

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

EBS/86/182
Supplement 1
Correction 1

CONFIDENTIAL

September 12, 1986

To: Members of the Executive Board
From: The Secretary
Subject: Nepal - Review Under Stand-By Arrangement - Revisions to
Monetary Statistics and 1986/87 Credit Ceilings

The following correction has been made in EBS/86/182,
Supplement 1 (9/8/86):

Page 16, para. No. 17, line 27: for "2 percent" read "0.2 percent"

A corrected page is attached.

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are several features to the new tax measures which we included in the 1986/87 budget. The domestic sales tax previously had 17 rates ranging from 1 to 20 percent, with different markups applicable to the tax base for various items. We reduced the number of rates to four and eliminated the markup system in order to ease administration. To broaden the sales tax base, we included telephone services under the general sales tax rate. Regarding excise tax, we introduced a flat rate for rice and edible oil mills and increased the rates on selected items, e.g., soft drinks and alcoholic beverages, while eliminating excise duty on some widely used construction materials and selected products produced by cottage industries. With respect to income tax deductions, we introduced a flat allowance for transportation, education, and periodicals, and generalized the provision for withholding tax on interest, dividends and rental income. We also introduced a flat (40 percent) corporate tax rate, combined with a 20 percent withholding tax on dividends, while exempting cottage and village industries from income tax on sales up to NRs 100,000. With respect to the property transfer tax, we increased the minimum property values to more realistic levels. Increases in the air flight departure tax rates, as well as adjustments in vehicle and entertainment taxes, will also provide additional revenue. These measures together should yield some NRs 220 million additional revenue out of the NRs 415 million.

15. With the present domestic prices of petroleum products, referred to in paragraph 8 and the level and trend in landed costs, there will be a large and growing revenue surplus from sales of petroleum products in the period ahead. In this regard, we increased import duties on petroleum products (gasoline, diesel, and lubricants) by a substantial amount to generate an additional revenue of NRs 73.5 million for the budget, while still allowing for a significant strengthening of the financial position of the Nepal Oil Corporation. We also expanded the list of imports not eligible for the 1 percent duty rate, thereby increasing the number of imports subject to higher duty rates. This measure, together with increases in duties on selected imports as well as on some exports, is expected to yield about NRs 121.5 million in 1986/87.

16. The intention also is to restrain growth in regular expenditures, while allowing for adequate growth in expenditure categories related to operations and maintenance of completed development projects. In these circumstances, the Government sees no viable alternative to retaining the freeze on wages and salaries of civil servants in 1986/87, as well as preventing an increase in the number of civil servants. On this basis, it is planned that the total wage bill will increase by less than 5 percent in nominal terms, thus declining significantly in real terms. The Government is also reviewing carefully the level of transfers to various deficit agencies and public enterprises, as well as various subsidies which directly or indirectly impinge on the budget, with a view to markedly reducing their weight in budgetary expenditure over time. With respect to deficit public enterprises, adequacy in

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pricing policies, improved managerial standards and financial practices, and restraints on their access to banking system credit, should provide incentives for reform.

17. Some public enterprises which traditionally operate with the aid of budgetary transfers and subsidies, such as the Nepal Food Corporation and the Agricultural Inputs Corporation, serve not only economic, but social objectives as well. The transfers/subsidies through the budget finance a major part of the heavy cost of transportation of food and agricultural inputs to remote areas. In the case of chemical fertilizers, the transport subsidy provided for in the budget represents only a small portion of actual subsidies in support of the fertilizer program in Nepal. The bulk of the subsidy represents the sale of fertilizer by the Agricultural Inputs Corporation to farmers at prices which until recently were about 40 percent below landed costs (at international prices) across the range of products. Most of the fertilizers are received under foreign assistance, and their provision at subsidized prices is designed to stimulate the use of fertilizers in Nepal in a program worked out with the donors concerned. Nevertheless, in view of the sizable magnitude of these subsidies, and in the light of serious budgetary constraints, a careful review of fertilizer pricing was undertaken. On May 21, 1986, the domestic sales prices of chemical fertilizers were increased by 20-29 percent to bring them in line with selling prices in India, in order to prevent the re-export of these commodities. However, in light of a strong intervening decline in international prices of fertilizers, in late July, the Government reduced the domestic sales prices by 5 percent across the board. Nevertheless, at current international prices, the per unit reduction in fertilizer subsidies in 1986/87 still will be substantially greater than that originally envisaged, and net receipts from sales of fertilizers are estimated to increase by an equivalent of about 0.2 percent of GDP. Given transportation costs, the small price differential with India would not lead to the re-export of fertilizers. The Government intends to maintain the domestic sales prices of fertilizers at levels that will prevent their re-export. The Government has instructed the Agricultural Development Bank to step up its collection efforts to recover a larger portion of fertilizer loans to farmers so that the Agricultural Inputs Corporation is repaid and can increase its contribution to the counterpart fund in the budget.

18. In collaboration with the World Bank, the ADB, the UNDP and bilateral donors, the Government has intensified, and will continue to intensify its efforts to increase Nepal's aid absorptive capacity by streamlining administrative and implementation procedures. Development expenditure to be financed with domestic resources will be carefully screened in terms of priorities and cost effectiveness and the scale of such expenditure continue to be closely monitored in the light of domestic revenue performance. Domestically financed development expenditure currently is projected to increase by 24 percent in 1986/87. In the event of any revenue shortfalls in 1986/87 below projected amounts,