of reach[12]. Climate change additionally is exacerbating financing challenges, particularly in vulnerable countries including Nepal[13].

Like many other low income countries, Nepal also faces mounting debt and debt servicing problems in recent years after steady decline for some years especially after the payment of internal debt by the government guaranteed loan. The debt distress is narrowing down the fiscal space leading to very adverse effect on the government funding of education and other social services programs. As is explained below, large reduction in government spending in education along with fast rise in debt serving partly corroborates this. The three graphs on total debt outstanding to GDP ratio, recent trends in the level of total external debt outstanding (bilateral and multilateral separately) and debt servicing to GDP ratio clearly entail that debt servicing problem could be a big constraint for Nepal to increase resource allocations to the education services in a required large scale .

Graph 2: Total Debt Outstanding as a Share of GDP

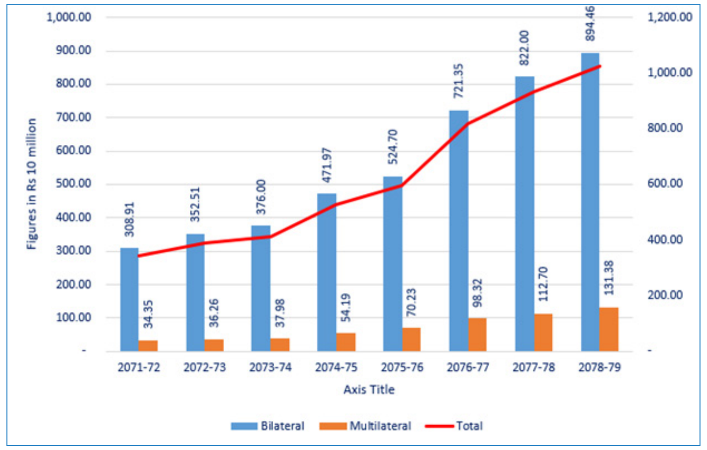


Source: PDMO 2022.

[12]For details on the effect of war on trade and investment see, among others, World Bank 2022.

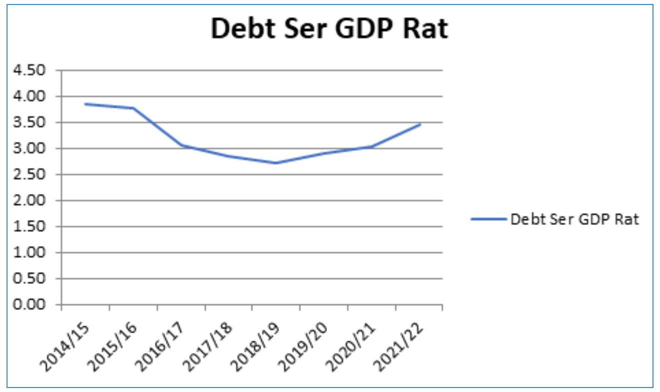
[13]The price rise in US has been historically high. Besides European countries almost all developing and LDCs are facing big pressures on prices.

Graph 3: Total External Bilateral and Multilateral Debt



Source: PDMO 2022.

Graph 3: Total External Bilateral and Multilateral Debt



Thus, prior to the Ukraine war, the developing and LDCs were facing fragile economic recoveries added by the problem of rising poverty, deepening inequality, enlarging socio-economic vulnerabilities and mounting resource gaps amidst mounting debt distress[14].

In such a situation, the Ukraine war has not only adversely affected the global economic revival process but also has aggravated many problems that were being continuously fought by various countries to minimize or overcome from the COVID-19 impacted quandaries.

A comparison of global economic outlook prior to Ukraine war and recent forecasts reveals how the war has impacted the global economy. The October forecasts of IMF show that growth of the global economy will reduce to 3.2 percent in the current year 2022 from 6.0 percent in 2021. It also predicts that the growth will further slowdown to 2.7 percent in 2023[15]. Such a growth rate will be the lowest since 2001 except for the global financial crisis year and the acute phase of the COVID-19 pandemic. Similarly, global inflation has been forecasted to be 8.8 percent in the year 2022 from 4.7 percent in 2021[16]. Such an average high inflation rate is very rare in recent years at the global level.

The most adverse impact of Ukraine war has been experienced through trade and investment effect. The effect, in turn, has been transmitted through channels such as commodity market (particularly through food and energy), logistic networks, supply chains, foreign direct investment, among others[17].

The food and energy crisis added by fueling of inflationary pressures[18] are the most dampening impact of the war as Russia and Ukraine are among the top seven global producers and exporter of wheat, corn, barley, sunflower seeds, and sunflower oil. Russia is also a major supplier of fossil fuels, such as crude oil and natural gas, in addition to fertilizer and agricultural commodities. Disruptions on the supplies of these products are fueling the prices with negative impact not only on global trade but also

[14]World Bank 2022b.

[15]See for such data and analysis UN 2022 a.

[16]See UN 2022a.

[17]Understandably, if interest rate in US is made high that instantly attracts investment from rest of the world. At the same time, it leads to appreciate the dollar correspondingly. This is what is happening in the US today. The major problem is that as being the international reserve currency, this further attracts financial flows/investment particularly from the developing and LDCs because of the possibility for high and secured return in the US. The outflow from developing countries is mainly due to this reason. Being an international reserve currency some coordinated policy was essential at least through multilateral institutions like the IMF in order to ensure that the US policy moves do not additional hurt economies of other countries markedly amidst adverse effect of war.

[18]See UNCTAD 2022 which very exhaustively has outlined how the impact of interest hike could be devastating. It more candidly argues that monetary and fiscal policy moves in advanced economies risk pushing the world towards global recession and prolonged stagnation, inflicting worse damage than the financial crisis in 2008 and the COVID-19 shock in 2020.

on people's welfare. As the World Bank study indicates, the contraction in exports leads to contraction in global income by 0.7 percent with low-income countries losing the income by about 1 percent[19]. Likewise, war is adversely affecting the services trade in general and tourism industry in particular with very unfavorable situation to many low-income countries which heavily rely on tourism for their country's economy and people's livelihood.

Though the direct effect of war on global FDI is limited except in neighboring countries of Ukraine, indirect effect is becoming deeper and far-reaching as a result of increased uncertainty and geopolitical risks leading to jeopardizing of investor's confidence. This is dampening the prospect of rise in FDI in developing and LDCs which is essential to them for the revival of their economies and boost socio-economic development. Amidst such a grim outlook on the FDI, the tightening of global financing conditions in a situation of rising inflation pressures is putting more countries at the risk of debt distress as already indicated and shrinking of fiscal space with, among others dampening effect on economic growth.

The fiscal stress during the pandemic and economic revival period followed by financial tightening faced by the developing and LDCs today has further augmented "great financial divide" between the developed and developing countries[20]. As well known, developed countries borrowed record sums at-low interest rates to support their economies and people throughout the pandemic and economic revival period. Conversely, the pandemic response of poor countries was highly constrained by the lack of fiscal space emanating from the decline in tax revenue in a situation of sharp contraction in economic activities. This had forced many low income countries to reduce investment in education and other productive areas which are yet to be brought to the pre-pandemic period[21]. The irony of the dominant global economic system is that today also the developing and LDCs are suffering more pervasively due to unilateral policy moves by the western developed countries in, among others, monetary fronts to cope with own generated inflationary pressures which augmented during and in the aftermath of pandemic and fueled after the Ukraine war. Today a phenomenal rise in interest rate in a phased wise manner has taken place in the US and European countries with most adverse effect on the global economy in general and developing and LDCs in particular. The impact has become more harmful in the developing countries and LDCs due to US dollar being the international reserve currency[22]. As pointed out by the UNCTAD Report 2022, long term impact of interest hike in the US could be devastating to the global economy. As report indicates, it may have more debt crises and defaults, significant output losses, higher unemployment, and sharp increases in inequality and poverty[23]. UNCTAD estimates that US interest-rate increases may reduce the future income of developing countries (excluding China) by at least $360 billion. As an offshoot, the report points out that every percentage point rise in the Fed's key interest rate may lower economic output in rich countries by 0.5 percent and by 0.8 percent in poor countries over the next three years. The problem is that while making unilateral policy moves[24] the probable consequences on the developing countries is hardly considered.

It is clear that the rise in interest rates accompanied by highly volatile bond markets may push many low income countries closer to default. More worrying phenomenon is that such a monetarist approach with exclusive focus on demand management through monetary instruments cannot be effective in a given situation in which the inflationary pressures are driven by supply-side constrictions, higher speculations and profit-gouging by major corporations[25].

More worrying phenomenon is that despite stresses on

[19]While taking unilateral policy decisions no coordination with multilateral agencies like the World Bank and the IMF is taking place which could be essential given as already indicated due to dollar being the reserve currency, among others.

[20]Such findings are very exhaustively discussed in UNCTAD 2022.

[21]Though the hangover of the neo-liberalism rooted primarily in monetarism is still there, the little space in it or failures has now enhanced the role of the fiscal policy to a greater extent, more so in the context of developing and LDCs.

[22]Noticeably, it is seen that after the deeper crisis aggravated in Sri Lanka and Pakistan there are attempts to bring some structural changes in the tax system by raising the income tax rates and slashing the VAT rates besides cutting energy subsidies massively. See for details SAAPE 2022.

[23]How the system has encouraged tax evasion and illicit flows limiting the huge revenue mobilization possibility see TJN 2021.

[24]SNCTAD 2022. For more dated data and information see World Bank 2022b.

inclusive, resilient and sustainable development in the aftermath of pandemic which by implication indicates on the need of supply side policy focus including focus on productive capacity enhancement and protection of people from vulnerability, multilateral donors like the IMF are continuously pushing for the restrictive fiscal policy regime. The IMF policy conditions still focus on narrowly specified objectives of debt and fiscal sustainability and serve the interests of powerful private sector financial institutions. The restrictive fiscal targets have led to a decline in public-investment-to-GDP ratios in many countries. However, as the experience indicates, due to often unrealistic conditions for fiscal consolidation, they have led to increase in the debt level further with new restrictive budgetary conditions for additional loans. Largely, austerity policies rather than solving debt sustainability problems have exacerbated inequalities, restricted economic activities and increased unemployment leading to the reduction in tax revenues with further shrinking of fiscal space[26]. Thus, the concealed motive is that the role of the monetary policy is continuously preserved and expanded by restricting the role of the fiscal policy in which role of the state comes to the forefront.

However, due to less effective or counterproductive role of the monetary policy in addressing the crisis of the economies as indicated above the importance of the fiscal policy has greatly enhanced today[27] which simultaneously requires that the conditions of fiscal consolidations limiting the fiscal space and hurting the economies of the low income countries are stopped. While activating or reviving the role of the fiscal policy, it should be recognized that the role of the taxation policy becomes vital in the developing and LDCs alike for mobilizing resources, creating business and investment environment, promoting green economy and enhancing equity in society. After the pandemic, there is increased emphasis on the need of wider reforms in taxation system in both developing and LDCs. Today as a part tax policy reform emphasis is on expanding the revenue base of the direct taxation which if implemented properly can not only enhance resource mobilization internally but also can reduce revenue dependence on indirect taxes in general and external trade based revenue reliance in particular besides augmenting equity in society. But despite such a policy focus, the taxation system is yet to be reformed in the desired direction.

Needless to add, domestic resource mobilization, with progressive taxation at its centre, is key to sustainable and democratic financing for education and other rights and the best solution to tap the gap for the estimated trillions of dollars needed to achieve the SGDs. This is to a greater extent is associated with tax justice system. Tax justice system refers to both fair domestic and international resource mobilization, such as progressive taxation, where those with a higher income pay more. Regressive taxation would mean the poor pay a greater proportion of their available resources than the rich (consumption taxes which employ a flat rate such as VAT are the best examples). Taxes can be made more progressive with well designed scales and thresholds[28].

The tax regimes tend to be regressive with excessive dependency on indirect taxes predominated by Value Added Taxes or Sales taxes[29]. Such a tax system provides low level playing field to the domestic investors or creates negative protectionism to the business and industries, encourages large scale evasions and distortions practices leading to erosion in tax bases, revenue losses in big scales, decline in revenue generating potentiality and escalating inequality in societies, among others. The discriminatory, biased and unjust tax system has been driven by interlinked domestic and international tax malpractices. It is estimated that figure of tax revenue lost each year to global tax abuse is US $ 483 billion. The amount lost to tax evasion (illegal) and tax avoidance (legal but morally wrong done through exploiting tax loopholes)

[25]An Oxfam study (2021) finds that the IMF that provided 85 percent support to the pandemic related expenditure through the emergency lending facilities, the Rapid Credit Facility (RCF) and the Rapid Financing Instrument (RFI) etc. had embodied the condition of undertaking fiscal consolidation, i.e. austerity, during the recovery period.

[26]For details see Isabel Qrtiz and Mathhew Cummins (9 Dec 2022) www.endiningtheausteritypandemic.org.

[27]In a recent paper (November 28, 2022)Suma Chakrabarti and Chris Humphrey indicate that, on average, the World Bank takes more than two years to process a loan, from conception to the first disbursement of funds. It further points out that the waiting period could be considerably longer for complex infrastructure projects (www.rebbotingtheworld bank. project syndicate.com).

[28]UNCTAD 2019.

[29]For details see TJN 2021.

amount to minimum of US $ 100 billion annually (with some studies pointing at US $ 200 billion per year). It is estimated that as a result of misinvoicing, a common practice that consists in deliberately misreporting the value of a commercial transaction to customs, there is a loss of US $ 800 billion annually for developing countries alone[30]. Thus, it is clear that the states are not doing enough to control elicit financial flows despite some new initiatives.

It is noteworthy that in a precarious situation of fiscal stress in the low income countries, some steps were taken by the international community to address the socioeconomic crisis faced by them due to COVID-19 pandemic. A new allocation of special drawing rights (SDRs) equivalent to US $ 650 billion was made with the provision of emergency financing. Similarly, debt service suspension initiatives (DSSI) were taken by the G20 countries for certain period to provide financial relief to the debt distressed countries. Likewise, multilateral donor agencies including the IMF and the World Bank took number of initiatives to support the developing and LDCs during the pandemic which, in many cases, have been continued to support the economic recovery. By pushing a new GRID approach taking pandemic and climate led crisis into account, multilateral donors have already started funding new projects linking with it which, apparently, is a positive step in view of more conservative funding approach in the past.

Notwithstanding the positive contribution of such initiatives, these have been highly inadequate and less supportive to the needs of the developing and LDCs. The LDCs are continuously demanding for the debt relief rather than debt suspension for certain period amidst, as already indicated, debt emerging a bigger problem in recent years which is further limiting their investment capacity partly constrained by rising debt servicing liabilities[31]. Likewise, the allocation limitations of SDR hardly met the need of these countries. This was the reason of strong demands for the allocation of at least SDR equivalent to US $ 2 to 2.5 trillion to support the most suffering developing and LDCs. At the same time, despite commitment to break from the past and support in a more generous way, the irony is that the financial support provided during the pandemic also had attached conditionality[32]. Noticeably, as already indicated, multilateral agencies like the IMF instead of using the word austerity have now started talking about fiscal restraints which by implication are fiscal consolidations. Hence they undermine the vulnerabilities and looming crisis in the developing and LDCs. This has again generated big debate. People are questioning such an approach rooted in neo-liberal orthodoxy[33]. Added problem is that the lengthy process of project lending being detrimental to the economic recovery or fast development is yet to be reformed[34].

More concerning is that in a situation of financial tightening through higher interest rates followed by appreciation of dollar, less conducive environment to the aid and growing resource outflows from the developing and LDCs coupled with many problems in the taxation system, parallel attempts of decoupling, de-globalization and protectionists' practices are continuing. The trade war between USA and China is intensifying further through tariffs, trade restrictions or ban. After Russian invasion of Ukraine, a policy of trade and financial embargo has been employed by the US and EU. The recent Inflation Reduction Act 2022 of the US has generated controversy as it provisions subsidies to various US made products. With rise in ultra nationalist forces in number of countries, the threat of further rise in protectionism has increased. In an unfair global trading system, such tendencies are additionally hampering trade in general and export trade in particular of the developing and LDCs with wider ramifications on the ongoing measures to minimize the adverse impact of pandemic and war and create suitable conditions for reviving the economies smoothly. This in turn has posed added challenges of mobilizing resources either internally or through international trade based revenue

[30]Going through literature it is seen that now almost all UN agencies and other multilateral donor agencies including World Bank and IMF are arguing on the need of introducing some form of such taxes. Countries like Sri Lanka facing unprecedented crisis are seriously considering introducing such taxes.

[31]In a very recent paper (Dec 2, 2022) www.theunaaoidablecrash.projecsyndicate.org Nouriel Roubini by exemplifying the limitations of the ongoing policies in tacking the mammoth rise in private and public debt and inflationary pressures concludes that there is a likelihood of unavoidable crash. His argument is that mother of all stagflationary debt crises can be postponed, not avoided.

[32]See MoF 2022.

[33]See UN CDP Document E/2021/33.

[34]It is also to be noted that Nepal is the only country which without fulfilling the income criteria is graduating in countries which indicates that the structural dimension of the economy is still weak and fragile.

leading to shrinking of fiscal space in many countries. As an offshoot, high dependence on ODA is continuing which accounts for over two-thirds of external finance with increased share of loan financing[35]. If the war is prolonged, the resource flows to the war may increase further with adverse effect on aid to the low income countries. Therefore, there is growingly realization from the period of pandemic that revitalization of taxation policy is essential for minimizing too much, among others, revenue based vulnerabilities of an economy and strengthening of sustainable development discourse.

But in a globalized world, more coordinated efforts are necessary. It is noticeable that despite many pitfalls and deficiencies in the global tax system, there are some initiatives that may have some positive contribution towards bringing reforms in the tax system of developing and LDCs as well. After the global financial crisis of 2008-09, some progresses on tax transparency and fighting against tax evasion by Multinational enterprises (MNEs) has been made through the adaptation of Automatic Exchange of Information (AEOI) Framework. Now the global minimum tax of 15 percent on the foreign profits of the largest MNEs has been introduced which may have important implications for international investment and investment policies. It is believed that this will discourage MNEs from shifting profits to low-tax countries and to reduce tax competition between countries. This by diminishing traditional tax incentives including tax exemptions may help to mobilize more resources. But it may have some near to medium term adverse effect on the FDI in those developing countries which are offering low income or corporate tax rates. Importantly, the extent of illicit flows that are thriving through massive tax evasions, tax leakages and other illegal means indicate[36] that the initiatives so far made are highly inadequate.

Positively, during and in the aftermath of pandemic it has been realized that the protracted taxation system popularized since long as a part of neo-liberal global agenda has immensely contributed to the unprecedented rise in income and wealth inequality leading to intensification in vulnerabilities in society and making socio-economic progresses unsustainable. This is the reason why a broad consensus is gradually emerging for the need of introducing progressive taxes such as wealth tax which could also enhance the prospect of revenue mobilization markedly. In parallel, there is also emphasis on introducing windfall gains taxes especially in view of often undue benefits reaped by highly privileged wealthy people or companies[37].

There is also parallel initiative at the global level to implement the declarations made in the Paris Climate Summit. The commitments made in Paris Summit to reduce the emissions and pursue large policy measures following adaptation and mitigation strategies have been reiterated in Glasgow and recent Sharm el Sheikh Summit. One of the achievements of the recent Summit is that countries have agreed "loss and damage" funding for vulnerable countries that are hit hard by climate-related disasters. There are, however, many daunting issues associated with fulfillment of commitments including setting of fair carbon prices and ensuring financial flows to the neediest countries without disruption. The required changes in overall development direction following GRID approach is yet to be internalized in a more concrete way. This also calls for accompanying tax policy changes in developing and LDCs to make the policies compatible with the GRID approach.

Notwithstanding various initiatives including policy changes and reforms in different fronts, there are indications that the global crisis may worsen further in 2023[38]. Neither there is a hope of ending war in immediate future nor there is a better prospect of more coordinated policy reforms at the global level that are fair, coherent and beneficial especially to the developing and LDCs which are most sufferers of COVID-19 pandemic, Ukraine war, unilateral policy moves of some dominant developed countries and protectionism. Ironically, some powerful countries are accustomed to dictate their terms directly or through global institutions including financial institutions having detrimental impact on the socio-economic fronts of the developing and LDCs. Thus, the underlying reasons of aggravating global crisis indicate that unless the existing dominant global system is reformed and changed drastically the developing and LDCs will continue to remain the most sufferers.

[35]UNDP 2020 and NRB 2020.

[36]See NPC 2020. The report estimates that apart from more than 12 million people being out of the job, the level of poverty increased by 4 percent due to COVOD-19 pandemic.

[37]For early assessment on the COVID-19 impact see Khanal, Pandey and Sharma 2020.

[38]The Global Human Development Report of 2021/2022 (UNDP 2022) shows that the adverse effect of pandemic , among others, on education has been more pervasive leading to reduction of overall Human Development Index from 0.604 in 2020 to 0.602 in 2021.

03

GLOBAL CRISIS, POLICY CHANGES AND THEIR IMPACT ON FINANCIAL FLOWS AND TAXATION POLICY IN NEPAL WITH SPECIAL REFERENCE TO EDUCATION BUDGET OF NEPAL

Prior to the COVID-19 pandemic, Nepal's overall growth performance was relatively satisfactory. The average growth rate was moderately high at around 7 percent for 2016/17 to 2017/18[39]. The progress was more perceptible in the social fronts since last many years which made it possible for Nepal to meet the graduation criteria in 2015, though due to downside risk in the aftermath of earthquake formal decision on Nepal's graduation was made in 2021 after Nepal's approach to the UN. Again in view of COVID-19 effect, the transition period has been extended to five years and hence Nepal's graduation will take place in 2026[40]. Nepal, however, has to ensure that the graduation is non-reversible, resilient, equitable, inclusive and sustainable[41]. The COVID-19 pandemic and its spillover effects, Ukraine war, and ongoing global crisis, however, are posing a big challenge for Nepal toward that end which if realized in a sustainable way could be a milestone in accomplishing the SGDs in time.

The outbreak of COVID-19 pandemic had more devastating impact on the socio-economic front leading to health, humanitarian and economic crisis. It reversed the progresses in many fronts. In 2019/20 economy registered a negative growth rate of 2.4 percent. Along with a negative growth resulting from heavy decline in output in critical sectors, employment, livelihood and poverty effect was very damaging, more so during the lockdown period. Survey based studies of UNDP and Nepal Rastra Bank show a very adverse employment and wage effect[42]. Similarly, a comprehensive study by the National Planning by corroborating the findings of such studies reiterates that apart from employment effect the poverty effect has equally been pervasive[43]. As an offshoot, the spread in pandemic and lockdown had very adverse effect on the health and education services. Amidst continued human losses, COVID-19 pandemic amplified the health inequalities by destroying many of the gains made in child survival, health and nutrition over the last several decades. The life threatening disease patients were deprived of treatment and faced the problem of medicine supplies amidst increased survival threats to such patients. Similarly, the nationwide school closures in response to the pandemic disrupted the education of millions of students which undermined the learning potential in the short run and foreshadowed major human capital losses in the long run. COVID-19 pandemic has also raised great inequities in access to the technologies required for remote learning and digital education, disproportionately affecting poorer communities[44]. More broadly, the notable progresses made in the areas of health and education was also threatened by the COVID-19 pandemic[45].

Though, prior to the Ukraine war, a recovery process was taking place in Nepal with estimated growth rate of 5.8 percent in 2021/22[46] as a result of number of measures including priority on containing virus and addressing intensified health, livelihood and economic crisis, the recovery was, however, immature, lopsided and unsustainable. Amidst continued pandemic led vulnerabilities and phasing out of limited fiscal stimulus packages, the growth was primarily demand driven, resulting from expansionary monetary policy. The rapid expansion in bank lending contributed to increase in import based consumption sharply and augment unproductive investment markedly. This had many undesired consequences. First, there was phenomenal rise in trade imbalances which led to the depletion of foreign exchange reserve rapidly. Similarly, in a situation of low deposits, liquidity problems followed by steep rise in interest rates led to escalate the crisis in the banking system[47]. On the other hand, negligence to supply side of the economy amidst aggravated fiscal management problems despite comfortable revenue situation, there were increased pressures in the price front. In a way, a phenomenon of stagflation was emerging added by policy parlays in the supply side of the economy prior to the Ukraine war.

Consequently, some tight monetary measures were announced by the Central Bank before the middle of the fiscal year as opposed to the soft monetary policy announcement made for 2021/22. Various monetary instruments were declared to control the credit expansion. This was accompanied by restrictions on imports of number of luxurious commodities to ease the pressures on foreign exchange reserve. The tight monetary policy course further hiked the interest rate leading to rise in the cost of capital with further discouraging environment to the private investment with more adverse effect to the small investors. Similarly, the import restrictions had adverse effect, among others, on revenue collection which was essential to support the most suffering sectors or services. In parallel, phasing out of monetary stimulus provided to the businesses and industry was also announced which also had adverse effect on the most suffering sectors which were engaged in the revival process. Paradoxically, despite strong measures there was no ease in the price front which showed that higher internal demand and rise in externally driven energy prices alone were not responsible for this. It indicated that supply side factors are equally important. It also revealed that informal economy and shadow banking system were also instrumental in the rise of prices and escalation in liquidity crisis in the economy.

In such a crisis prone situation, Russian invasion of Ukraine took place in February 2024. The war has had further adverse effect on energy and food prices. The supply disruptions added by export restrictions of certain food items by the neighboring country has had extra[48] effect on supplies with more pressures on the price front. With continued price rise and liquidity problems in the banking system, the tight monetary policy has been continued. This has resulted in continued high interest rate which among others has raised cost of capital with adverse effect on private industry and businesses. A recent study shows[49] that in such a policy discourse massive reduction in production and closer of enterprises

[39]See MoF 2022.

[40]See CBFIN 2078 (in Nepali) for understanding how banking sector crisis augmented in Nepal in 2021. See also NRB 2022.

[41]In the first three months of this fiscal year the price rise has been high at 8.8 percent indicating the ineffectiveness of the tight monetary policy. See NRB 2022b.

[42]See CNI 2022.

[43]The World Bank (World Bank b 2022) has projected the growth rate of 5.1 and 4.9 percent for 2022/23 and 2023/24 which may be at the higher side due to the reasons explained above.

[44]In Nepal despite consumption inequality remaining relatively low the income inequality in general and wealth inequality in particular is very high. See Oxfam/HAMI 2019.

[45]See FCGO 2022 (Nov –Dec).

[46]It should be noted that a high level Public Expenditure Review Commission constituted by the government deriving such a conclusion has made strong recommendations to the government which is yet to be implemented. See Khanal et al 2075 (Nepali) which is yet to be published.

[47]Some of these problems are highlighted in MoF 2021.

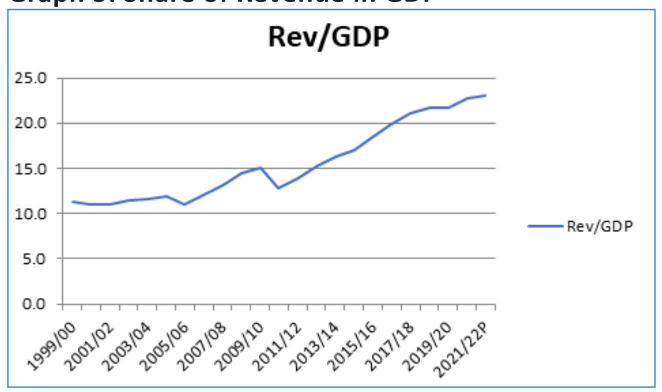
[48]See for examining the recent trend WB b 2022.

[49]Progress review and monitoring of the projects and programs corroborate this.

has taken. The study indicates that such a problem compounded as a result of deceleration in the consumer demand which in turn was due to the rise in cost of living and erosion in purchasing capacity of the people. By implication, as a result of supply shocks the pressures on prices has continued through cost push mechanism and hence intended price reduction through tight monetary policy has largely failed. After longer period, the import restrictions have been removed amidst certain ease in the Balance of Payments problems due to some pick up in the remittances inflows. The sharp fall in international trade based revenue accompanied by deceleration in internal revenue source also generated pressures for removing the restrictions. It is thus seen that both demand and supply side effect are dampening the higher growth prospects[50]. At the same time, it may have added adverse welfare implications at least in the medium term given the vulnerability of the larger section of the population amidst higher income and wealth inequality[51]. This in turn would have budgetary implications through revenue effect if revenue loss is not compensated either through added efforts at internal revenue mobilization or through financial inflows which again will depend on the global environment including the possibility of ending of war.

In the past, Nepal has performed satisfactorily in the revenue front with revenue as a share of GDP reaching 23 percent in 2021/2022 from 11.3 percent in 1999/2000 which is one of the highest in South Asian region. . The graph presented below corroborates this. The larger inflows of remittances coupled with rapid increase in imports have contributed to the fast rise in the revenue. A steady expansion in the VAT revenue has also taken place after its implementation in the mid-1990s. The income tax has also picked up gradually from a low base. However, as indicated above, after the COVID-19 pandemic followed by Ukraine war together with imports restrictions, the revenue growth slowed down considerably and now the revenue collection has been far

Graph 5: Share of Revenue in GDP



below the level of current expenditure . This shows that after adverse revenue impact neither concerted efforts to contain the burgeoning current expenditure nor to enlarge the revenue base has been made amidst higher revenue vulnerability due to as indicated above excessive revenue dependency on imports. Thus, contrary to some attempts to bring changes in the tax policy at the global level, similar initiatives have not been taken in Nepal so far. Instead, the tax revisions or changes made in the current budget 2022/23 have not only provided negative protection to the important industries but also have contributed to the revenue loss to the government. This again reinforces on the essentiality of revamping the budgetary system[53] with equal focus on major reforms in both government expenditure and revenue system.

In the adverse revenue conditions, the importance of financial flows rises further. In Nepal the financial flows consist of foreign aid, remittances inflows and FDI. From

[50]The worsening environmental problems and deepening climate crisis add challenges for which large mobilization of financial resources will be required for containing such crises and promoting green economy. Though the adaptation of GRID approach is timely, internalization in the development programs within the federal governance system through larger financial mobilization is yet to take place.

[51]For details see Khanal et all 2075(Nepali).

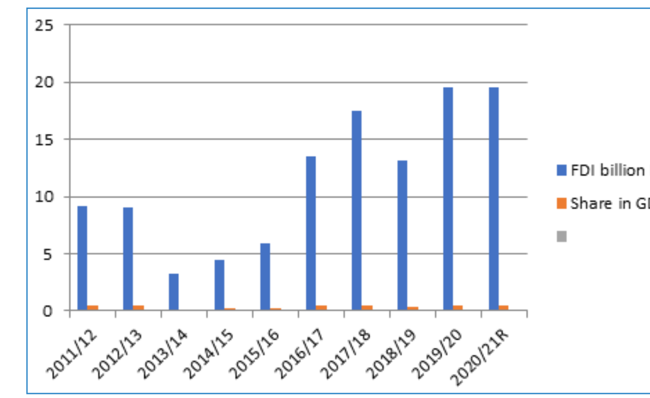
[52]See World Bank 2021.

[53]See MOF 2021.

the budgetary point of view foreign aid is still highly important. In Nepal foreign aid effectiveness, rather than commitment has been a major problem in the past. Still off budget, aid fragmentation, timely procurement, mutual accountability, poor aid alignment with national priorities and ownership issues constitute the major problems[54]. In recent years, the share of grant has also decreased substantially. In 2020/21, for instance, its share was 3.1 percent of the total expenditure. On the other hand, with continuous rise in foreign loan, the total debt outstanding has reached almost 42 percent as a share of GDP[55] as already shown above in the graph. With very dismal performance of the projects including national pride projects[56] coupled with larger chunk of unwanted or sick projects and programs, rise in external loan would have larger debt servicing and dependency problems. Therefore, despite less possibility of major downfall in aid in the coming years even in an adverse global aid environment, aid effectiveness is a major problem which could be a major constraining factor for augmenting aid mobilization.

Another important source having positive spillover effects is FDI, provided scrutiny of projects are made judiciously for ensuing major benefits to the national economy. However, it should be noted that Nepal has dismally failed to mobilize FDI despite often larger commitments by the foreign investors. The graph presented below shows that during the period 2011/12 to 2019/20 the FDI inflows in Nepal have hardly crossed 0.5 percent of GDP despite competitive strengthens in many sectors including manufacturing, IT based industries, energy and tourism. The average inflow of FDI in South Asia was 1.2 percent with highest inflow in Maldives and India at 8.2 and 1.4 percent of GDP respectively in 2021[57]. More concern is that amidst very low level of FDI inflows, the dividend repartition has been higher than the FDI inflows in the past. The latest information shows that in 2020/21, for instance, the dividend repartition was in the order of Rs 26.1 billion as against Rs. 19.5 billion FDI inflows[58]. Thus, in Nepal's context there is a need of not only increasing FDI inflows to meet the resource gap but also using it in a most productive way for the larger benefits of the economy and people.

Graph 6: Total Inflow of FDI and as a Share of GDP



Source: NRB 2022.

Another important source is remittances which as indicated above has been one of the main contributors to the expansion of the economy and economic activities. It has eased both youth unemployment and people' livelihood problems to a greater extent. Notwithstanding this, the productive use of remittances is yet to take place to the desired extent. At the same time, the foreign employment is still dominated by unskilled workers. In a very adverse environment with looming recession in the global economy, there are increased uncertainties on the foreign employment front. Importantly, continued encouragement to the outflow of most productive forces necessary for nation building cannot be considered as a panacea to the economic problems.

Considering from different angles, undisrupted unconditional aid, tapping of larger revenue potentials and attracting of FDI inflows including inflows from NRN in priority areas will be desirable for overcoming from

[54]See NPC 2022.

[55]See for examining the recent trend WB b 2022.

[56]Progress review and monitoring of the projects and programs corroborate this.

[57]For the trends see www. data.worldbank.org/indicators.

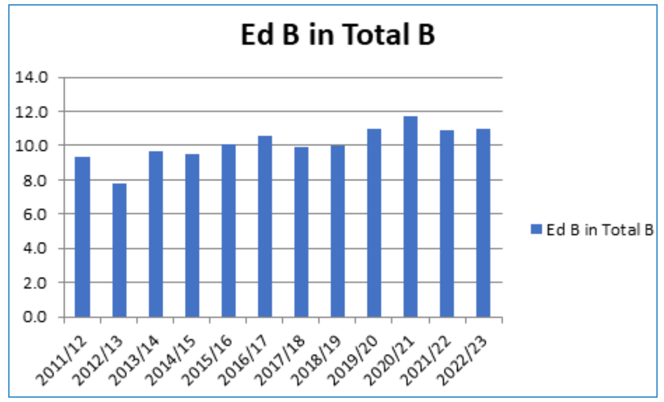
[58]See NRB 2022.

the looming bigger crisis[59], graduating by 2026 smoothly and accomplishing the SDGs within the stipulated time. But it should be noted that policy parlays and immature policy decisions coupled with business as usual governing practices could again be a disaster even if both internal revenues and external financial flows are mobilized markedly. Therefore, it is essential that a path to productive transformation is pursued with exclusive focus on human capability development and progressive transformation of the economy in which institutional and governance transformation becomes an integral part of such a discourse. This, among others, calls for human resource development in which education is a cornerstone.

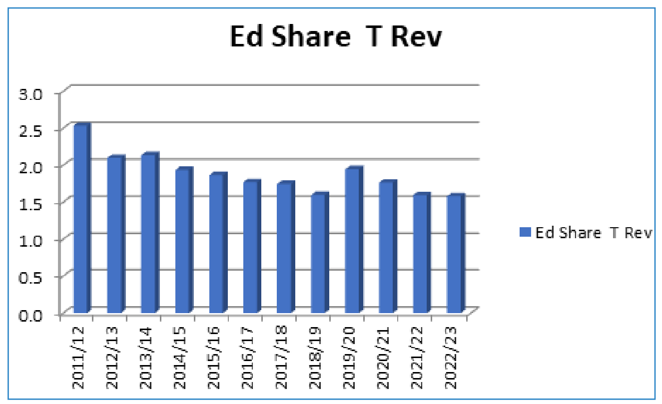
However, it is seen that despite education being the backbone of the society's progressive transformation, sustainable development and prosperity of the country, it has received low priority over the years in Nepal. There are fears that if the looming bigger crisis intensifies with adverse revenue or aid effect, this may have more damaging effect on the low priority attached education budget of Nepal.

A trend analysis shows that along with steady decline in the education budget over the years, the share of education reduced to 9.3 percent in 2011/12. It was 9.9 percent in 2017/18 when the fiscal federalism was introduced. The total budget allocated to the education sector covering sub-national governments was around 11 per cent in this fiscal year 2022/23. Similarly, out of the total revenue, the share of education expenses was 2.5 percent in 2011/12. Such a ratio declined to 1.6 percent in the current budget of 2022/23. The share of education in total budget as well as total revenue is presented below in the graph separately which clearly show that even after the introduction of federal system of governance, the education sector receives low priority.

Graph 7: Total Education Budget in Total Budget



Graph 8: Education Budget Share in Total Revenue



Source: Economic Surveys and Budgets of Various Years, MoF.

A dismal allocation and use pattern is seen when the share of education in capital expenditure is separately analyzed. Its share reduced to as low as 0.1 percent from a very low share of 0.3 percent during the period 2010/11 to 2017/18[60]. Similar pattern has been derived by a more recent World Bank study on public expenditure management and fiscal sustainability[61]. The same study shows that though the devolution of responsibilities in education has reduced federal spending on education from 1.2 percent of GDP in 2014/2015 to 1 percent of GDP in 2018/19, the reduction was not fully compensated by

[59]The worsening environmental problems and deepening climate crisis add challenges for which large mobilization of financial resources will be required for containing such crises and promoting green economy. Though the adaptation of GRID approach is timely, internalization in the development programs within the federal governance system through larger financial mobilization is yet to take place.

[60]For details see Khanal et al 2075(Nepali).

[61]See World Bank 2021.

the sub-national governments through their allocations to the education. Even at the time of higher pandemic effect also, education did not receive priority under the ODA. The Development Cooperation study 2021 of the MOF shows that out of the total ODA in 2020/21, the allocation to the education sector was 12.99 percent as against 17.66 percent to the energy sector followed by 15.03 percent to the transportation and 13.22 percent to the health sector respectively[62]. An analysis of the current budget of 2022/23 shows that out of the total budget of Rs 1793.84 billion, total budget allocated to the education sector has been around 10.95 percent. Out of the total allocation of Rs 196.4 billion, federal government, provinces and local governments have allocated around 5.1, 4.1 and 40.3 percent respectively. Again the provinces and local government's allocations are based on the fiscal transfers from the federal government.

More concern is that a sharp decline in the education budget has been planned / agreed for 2023/24 and 2024/25 respectively in the Medium Term Expenditure Framework (MTEF) of the NPC. In that a sharp decline in the share of foreign aid to the education sector has also been projected[63]. This simply means that the UN's Sustainable Development Goal for Education which aims to ensure inclusive and equitable quality education and promote lifelong learning opportunities for all by 2030 will be out of reach and unattainable. This again reinforces the need of overhauling the budgetary system focusing on reforms in the areas of resources allocations and uses.

More specifically, there is a need of raising the share of education budget to 20 percent of the total budget in near future as per the benchmark recommended by the UNESCO. This will require revamping of macroeconomic policy premises as well under which they are set and, in turn, limit the resources available for public spending in general and education sector spending in particular. In the process, there is an urgency of raising the effectiveness of government spending including aid for better returns and outcomes through systemic reforms in which transparency and accountability should be integral part of it. This will enable to transfer resources from unproductive and resource drain areas to the productive one including the pressing areas such as education. Within the education sector, equity in public expenditure to redress inequality and tackle discrimination (e.g. expanding access and quality of public education, increased stipends for children with disabilities, increased investments in incentives for teacher postings in poor rural areas) will be needed. In parallel, major reforms in tax system are required for mobilizing resources up to the potential level at all three levels and meet the growing resource gap as indicated above. This demands widening tax bases, controlling of tax leakages and evasions and raising the share of direct taxes by bringing progressivity in the tax system. Introduction of equity index to apply a nation-wide equity funding formula which explicitly addresses discriminations and strengthens equality dimension in development could be a better option for improved resource allocation decisions. The bigger socio-economic developmental gap across provinces additionally justifies for such a formula[64]. Indeed, such an equity and fair dimension is equally urgent in the dominant global dominant system to replace unilateralism which as indicated above have been instrumental to aggravate the crisis in the low and lower middle income countries. While reforming the dominant system it is also urgent that more bold steps are taken to strengthen the tax justice system that takes step to abolish the sources of illicit flows including the major sources such as tax heavens.

[62]See MOF 2021.

[63]See NPC 2022.

[64]For such specific suggestions see Action Aid International 2021 (Nepal factsheets).

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CONCLUSIONS AND WAY FORWARD

4.1 CONCLUSIONS

1. The world is facing deepening crisis in multiple fronts today. At a time when the economies were gradually recovering from the worse impact of COVID-19 pandemic, Russian invasion of Ukraine has already made very adverse effect on the global economy apart from intensifying humanitarian crisis. There are fears that in the next year 2023 the world may go into deeper recession with likely large damaging effect on the economies of the developing countries in general and least developed countries (LDCs) in particular.

2. A closer review and assessment depicts that many unilateral policy moves and actions by the world dominant powers are aggravating global crisis with more pervasive adverse effect on the developing and LDCs which exemplify that there are serious flaws in the global system which is unfair and unjust.

3. Evidently the foremost adverse impact of Ukraine war has been on the trade and investment front leading to swelling of food and energy prices added by disruption in the supply chains. This has escalated world prices with losses in, among others, people's welfare particularly in the low income countries.

4. It is to be noted that prior to the Ukraine war also, a continuous rise in the prices was taking place across the globe. The massive fiscal stimulus package introduced by the developed countries through quantitative easing and other deficit financing to cope with the devastating impact of COVID-19 was not only building inflationary pressures but also was raising the level of debt outstanding phenomenally despite fast recovery in the economies. As a result, tight monetary policies coupled with heightening of interest rates were under implementation at a time when the war broke out. Such a tight monetary policy discourse has been pushed more aggressively after further escalation of prices. This means that underlying reasons of building price pressures and steps taken subsequently needs segregation from developing and the LDC's perspectives.

5. As well known, due to limited fiscal space and poor external support, the developing and LDCs had introduced limited fiscal stimulus package to cope with the pandemic leading to slow and fragile recoveries. Despite this, they are facing the chain effect of both loose as well as tight monetary policy of the dominant developed countries. During the pandemic they faced spillover effect of steep rise in prices in the developed countries. In the post pandemic and now in war period they are facing very adverse effects of tight monetary policies.

6. Now dominant developed country's more aggressive financial tightening policy has further augmented "great financial divide" between the developed and developing countries. The impact has become more harmful in the developing countries and LDCs due to US dollar being the international reserve currency. As the studies indicate, the long term impact of interest hike in the US could be devastating to the global economy due to more debt crises and defaults, significant output losses, higher unemployment, massive financial outflows and sharp increases in inequality and poverty. The irony is that while making such policy moves neither any coordination with responsible multilateral institutions was made nor probable consequences on the developing countries were considered.

7. More worrying phenomenon is that such an aggregate demand containing policy approach could be highly ineffective in a given situation in which the inflationary pressures are driven by supply-side constrictions, higher speculations and profit-gouging by major corporations. The ineffectiveness of such a policy corroborates this.

8. Though during the pandemic, a new allocation of special drawing rights (SDRs) was made accompanied by debt suspensions by G20, these have been highly inadequate. At the same time, despite some added support by the multilateral donor agencies including the IMF and the World Bank, such supports have been conditional and hence less beneficial. There is also a problem of delays in the implementation of aid funded projects which hamper the fast recoveries of the economies and constraint the resource inflows to the developing and LDCs. Continuous larger financial support to the Ukraine war and no sign of sooner ending of war raises the fear of reducing the flows to the developing and LDCs.

9. Considering from different angles, the importance of the fiscal policy has greatly enhanced especially in the developing and LDCs. It is noticeable that despite many pitfall and deficiencies in the global tax system, there are some encouraging initiatives. After the global financial crisis of 2008-09, some progresses on tax transparency and fighting against tax evasion by Multinational enterprises (MNEs) has been made through the adaptation of Automatic Exchange of Information (AEOI) Framework. Now the global minimum tax of 15 percent on the foreign profits of the largest MNEs has been introduced which may have important implications for international investment and investment policies. There is also growing realization on the need of introducing progressive taxes such as wealth tax and windfall gains taxes. However, it should be noted that the predominance of indirect taxes in general and highly regressive taxes such as VAT in particular in the developing and LDCs added by massive illicit flows through wider tax evasions, tax leakages and other illegal means indicate that the initiatives so far have been highly inadequate.

10. A parallel follow up initiatives to implement the Paris Climate Summit declarations is a positive development for addressing the intensified climate crisis. The recent Sharm el Sheikh Summit agreeing "loss and damage" funding for vulnerable countries that are hit hard by climate-related disasters is a positive step. There are, however, many daunting issues associated with fulfillment of commitments including setting of fair carbon prices and ensuring financial flows to the neediest countries without disruption. The required changes in overall development direction following GRID approach is yet to be internalized in a more concrete way. This also calls for accompanying tax policy changes in developing and LDCs to make the policies compatible with the GRID approach.

11. It is noticeable that prior to the COVID-19 pandemic, Nepal's overall growth performance was relatively satisfactory. After devastating socio-economic impact of COVID-19 pandemic, a recovery process was also picking up. But the recovery was lopsided and became

high unsustainable. The loose monetary policy pursued in the aftermath of pandemic leading to rapid expansion in bank lending in import driven consumption added by investment in unproductive areas widened trade imbalances and eroded the foreign exchange reserve rapidly. In such a situation, a tight monetary policy added by high interest rate was pursued leading to crisis in the banking system. On the other hand, due to negligence to the supply side of the economy amidst aggravated fiscal management problems despite comfortable revenue situation, there were increased pressures in the price front. In a way, a phenomenon of stagflation was emerging added by policy parlays in the supply side of the economy prior to the Ukraine war.

12. In such a crisis prone situation, Russian invasion of Ukraine took place in February 2024. The war has had further adverse effect on energy and food prices. With continued rise in prices and foreign exchange reserve problems, the tight monetary policy has been continued. But such a policy has had very detrimental impact on industry and businesses leading to massive reduction in production, closer of enterprises and deceleration in consumer demand. Though after a long period, the import restrictions have been removed amidst massive revenue shortfalls, the problem of liquidity and rise in prices is continuing with a threat of both demand and supply side led bigger economic crisis in the country.

13. The likely implication is that there may be added adverse growth and welfare implications amidst higher income and wealth inequality. This in turn may have added dampening implications on development budget through revenue effect if revenue loss is not compensated either through added effort at internal revenue mobilization or through financial inflows which again will depend on the global environment including the possibility of ending of war besides enhancing of absorption capacity of the development budget which includes raising aid effectiveness substantially. The excessive revenue dependency on international trade based revenue and dominance of regressive taxes such as VAT shows little progress on enhancing progressivity and enlargement of built in elasticity in the tax system. Predominance of informal economy and often inducement to it makes the revenue prospect more complicated and challenging.

14. It is a matter of serious concern that despite looming budgetary crisis no serious efforts are there to contain unproductive expenses, enhance resource allocation efficiencies and raise productivity of the expenditure by introducing performance based budgetary system. One of the most sufferers of such a poor budgetary system has been the education sector. There has been continuous decline in the allocation of education budget since many years with capital expenditure reducing to just 0.1 percent of GDP. Though in the federal system, reduction in the share of education in the federal budget was expected, the reduction has not been compensated through sub-national government's budget. Now more worry is that with likely deceleration in revenue growth and less encouraging foreign aid environment, the adverse effect on education budget seems eminent under business as usual environment. Though higher FDI inflows could provide certain cushion to divert government revenue to the education sector from other areas, such a prospect is also not encouraging as the past trend indicates.

15. Thus, considering from different angles amidst likely aggravation in global crisis further, Nepal may faces more challenges in the economic front in the coming days unless more drastic reforms are carried out with highest priority.

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4.2 WAY FORWARD

16. Today's aggravating global crisis in multiple fronts clearly shows that the present dominant global system has to be transformed into a fair and more equitable system in which the role of the UN system becomes effective and dominant. This also requires that the role of the other global institutions responsible to promote development in poor countries, maintain liquidity and strengthen financial stability and promote fair trade globally is strengthened accordingly.

17. At present the immediate task of the global players is that the war in Ukraine ends sooner than letter to prevent humanitarian disaster and economic crisis further. Indeed, it is essential that all type of aggression and interferences in internal affairs of other countries in any pretext are fully stopped.

18. A system of coordinated efforts to resolve global crisis and support most suffering developing and LDCs countries has to be institutionalized and strengthened by replacing a practice of unilateral moves by dominant developed countries undermining the serious adverse consequences on the economies and people of developing and LDCs. Countries possessing the reserve currency have to comply with their international responsibilities.

19. It is necessary that some important initiatives are taken with priority that could provide enough financial resources flows to the developing and LDCs for assisting them to cope with the crises, revive the economies and ensure accomplishment of SDGs by 2030. Increased vulnerability in the aftermath of pandemic and ongoing crisis indicates that high priority on funding social protection including education and climate related areas will be particularly necessary. For ensuring adequate financial flows, at first creation of emergency fund in the UN to support the most affected developing and LDCs is necessary. This has to be accompanied by new SDR allocations of dollar equivalent of 1.5 to 2 trillion to support highly affected countries. In parallel, rapid expansion of ODA has to take place as per commitments apart from prompt actions in restructuring debt and providing relief to the highly indebted or debt rising vulnerable countries. Similarly, loss and damage funding for vulnerable countries agreed in Sharm el Sheikh Climate Summit has to be implemented with high priority added by a robust carbon pricing policy. Largely, such initiatives will require revamping global financial system.

20. In parallel, there is need of revamping global taxation system in which the focus has to be given on introducing the progressive wealth tax system which has to be added by implementation of gainful and other similar taxes. In the globalized world, unless such an initiative at global level is taken, isolated efforts at country level may backfire as a result of capital flights. A modern wealth tax can overcome many weaknesses in the existing system. First, offshore tax evasion can be fought more effectively. Second, a comprehensive wealth tax base with a suitable exemption threshold and no preferential treatment for any asset classes could reduce avoidance possibilities. Third, by leveraging modern information technology, tax evasions could be drastically reduced. Along with such a prompt move, additional special measures to control the elicit flows have to be pursued that are affecting the resource scarcity problems in developing and LDCs in a big way.

21. Similarly, there is a need of strengthening oversight and watchdog institutions by among others, increasing the role of non-governmental organizations including civil society organization. For enhancing participatory, transparent, accountable and responsive system in both global and state institutions also this is essential.

22. It is also necessary to revamp macroeconomic policies globally that simply focus on fiscal balance and economic stabilization which are again rooted in neo-liberal orthodoxy and overlook budgetary crisis resulting from aggravated structural and institutional problems. The overemphasis on austerities or fiscal restraints often by multilateral institutions is grounded on shallow presumptions with adverse affects on investment, among others, in human resources development. The failure of demand driven tight monetary policy, for instance, indicates that supply side of the economy is more important which demands persuasion of structural approach in addressing today's economic crisis.

23. Along with such global initiatives, in Nepal immediate actions are necessary in critical fronts to address the looming bigger crisis. Fr this, a more balanced fiscal and monetary policy discourse has to be perused immediately. Along with gradual relaxing of tight monetary policy coupled with reduction in high interest rate, there is a need of changing investment portfolio of the banking and financial institutions drastically in way that could induce investment in productive sectors having high and relatively immediate returns. This will help to ease the pressures on the prices through supply side effect. This will also promote exports. A better policy and institutional environment has to be created simultaneously to discourage shadow banking and remittances inflows from informal channels which will help raising bank deposits simultaneously. A bold step will be needed to discourage informal or parallel economy along with measures to bring rapidity in the formalization of the economy.

24. In parallel, absorptive capacity of the capital budget has to be enhanced massively which will help to raise liquidity in the economy, create spillover positive impact on the private investment and raise foreign aid inflows. This will give positive signal to the FDI also.

25. Along with such immediate steps, strategies and policies in revamping economic policies have to be pursued simultaneously from medium to long term perspectives. Initiatives to bring drastic reforms in the budgetary system with equal focus on both expenditure and revenue system will be essential. A performance based budgetary system needs introduction through which resource allocations efficiency and effectiveness in expenditure management could be ascertained. This will help to curtail unproductive expenses massively, drop sick or wasteful projects under capital budget and divert scarce resources to the highly productive areas. This will also facilitate to release resources to the sectors like education for ensuring inclusive and equitable quality education and promoting lifelong learning opportunities for all by 2030 which is the main goal of the SDGs. In this process strengthening of federal system will be particularly necessary for accomplishing the goals in the education sector.

26. In parallel, drastic reform in taxation system will be essential to reverse declining tendency of revenue and enlarging of revenue bases for meeting growing resource demand. For this, highest priority has to be given on direct taxes through expansion in tax bases and raising progressivity in the tax system. The time has come to introduce wealth tax and taxes like windfall gains to augment revenue, reduce growing inequality and control malpractices in the tax system. As an offshoot, special administrative measures will be needed to control tax evasions, loopholes and rise in illicit outflows. In this process, revenue mobilization capacity of the sub-national governments has to be strengthened markedly to reduce their excessive dependency on the federal government.

27. Considering from different angles, undisrupted unconditional aid, tapping of larger revenue potentials and attracting of FDI inflows including inflows from NRN in priority areas will be needed for overcoming from the larger resource gaps problems. It should be noted that policy parlays and immature policy decisions coupled with business as usual governing practices could again be a disaster even if both internal revenues and external financial flows are mobilized markedly. Therefore, it is essential that a path to productive transformation is pursued with exclusive focus on human capability development and progressive transformation of the economy in which institutional and governance transformation becomes an integral part of such a discourse. This, among others, calls for human resource development in which education is a cornerstone.

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NATIONAL CAMPAIGN FOR EDUCATION NEPAL (NCE- NEPAL)

National Campaign for Education Nepal (NCE- Nepal) in UN ECOSOC special consultative status is a civil society movement with mandates to lobby and advocacy for ensuring quality education for all. The history of NCE-Nepal traced back in April 2003, after obtaining membership from the international network, Global Campaign for Education (GCE). As GCE Nepal network decided to broaden its spectrum on advocacy, all coalition members felt a need of its legal identity. As a result, NCE- Nepal was formally established on 2010 as civil society movement to ensure the right to equitable, inclusive quality education for all.

NCE-Nepal is a campaign for undertaking collective efforts and coordinating among individuals/ organizations engaged in promoting the human rights to quality education in Nepal. It works as a watchdog to ensure everyone's rights to education and advocates for the same. It focuses on strategic interventions related to policy advocacy, networking, lobbying and campaigning at the district, regional, national and international levels. Currently, it has 460 member organizations including 52 General members and 408 affiliated members ranging from international and national non- government organizations, federation, education media organizations and teachers' community to grassroots institutions working in the field of education and child rights. Besides, it has district coalition in 36 districts covering 7 provinces of Nepal.

NCE-Nepal is also a member of Asia South Pacific Association for Basic and Adult Education (ASPBAE) and Global Campaign for Education (GCE). In addition to this it has recently registered as a member of Inter Agency Network for Education in Emergencies (INEE). Being a member of GCE and ASPBAE, NCE-Nepal has access to engage to debates on education issues at local, regional and international forums. It is one of the recognized CSO network to contribute in the national policy making process for education in Nepal as acknowledged by the Government.

VISION
Equitable inclusive quality public education for all in Nepal.

MISSION
Lead the creative campaigning to hold the government accountable and to ensure right to quality public education in Nepal with civil society organizations, social justice movements progressive academia and marginalized communities.

GOAL
To ensure equitable, inclusive, free, compulsory and quality education for children, youth and adult as their fundamental right to education in Nepal.

In collaboration with TaxEd Alliance

Tax And Fiscal
Justice Alliance, Nepal