

## PROGRAM EXPENDITURE AND FINANCING ASSESSMENT

### A. Expenditure Framework

1. The high priority that the Government of Nepal accords investments in education is evident in the current periodic plan (2014–2016), forthcoming periodic plan (2016–2020), and other policy documents, and is supported by annual budget allocations to education. These have remained at around 4% of gross domestic product (GDP) and at more than 12% of total government expenditure since 2009. External development partners have been supporting government efforts to ensure continued priority for education investments, particularly under the School Sector Reform Program (SSRP), which was implemented from FY2010–FY2016 through a sector-wide approach. The share of development partner financing for the SSRP was, on average, 18.5% of the pooled budget (Table 1). The government’s School Sector Development Plan (SSDP) is a continuation of this partnership.

**Table 1: School Sector Reform Program – Budget Allocation (\$ million)**

	FY2012	FY2013	FY2014	FY2015	FY2016	5-year total
SSRP pooled budget	721.2	604.5	771.3	826.5	807.8	3,731.0
Government	549.7	485.8	601.0	715.6	689.1	3,041.0
Development partners	171.5	118.7	170.3	110.9	118.7	690.0
Development partners’ share in the SSRP (%)	23.8	19.6	22.1	13.4	14.7	18.5

FY = fiscal year, SSRP = School Sector Reform Program.

Note: Figures are allocations, not actual expenditures.

Source: Government of Nepal. Ministry of Education. *Annual Strategic Implementation Plan*. Kathmandu.

2. **School sector budget.** The budget of the Ministry of Education (MOE) for FY2017 (the first year of the SSDP), is NRs116.4 billion (\$1,109 million). This is an increase of 32% in nominal terms and 24% in real terms. The school sector budget is equivalent to the MOE budget excluding teacher pensions, tertiary education, and non-school-based technical and vocational education and training. It accounts for 80% (\$886 million) of the total MOE budget, constituting the bulk of government investments in education, encompassing the entire school sector from grades 1–12, including early childhood education.

3. **Supporting School Sector Development Plan.** The government developed the 7-year SSDP (FY2017–FY2023) and a 5-year program (FY2017–FY2021) covering all levels of school education and nonformal education. The proposed loan ‘Supporting School Sector Development Plan’ by the Asian Development Bank (ADB) will finance the program with the government during FY2017–FY2021 through a sector-wide approach. The program will be financed by the Asian Development Bank (ADB) under the results-based lending (RBL) modality during FY2017–FY2021, and will provide much-needed financial leverage for more investments to improve access to and quality of school education, with particular focus on secondary education. The SSDP cost estimate is based on a medium-term planning process to achieve planned targets.<sup>1</sup> The government will support the expenditure framework through annual budgets executed by MOE. Nine joint financing partners (JFPs)—ADB, Australia, European Union, Finland, Global Partnership for Education, Japan International Cooperation Agency, Norway, United Nations Children’s Fund, and the World Bank—will cooperate through a Joint Financing Arrangement and sector-wide approach to harmonize support for the SSDP.

<sup>1</sup> The National Planning Commission develops annual development program documents based on the previous year’s expenditure adjusted for inflation, rather than through a medium-term planning process. The sector medium-term expenditure framework is expected to be strengthened by incorporating estimated SSDP expenditures, which will improve the provision of annual budget allocations to meet the goals and targets in a timely fashion.

4. **Estimation of the plan's resource envelope.** The resource envelope for the SSDP was estimated by assuming a plausible scenario of future allocations based on current trends of real GDP growth, inflation rate, share of education in GDP, and share of the school sector in the education budget.<sup>2</sup> The school sector resource envelope (macro fiscal space) for 7 years (FY2017–FY2023) is estimated at \$10,655 million, and for 5 years (FY2017–FY2021) at \$6,498 million (Table 2).

**Table 2: School Sector Development Plan – Resource Envelope and Expenditure Estimate** (Plausible scenario, current prices)

Item	SSDP (FY2017–FY2023)		RBL Program (FY2017–FY2021)	
	(NRs billion)	(\$ billion)	(NRs billion)	(\$ billion)
School sector resource envelope projection	1,119.0	10.7	682.0	6.5
SSDP expenditure estimate <sup>a</sup>	1,111.0	10.6	678.0	6.5
Recurrent	1,013.0	9.7	616.0	5.9
Capital	97.0	0.9	62.0	0.6
Capital expenditure as percentage of total expenditure	8.8	8.8	9.1	9.1
Regular expenditure <sup>b</sup>	754.0	7.2	471.0	4.5
Development expenditure	357.0	3.4	208.0	2.0
Development expenditure as percentage of total expenditure	32.1	32.1	30.6	30.6

FY = fiscal year, RBL = results-based lending, SSDP = School Sector Development Plan.

<sup>a</sup> Includes all school-related expenditure (government and external development partners) except teacher pensions. Excludes \$735 million (FY2017–FY2023) and \$715 million (FY2017–FY2021) for estimated disaster risk reduction expenditure for the school sector implemented directly by the National Reconstruction Authority. Although the disaster risk reduction budget to be implemented through the National Reconstruction Authority contributes to program results, it is not included in the program cost because the resources are channeled directly through the National Reconstruction Authority and not through MOE's resource envelope.

<sup>b</sup> Salaries and remuneration plus regular organization and management expenditure.

Source: Ministry of Education estimates.

5. **Expenditures.** SSDP expenditures (excluding reconstruction and retrofitting activities implemented by the National Reconstruction Authority) is estimated to be \$10,577 million for 7 years (FY2017–FY2023), and \$6,461 million for 5 years (FY2017–FY2021). The budget estimate includes both ongoing expenditures and incremental budget required for additional interventions under the SSDP. Capital costs account for 9.1% in the first 5 years and decline afterward. The estimated program expenditure falls within the projected school sector fiscal space, making it a realistic program from the financing point of view.

6. Table 3 and 4 summarize the program's support for the first 5 years of SSDP expenditures, from FY2017 to FY2021.

**Table 3: Supporting School Sector Development Plan – Expenditure Framework FY2017–FY2021 by component** (current prices)

Component	Amount (NRs million)	Amount (\$ million)	Share of Total (%)
1. ECED/pre-primary education	25,800	246	3.8
2. Basic education (grades 1–8)	371,289	3,536	54.7
3. Secondary education (grades 9–12)	172,314	1,641	25.4
4. Technical education under DOE	9,071	86	1.3
5. NFE and lifelong learning	8,011	76	1.2
6. Teacher management and professional development	13,219	126	1.9

<sup>2</sup> Resource envelope here refers to the fiscal space that can be provided for the school sector as a whole and is estimated based on past trends in resource allocations; the program's cost estimate represents the required costs to implement SSDP activities. The plausible scenario assumes average annual real GDP growth of 4.4%, an annual inflation rate of 8.0%, share of education in GDP of 5.2%, share of the SSDP at 80.0% of the total education budget during the 7-year plan period, and is used to arrive at the projected resource envelope for the education sector.

<b>Component</b>	<b>Amount</b> (NRs million)	<b>Amount</b> (\$ million)	<b>Share of</b> <b>Total (%)</b>
7. Disaster risk reduction <sup>a</sup>	31,364	299	4.6
8. Governance and management (district)	5,216	50	0.8
9. Monitoring and evaluation	3,508	33	0.5
10. Capacity development	7,249	69	1.1
11. Organization and management <sup>b</sup>	31,321	298	4.6
<b>Total</b>	<b>678,362</b>	<b>6,461</b>	<b>100.0</b>

DOE = Department of Education, ECED = early childhood education development, FY = fiscal year, NFE = nonformal education.

Note: Numbers may not sum precisely and percentages may not total 100% because of rounding.

<sup>a</sup> Excludes disaster risk reduction allocation to National Reconstruction Authority.

<sup>b</sup> Regular expenditure of Ministry of Education institutions (central line agencies, district education offices, regional education directorates) including staff salaries and utilities.

Source: Ministry of Education estimates.

7. The predominant share of program expenditures will be for basic education (early childhood education or pre-primary education and grades 1–8) and secondary education (grades 9–12). The share of secondary education in the SSDP has increased to 25.4%, compared with 15.0% under the School Sector Reform Program, thanks to new interventions such as separate head teacher positions; trained subject teachers for math, science, and English; promotion of science education; model school program; and information and communication technology (ICT). The share of the SSDP capital budget is 9.1% (higher than the SSRP's 2.3%) and includes infrastructure support and ICT.

**Table 4: Supporting School Sector Development Plan – Expenditure Framework  
FY2017–FY2021 by cost category (in FY2016 prices)**

<b>Item</b>	<b>Amount</b> (NRs million)	<b>Amount</b> (\$ million)	<b>Share of Total</b> (%)
A. Salaries and remuneration	<b>443,144</b>	<b>4,220</b>	<b>65.3</b>
B. Program intervention costs	<b>184,684</b>	<b>1,760</b>	<b>27.3</b>
1. Information and communication technology	14,364	137	2.1
2. Textbooks and learning materials	45,283	432	6.7
3. Scholarship and incentives	40,516	386	6.0
4. Civil works <sup>a</sup>	36,131	344	5.3
5. Equipment and fixtures	7,325	70	1.1
6. Training and capacity development	18,149	173	2.7
7. All other items <sup>b</sup>	22,915	218	3.4
C. Management and administration costs	<b>50,525</b>	<b>481</b>	<b>7.4</b>
<b>Total</b>	<b>678,353</b>	<b>6,461</b>	<b>100.0</b>

FY = fiscal year.

<sup>a</sup> Excludes expenditure of \$621 million on disaster risk-resilient reconstruction and retrofitting of schools managed directly by the National Reconstruction Authority.

<sup>b</sup> Includes costs for education of students with disabilities, monitoring and review, school operation costs, etc.

Source: Ministry of Education.

8. **Assessment of the expenditure framework.** ADB's RBL financing will be channeled through the government's consolidated fund, provided by the assessment made of the program expenditure framework in terms of effectiveness, efficiency and economy, and adequacy.

9. **Effectiveness.** The main issues that limit effectiveness are: (i) focus on input and activity-based budgeting without link to expected results; (ii) inadequate budget for quality-enhancing programs; (iii) emphasis on delivery of per capita fund (PCF) grants to schools without adequate monitoring of the school management committees in spending the fund efficiently to improve school performance; (iv) not enough subject teachers in upper basic education schools (grades 6–8) and secondary schools (grades 9–12), especially in math, science, and English; (v) lack of adequate budget allocation to higher secondary education (grades 11–12) to ensure affordability for the poor; and (vi) no public funds allocated to the private sector.

10. The program reforms aimed to rectify the above issues include (i) costing of prioritized quality-improving interventions in upper basic and secondary education; (ii) plans to introduce a more robust medium-term expenditure framework in tune with the SSDP expenditure framework, to ensure appropriate annual budget allocations; (iii) revision of the school grant system to support performance-based financing, and improvements to the education management information system to make it more reliable and to boost the effectiveness of PCF grants; (iv) a proposal to create additional teacher positions in secondary education, and rationalization of teacher management; (v) allocation of about 25.0% of SSDP expenditure to secondary education; and (vi) piloting of a school voucher program involving the private sector for marginalized groups. Teacher pensions, which constitute 10.0% of the school sector budget, are excluded from the SSDP expenditure framework, which will increase the share of SSDP resources for quality-enhancing activities.

11. **Efficiency and economy.** School sector planning and budgeting is hampered by suboptimal allocation and inefficient fund utilization, especially of school grants. Shortcomings in timely (efficient) and cost-effective (economic) achievement of SSDP results are summarized below with key strategies proposed to overcome them:

- (i) **Weak planning and budget preparation.** District education initiatives are planned based on norms rather than needs because the budget allocation provided by the Department of Education does not reflect the needs of districts. The program will strengthen bottom-up planning and improve annual planning and budgeting to facilitate results-based financing for the SSDP.
- (ii) **Delayed budget release, actual expenditure and utilization.** On the positive side, most of the funds allocated to education (about 90%) have been spent year on year (with the exception of FY2015), indicating efficiency of the system. However, the use of funds is not as effective because of (a) delays in budget release to schools (more than 47.0% released in the last four months); (b) unit costs for classroom construction being lower than real costs; and (c) a weak school grant compliance monitoring mechanism. The program aims to (a) improve the financial management system for timely fund release to schools; (b) revise the school grant mechanism so it responds to specific needs and is supportive of enhancing school quality performance; (c) create more capacity for supervising and monitoring civil works; (d) boost the reliability of education management information system data through third-party verification; and (e) strengthen district and school management capacity for supervision and monitoring of school grants to achieve results.
- (iii) **Earmarked school grants.** Most of the grants have been earmarked, allowing very little flexibility. The program plans to improve the school financing mechanism with emphasis on needs-based allocation of resources by linking it to results and effective grant utilization so as to enhance program economy (i.e., achievement of results at lower costs).

12. **Adequacy.** The overall expenditure framework allows adequate resources for (i) providing math, science, and English teachers to upper basic and secondary schools and implementing the pro-poor scholarship scheme nationwide (output 1); (ii) providing training to subject teachers and delivering activity-based kits focusing on math, science, and English (output 2); (iii) establishing and operating 200 model schools and augmenting ICT-enriched teaching and learning in upper basic and secondary schools (output 3); and (iv) implementing capacity-building plans for improving governance and management of the school system (output 4). Price and physical contingencies are also included in the costing exercise to avoid underfinancing of activities because of price and physical uncertainties.

13. To judge the adequacy of the SSDP cost estimates, the incremental school sector investment was estimated and compared with the estimate based on trends of budget allocations. The planned SSDP investment exceeds the school sector budget trend estimate by \$1.69 billion (Table 5). This surplus investment will fund new interventions such as: (i) rationalization and upgrade of surplus primary-level teachers<sup>3</sup> (grades 1–5) to help rectify the shortage of teachers in grades 6–8; (ii) creation of new teacher positions in secondary education; (iii) upgrade of some secondary schools to model schools with comprehensive quality inputs, such as more subject teachers, separate head teacher positions, disaster risk-resilient classrooms, sanitation facilities, library, ICT facilities, and science labs; (iv) greater use of ICT in pedagogy; and (v) implementation of an equity-enhancing program.<sup>4</sup>

**Table 5: Supporting School Sector Development Plan (Incremental Investment)  
FY2017–FY2021**

Items	NRs billion	\$ billion
a. Budget allocation based on trend estimate using FY2016 budget <sup>a</sup>	500.5	4.77 <sup>c</sup>
b. SSSDP expenditure estimate <sup>b</sup>	678.4	6.46
c. Additional SSDP investment (b-a)	177.9	1.69

FY = fiscal year, SSDP = School Sector Development Plan, SSSDP = Supporting School Sector Development Plan.

<sup>a</sup> Based on calculation of school sector budget trend in recent years (excluding pension).

<sup>b</sup> SSDP cost estimates.

<sup>c</sup> This projection is calculated using an annual 8% nominal increase in education sector allocation based on FY2016 base-year budget.

Source: Asian Development Bank estimates.

14. The program expenditure framework is adequate since it is based on detailed SSDP cost estimates by MOE for achieving intended results. It is important that the government reflects this framework in the education medium-term expenditure framework (under preparation by the National Planning Commission) and the annual budgeting and execution cycle for MOE (being strengthened under the SSDP).<sup>5</sup>

## B. Financing Plan

15. **Program financing.** It is expected that the JFPs that are supporting the SSDP in a sector-wide approach would finance about \$436 million (6.7%) and the government would bear the rest (89.1%) (Table 6). The following table is based on commitments indicated so far. It is expected that the government will raise additional resources and request additional financing from ADB and other JFPs based on satisfactory implementation in the first 3 years, to bridge the financing gap from 2019 through 2021.

**Table 6: Program Financing Plan, FY2017–FY2021**

Source	Amount (\$ million)	Share of Total (%)
Government	5,761.00	89.17
Development partners		
Asian Development Bank (Special Funds resources [loan])	120.00	1.86
Other joint financing partners <sup>a</sup>	316.0	4.89
Financing gap	264.0	4.08
<b>Total</b>	<b>6,461.00</b>	<b>100.00</b>

FY = fiscal year.

Note: Development partners' financing is estimated based on commitments indicated so far.

<sup>a</sup> Expected contributions: World Bank (\$150.00 million), European Union (\$63.10 million), Norway (\$39.46 million), Global Partnership for Education (\$26.60 million), Finland (\$22.34 million), Australia (\$9.00 million), Japan International Cooperation Agency (\$3.00 million), United Nations Children's Fund (\$2.50 million).

Source: Asian Development Bank.

<sup>3</sup> Additional investment finances higher salary grades of teachers.

<sup>4</sup> Additional cost for out-of-school program and incremental cost for scholarships and equity-enhancement programs.

<sup>5</sup> No MTEF for the education sector exists at present. It is being prepared by the National Planning Commission.

16. **Fiscal affordability and sustainability.** The program expenditure (\$6.461 billion) falls within the estimated school sector resource envelope, indicating the feasibility of the required budget allocation (internal and external sources combined) to meet estimated program costs during FY2017–FY2021 (Table 1). This analysis assumes that the economy grows at an average annual rate of 4.1% until FY2021 at constant prices, and that the Ministry of Finance provides on average about 5.2% of GDP as education expenditure. The constitutional provision of free and compulsory education up to grade 8 and free education up to grade 12 is expected to ensure adequate budget allocations to the education sector.

17. Long-term sustainability considerations are built into the SSDP design by (i) using country systems for budgeting, accounting, reporting, and auditing; (ii) strengthening institutions to sustain school sector improvements; (iii) using disbursement-linked indicators to strengthen results orientation; and (iii) strengthening governance and management.

### C. Managing Risks and Improving Capacity

18. Based on the assessment of the expenditure framework, program expenditure and financing risks were identified, along with measures to mitigate them (Table 7). These measures are included in the Program Action Plan and will be monitored regularly.

**Table 7: Expenditure and Financing Risks and Mitigation Measures**

<b>Risks</b>	<b>Rating without the Mitigating Measures</b>	<b>Key Mitigating Measures</b>
<b>Effectiveness of expenditure framework.</b> Inadequate budget allocation for SSDP and weak link between policy targets and budget allocations.	Substantial	Adequate budget allocation will be ensured through improved Annual Strategic Implementation Plan and Annual Work Plan and Budget with a stronger results chain of inputs and outputs.
<b>Efficiency and economy.</b> (i) Suboptimal allocation, and (ii) suboptimal utilization of grants by schools.	Substantial	(i) Allocation, release, and spending will be monitored with a more accurate EMIS and (ii) grant management units at DEOs will be established to monitor and supervise grant utilization.
<b>Adequacy.</b> Given the decreasing share of the education budget in total budget in recent years, and decreasing share of resources from development partners, adequate budget for the school sector, especially for quality-related activities may not be available.	Substantial	The Eighth Amendment to the Education Act and the new Constitution provide for strong government engagement. JFA will include the provision that (i) annual allocation to the education sector increases in real terms, and (ii) the share of the school sector (grades 1–12) will not be less than 80% of the education budget.
<b>Sustainability.</b> The government may not be able to continue financing the sector after 7 years at the same level, and schools are not allowed to generate funds to meet their operating costs under the policy of free and compulsory basic education and free secondary education.	Medium	(i) School financing policy will be developed, approved, and implemented during the SSDP with provision of cost sharing between federal government, state government, and local authorities; (ii) some of the development programs will be integrated in the regular program of the government starting from FY2018.

ASIP = Annual Strategic Implementation Plan, DEO = district education office, EMIS = education management information system, JFA = Joint Financing Arrangement, MTEF = medium-term expenditure framework, SSDP = School Sector Development Plan, SSSDP = Supporting School Sector Development Plan.

Source: Asian Development Bank.