

PUBLIC DEBT SERVICING IN NEPAL

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RECOMMENDATION

This is to certify that the thesis

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has been prepared as approved by this Department in the prescribed format of the Faculty of Management. This thesis is forwarded for examination.

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DECLARATION

I hereby declare that the work reported in this thesis entitled "**Public Debt Servicing in Nepal** " submitted to Office of the Dean, Faculty of Management, Tribhuvan University, is my original work done in the form of partial fulfillment of the requirement for the degree of Master of Business Studies (MBS) under the supervision of **Lecturer Rita Maskey** of Shanker Dev Campus.

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Parbati Ghimire

ABBREVIATIONS

ADB	:	Asian Development Bank
BOP	:	Balance of Payment
CIC	:	Citizen Investment Certificate
DB	:	Development Bond
EDO	:	External Debt Outstanding
FACD	:	Foreign Aid Coordination Division
FCGO	:	Financial Comptroller General Office
FG	:	Foreign Grants
GDP	:	Gross Domestic Product
ID	:	Internal Debt
IDA	:	International Development Agency
IFAD	:	International Fund for Agricultural Development
IME	:	International Monetary Exchange
LDC	:	Least Developed Country
MOF	:	Ministry of Finance
NG	:	Nepal Government
NRB	:	Nepal Rastrya Bank
NSC	:	National Saving Certificate
SAFTA	:	South Asian Free Trade Association
SAPTA	:	South Asian Preferential Trade Association
SB	:	Special Bond
TD	:	Total Debt
TDS	:	Total Debt Servicing
TE	:	Total Expenditure
TR	:	Total Revenue
TS	:	Treasury Bill
UK	:	United Kingdom
VAT	:	Value Added Tax
WTO	:	World Trade Organization

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CHAPTER - I

INTRODUCTION

1.2 Background of the Study

Nepal is one of the low-income countries in the world with a per capita income of \$735. Statistics on social sector development such as life expectancy, infant mortality, and literacy also indicate poor status compared with many other SAARC countries. Poverty alleviation and improved quality life is emphasized as the important objective in the current 10th plan of the country. Thus borrowing should be directed to relevant sectors, and efficient utilization of external resources should be accorded due attention.

In developing countries economic development is widely accepted as major goal of national policy, whereas economic growth as a major goal of the industrialized countries. Economic development is viewed as a process, which implies the series of changes in social, technological and economic forces, which are useful in accelerating the pace of the development. In underdeveloped countries one of the tasks foremost to the state is to stimulate the growth and escape from 'vicious circle of poverty'. There is small capacity of saving owing to a low level of real income. Low income is a reflection of low productivity, which is usually due to lack of appropriate technology of capital equipment and the capacity to use them to the best advantage.

The lack of capital is resulted largely from the small potentiality of saving. This in turn is resulted from the low investment. Hence the poverty sequences move like inadequate capital, low productivity, low real income level and low purchasing power, inadequate inducement to save and to invest and inadequate capital gain. This justifies that capital deficiency in the developing countries is a serious bottleneck in the development. Under developed countries are facing the deficiency of capital in the relation to their population and natural resources. Most of the developing countries are characterized by deficiency of capital. To break vicious circle and uplift a country with a self-sustaining growth, a large amount of initial investment is necessary.

Nepal is a small beautiful and covered with natural resources but poor and underdeveloped country. Nepalese people are moving around "vicious circle of poverty" About 25.16 percent of people is below the poverty line. Agriculture is the main source of Nepalese economy, which provides employment for 81 percent of the country. So to reduce poverty and to enhance economic development government requires investing big amount in the field of transportation, communication, power, road and other basic infrastructure. To invest in all these areas government need higher amount of revenue but the source of revenue is very small and limited. The government needs to borrow from internal and external sources. The government of the country gets income from two sources namely, public revenue and public borrowing (debt). Public debt carries with the obligations to pay back to person, institution or countries from which it has been obtained but there is not any repayment obligation in taxation.

Nepal remained almost a debt free country till 1961/62. The accumulation of the debt begins since 1963. Since then Nepal has been receiving public debt from both internal and external sources. In internal sources financial sectors dominates others and in external debt it's receiving from bilateral and multilateral sources. The trend of borrowing through the external source is very high in Nepal as compared to internal. Developing countries like Nepal are always facing the problems of fund; tax payable capacity is very low which leads to low level of government revenue. Low level of revenue and increasing demand for development expenditure has forced to resort to borrowing. It is an instrument for to collect the needy fund.

Nepal is basically an aid dependent country, which is not able to attract bank lending, and has to depend mainly on foreign aids for the required capital imparts. Since the credit worthiness of a particular country depends upon the economic condition and performances need not to say that Nepal does not have that credit worthiness that can attract the bank lending from the abroad. The main sources of external borrowing for Nepal are western developed countries. Foreign aid as a source of financing development plans has been increasing used in Nepal since the inception of planning.

In the recent year, several technique of financing economic development of under developing countries public debt both internal and external as means of financing economic development has come to significant role in the context of planned economic development. For this public borrowing has to be undertaken within the country as well as abroad. The scope of domestic borrowing in these countries is very limited. Therefore only external borrowing remains the alternative to these countries.

In the first two five year plans, the major goal was to collect the information about the economic variables. From the 1970s, government started investing directly in productive activities, which increased the volume of government expenditure. The demand for the goods and services also increased due to increased government expenditure it lead to inflationary situation appeared. But on the other hand government revenue could not increase to fulfill the required expenditure. So, government has to relying upon public debt as other sources were limited.

Hence, both developed as well as developing countries are availing public debt as a major source of resource mobilization to meet budgetary deficit. Now it is widely accepted means for financing deficit. The role of public debt is increased significantly by the planned economic development. The persistent feature of Nepal's is that public debt both internal and external debt has been increasing rapidly each year. The trend of external debt is increasing more rapidly than internal debt. Nepal is facing serious problem of financial resource gap in one hand and increasing population growth and inflation in another. The government cannot rely entirely upon the tax revenue, supply of public undertaking and deficit financing as an internal financial resource. Those resources of financial have to be supplemented by borrowing in a large scale from public bank, other financial institutions internally and externally. But no doubt if the trend of foreign debt goes on like this at present Nepal will be debt trapped in the near future.

1.1.1 Importance of Public Borrowings

Internal debt is one of the several means of procuring public funds. When taxation solely fails to meet the needs of resources, the government enters in the money market in search of fund just as a private borrower. The need of public borrowings in Nepal

streams from the necessity of financing the numerous developmental projects for which the government cannot raise adequate tax revenues. Moreover, the prudent and efficient IDM also initiates numerous facilities and products for the development of money and capital markets. However, the importance of public borrowings can be summarized in the following points:

- To mobilize adequate resources for developmental activities and Infrastructure developments.
- To stabilize the economic swings and ensure high and sustainable growth.
- To provide avenues of investment to individuals and institutions.
- To provide marketable instruments for the development of money and capital markets.
- To enhance saving habits among people and provide fixed income Instruments.
- To protect the nation from vulnerability of international financial shocks as extreme exposure on external debt increases global financial contagion.
- To develop and maintain an efficient market for government securities and financial system.

1.2 Statement of the Problem

The volume of budgetary deficit is increasing. The revenue mobilization is not increasing to that extent to cover the total budgetary outlay. The debt should be repaid with interest in the future. Therefore, the excessive public debt to finance the deficit budget may create a debt trap situation for the country. For the economic sustainability, the public debt management, the export earnings, the revenue growth and the real interest rate structure should be in favorable condition in the future to pay off the debt. All these aspects are governed by so many other economic factors. Therefore, a careful evaluation of public debt position is extremely necessary for any country. In this context, it will be relevant to examine that whether our country has adopted the prudential norm in raising the debt or not. For this, the government should also have a look over the practices adopted by other country for the better public debt management. It has been observed that there are some golden rules and fiscal disciplinary measures set by the legal framework in the other countries to restrain the growth in the level of debt. Therefore, the adoption of such fiscal discipline measure

would be helpful for the country before entering into a problematic situation. Lack of study and information in this regard may be one of the constraints for the policy makers to initiate appropriate measures and strategy in public debt management. This study is an attempt to study this problem by providing some information in these aspects. Therefore, the study of public debt management especially focusing on practices of debt management, indebtedness of debt and sustainability of debt in Nepal, is a small attempt to fill the gap. This Study mainly deals with following questions:

- What is the present situations public debt?
- What is the growth Patten of budgetary deficit in Nepal?
- Which trend of public debt servicing in Nepal?
- What is the Nepalese government revenue and expenditure?
- Which proportion of foreign aid, grants and loans?

1.3 Objectives of the Study

The main objectives of the study are as follows:

- To analyze the structure and trend of public debt
- To examine the role of public debt in Nepalese budgetary system.
- To identify the debt servicing and per capita debt in Nepal.
- To identify the problems of debt and to recommended for optimal utilization of debt.
- To study the effects of public debt on national GDP.

1.4 Significance of the Study

In modern era, planning is taken as the main tool for economic development. In economic planning, various objectives are set for economic development. To meet the objectives public debt is necessary due to low level of tax paying ability of the people. Mostly in developing countries, needs are increasing but resources are limited; in such situation public debt is common and reliable source for resource mobilization.

For economic development of under development countries government must invest on various sectors such as education, health, transport, communication etc. To build

up such social overhead capital there is need of heavy investment so that importance and scope of debt is increasing over time. It is not limited only in developing countries like; else and everywhere it is used as a reliable source of financing deficit for development activities.

Now, public debt has been an economic issue or hot case for debate. Expending in scope from a simple source o supplementing budgetary resources for the government. Public debt is now considered to be an important instrument of monetary and financial management. For the more economic analysis public debt relates with inflation, income redistribution and overall resource allocation in the economy.

Development of resource and technology growing ideas of globalization liberalization and privatization increased the role of debt. Only Nepal cannot be escape from it, which is facing various, socio-economic constrains. Debt is needed for economic development but effective and appropriate utilization of debt is the matter of concern.

1.5 Limitation of the Study

Within some limitations this study is prepared, which are as follows:

- Due to time and budget constrains this study covers the period from 2002/03 to 2011/12.
- This study is based on secondary data and information and no attempt has been made to examine the reliability of data
- This study has not attempted to examine the effect of public debt on macro economic variables such as national income, employment, investment, general price level etc.

1.6 Organization of the Study

The study is divided in five chapters. Prior to the body of this several pages of preliminary materials such as title page, approval sheet, viva sheet, acknowledgements, table of contents, list of tables, list of figures, abbreviation used etc have been presented.

Chapter –I: Introduction

This Chapter includes introductory matter which contains introduction of public debt, limitation of public borrowings, statement of problem, objectives of the study, significance of the study, limitations of the study and organization of the study.

Chapter –II: Review of Literature

This Chapter deals with the review of available literature, which consists of conceptual Framework, Trend and structure of public debt in Nepal, Role of Public Debt in Nepalese Budgetary System, 3 Public Debt Servicing in Nepal, Internal Debt Servicing, Historical Background of Public Debt, fiscal policies and capital formation, deficit financing and economic development, Review of Unpublished Dissertation, public borrowing and research gap.

Chapter –III: Research Methodology

This Chapter is research methodology and it contains research design, population and sample, source of data, data analysis tools.

Chapter –IV: Data Presentation and Analysis

This Chapter deals with data presentation and analysis, which contains presentation of data, in various ways and its interpretation. This chapter also includes major findings of the study.

Chapter –V: Summary, Conclusion and Recommendation

This chapter included summary, conclusion and recommendation.

After the body of the thesis bibliography and appendices are presented as supplementary materials.

1.3

1.4 CHAPTER- II

REVIEW OF LITERATURE

Review of literature means reviewing research studies or other relevant proposition in the related area of the study so that all the past studies, their conclusions and deficiencies may be known and further research can be conducted. It is an integral and mandatory process in research works.

2.1 Conceptual Framework

The public debt is the amount of debt owed by a sovereign government to its creditors within and outside the country. This is the total of all bonds and other debts owed by a government. If revenue collected through taxes and other sources is not adequate to cover government expenditure then government may resort to borrowing. Borrowings for the government may become necessary in times of budgetary deficit, economic crisis and emergency. This may be the case of developed, underdeveloped and developing economies. While, in the case of underdeveloped and developing economies, the public debt may be raised for financing the development projects as well. Public debts are mostly voluntary. However, in case of domestic debt, it may be compulsory during special circumstances, like war and national crisis.

Public debt is a legal obligation on the part of government to make interest and amortization of principal to holder of designated claims in accordance with a defined temporal schedule. It is created through the government borrowing from individual, corporations, institutions and other governments. It refers to loan to rise by government within the country or outside the country. Every government like individual has to borrow when its expenditure exceeds its revenue.

Opportunities for the government borrowing at home are limited in most developing countries due to low level of income and saving. This in turn is resulted from the low level of investment. This justifies that capital deficiency in the developing countries is

a serious bottleneck in the development. Developed countries are facing the deficiency of capital in the relation of their population and natural resources. Most of the developing countries are characterized by deficiency of capital. To break vicious circle and uplift a country a large number of initial investments are necessary. Thus underdeveloped countries should emphasize to stimulate and accelerate capital formation.

Borrowing abroad gives a country command over more goods and services than it produce currently, but it had future real cost and transfer problem. The burden of external debt should be conceived in term of benefit cost question: an immediate gain in resources is to be balanced against the future real cost of debt servicing and amortization (i.e. debt repayment)

The government borrowing is not the new and keen matter. From the very beginning of the 19th century economist have been arguing and discussing for and against the public debt. Particularly the classical economist such as Pigou, T.R. Malthus. J. B. Say, Ricardo, Adam Smith, C. F Bastable visualized their views against the public debt saying " Nation once begins to borrow would be resist until it reached the point of bankrupt". Whereas post Keynesian and the modern economists including J.M. Keynes, Harris, Hansen, Buchanan, Musgrave, Davis, Kopt, and other have challenged the version of classical economists and hold opposite opinion on the subject o public debt, its size and use.

2.1.1 Trend and Structure of Public Debt in Nepal

Public debt is taken as a great instrument of the government to fulfill its budgetary deficit. Since it becomes greater than current revenue collection, it refers to those obligation, of the state as borrower and promises to pay to amount borrowed with the return in a given period of time (Barman, 1986:8).

The government of a country may borrow because current revenue may not be sufficient to meet its expenditure. The government borrowing is necessary to fill the gap between the tax and non-tax revenues and the growing expenditure. The loan

operation of the modern government especially in LDCs has been increased due to the government's active participation in the economic development one hand and the limited availability of funds for investment from the private sectors on the one other hand. Thus, the investment for accelerating the role of capital formation for development purpose has led to the government to expend resources through public borrowing externally and internally.

Now a day's public borrowing is considered as an effective instrument. There are two major source of public borrowing external and internal. Internally a government can borrow from individual, financial institutions, non-financial institutions, commercial banks and central bank. Similarly the main sources external borrowing is; Firstly, International financial institution likes, IME, World Bank, IDA and ADB etc. These institutions give loan to member countries for a short term for covering the temporary balance of payment difficulties and for long term for the development projects. Secondly, friendly countries also provide loans for the development projects.

The objective of public debt in developing countries is that the public debt should be used as an instrument to mobilize saving of people which would otherwise have gone to idle or wastefully consumption. Public debt should be advocated for creating capacity and producing capital equipment. Generally government borrows for the creation of infrastructure in the economy, since it requires huge investment initially, which cannot be meet through only revenue collection. The aim of the public of debt policy should be to help in strengthening the money and capital market, which is turn accelerate development and price stability.

Internal borrowing is the source of public borrowing. It is applied as a means of mobilizing internal resources in the development process of the country in a wide perspective. It has been taken as a means of revenue generation as well as economic stabilizer. As a fiscal measure it is source of revenue of the government as it mobilizes saving from public to the state. As a monetary measures, it is a weapon in the hands of the central banks to regulate the economy, so that the inflation generated

in the process of economic growth may not take the form of hyperinflation, but these methods are applied in two different ways;

- Borrowing from non-bank lenders as individuals or groups known as real borrowing or real debt creation which takes place only if some individual or group in the economy deliberately exchanges current purchasing power for government obligation to provide an income refers in the future periods.
- Borrowing from the central bank and with its support from the commercial banks is known as unreal borrowing or disguised money creation. Under this methods the banking system provide with an interest income in exchange creating additional currency, for any sacrifice of the purchasing power for liquidity but interest for carrying out the operation that is especially within the constitutional power of the government.

Therefore it is difficult to borrow from the internal source due to many constraints and on the other hand, country need foreign currency to import capital goods for development project and to finance the balance of payment deficit, These make the country to depend more on foreign borrowing than on internal one. Like other countries, Nepal is also indebted from the external debt and seems likely to increase further.

2.1.2 Role of Public Debt in Nepalese Budgetary System

The word budget is said to have its origin from the French word baguette, which means small leather bag. In 1773, when Walpole was the chancellor of exchequer, he used to keep his documents in a leather bag. Today, bag itself is not a vital importance but people are anxious to see what the bag contains. Therefore, the bag contains economic bill presented by the finance minister in the parliament house annually. In the modern times, governments are welfare oriented. They have made some vigorous efforts to maximize the welfare of the society. In order to achieve it, government has to perform various socio-economic activities. This requires proper manipulation in the budgetary policy of the government. A budget, therefore, is not only a financial statement of actual and anticipated revenues and outlays of the government but it is

also documents of detailed programmers and policies of action which they desire to pursue in the coming years to raise the level of economic activities.

A budget is the compendium of annual plans with resources allocation. It is the financial plan covering the outlays and receipts of the government. Usually, it is embodied in a document that may be called the budget, but budget is much more than that. It is the outcome of a process that includes preparation of the financial plan, review of the plan by the legislature where there if one, execution of the plan and evaluation and public reporting of the results.

A budget is both political as well as economic documents because it contents both political as well as economic elements. Its political elements are good governmence strengthening the democratic values and norms, etc. through achieving the macro economic goals. Its economic elements are estimation of income and expenditure collection of taxes, allocation of public expenditures, etc.

The budget occupies a significant place in the modern financial system. It affects the working of the whole economy through its effect on aggregate demand. It is an important instrument to achieve macroeconomic goals or objectives. It has various purposes through which the macro goals or objectives can be achieved. The major purposes of budget are as follows.

- It sets a framework for policy formulation. This requires decisions about the action to be taken to reach objectives. Choices must be made about which of many competing proposals should be adopted to further particular national objectives and about the extent to which various objectives can be advanced simultaneously. Thus, it provides guideline to formulate various policies.
- Budgeting is the means for policy implementation. It provides guideline for policy implementation. It is the guide for management and at the same time budgetary procedures are instruments of administrative control.

- Budget is the means for legal control. Once the budget passes from the house, it becomes the means for legal control.
- Budget documents may be the good source of information on past activities, current decision and future prospects.

Some Observation of Nepalese Budget

- For the last few years, regular expenditure seems to be greater than development expenditure; it slows down the process of economic transformation and the process of economic development. This is because regular expenditure is consumption in nature, which does not have direct relationship to economic growth. This has increased the challenges to maintain the macro economic stability by rationalization the regular expenditure, streaming development expenditure to highly productive sectors, broadening the tax base, and reducing the size of deficit financing.
- Nepal's budget is always a deficit budget. This is our compulsion and also a strategy to have deficit budget to mobilize the resources. This trend will continue in future if there is no specific effort to mobilize the resources.
- Of the total deficit financing, the share of foreign loan is around 51 percent. As they are conditional, we cannot mobilize them according to our need and policy. Such excessive dependence on foreign loan is not productive for economic development.
- Our budget is still traditional in nature. It is because it has adopted the traditional methods of resource mobilization and management. (such as traditional sources of revenues: borrowing, traditional tax system, etc.)
- Amount of domestic loan and foreign loan are increasing year by year. This also shows the failure of government to mobilize the internal revenue.
- Considering the development in the context of SAPTA/SAFTA and WTO, there may be reduction in the government revenue as tax rates are to be rationalized compatible to international standard/WTO criteria, there is urgent need to mobilize the internal resources compatible with the increase in GDP.

In the modern times, the expenditures of the governments are increasing very rapidly as compared to the increase in their incomes. It is due to the fact that government is welfare oriented, as a result of which, there is rapid increase in the services performed by the government. This results in budget deficit. That deficit can be bridged by imposing more taxes, or by borrowing the money from public or other agencies. However there is certain limit to which taxation can be used to cover up the deficit in the budget without having adverse effect on the economy. Similarly, external borrowing is subject to various factors as it is conditional.

The money, which the government raises in the form of loan domestically, is known as internal borrowing. The concept of internal borrowing began in the decade of 1930s in order to fight against the depression...Keynesians strongly recommended the increasing use of government expenditures even by undertaking the internal and external loans to bring the economy out of the depth of depression. This has increased the importance of internal borrowing.

Internal borrowing is one of most important way to mobilize the internal resources in under developed countries like Nepal, where size of savings are small; they are scattered; there are very low opportunities of investment for general public; private sectors are still in infant stage; etc. The resource, which the government collects in the form of internal borrowing, can be utilized on the socio economic development such as economic and social overhead capital. Hence, internal borrowing mobilizes the available saving even though they are scattered and they are of small size. Beside this, it increases the saving habit on general public. It avails the opportunity to the general public to participate in the process of nation building. To some extent, it is desirable than external borrowing as they are conditional and they have to be paid after maturity in the convertible foreign currency with interest.

External resources contribute to development by supplementing domestic savings and by financing imports. They also permit flexibility in managing the balance of payment. The reasons for increasing the external loans are mainly

2.1.3 Public Debt Servicing in Nepal

The burden of internal debt means that the greater part of the debt is held internally. Beyond this it may be pointed out that large public sector deficit, which are financed by inflationary methods, serves to reduce the purchasing power of the economy. Government borrowing has been excessive and the burden of public debt increasing daily according to increases on the outstanding portion of the debt composition.

Large-scale of public debt has been incurred for the financing development programmers. While large-scale public borrowing for financing development expenditure may be justified, resulting rise in public debt raises several issues of which most important is the burden of public debt. The burden of public debt is one of the oldest controversial issues in the economics of public finance (Singh, 1983).

The total burden of public debt can be divided into two parts: (i) internal burden of public debt (ii) external burden of public debt. The internal burden means that the greater part of the debt is held internally. Dalton (1949) takes internal public debt burden as not much significant as the payment of principle amount and its interest involves taxation. It is merely transfer of purchasing power from one person to another or money does not flow out of the national money market. Similarly, Lerner (1946) points out, the internal debt may not have any direct money burden on a community as a whole, since the payment of interest and taxation to meet the burden of debt involved simply transfer the purchasing power from one group of person to another, to the extent the creditors and tax payer are the same, there may not be any net burden at all in the community. But to the extent of the creditors and taxpayer belong to different income groups; the changes in the distribution of income among different section of the community may take place.

External debt burden is, however, completely different. External debt imposes real burden on the economy because it reduces national welfare. External debt is paid not in money terms but in real terms, in terms of goods and services, which are exported to the creditor country for the settlement of the debt. This process will have to

continue during the whole period of loan because the borrower country has to pay interest charges, but if external loans are used for increasing the productive capacity of the country the debt repayment may not be a serious burden. The debtor country may pay off the debt and interest without any difficulty because of increased capacity of export oriented industries. If debtor country does not sufficiently increase the productive capacity they will have to face the balance of payment problem.

2.1.4 Internal Debt Servicing

The payment of interest and principle of public debt is known as debt servicing in economics and finance. The ratio of internal debt servicing to the total government revenue is an important indicator for estimating burden of internal debt servicing charge. The relation of internal debt servicing to government revenue clearly indicates the burden of servicing charge on the taxpayers.

The burden of internal debt can be examined also taking into consideration of national income (GDP), government revenue and expenditure etc. If the national income (GDP) increases due to the public debt at a faster rate than the debt servicing costs, the ration between the two will register downward trend and indicates falling burden of national debt. It will also show that society has benefited by the benefits of the public debt. But, if the service costs expand at a faster rate than the national income (GDP), the ratio between the two will rise and indicate increasing burden.

2.2 Historical Background of Public Debt

The history of the public debt in the world reveals that the idea was originated in the Great Britain in 17th century, where a group of merchants provided grants and loans to the government. In return they received the privilege of royal charter to found the bank of England, which became the country's central bank. Public debt had been developing simultaneous with the increasing role of the government for development. During and after the world war, the government borrowed large amount of loans to meet its expenditures (Joshi, 1982).

After the first and Second World War large amount of loan were borrowed for the reconstruction and maintenance. In the previous time state only have had to maintain

the internal peace, law and order and prevent external disruption. But now days every state should be aware of for overall economic development and public welfare programmers in addition to the previous works. So the public debt becomes one of the most useful instruments of generating income to maintain the welfare state and economic development.

In the context of Nepal, the government debt statistics indicate that the country remained debt free nation till 1950s. However the foreign and domestic borrowing has been alternative means of debt financing in Nepal after inflation of planned economic development.

M.C Regime has written in "Nepalese Economic History" that there was no existence of public debt before eighteenth century, but the government provided some regulation to public finance. For instance public debt held in Nepal during the period of Rana Bahadur Shah. He borrowed a large amount of money (60, 000, 00) from the Indian merchants even to meet internal expenses. Cash levy was imposed on countrywide basis in 1804-1806 to finance the repayment of debt incurred by the king Rana Bahadur Shah. (Regmi, 1971:59). Prime minister Jung Bahadur Rana came into power and no development work was carried out. They had collected the revenue for their own expenses. They never thought the need of economic welfare for the Nepalese people. Thus 104 years passed of a way without significant development activities were not launched out. After the democracy, the first five years plan was introduced in the years 1956. In this plan period most of the expenditure was incurred with the foreign grants. During that plan period, some deficit amount of Rs 2708 million was met from surplus balance account and loan from Nepal Rastra Bank (NRB, 1996:29).

The government at the first time issued the securities (Treasury bills) in the fiscal year 1961/1962 and in the fiscal year 1963/1964. The government for the first time floated securities (long- term loan) for mobilizing saving to finance the country's economic development programmed and for giving compensation of the forest and Brita land (Joshi, 1982:29).

Similarly, on Feb. 12, 1964 the government floated development bond of Rs 13.1 million carrying on interest rate of 6 percent per year with maturity period of five years. In the same year, the government issued compensation bond for the land acquisition with the interest rate of 3 percent per annum with the maturity period of 10 years amounting Rs 407 thousands and composition bond for the land acquisition with one percent interest rate per annum with the maturity period of 20 years amounting 5.56 million. The other component of borrowing was from NRB as guaranteed loans and special bond. Since 1984 the government also started to borrow by issuing national saving certificate which amounted Rs 500 million that after. Similarly in 1991 the government started to borrow by issuing CB pass and other bond, which amounted to Rs 8,478. Million there after. Now, there are treasury bills, development bonds national saving certificate, citizen investment certificate and special bonds as the, main source of internal borrowing.

In the context of evaluation of foreign assistance, Nepal's first experience of foreign economic assistance was heralded by the POINT FOUR program agreement signed on 23rd Jan 1951. The U.S government assistance of Rs 22 thousand provided under president Henry Truman's POINT FOUR program was soon followed by assistance from India in October the same year. It was then followed by China (1956) and U.S.S.R (1958), membership of Colombo plan (1955) widened the number of donor countries and agencies. Formation of Nepal aid group (1976) also named as "Paris club" began to accelerate the quantum of foreign aid move significantly in a planned way.

Similarly, Nepal has also started to borrow from external sources since 1964/65. Since then Nepal has started to borrow from external sources to bridge financial gap on the budgetary position. Since then the amount of external borrowing has contributed to increase each year. The main sources of the external borrowing of Nepal are the government of developed countries, International Agencies and Commercial banks mainly I.M.E, World Bank and Asian Development Bank etc.

2.3 Role of Public Debt

Public debt now is considered to be an important tool of monetary and financial management, extending in space from a simple source of supplementing budgetary resources for the government. Public debt has become sine-qua-non for economic development because the factors of economic development like a plenty of natural resources, technically trained labor, a spirit of entrepreneurship, dedicated civil servants, capable planners are the major problem of economic development. So, the capital formation in mobilization of all resources is possible only through the public debt (Jhingan, 2001).

In the past, the way of living was very simple and borrowings were very small. The government also followed the policy of non-intervention in economic system. But in modern time, especially after the world depression of 1929/30, the public authorities started to take keen interest in economic development of their respective countries. Thus public borrowing has become 'sine-qua-non' for the economic development of the nation (Lekhi, 1995).

For the underdeveloped countries like Nepal, it has so vague areas where resources are abundant but those are not in use. People have no adequate incentives to save and also have no opportunities to save. The government policy to promote development is less effective. Despite such problems, the non-bank financial intermediaries offer high interest rate and divert funds to speculative trade unproductive private expenditure and abstract in the way of mobilization of financial resources. Likewise, non-availability of markets and capital markets on non-urban uses create trouble in resource mobilization.

2.4 Fiscal Policies and Capital Formation

Fiscal policy with tools taxation, expenditure borrowing to act rapid economic growth shouldering with stable monetary policy serves to forward ejection of capital formation and stability maintenance. So the focus of developing countries is capital formation. As Higgins observed "The sheer poverty of underdeveloped countries makes the raising of the propensity to save as well as inducement to invest necessary part of fiscal policy' (Higgins, 1959).

Public debt is a useful tool for diverting resources from unproductive to productive channels. Public debts, with joint ventures where by foreign investors bring technical knowhow along with capital and they train local labor and enterprises which adds in the capital formation (Jhingan, 2001).

2.5 Deficit Financing and Economic Development

Deficit spending by the country on development projects leads to increased employment, output and income. The increased income tends to raise the demand for consumer goods; on the monetary side government meets the increasing demand for money through deficit financing. I.e. expansionary effect in the economy is essential (Jhingan, 2001).

In Nepalese context, deficit financing has a crucial role in development plans. It has been regarded as a means to cover the gap in financial resources to achieve the targets of different short term and long term plans.

2.6 Public Borrowing and Resource Mobilization

No doubt, to uplift the economic development, public borrowing has been playing the significant role. Nevin observed a vital importance role of public debt in underdeveloped territory is to secure funds not for the government itself, but in order to established a regular acceptable channel by which private investor may obtain access to funds which would otherwise have been last to invest within that territory (Nevin, 1963).

In developing countries, the expanding developments activities cannot exclusively out of own resources of the government. Taxation and saving are also inadequate for development financing. It is neither desirable nor possible to raise funds though taxation beyond a certain limit. People also react unfavorably to the imposition of taxation as it reduces their income. Alternatively, there is no substitute left for public loan or borrowing. It is an effective measure for mobilizing private saving. Often, private saving where the rate of profitability is higher. As a result, pattern of investment is not comparable with balance development of the economy. It pushes private saving in the government filled to mobilize the some productive channel.

Underdeveloped countries like Nepal have characterized by market imperfection. There is immobility of resources, which lead to elasticity's of supplies. There is also lack of large volume of fresh resources which is created by increased government deficit spending is fulfilled by foreign loan. Income increases as a result of deficit spending. There are not sufficient domestic resources to carry out infrastructural and social development programs; so public borrowing plays a major role in overall economic development of the country.

2.7 Problem of Public Debt in Nepal

The Landlocked nature and mountainous to Geography are the major constraints for development in Nepal. Economically, Nepal is backward and its economic performance is not satisfactory. Now, Nepal is facing an acute resource gap problem, which is also expected to grow in coming years. Nepal is thus, compelled to borrow more and more public debt to bridge the growing resource gap in the budget.

Large-scale public debt has been availed in the past for financing development programs. While large-scale public borrowing for financing development expenditures may be justified, the resultant rise in public debt raises several issues of which most important is the burden of public debt. The burden of public debt is one of the oldest controversial matters in the economics of public finance.

Owing to heavy reliance on external assistance in the form of borrowing on public account, Nepal's external public indebtedness has increased very much. A rise in external indebtedness should be accompanied by an increase in debt servicing capacity so that there may not be undue strain in the balance of payment, owing to outflow of funds through debt servicing.

In Nepal both internal and external borrowing has been increasing rapidly. It is very common that a rise in the magnitude of public debt must be accompanied by an increase in the debt servicing capacity so that there may not be undue strain on the balance of payments owing to outflow of funds through debt servicing and there may not be unnecessary increase in the rate of taxes for meeting requirement of internal debt servicing charge.

It is generally observed that the present increasing size of Nepal's public debt is a matter of concern. It is necessary to have a careful work on the increasing magnitude of public debt and proper care must be taken to increase the debt servicing capability of the country.

2.8 Review of Related Studies

In review of literature on public debt in Nepalese context some of students of master level specially say, have or university and some writer have preceded to male their dissertation and article on public debt. This study includes review of some articles, thesis and projects reports. They are as follows:

2.8.1 Review of Journal and Articles

Koirala (2002) , in his article titled, “*Effective Public Debt Management in Nepalese Perspective*”, has viewed that if debt is not handled properly, our future generations may tire paying back ancestral loans. In this perspective, he prescribed some policies to mitigate the pain of the adverse effects of ever increasing trend of public debt in Nepal. Loan assistance should be utilized selectively, after careful scrutiny of the purpose. Cost and benefits of such projects and programs should be carefully analyzed in order to reduce burden of external debt while contribution to accelerating growth meeting socioeconomic objectives. The Medium Term Expenditure Framework (MTEF) should be implemented effectively Increase the share of tax and reduce the dependency on foreign debt for the financial resources mobilization. Unproductive expenditure should not be made out of foreign grant or loan. Proper attention should be given to the macroeconomic stability of the country while accepting short-term and long-term loans. Proper attention should be given to cost benefit analysis when using public debt.

Thapa (2005), in his article “*Domestic Debt Management' Analyzed about Public Debt*”. He illustrated that; to manage the government borrowing Efficiency development of an efficient security market is a must. The borrowing amount should

be invested in the productive sector. The financial return to government out of these investments should be greater than the cost. The assets created out of such borrowing (yield) should be at the higher level. The borrowing cost and return should be widened every time. The Objectives of borrowing should not be for making easy money for the government. If the return is less than the borrowing cost, this will result in the gradual deterioration in the paying capacity of Government and finally the public will have less confidence towards Government.

The borrowing instruments can be used for maintaining monetary balance as well as for Government's financing. So, there should be a cordial co-ordination between fiscal and monetary policy maker and debt manager. They should share their common interests to attain the goals.

The borrowing should not be for the payment of interest and principal amount. It should be invested in the productive sector so that the return from such investment will be sufficient for repayment. Hence, an efficient monitoring mechanism should be developed. Likewise, the effective and efficient uses of such borrowing are more crucial.

For the implementation of the Issue Calendar, a very cordial co-ordination is needed between the fiscal manager and domestic debt manager of the country. Through the primary issue of the government securities, liquidity will be drained and there will be a decline in the reserve position in the financial system. So, the fiscal manager should be aware of this effect on the monetary sector. Likewise, the monetary authority should also bear in mind that it is also used for fiscal management of the government.

Nepal Rastra Bank (2009) , on the article “*An Overview of Macroeconomic Situation*” The performance of Nepalese economy in terms of economic growth remained normal in 2008/09. The overall growth of Gross Domestic Growth (GDP) at producer's prices grew by 4.9 percent in 2008/09 compared to a growth of 6.1 percent in the previous year. The growth rates of both agriculture and non-agriculture sector in the review year, remained less than that of the previous year.

The fiscal situation remained broadly stable in 2008/09, despite the political transition phase of the economy. The fiscal deficit stood at only 1.9 percent of GDP as against the estimate of 3.9 percent in the budget of 2008/09. Such a prudent fiscal situation attributed to impressive revenue mobilization and foreign grants. The government's strong commitment in revenue leakage control, strong implementation of voluntary disclosure of income scheme (VDIS), several reforms in tax administration, growing imports and consumption induced by the significant rise in remittances, the increasing imports of high tax yielding vehicles and spare parts and increase in non-tax revenue are mainly responsible for the encouraging growth of revenue mobilization. The limited foreign borrowing and prudent debt management also helped to reduce public debt to 41.1 percent of GDP in the review year from 44.1 percent in the previous year.

In 2008/09, the external sector depicted a mixed performance. Although there was an increase in exports, there was a significant growth in trade deficit as the growth rate of imports was relatively much higher. Owing to the sharp rise in remittances, both the current account and the balance of payments posted a surplus in the review year. Consequently, there was a rise in foreign exchange reserves that facilitated the maintenance of exchange rate and external stability.

Nepal, Bista, and Dhakal (2012), in the article "*The Study of Overall Situation of Public Debt in Nepal*" almost all governments face budget deficit¹ due to high expenditure and fewer revenues. Governments can get revenue by increasing taxes, printing money, domestic or external borrowing and using previous budget surplus. When the government decides to borrow instead of introducing additional tax measures, to finance the budget deficit, it creates a liability on itself known as public debt. Government follows debt financing because it provides a relief to the current taxpayers and shift the burden of present tax to future generation reducing further the political costs of the government. A debt management policy improves the quality of decisions, provides justification for the structure of debt issuance, identifies policy goals, and demonstrates commitment to long-term financial planning, including a multi-year capital plan. Debt management policies are written guidelines and restrictions that affect the amount and type of debt issued by a government, the issuance process, and the management of a debt portfolio. An effective debt

management policy provides guidelines for a government to manage its debt program in line with those resources and minimizing the cost of borrowing while reducing the risk. Adherence to a debt management policy signals to rating agencies and the capital markets that a government is well managed and should meet its obligations in a timely manner. Debt levels and their related annual costs are important long-term obligations that must be managed within available resources.

The government has various alternatives to borrow for the purpose of financing fiscal deficit. One way is to borrow directly from the central bank which is equivalent to printing of money. The other alternatives are: borrowing from domestic commercial banks, borrowing from domestic non-bank sector and borrowing from external sources. Each method has its own implications for various aspects of the economy. Government usually adopts a mixed strategy and utilizes a number of options at the same time that have more benefit for the present situation of the country.

Growing public debt is a worldwide phenomenon. It has become a common feature of the fiscal sectors of most of the economies. Almost all developing countries are under minor or high public debt situation. Economists do not consider public debt a major problem per se; rather problem is the mismanagement and un-sustainability of the public debt. Sustainable debt is a level of debt where debt ratio turns down or remained unaffected, and the fiscal deficit is not necessarily to be at zero but it should not push the debt ratio to increase or move faster than growth rate of GDP. Research findings support that foreign aid (including loans) is also effective if appropriate debt management policies are in place.

The debt burden of a country inevitably imposes a number of constraints on its growth prospects. However, it is assumed that such problems are not likely to be solved unless an aggressive approach is applied. Government's prudent debt management would ensure that revenues are not diverted from growth enhancing investments, but they are redirected towards investments in infrastructure, drinking water, basic education and health which consolidate and accelerate the diversification of the economy.

Financial Comptroller General Office (FCGO) under the Ministry of Finance (MOF) is the main government agency responsible for treasury management of the Government of Nepal. FCGO is mandated in undertaking several functions in the areas of public financial management. Of which, public debt management is one of the core function of FCGO. The structure of the government finance in Nepal clearly indicates the important role of public debt, both internal and external, in meeting the resource gap. Public debt has been used in Nepal as a regular mechanism of deficit financing since last five decades. Public debt management comprises of projection for debt requirements, receipt of debts, utilization of debts, repayment of debts (principal plus interest) and maintaining of records of the receipt, repayments and liabilities thereof.

Nepalese economy relies heavily on short-term domestic debt and concessional foreign loans, particularly multi-lateral agencies like The World Bank, ADB, IFAD, etc., of long maturity. More than 65% of domestic debt has maturities of one year or shorter, and less than 9% of domestic debt has maturities of 10 years or longer. The bulk of the cheap foreign loans have maturities of longer than 30 years and account for more than 57% of the financing of the budget deficits in Nepal. Concessional foreign loans have been the best source of financing, which will not be available forever. The high stock of debt, slow growth rate of economy and outflow of considerable amount of resources in the form of debt servicing have raised questions that whether foreign borrowing on current terms is beneficial for developing economies or not. Therefore, the problem of debt management is increasingly important for the Nepalese economy.

Against this backdrop, FCGO has accorded a particular priority in enhancing capacity for public debt management in Nepal. This has demanded an independent study to assess the Existing overall scenario of public debt management, its gaps and the areas of improvements. As such, this study has been carried out as per the call made from FCGO in undertaking the proposed study on Overall Situation of Public Debt in Nepal.

Koirala (2012), in his article entitles “*Government Revenue Forecasting in Nepal*” The revenue forecasts by the national government are carried out in course of

budget preparation. An accuracy of revenue forecasts is one key issue in the design and execution of fiscal policies (IMF, 2001). Under or over-prediction of revenue forecast creates budget planning vulnerable. Revenue forecast provides necessary discipline for negotiations between the executive and legislative branches of the government. It helps in setting up performance targets for revenue departments and agencies (Auerbach, 1999, Danninger, 2005). One of the major sources of error (or bias) in revenue forecasting is the methods adopted in forecasting revenue in addition to variety of political and institutional factors determining such bias (Goloso and Kind, 2002, Kyobe and Danninger, 2005).

In Nepal, revenue forecasts is an important task of Ministry of Finance (MOF) in the course of budget preparation and specifying performance targets of revenue collection offices. Major institutions involved in forecasting revenue in the country are MOF and Nepal Rastra Bank (NRB) as their work of forecasting is an essential part of the budgetary process. The IMF, especially its Fiscal Affairs Department (FAD) often gives advice for a systematic analysis of forecasting in low-income countries in the context of reforms on the budget planning process (Kyobe and Danninger, 2005). However, forecasting techniques are generally not put down in formal documents, and country practices are often a mix of idiosyncratic budget practices and influences from legacy systems. Too much reliance on few methods in forecasting revenue of the government of Nepal is considered to be less efficient in capturing true DGP of revenue sequence. Not a remarkable exercise has been carried out in identifying appropriate methodology of revenue forecasting from those institutions involved in revenue forecasting at present and there is a lack of private institutional forecaster of revenue in the economy.

2.8.2 Review of Thesis

Poudel (2009), in the form of a case study titled *“A Study on Public Debt in Nepal”*

The Main Objectives of this Study

- To analyzed the structure of internal public debt and impact of it on the economy.

- To analyzed the situation using ever widening saving investment gap.
- The system and practice of public debt in Nepal, to understand the attitude of investors towards the government securities.
- Growing share of regular expenditure with respect to total expenditure.

The Major Findings of the Study

- The poor performance of the economy has failed to create productive capacity for meeting the situation.
- The payment of debt on maturity can be adjusted through the issue of fresh public debt.
- Investors have full trust on government bond and subscription government bond is higher than the bonds issued by other non government institution.
- The habit of purchasing bond issued by the government should be developed among the people.

Thapa Magar (2010), in his dissertation entitled “*Trend and Structure of Public Debt Situation in Nepal*”

The Main Objectives of this Study

- To study the role of public debt in Nepalese fiscal system and under plans.
- The taxation and mobilization of resources, public borrowing and mobilization of resource deficit financing and contribution of public debt.
- The public debt should be used as an instrument to mobilize saving of people.
- Public debt should be advocated for creating capacity and producing capital equipment.

The Major Findings of this Study

- The classical economists were against public borrowing ad favored the minimum expenditure from the government side.

- They liked to approve public debt only for productive purposes and believed that debt servicing did not necessitate additional taxation.
- Government borrowing has increased rapidly and financed mostly on the unproductive sector and hence government always lacks the resources, and then borrows the new loan to pay the previous ones.
- Such excessive dependency upon external loan may lead the nation into debt trap, if the terms of trade are not improved. Therefore extra care should be exercised in procuring such loans”.

Acharya (2011), in his M.A. dissertation entitled “*Structure of Public Debt in Nepal*”,

The Main Objectives of this Study

- To study the role of public debt in Nepalese fiscal system and under plans.
- He pictured the poor economic performance of the nation, which is due to nation’s national topography and human behavioral limitation.
- Structure of public debt in Nepal and importance of public debt in financial development.
- The structure of internal public debt and its impact on the economy.

The Major Findings of this Study

- Most inflationary nature of internal borrowing, which increases inflation in the economy.
- The impact towards rapid increase money supplies resulting in an increase in demand for goods and services, which leads to a rapid increase in imports.
- The unlimited burden falls on balance of payment situation.
- The internal Borrowing is most essential to develop the money and capital market in the nation.
- A public debt is one of the best ways of financing development expenditure of the government which helps to control inflation in the country.

Acharya (2011), in his prepared a thesis on “*Burden of Public Debt in Nepal*”.

The Main Objectives of this Study

- To examine the system and practice of public debt in Nepal.
- To see the trend and structure of public debt in Nepal.
- To see the attitude of investors towards the government securities

The Major Findings of this Study

- It has caused several real burden of public debt.
- He examined the positive as well as negative impact of public borrowing in the process of economic development.
- The expansionary impact of the ownership pattern of securities has contributed to the inflationary spiral in the country.

Pandey (2011), in his M.A. dissertation entitled. *“Public Debt in Nepal”*

The Main Objectives of this Study:

- To analyzed the trend and structure of public debt in Nepal.
- He expressed his view that exclusive dependency on foreign loan for development expenditure is persistence because of poor mobilization of internal resources.
- Macroeconomic imbalance such as ever widening trade deficit, Investment saving gap and larger amount of fiscal deficit has been the main issues before NG.
- The factors contributing to the foreign aid dependency syndrome.
- These have been excessive flow of foreign loan to bridge up three gaps (fiscal deficit, trade deficit and investment saving gaps).
- The substantial increase in foreign debt has increased its burden of debt servicing but debt-servicing capacity of the economy is no increasing satisfactory.

The Major Findings of the Study

- The average annual growth rate of GDP; export earning is considerably as compared with the rate of magnitude of debt and debt servicing requirements.
- The debt servicing capacity of Nepal is very poor which is also responsible for increasing debt obligations.
- This problem of debt servicing is worldwide yet Nepal should have to take urgent action in creating servicing capacity.

Pandey (2012), in the form of a case study titled “*Public Debt in Nepal: A Study of its Structure and Burden*” .

The Main Objectives of this Study

- Structure of public debt in Nepal and importance of public debt in financial development.
- To examine the practice and legal frame works of Nepal and other countries regarding fiscal rule on public debt.
- To examine the indebtedness, debt servicing capacity and debt sustainability of Nepal.

The Major Findings of this Study

- The system of public debt is one of the best ways of financing development expenditure of the government.
- He examined the positive as well as negative impact of public borrowing in the process of economic development.
- Most inflationary nature of internal borrowing, which increases inflation in the economy.
- Government borrowing has increased rapidly and financed mostly on the unproductive sector and hence government always lacks the resources, and then borrows the new loan to pay the previous ones.

2.9 Research Gap

After reviewing the related study and studying of master degree thesis. I found that there is no sufficient study has been conducted yet, to analyze public debt servicing in Nepal. So, this study will focus on the existing scenario of public debt, necessity of borrowing from public, trend and structure of public debt and consequences of debt in the overall performance of economy. The growth of expenditure has resulted to increase in higher percent than the revenue generation. Therefore, in order to fulfill the gap between the revenue and expenditure government need to borrow from external as well from internal source. Many researches were done government debt practices and issue system. Most of researches were based on post secondary data. Major thesis focused on the trend analysis of public debt. Some researcher had attempted to analyze the primary data classifying them into the category institutional and individual group but had not tried to analysis specially, this study has been prepared to fulfill the following research gaps:

- Existing scenario of public debt of government in Nepal.
- Necessity of borrowing of internal and external debt by government of Nepal.
- Trend and structure of public debt government of Nepal.
- consequences of debt in the overall performance of economy
- The growth of expenditure has resulted to increase in higher percent than the revenue generation.
- Most of researches were based on post secondary data.
- Major thesis focused on the trend analysis of public debt.

Nepal is experiencing a serious and growing resource gap. This is because the annual growth rate of the total expenditure and revenue is not increasing in the same pace. Most of researches the primary data based on their income bracket, profession, who he or she belong to further one's research work studies the structure analysis of government borrowing, fiscal deficit, inflation, domestic resources gap, external borrowing, which is crucial matter of public debt. It shows the interest of various investors on specific types of government securities. Besides most of researcher had analyzed the trend and issue system of government securities on lump sum but because of specific nature of particulars securities it has to be analyzed separately.

Hence review the related literature in this regards and considering the several gap as above. This research has attempt to analysis the internal and external debt of Nepal and structure analysis obtaining recent data to find out the objectives of this research works.

CHAPTER- III

RESEARCH METHODOLOGY

Research methodology is the plan, structure and strategy of investigation conceived to answer the research question or test the research hypothesis and to control variances (Kerlinger, 1960: 19). Research methodology refers to the various sequential steps adopted by a researcher in the studying a problem with certain objective in view. It is the way to study systematically about the research problem (Kothari, 1994). Thus the overall approach to the research is presented in this chapter. This chapter consists of research design, population and sample size sources of data and processing techniques and tools.

3.1 Research Design

A research design is the arrangement of conditions for collection and analysis of data in a manner that aims to combine reference to the research purpose with economy in procedure. The research design followed to analysis the public debt and debt servicing in public sectors in Nepal. Analytical and descriptive approaches are used to evaluate the public debt and debt servicing in public sector on the basis of secondary data financial statement. To fulfill such target several tools have been used.

3.2 Population and Sample

Population refers to all items that have been chosen for study. Population may be definite or infinite. A small portion chosen from the population for studying its properties is called sample size. A sample is the representative of the population. The total trend, structure and debt servicing in the public sectors is the population of the study, out of them 10 years (2002/03 to 2011/2012) trend, structure and debt servicing in the public sector are the sample size.

3.3 Sources of Data

This study is totally based on secondary data. The main sources of secondary data comprise textbooks, Economic survey, Budget speeches, various publications of

Nepal Rastra bank, related case study and thesis work etc. The data and information are collected from different library such as library of Shanker Dev campus, and T.U. central library.

3.4 Data Analysis Tools

In order to make the study more reliable and authentic, financial indicators and statistical tools have been used which are believed to make the analysis more convenience. A brief explanation of the data analysis indicator and tools in the study are as follows: -

3.4.1 Financial Tools

These tools will focus on proportional analysis of public debt with total debt servicing. Composition of public debt, internal debt with total debt and it's servicing, external debt with total debt and it's servicing. The financial indicators used in this research study are as follows:

a) Percentage

Percentage can be calculated as follows:

$$i) \quad \text{Total Debt to Total Deficit} = \frac{\text{Total Debt}}{\text{Total Deficit}}$$

$$ii) \quad \text{Internal Debt to Total Deficit} = \frac{\text{Internal Debt}}{\text{Total Deficit}}$$

$$iii) \quad \text{External Debt to Total Deficit} = \frac{\text{External Debt}}{\text{Total Deficit}}$$

$$iv) \quad \text{External Debt Servicing to Total Debt Servicing} = \frac{\text{External Debt Servicing}}{\text{Total Debt Servicing}}$$

$$v) \quad \text{Internal Debt Servicing to Total Debt Servicing} = \frac{\text{Internal Debt Servicing}}{\text{Total Debt Servicing}}$$

$$vi) \quad \text{Internal Debt Servicing to Total Revenue} = \frac{\text{Internal Debt Servicing}}{\text{Total Revenue}}$$

$$vii) \quad \text{External Debt Servicing to Total Revenue} = \frac{\text{External Debt Servicing}}{\text{Total Revenue}}$$

$$viii) \quad \text{Internal Debt to Regular Expenditure} = \frac{\text{Internal Debt Servicing}}{\text{Regular Expenditure}}$$

$$\text{ix) External Debt Servicing to Regular Expenditure} = \frac{\text{External Debt Servicing}}{\text{Regular Expenditure}}$$

3.4.2 Statistical Tools

a) Mean

The sum of the entire observation is divided by the number of observation is called mean

$$\text{Mean } (\bar{X}) = \frac{\sum X}{N}$$

Where,

X = Sum of all values of the variable 'x'

N = Number of observations

X = Variables involved

b) Coefficient of Correlation

Correlation is an analysis of the co-variation between two or more variable. It deals to determine the degree of relationship between two or more variable. The degree of relationship between two variables is known as simple correlation. Simple correlation is computed as:

Simple correlation coefficient (r)

$$r = \frac{n \sum xy - (\sum x)(\sum y)}{\sqrt{n \sum x^2 - (\sum x)^2} \sqrt{n \sum y^2 - (\sum y)^2}}$$

c) Analysis of Trend

Trend is future direction in which the situation is changing of developing on particular things. The main purpose of this chapter is to analyze the future direction of public Debt.

For this purpose a widely and most commonly used method to describe the trend has been followed. That is known as Least Square Method.

Let the trend line between the dependent variable y and independent variable x (i.e. time) be represented by:

$$Y = a + bx$$

Then for any given value of independent variable x , the estimate value of y denoted by y_c given above equation is

$$Y_c = a + bx$$

Where,

a = y intercept or value of y where $x = 0$

b = Slope of the trend line or amount of change that comes in y for unit change in x

To determine the straight line trend, the value of a and b is calculated by following way,

$$a = \frac{\sum y}{N} \quad b = \frac{\sum xy}{\sum x^2}$$

CHAPTER- IV

DATA PRESENTATION AND ANALYSIS

This is the most important Section of the research study. In this chapter all the information/data collected from different sources are analyzed, tabulated and interpreted.

4.1 Resources gap in Nepalese Economy

Resource gap in Nepalese economy has been always a common phenomenon since the start of the systematic budgeting system in Nepal. Nepal is experiencing a serious and growing resource gap. This is because the annual growth rate of the total expenditure and revenue is not increasing in the same pace. The growth of expenditure has resulted to increase in higher percent than the revenue generation. Therefore, in order to fulfill the gap between the revenue and expenditure government need to borrow from external as well from internal source. The following table shows the different scenarios of financial resource gap in Nepalese budget.

Table 4.1

Different Scenarios of Resource Gap

(Rs. In million)

Fiscal Year	Total Revenue	Growth rate Of T.R. (%)	Total Expenditure	Annual G.R. Of T.E. (%)	Deficit	A.G. rate Of Deficit (%)	Foreign Grants	A.G. Of F.G. (%)	External Loan	A.G. rate Of E.L. (%)	Internal Loan	A.G. growth rate of I.L. (%)	Fiscal Deficit [T.E. - (T.R. + F.G.)]
2002/03	57131.6		80072.2		22940.6		6686.1		7698.7		8000		16254.4
2003/04	67568.9	18.67	84006.1	4.91	16437.2	-28.35	11339.1	69.6	4546.4	-40.95	8880	11	5098.1
2004/05	73614.4	8.95	89442.6	6.08	15828.2	-3.71	11283.4	-0.49	7629	67.8	5607.8	-36.85	4544.8
2005/06	84513.9	14.81	102560.4	12.8	18046.5	14.01	14391.2	27.54	9266.1	21.46	8938.2	59.39	3655.3
2006/07	86109.6	1.89	110889.2	8.12	24779.6	37.31	13827.5	-3.91	8214.3	-11.35	11834.2	32.40	10952.1
2007/08	103513	20.21	133604.6	20.48	30091.6	21.47	15800.8	14.27	10053.5	22.39	17892.3	51.11	14290.8
2008/09	127943.2	23.60	161349.9	20.76	33406.7	11.02	20320.7	28.61	8979.9	-10.67	20496.4	14.55	13086.0
2009/10	169857.3	32.76	219661.9	36.14	49804.7	49.09	26382.8	29.83	9968.9	11.01	18417.1	-10.14	23421.9
2010/11	218491.7	28.63	259689.1	18.22	41197.4	-17.28	38545.9	46.10	11223.4	12.57	29914.0	62.43	2651.5
2011/12	245741.2	12.47	295363.4	13.74	49622.2	20.45	45922.2	19.14	12075.6	7.59	42515.8	42.13	3700.0
Average Annual G.R. (%)		17.99		15.69		11.56		25.63		8.87		25.11	

Source: www.mof.gov.np/publication(2011/12)And Appendix- 1

Table 4.1 reveals the resources gap of the government, which is the difference between revenue and expenditure of the government. The resources gap is increased from Rs 22940.6 million in fiscal year 2002/03 to Rs. 49622.2 million in fiscal year 2011/2012. In average annual basis, it remained at 11.56 percent. However, the revenue of government has been increased Rs. 57131.6 million in Fiscal Year 2002/03 to Rs 245741.2 million in 2011/12. In average annual it was 18.0 percent. But the expenditure has been increased more rapidly than the revenue which is Rs.295363.4 million in FY 2011/12.

Thus, it shows the rapid growing tendency of budget deficit since 2002/03 to 2011/12. But however this deficit is fulfilled by three elements that are: Grants, External Loan and Internal Loan.

Grants are the most potential source of foreign currency, which is the best instrument for the government to import the capital goods and to pay the interest and principle of external debt. Moreover, it can be used on capitalization itself. It does not give burden to the economy. But the table 4.1 shows the up-swing and downswing tendency of grant component. In fiscal year 2011/12 the total grants received by the government worth Rs. 6686.1 million, which fluctuated after that and reached to Rs. 45922.2 million in fiscal year 2011/2012.

During the review period, amount of bilateral and multilateral grants has not been increased sufficiently, which has created a sort of constraints in the scenario of state's economy as a whole. Hence NG has staunchly compelled to reduce the unproductive expenses, though considering the achievement we cannot get the satisfactory impacts on aggregate economy of the nation.

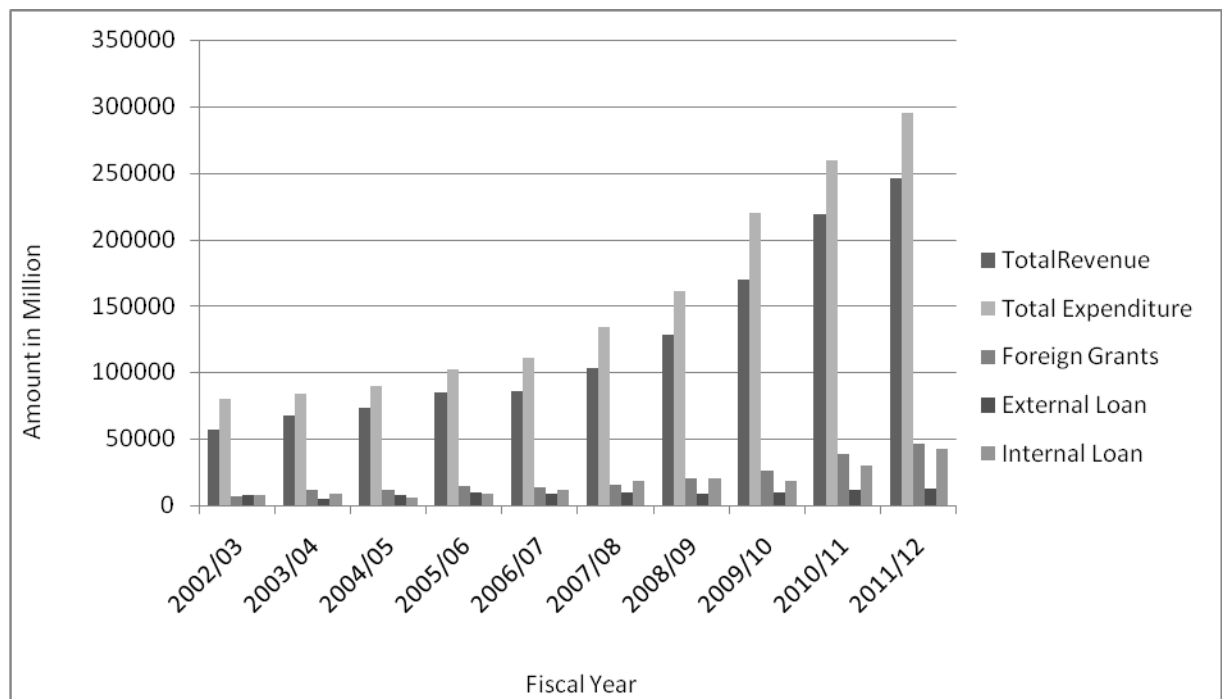
The second element of resources, the external loan was Rs. 7698.7 million in 2002/2003 but it reached Rs. 12075.6 million in 2011/2012, which is 8.87% increase in average from 2002/2003 to 2011/2012. On the other hand, the internal debt

amounted from 8000 million in 2002/2003 to Rs. 42515.8 million in 2011/2012. In average annual basis it was 25.11 percent.

And the final column shows the fiscal deficit (TE- (TR+ FG). Which has decreased from Rs. 16254.4 million in starting year of review period 2002/2003 to Rs. 3700 million in last year of review period 2011/12.

However, the table 4.1 can be clear with help of the diagram which is presented below:

Figure 4.1
Different Scenario of Resource Gap



Source: Table 4.1

From the diagram 4.1, we can see that revenue has been increased from fiscal year 2002/03 to 2011/12 but the expenditure has been increased more rapidly than that of the revenue. This creates the resource gap and this gap is fulfilled by the three

elements: Foreign Grants, External Loan and the Internal Loan as shown in the above diagram.

4.1.1 Growth Trend of Grants and Government Borrowing

The dependency on the taxation only cannot meet the expenditure of the government, therefore in order to fulfill the financial deficit the government must rely on the internal as well as external loan and the foreign grants. The different scenario of grants and government borrowing is presented in the following table 4.2.

Table 4.2

Annual Growth Rate of Grants and Government Borrowing

Fiscal Year	Total Debt	Annual Growth Of TD (%)	Grants	Annual Growth Rate of Grants (%)	Internal Debt	Annual Growth Rate of I D (%)	External Debt	Annual Growth Rate of ED (%)
2002/03	15698.7		6686.1		8000		7698.7	
2003/04	13426.4	-14.47	11339.1	69.6	8880	11	4546.4	-40.95
2004/05	13236.8	-1.41	11283.4	-0.49	5607.8	-36.85	7629	67.8
2005/06	18204.2	37.53	14391.2	27.54	8938.2	59.39	9266.1	21.46
2006/07	20048.5	10.13	13827.5	-3.91	11834.2	32.40	8214.3	-11.35
2007/08	27945.8	39.39	15800.8	14.27	17892.3	51.11	10053.5	22.39
2008/09	29476.3	5.48	20320.7	28.61	20496.4	14.55	8979.9	-10.67
2009/10	28386	-3.70	26382.8	29.83	18417	-10.14	9968.9	11.01
2010/11	41137.4	44.92	38545.9	46.10	29914.0	62.43	11223.4	12.57
2011/12	54591.4	32.71	45922.2	19.14	42515.8	42.13	12075.6	7.59
Average Annual Growth Rate		16.73		25.63		25.11		8.87

(Rs. In million)

Source: - www.mof.gov.np/publication(2011/12)

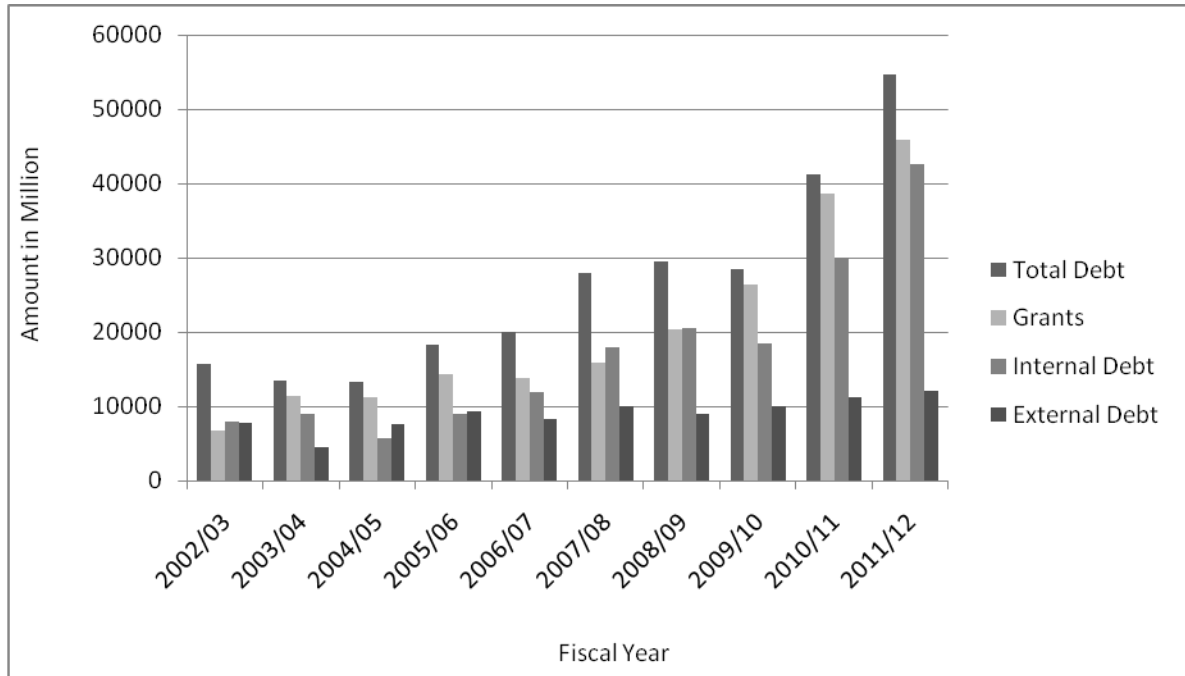
Table 4.2 shows increasing trend of the government borrowing. It also shows the heavy reliance on foreign grants. Indeed the grants are not the debt but everlasting reliance on it definitely arises a question upon capability on internal resource mobilization and industrialization. It is because the grants have reached to Rs.45922.2 million in fiscal year 2011/12 from Rs. 6686.1 million in 2002/03.

Similarly internal borrowing has reached to Rs. 42515.8 million in fiscal year 2011/12 from Rs. 8000 million in 2002/03. It has average annual growth rate of 25.11percent. External borrowing was only Rs. 7698.7 million in 2002/03 to Rs. 12075.6 million, in 2011/2012. It has 8.87 percent of average annual growth rate, which is remarkably less than average annual growth rate of internal debt. It indicates that government prefers internal loan to external loan, which is not good symptoms for the economy as it crowds out private investment.

Likewise, the table 4.2 indicates that the total debts (internal debt + external debt) amounted to Rs. 54591.4 million in 2011/12 from Rs. 15698.7 million in 2002/03. It has 16.73 percent of average annual growth rate. It obviously indicates the increasing trend of government borrowing year by year. The table 4.2 can be clearer with the help of the following Line figure 4.2

Figure 4.2

Annual Growth Rate of Grants and Government Borrowing



Source: Table 4.2

From the figure 4.2 we can see the increasing trends of government borrowing. Though the total debt of the government has been decreased in year 2002/2003 to 2004/2005, thereafter it has been increased rapidly. The Internal loan of the government has been increased more rapidly than that of the external loan as shown in the above figure. That means government has been given more focus on the internal loan which is not good symptoms for the economy as it crowds out private investment.

Beside the debt government has also heavily dependent on the foreign grants. As shown in the above figure the government grants have been increased in faster rate.

4.1.2 Debt as Percentage in Government Deficit and Total Debt

As per the increasing role of the government in the development activities, the government expenditures has been increasing every years but the revenue has not been increased in the same ratio as the expenditure. Therefore, the country is facing the resource gap. Though the revenue is the prime instruments of the government to meet its expenditure, government has always failed to collect the required revenue for its expenditure. The tax and custom administrations are not transparent and able so that government cannot collect the revenue as it predicts. Therefore, government has always faced the problem of budgetary deficit.

In this very persistent condition the government follows four of sources meet deficit financing:

- Printing money
- Drawing down foreign exchange reserve.
- By Grant from home and aboard
- Borrowing from home and abroad

Most of the countries do not want to print money and make drawing from the foreign exchange reserve for the fulfillment of budget deficit as it make inflationary and much other adverse effect to macro economy. Besides this, government has also received grants and loan from home and abroad to face the problem of budgetary deficit. Let's see the debt as percentage in Government deficit and total debt in following table:

Table 4.3

Debt as Percentage in Government Deficit and Total Debt

(Rs. in million)

Fiscal Year	Deficit	Total Debt	% Of T. D. In Deficit	Grants	Internal Debt	External Debt	Debt as % of Deficit		Internal & External Debt as % of T.D.	
							Internal Debt	External Debt	Internal Debt	External Debt
2002/03	22940.6	15698.7	68.34	6686.1	8000.0	7698.7	34.9	33.56	50.96	49.04
2003/04	16437.2	13426.4	81.68	11339.1	8880.0	4546.4	54.02	27.66	66.14	33.86
2004/05	15828.2	13236.8	83.63	11283.4	5607.8	7629.0	35.43	28.2	42.37	57.63
2005/06	18046.5	18204.3	100.87	14391.2	8938.2	9266.1	49.53	51.34	49.10	50.90
2006/07	24779.6	20048.5	80.91	13827.5	11834.2	8214.3	47.76	33.15	59.03	40.97
2007/08	30091.6	27945.8	92.87	15800.8	17892.3	10053.5	59.46	33.41	64.03	35.97
2008/09	33406.7	29476.3	88.23	20320.7	20496.4	8979.9	61.56	26.88	69.54	30.46
2009/10	49804.7	28386	56.99	26382.8	18417.1	9968.9	36.98	20.01	64.88	35.12
2010/11	41197.4	41137.4	99.85	38545.9	29914.0	11223.4	72.61	27.24	72.72	27.28
2011/12	49622.2	54591.4	110.01	45922.2	42515.8	12075.6	85.68	24.33	77.88	22.12
Average			86.34				53.77	32.58	61.67	38.33
Annual %										

Source: www.mof.gov.np/publication (2011/12) And Appendix- 2

Table 4.3 we can find out the budgetary deficit of the government and this deficit has been fulfilled by the total debt (internal debt + external debt) and the grants. From the above table we can find the increasing trends of the government deficit since fiscal year 2002/03 to fiscal year 2011/12. The deficit has been figured out to Rs.22940.6 million in the fiscal year 2002/03, which increased to Rs.49622.2 in the fiscal year 2011/12. The main cause of increasing the deficit from Rs. 23378.8 million to Rs.76817.4 million is due to the increase in the government expenditure with that of the revenue collection. It clearly shows that the government heavily depends on grants and debts; as these both are the easy instruments for financing the deficit budget.

Heavily reliance on grants and loan indicates capital scarcity on the one hand and in the other it shows inefficiency in proper mobilization of internal resources. Over the study period between fiscal year 2002/03 to 2011/12 total debt also increased from Rs. 15698.7 million to Rs. 54591.4 million. Hence, the total debt increased the review period.

Similarly, the table presents the annual average percentage of total debt to total deficit. On an average it is 86.34 percent of the total deficit. Rest amount of budgetary deficit is shared by grants and cash balance. It is being argued that reliance on foreign debt is better than reliance on external grants because it may have adverse impact on the national sovereignty.

Internal debt has occupied 34.9 percent of total deficit in starting year (2002/03) of review period, but is increased to 85.68 percentages in fiscal year 2011/2012. In an aggregate, internal debt has 53.77 percent share in total deficit during review period. Similarly external debt has increases Rs. 12075.6 million in 2011/2012 from Rs.7698.7 million in 2002/03.. It occupies 32.58 percent of share out of total deficit on an average.

⇒ However the percentage of external debt to total debt was higher in 2002/03 with that of internal debt. In 2002/03 the percentage of external debt to total debt was

49.04 whereas the percentage of internal debt was only 50.96. But however the ratio of internal debt increased to 77.88% in 2011/12 whereas the ratio of external debt came into 22.12% in 2011/12. This shows that the government is heavily dependent upon the internal debt than the external debt.

Government Deficit and Total Borrowing - An Analysis

Government budgetary deficit has always been fulfilled by internal as well as external source. Therefore government deficit and the total debt are correlated. Government deficit is a dependent variable(X) as it is dependent on the total debt(Y). The correlation between Govt. Deficit and total borrowing (Total Debt) is analyzed with the following data presented in table 4.4.

Table 4.4

Correlation Analysis between Govt. Deficit and Total Borrowing

Fiscal Year	Govt. Deficit (X)	Total Debt (Y)	$x = X - \bar{X}$	$y = Y - \bar{Y}$	xy	x^2	y^2
2002/03	22940.6	15698.7	-7274.87	-10516.5	76505806.6	52923733.5	110595721
2003/04	16437.2	13426.4	-13778.3	-12788.8	176206850	189840724	163552127
2004/05	15828.2	13236.8	-14387.3	-12978.4	186723026	206993538	168437569
2005/06	18046.5	18204.2	-12169	-8010.95	97485010.2	148083831	64175319.9
2006/07	24779.6	20048.5	-5435.87	-6166.65	33521107.7	29548682.7	38027572.2
2007/08	30091.6	27945.8	-123.87	1730.65	-214375.616	15343.7769	2995149.42
2008/09	33406.7	29476.3	3191.23	3261.15	10407079.7	10183948.9	10635099.3
2009/10	49804.7	28386	19589.23	2170.85	42525279.9	383737932	4712589.72
2010/11	41197.4	41137.4	10981.93	14922.25	163875105	120602787	222673545
2011/12	49622.2	54591.4	19406.73	28376.25	550690222	376621169	805211564
	ΣX 302154.7	ΣY 262151.5			1337725112	1518551690	1591016256

(Rs. in Million)

Source: www.mof.gov.np/publication (2011/12) And Appendix- 3

From the calculation we have found out that the correlation between the government deficit and the total debt is 0.86. Hence it seems that the relationship between these

two variables is positively correlated. That means the increase in the government deficit also lead to the increase in the total debt and vice versa.

4.1.3 Pattern of Ownership of Public Debt in Nepal

Due to the huge amount of the disparity between the government revenue and expenditure there occurs widening gap between saving and investment. Small proportion of development expenditure is made by the revenue surplus and remaining large segment of development expenditures is made from the internal and external borrowing.

The internal borrowing for the first time was issued out in Nepal in 1961/62 through treasury bills after the enforcement of Public Debt Act 1960. Nepal has been borrowing the internal debt to bridge the resource-gap and mobilizing the internal resources and strengthening capital market. The government raises the internal debt by using various securities like, Treasury Bill, Development Bond, Special Bond and National Saving Certificate etc.

The systematic record first external borrowing was from the USSR for the establishment of Birgunj Sugar Factory and Janakpur Cigarette Factory in 1963/64. Only the bilateral debt was borrowed previously than the fiscal year 1961/62. After than both bilateral and multilateral debt have been borrowed till now" (Thapa, 2000:7).

(I) Sources of Internal Debt`

One of the major sources of the government to fulfill its budgetary deficit is the internal debt. The government can borrow through internal debt mainly by four instruments: Treasury bill, National Saving Certificate, Development bonds, Special bonds and citizen saving certificate. By selling these instruments government can borrow internally from banking and non banking sources.

Table 4.5**Source of Internal Debt**

(Rs in million)

Fiscal Year	TD	Treasury Bills	Development Bonds	National Saving Certificate	Citizen Saving Certificate	Special Bonds
2002/03	60043.7	27610.8	5962.2	12476.4	-	13994.3
2003/04	84645.5	48860.5	16059.2	9629.8	931.1	9164.5
2004/05	86133.7	49429.6	17549.2	9029.8	1178.9	8946.2
2005/06	87564.2	51383.1	19999.2	6576.7	1428.9	8176.3
2006/07	94710.8	62970.3	17959.2	3876.8	1678.9	8225.6
2007/08	103776.0	74445.34	19177.1	1516.9	1391	7245.69
2008/09	116039.46	85033.03	21735.43	1116.9	3014.36	5139.77
2009/10	125674.1	86515.1	29478.5	2169.0	4433.6	5030
2010/11	148059.7	102043.7	35519.4	-	5126.9	5369.7
2011/12	184205.7	120340.7	43519.4	10680.0	4636.5	5029.0

Source: [\(www.mof.gov.np/publication\)](http://www.mof.gov.np/publication).(2011/12)

Table 4.5 shows out the five source of the internal debt: Treasury Bills, Development Bonds, National Saving Certificate, citizen saving certificate and Special Bonds.

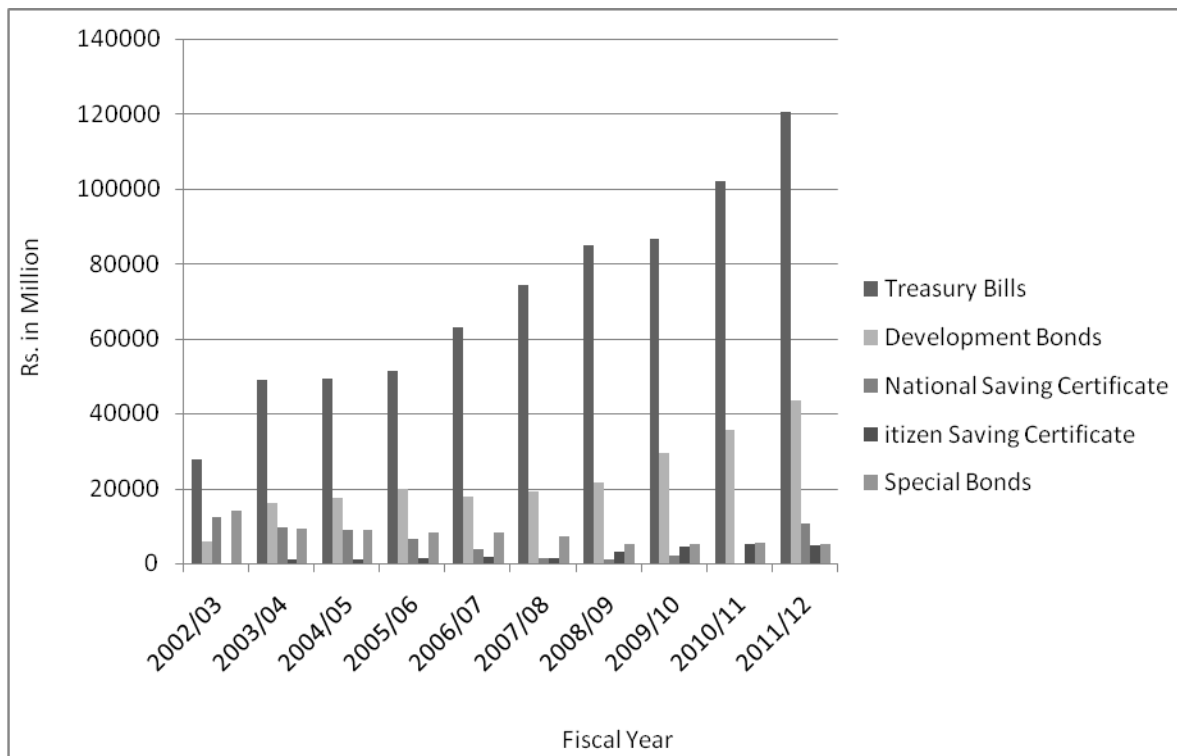
Treasury Bills is the short-term loan as these are raised for the period of less than one year. Other remaining securities are called long-term securities as they are issued for the period of more than one year. Normally treasury bills are floated for the period of 91 days. Similarly government bonds and national certificates have 3-15 years periods of maturity. Accordingly these are identified as long-term securities.

Treasury bills increased to Rs. 120340.7 million in fiscal year 2011/12 from Rs. 27610.8 million in Fiscal Year 2002/03. Similarly development bonds increased to Rs 43519.4 million in fiscal Year 2011/12 form Rs. 5962.2 in Fiscal Year 2002/03. National saving certificate amounted Rs. 10680.00 million in fiscal Year 2011/12 from Rs. 12476.4 million in 2002/03. Special bond reached to 5029.1 million in fiscal year 2011/12 from 13994.3 m. in 2002/03. Similar citizen saving certificate amounted to Rs. 4636.5 million in fiscal year 2011/12.

The Treasury bills have dominating place in the structure of total outstanding internal debt in the study period. The treasury bills are mostly inflationary in nature. Since these are mostly owned by commercial banks, financial institutions and Nepal Rastra Bank. It is concluded that the government become lethargic in managing its finance prudently as there is easy access for funding the source of finance in the form of borrowing and grants. The above table can be made clear with the help of the figure 4.3

Figure 4.3

Source of Internal Debt



Source: Table 4.5

From the figure 4.3 also we can assume that the Treasury bill has played the important role in the government internal borrowing. Since Treasury bills are issued for a short period of time, most of the financial institutions and others are interested to invest in the Treasury bill. After Treasury bill development bonds has occupied the dominant role in the government internal debt and so on.

I.A. Growth Rate of Internal Debt and Its Components

Table 4.6

Growth Rate of Internal Debt and Its Components

Fiscal Year	ID	Treasury Bills	Development Bonds	National Saving Certificate	Citizen Saving Certificate	Special Bonds
2002/03	-	-	-	-	-	-
2003/04	40.97	76.96	169.35	-22.82	-	-20.22
2004/05	1.76	1.16	9.28	-6.23	26.61	-2.38
2005/06	1.66	3.95	13.96	-27.17	21.21	-8.61
2006/07	8.16	22.55	-10.20	-41.05	17.50	0.60
2007/08	9.57	18.22	6.78	-60.89	-17.15	-11.91
2008/09	11.82	14.22	13.34	-26.38	116.70	-29.06
2009/10	3.40	1.74	35.62	94.32	47.08	-2.14
2010/11	17.81	17.95	20.49	-1.0	15.64	6.75
2011/12	24.41	17.93	22.52	-	-9.57	-6.34
	13.28	19.41	31.24	-11.40	24.22	-6.50

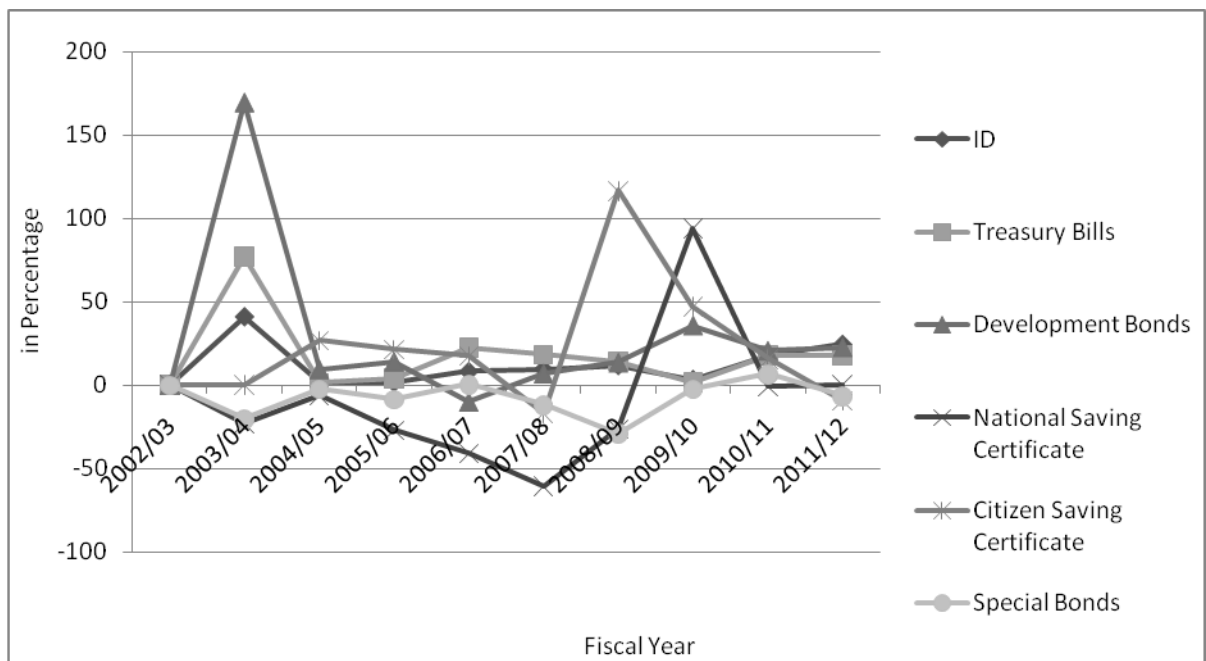
Calculated from table 4.5

The annual average growth rate of internal debt for the study period from fiscal year 2002/03 to 2011/12 are 13.28%. Among the instruments used for raising internal debt, growth rate of development bond outstanding is very high which is 31.24%. The average growth rate of TB, NSC, CSC, and SB are 19.41%, -11.40%, 22.24%, -6.50%. Banks and the financial institutions are the major holder of TB, DB and SB. Therefore, fund raising composition has not been balanced between the individuals and

institutional sectors. Normally, individuals buy hold the instrument until maturity but banks and institutions liquidate it when the rate of interest rises in the capital market. Long term bonds are advantageous to the government when low interest rate can be booked for longer periods and short term bonds are advantageous when there is a continuous rise in the interest rate structure. Today the interest rate in the market is very high and in order to have a cost advantage on borrowing the government needs to borrow the internal loan for a short period of time.

Figure 4.4

Growth Rate of Internal Debts



Source: Table 4.6

From the figure 4.4 also we can see internal debt, growth rate of development bond outstanding is very high which is 31.24% . The average growth rate of TB, NSC,

CSC, and SB are 19.41%,-11.40%, 22.24%, -6.50%. Banks and the financial institutions is the major holder of TB, DB and SB. Therefore, fund raising composition has not been balanced between the individuals and institutional sectors.

I.B. Share of Debt Instruments on Total Debt

There is the liquid risk to the NRB towards government borrowing. There is another liquidity risk for the government also, that when commercial banks will have enough opportunity to lend in higher rate and will find other investment opportunity, then they will not buy the TB in a big volume like today. In such a case, there will be a possibility of difficulty in raising funds through internal loan in a low interest rate. The share of each instrument on total debt is presented in the table below:

Table 4.7

Share of Debt Instruments on Internal Debt

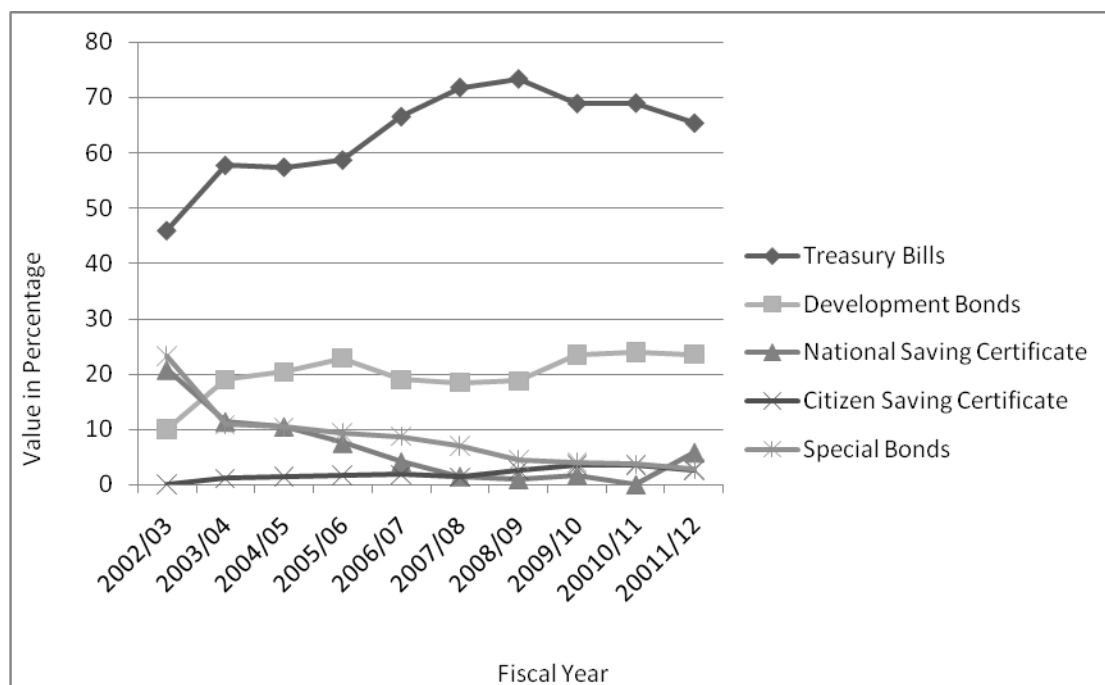
Fiscal Year	Treasury Bills	Development Bonds	National Saving Certificate	Citizen Saving Certificate	Special Bonds
2002/03	45.98	9.93	20.78	-	23.31
2003/04	57.72	18.97	11.38	1.10	10.83
2004/05	57.39	20.37	10.48	1.37	10.39
2005/06	58.68	22.84	7.51	1.63	9.34
2006/07	66.49	18.96	4.09	1.77	8.68
2007/08	71.74	18.48	1.46	1.34	6.98
2008/09	73.28	18.73	0.96	2.60	4.43
2009/10	68.84	23.46	1.73	3.53	4.00
20010/11	68.93	23.99	0	3.46	3.63
20011/12	65.33	23.63	5.80	2.52	2.73
	63.44	19.94	6.26	1.87	7.83

Source: Calculated from table 4.5

The share of component of internal debt is changing over the year. The share of short term instruments like Treasury bill on total internal debt outstanding was 45.98% and the rest 54.02% was covered by long term instruments like development bond, national saving certificate, and citizen saving certificate and special bonds in fiscal year 2002/03. Later on the Treasury bill has been dominating in the structure of total outstanding of internal debt. In the fiscal year 2011/12 TB has covered 65.33% and the rest was covered by others. Treasury bill is more liquid instruments in the market. There is secondary market in the NRB to liquidate it at any office day for banks and the financial institutions. Therefore, there is the liquid risk to the NRB towards government borrowing. There is another liquidity risk for the government also, that when commercial banks will have enough opportunity to lend in higher rate and will find other investment opportunity, then they will not buy the TB in a big volume like today. In such a case, there will be a possibility of difficulty in raising funds through internal loan in a low interest rate.

Figure 4.5

Share of Debt Instrument of ID



Source: Table 4.7

From the figure 4.5 also we can see share of debt instrument of internal debt. Treasury bill has played the important role in the government internal borrowing. Since Treasury bills are issued for a short period of time. Treasury bills are increasing trend and fiscal year 2009/10 decreasing trend. Development bonds are increasing trend fiscal year 2002/03 to 2005/06 and decreasing trend 2006/7 to 2008/9 then increasing trend. National saving certificate and special bonds are decreasing trend. Citizen saving certificate are increasing but in fiscal year 2007/08, 2010/11 and 2011/2012 decreased.

I.C Pattern and Ownership of Internal Debt Instruments

Government issues various types of bonds in order to raise the internal debts. In Nepalese context, government has issued TB, NSC, DB and SBs. Government of Nepal raise the funds from banking and non-banking sectors. The implication of borrowing from banking and non-banking system is different. Borrowing from banking system may have credit crunch in the economy but such effects will not happen if the funds are borrowed from the hand of public. The table below shows the pattern and ownership of internal debt instruments.

Table 4.8

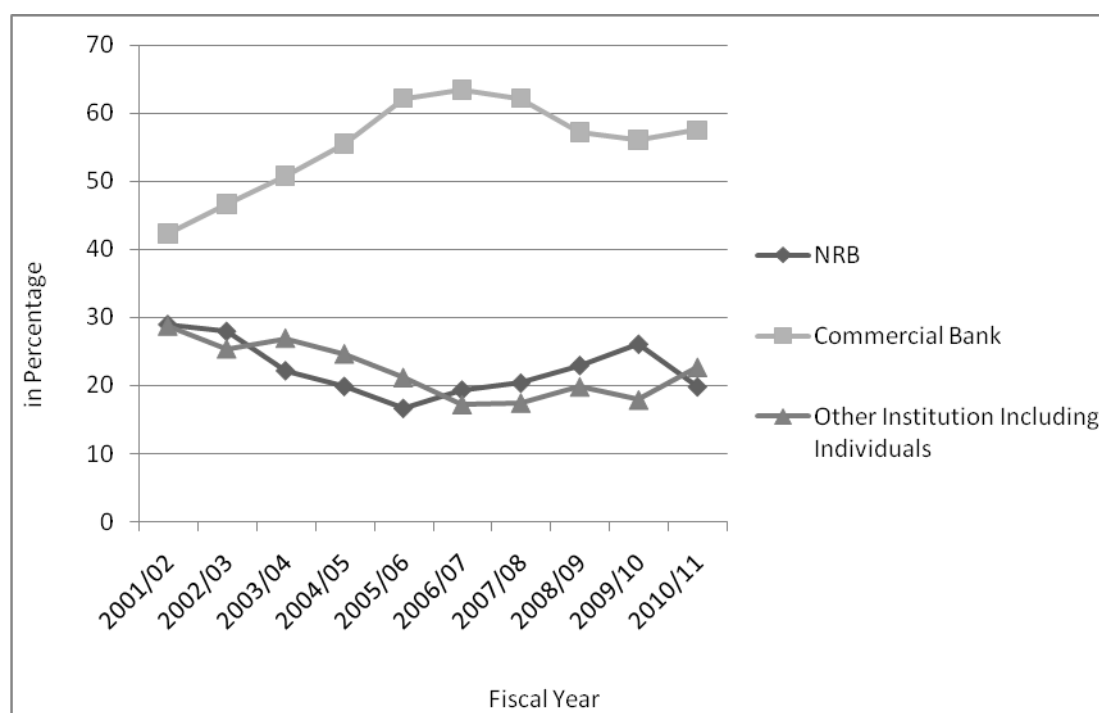
Pattern and Ownership of IDs

Fiscal Year	NRB	Commercial Bank	Other Institution Including Individuals	Total
2001/02	28.98	42.29	28.73	100
2002/03	27.98	46.63	25.39	100
2003/04	22.22	50.85	26.93	100
2004/05	19.92	55.45	24.63	100
2005/06	16.69	62.15	21.16	100
2006/07	19.37	63.44	17.19	100
2007/08	20.4	62.17	17.43	100
2008/09	22.98	57.25	19.78	100
2009/10	26.09	56.06	17.86	100
2010/11	19.84	57.51	22.65	100

Source: www.mof.gov.np/publication(2010/11)

Figure 4.6

Pattern and Ownership of IDs



Source: Table 4.8

From the table 4.8 and figure 4.6, we can see depicts that the ownership pattern of government bonds by NRB was 28.98% in FY 2002/03 which came 19.94% in the FY 2011/12. The commercial banks have begun to show their interest in purchasing the government bonds. Commercial banks were holding 42.29% of government bonds in fiscal year 2002/03, which increased to 57.51% FY 2011/12. However the holding pattern of others was 22.65% FY 2011/12. So, in recent years, ownership pattern shows that the commercial banks holding are increasing significantly.

(II) Structure of External Public Debt in term of Disbursement by Major Sources

The major sources for foreign currency for Nepal are grants, foreign assistance and loans. Nepal a basically in aid dependent country. It has to depend mainly on foreign assistance, grants and loans for the required capital imports. Moreover at the same time, terms of trade of the developing countries like Nepal are unfavorable, it has to borrow from outside in order to finance the balance of payment deficits.

Nepal has started borrowing the foreign loan from Fiscal Year 1964/65 and till now, we have the burden of Rs. 12075.60 million in 2011/2012 of foreign loan.

External loan can be divided into following two parts:

1. Bilateral external debt.
2. Multilateral external debt

Bilateral loans are the loans from foreign government and their agencies, loans from autonomous bodies and direct loans form official expert credit agencies. Similarly, multilateral loans are, loans and credits from multilateral agencies such as World Bank, International Monetary Fund, Regional Development Banks and other multinational and inter government agencies.

Table 4.9
Structure of External Public Debt in Terms of
Disbursement by Major Source

(Rs. in million)

Fiscal Year	Total External Loan	Bilateral Debt	Multi Lateral Debt	% Of Bilateral Debt	% Of Multilateral Debt.
2002/03	7698.6	87	7611.6	1.13	98.87
2003/04	4546.4	657.2	3889.2	14.46	85.54
2004/05	7629	66	7563	0.87	99.13
2005/06	9266.1	126.5	9139.6	0.14	98.63
2006/07	8214.3	40.6	8173.77	0.49	99.51
2007/08	10053.52	9004.59	1048.93	89.57	10.43
2008/09	8979.88	632.11	8347.77	7.04	92.96
2009/10	9968.90	612.90	9356.00	6.15	93.85
2010/11	11223.4	4550.6	6672.8	40.55	59.45
2011/12	12075.6	4112.4	7963.2	34.06	65.94
Average Annual growth rate				19.45	80.55

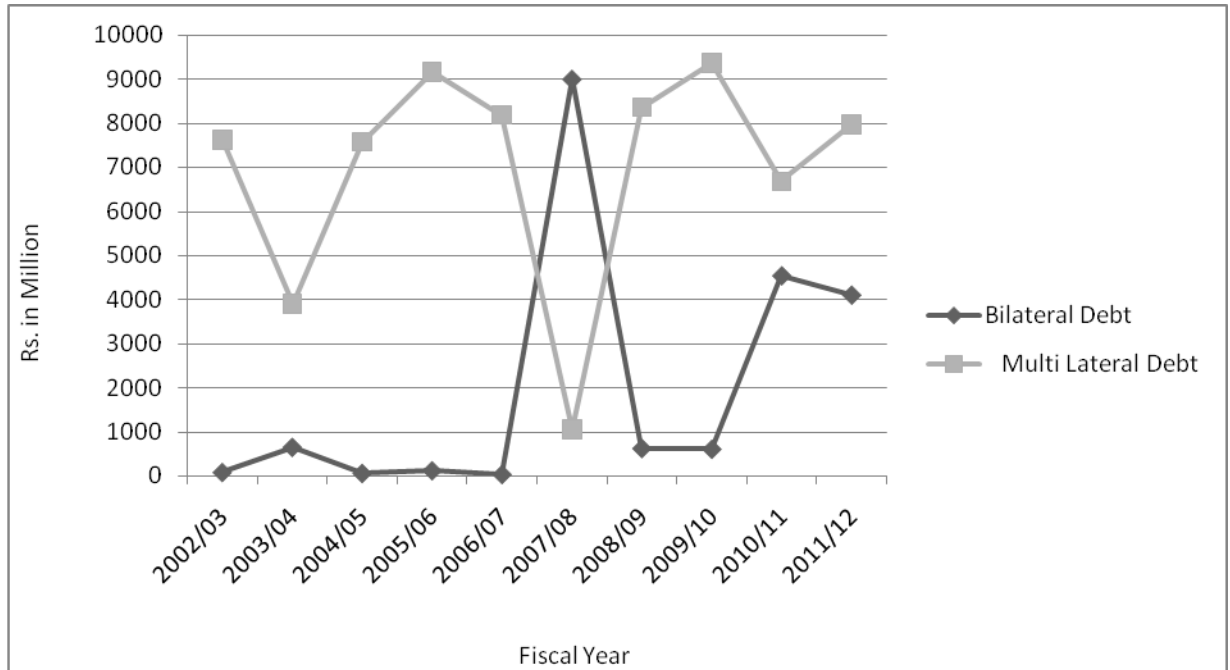
Source: www. mof.gov.np/publication (2011/12)

Table 4.9 shows structure of external debt in term of disbursement by major sources. During the study period between fiscal year 2002/03 to 2011/12 the multilateral external debt has dominated the bilateral debt in the structure and composition of external debt in Nepal. In the starting year of review period (2002/03), the percentage share of bilateral and multilateral loans on total external debt was 1.13 and 98.87.1

respectively. And by the end of study period (2011/12) it remains respectively 34.06 percent and 65.94 percent of share out of total external loans.

Figure 4.7

Trend of Multilateral and Bilateral Debt



Source: Table 4.9

From the figure 4.7 also we can conclude that the multilateral debt has a dominant role in the external role. Though the multilateral debt has been decreased heavily in fiscal year 2007/08 but also it has occupied a major role in the external debt of the government.

4.1.4 Net Outstanding Public Debt in Nepal

If we look at the budget of each fiscal year of Nepal, the deficit amount has been mounting up. It further leads to increase the debt portion of the government. Here, an attempt has been made to analyze the trend of increased volume of public debt. The following table clearly presents the net outstanding public debt in Nepal, up to the final year of study period.

Table 4.10**Net Outstanding Public Debt in Nepal**

(Rs. in Million)

Fiscal Year	Total Public Debt	Internal Public Debt	External Public Debt	Percentage of I.D.	% of external Debt in TD	A.G. Rate of T.D.	A.G. Rate of I.D.	A.G. Rate of E.D
2002/03	280169.3	60043.7	220125.6	21.43	78.57	-	-	-
2003/04	308078.5	84645.3	223433.2	27.5	72.52	9.96	40.97	1.50
2004/05	318913	86133.7	232793.3	27.0	73.0	3.52	1.76	4.18
2005/06	307206.1	87564.2	219641.9	28.5	71.5	-3.67	1.31	-5.64
2006/07	328679.4	94710.8	233968.6	28.82	71.18	6.99	8.17	6.52
2007/08	320404.9	103776	216628.9	47.9	52.10	-2.52	9.57	-7.41
2008/09	362668.4	116039.5	249965.4	32	68.00	13.19	11.82	15.39
2009/10	402714.5	125674.1	277040.4	31.21	68.79	11.04	8.30	10.83
2010/11	404303	148059.7	256243.3	36.62	63.38	0.39	17.78	-7.51
2011/12	443757.5	184205.7	259551.8	41.51	58.49	9.76	24.41	1.29
Annual Average Growth rate				32.25	67.75	5.41	13.79	2.13

Source: www.mof.gov.np/publication (2011/12)

Table 4.10 shows the net outstanding loan including internal and external loan and their average annual percentage growth. The net outstanding public debt is in increasing trend and the average growth rate is 5.41 percent from fiscal year 2002/03 to 2011/2012. The total public debt outstanding till 2011/12 amounted to Rs. 443757.5 million.

The average annual share of internal and external loan is 32.25 percent and 67.75 percent respectively in total net outstanding debt. Internal loan has increased with an average annual growth rate of 13.79%, have been indebted by foreign loans to a considerable extent. Therefore government should take the serious attention towards the burden of external debt.

4.2. Issue of Debt Servicing in Nepal

The annual and average growth rate of total debt servicing and share of external and internal debt servicing in total debt servicing during the review period of fiscal year 2002/03 to fiscal year 2011/12*(eight months)are given in the following:

1.4.1.1 Table 4.11

Share of Internal and External Debt Servicing in Total Debt Servicing

(Rs. in million)

Fiscal Year	Total Debt Servicing	Annual Growth of TDS %	Internal Debt Servicing	Annual Growth of IDS %	External Debt Servicing	Annual Growth Of EDS	%of IDS to TDS	% Of EDS to TDS
2002/03	12205.2		5637.7		6567.5	12.14	46.2	53.8
2003/04	16181.3	32.58	8662.1	53.64	7519.2	14.49	53.5	46.5
2004/05	17340.1	7.16	9431.2	8.88	7908.9	5.18	54.4	45.6
2005/06	19752.8	13.91	11651.3	23.54	8101.3	2.43	59.0	41.0
2006/07	20423.5	3.4	11272.1	-3.25	9151.4	12.96	55.19	44.81
2007/08	22916.3	12.21	13321.77	18.18	9594.53	4.84	58.13	41.87
2008/09	22760.58	-0.68	12745.88	-4.32	10014.7	4.38	56.00	44.00
2009/10	26988.40	18.58	14494.40	13.72	12494.00	24.76	53.14	46.86
2010/11	28413.6	5.28	15064.50	3.93	13349.10	6.84	53.02	46.98
2011/12	29957.6	5.43	15345.88	1.87	14611.72	9.46	51.22	48.78

Average Annual Growth Rate %		10.87		12.91		10.17	52.3	46.02
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Source: www.mof.gov.np/publication(2011/12)

Table 4.11 reveals that the total debt servicing amount has increased to Rs.29957.6 million in fiscal year 2011/12 from Rs. 12205.2 million in the beginning year of review period. Similarly the total debt-servicing amount has increased with an average annual growth rate of 9.48 percentages. The internal debt servicing has increased from Rs5637.7 million in the starting year of study period 2002/03 to Rs 15345.88 million in 2011/12. The external debt-servicing amount has increased to Rs.14611.72 million in 2011/12 from Rs6567.5 million in 2002/03. From the above table we can conclude that the internal debt servicing has been increased more than that of external debt servicing.

In the starting year of review period, the internal and external debt servicing has placed 46.02 percent and 53.08 percent of total debt servicing respectively. But last year of review period 2011/12 it comprises 51.22 percent and 48.78 percent of total debt servicing. It enforce on our conclusion that the internal debt servicing has increased to some extent in fiscal year 2011/2012 than the external debt servicing. Table 4.11 presents the overall annual growth rate of internal and external debt servicing to total debt servicing which is 53.98 and 46.02 percentage respectively under the review period 2002/03 to 2011/2012.

Table 4.12

1.4.2 Share of Interest and Principle Payment in Total Debt Servicing

(Rs. in Million)

Fiscal Year	Total Debt Servicing	Principle Payments	Interest Payments	% of Principle in TDS	% of Interest In TDS
2002/03	12205.2	6434.9	5770.3	52.7	47.3
2003/04	16181.3	9559.5	6621.8	59.1	40.9
2004/05	17340.1	10794.9	6545.2	62.3	37.7
2005/06	19752.8	13533.3	6219.5	68.5	31.5
2006/07	20423.5	14264.8	6158.7	69.85	30.15

2007/08	22916.3	16752.34	6163.96	73.10	26.9
2008/09	22760.58	16386.93	6373.65	72.00	28.00
2009/10	26988.40	18834.10	8154.2	69.79	30.21
2010/11	28413.6	18432.3	9981.3	64.87	35.13
2011/12	29957.6	17220.5	12737.1	57.48	42.52
Average Annual Growth Rate %	10.87	10.88	9.91	64.97	35.03

Source: www.mof.gov.np/publication (2011/12)

While observing table 4.12, we noticed a 10.87 percent of average annual growth rate of total debt servicing. The share of interest amount was Rs. 5770.3 million and has maintained up to Rs 12737.1 million and share of principle amount was Rs 6434.9 million and has gone up to Rs17220 million under the review period of this study. The average annual growth rates of these are 9.91 and 10.88 respectively. This shows the increasing trend of principle payments than interest payments.

The share of interest and principle payment to total debt is 47.3% and 52.7% in fiscal year 2002/2003. But in the last year it comprises 42.52% and 57.48%. So we can conclude that the share of principle payment to total debt is higher than that of interest payment. Above table also presents the overall average of principle and interest to total debt servicing, which is 64.97% and 35.03%.

4.3 Annual Internal Borrowing and Debt Servicing

Proportional relationship between annual internal debt servicing and annual borrowing can be taken as important aspects of internal debt analysis.

Table 4.13
Annual Internal Debt Servicing as Percentage of
Fresh Annual Internal Borrowing

(Rs in million)

Fiscal Year	Internal Debt (fresh)	Internal Debt Servicing	IDS as % of ID
2002/03	8000	5637.7	70.5
2003/04	8880	8662.1	97.5
2004/05	5607.8	9431.2	168.2
2005/06	8938.1	11651.3	130.4
2006/07	11834.2	11272.1	95.3

2007/08	17892.3	13321.77	74.5
2008/09	20496.4	12745.88	62.2
2009/10	18417.10	14494.40	78.70
2010/11	29914.0	15064.50	50.36
2011/12	42515.8	15345.88	36.09
Average Annual Growth rate			86.38

Source: [www.mof.gov.np/publication\(2011/12\)](http://www.mof.gov.np/publication(2011/12)) And Appendix-4

Table 4.13 shows the proportion of annual borrowing being spent on debt servicing. In the starting year of study period 2002/2003-percentage share of internal borrowing was 70.5 percent. However, this proportion has increased tremendously and reached 168.2 in the Fiscal Year 2004/05 and then it decreased trend in fiscal year 2005/06 to 2008/2009 then after started to increase and next year decreased and reached at 36.09% in fiscal year 2011/12.

This shows that the government's ability to borrow from internal sources conducive to raise enough funds for development requirement. And this also shows that the increasing proportion of internal debt servicing is the manifestation of productive spending of borrowed fund.

The high reliance on internal borrowing for financing budgetary deficit may have some effects like

- Huge amount of development fund is diverted for meeting debt-servicing charge annual which comes under regular expenditure.
- Some borrowing portion, from NRB, will have effect on money supply and consequently it has direct impact in money supply and increased prices.
- Likewise, borrowing from commercial banks will create Crowding for private sector investment.

4.5 External Debt Flow and Its Annual Servicing

Here an attempt has been made to compare the annual flow of external debt with annual debt servicing obligation. The ratio of external debt servicing to new borrowing is shown on the following table 4.14.

Table 4.14**External Debt Flow and its Servicing**

(Rs. in million)

Fiscal Year	External Debt (New Borrowing)	External Debt Servicing	Debt Servicing / External Debt
2002/03	7698.6	6567.5	85.3
2003/04	4546.4	7519.2	165.4
2004/05	7629	7908.9	103.7
2005/06	92661	8101.3	87.43
2006/07	8214.31	9151.4	111.41
2007/08	10053.5	9594.53	95.43
2008/09	8979.9	10014.7	111.52
2009/10	9968.90	12494.00	125.33
2010/11	11223.4	13349.1	118.94
2011/12	12075.6	14611.72	121.28
Annual Average Growth rate		9.48	112.58

Source: [www.mof.gov.np/publication\(2011/12\)](http://www.mof.gov.np/publication(2011/12)) And Appendix- 5

Table 4.14 reveals the proportion of external debt servicing to total external debt. Hence the ratio of external debt servicing to new borrowing is 85.3% in the starting fiscal year 2002/03 which came into 121.28% in the fiscal year 2011/12 after the up and down swing.

This states that the proportion of debt servicing to new external borrowing has been 112.58 percent over the review period whereas the annual rate of growth debt servicing has been 9.48 percent per annum. The indicator raises fear about its increasing burden because it is going to devour not only large proportion of exchange earning but rather large proportion of new borrowing too.

4.5 Per Capita Debt in Nepal

Per capita debt in Nepal swings up and down during the study period which is shown in the table below:

Table 4.15
Per Capita Debt in Nepal

Fiscal Year	Population in Thousand	Total Debt in Million	Per Capita Debt	
			Million	%
2002/03	23800	15698.7	0.659	0.00420
2003/04	24100	13426.4	0.557	0.00415
2004/05	24500	13236.8	0.540	0.00408
2005/06	24800	18204.2	0.734	0.00403
2006/07	25200	20048.5	0.796	0.00397
2007/08	25500	27945.8	1.096	0.00392
2008/09	25900	29476.3	1.138	0.00386
2009/10	26300	28386	1.079	0.00380
2010/11	26600	41137.4	1.547	0.00376
2011/12	27000	54591.4	2.022	0.00370

Source: [www.mof.gov.np/publication\(2011/12\)](http://www.mof.gov.np/publication(2011/12))

Table 4.15 shows per capita debt in Nepal. During the study 2002/2003 to 2011/12, the population and total public debt have been increased. From the starting year of review period 2002/2003 to 2011/12 population has increased from 23800 thousand to 27000 thousand. Likewise total public debt has also increased to Rs.15698.7 million from Rs54591.4 million in the review period of 2002/2003 to 2011/12. Per capita debt swings up and down from fiscal year 2002/2003 to 2011/12. In the starting year it was 0.659 (0.00420%) which came into 2.022 million (0.00370%) in 2011/12 after up and down. This means total debt per head of Nepalese people has reached to 1.022 million in 2011/12 from 0.765 million in 2002/03, which is too high. The increase in the per head debt of the Nepalese people is due to slow development of the country, low per capita income.

4.6 Debt to GDP Ratio

Total debt to GDP ratio is commonly used indicator to measure the indebtedness of a country. This ratio can be further segregated into internal debt to GDP and external

debt to GDP. The following table shows the total debt (internal debt and external debt) to GDP ratio.

Table 4.16
Debt to GDP Ratio

Fiscal Year	Total Debt Outstanding (million)	GDP at Factor Cost (million)	TD/GDP %
2002/03	280169.3	406138.0	68.98
2003/04	308078.5	460325.0	66.93
2004/05	318913	500699.0	63.79
2005/06	307206.1	548485.0	56.01
2006/07	328679.4	611118.0	53.78
2007/08	320404.9	675859.0	47.41
2008/09	362668.4	755257.0	48.02
2009/10	402714.5	909528.0	44.28
2010/11	404303.0	1083415.0	37.32
2011/12	443757.5	1246423.0	35.60

Source: www.mof.gov.np/publication(2011/12)

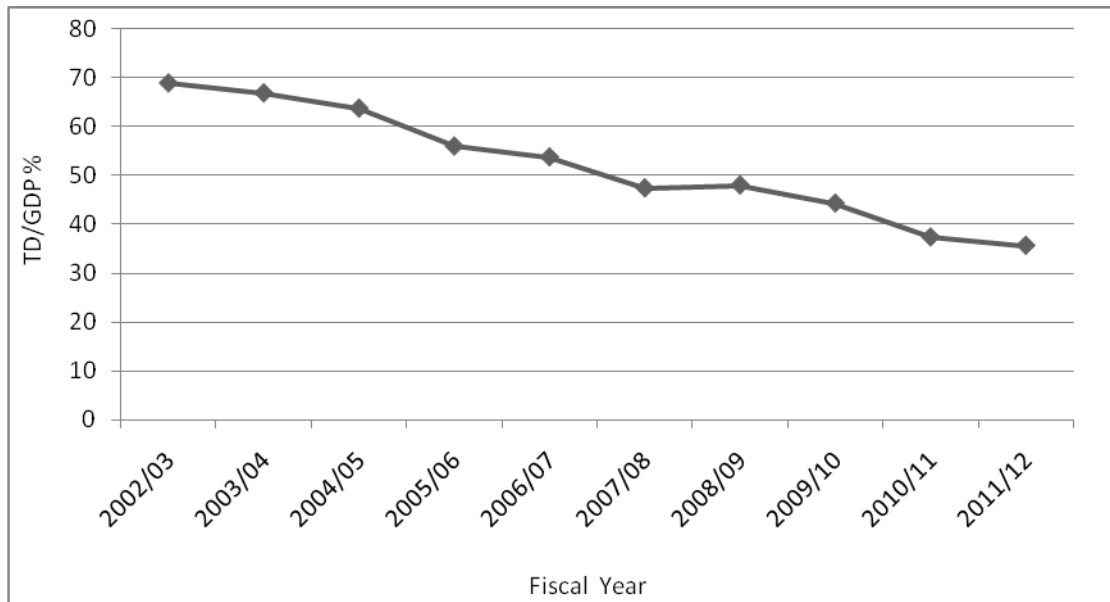
The table 4.16 depicts the debt to GDP ratio. Total debt includes both internal debt and external debt. The total debt to GDP is fluctuating during the study period. In 2002/2003 TD/GDP was 68.98%, which becomes 35.60% in 2011/12. This shows that the current gross domestic production of the economy is enough to cover only 35.60% of the debt obligation.

1.4.2.1.1.1

Figure 4.8

1.4.2.1.1.2

Ratio of TD Outstanding as a Percentage of GDP



Source: Table 4.16

The figure 4.8 shows the rise and fall in the TD to GDP. The TD/GDP is higher in the fiscal year 2002/03, which slowly starts to decrease and again starts to rise after fiscal year 2007/08.

4.9 Ratio of External Debt Outstanding to Export

This concept also helps to measure the indebtedness of a country. High value of the debt outstanding to export definitely shows the increasing trends and high level of indebtedness. The high value of debt outstanding to export for different years implies the earnings of the foreign currencies is not enough to cope up with the increasing borrowing from abroad. The ratio external debt outstanding to export for fiscal year 2002/03 to 2011/12 is presented in the Table 4.17.

Table 4.17

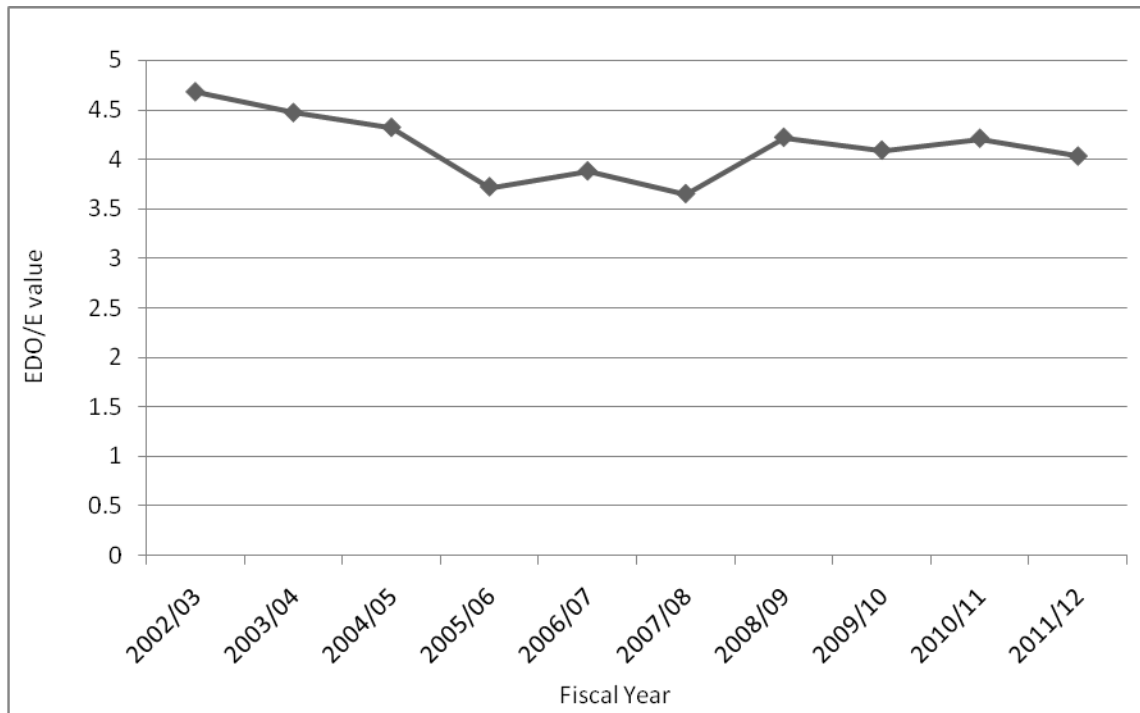
Ratio of External Debt Outstanding to Export

Fiscal Year	External Debt Outstanding	Export(E)	EDO/E
2002/03	220125.6	46994.8	4.68
2003/04	223433.2	49930.6	4.47
2004/05	232793.3	53910.7	4.32
2005/06	219641.9	58705.7	3.72
2006/07	233968.6	60234.1	3.88
2007/08	216628.9	59383.1	3.65
2008/09	249965.4	59266.5	4.22
2009/10	277040.4	67697.5	4.09
2010/11	256243.3	60824.0	4.21
2011/12	259551.8	64338.5	4.03

Source : [www.mof.gov/publication\(2011/12\)](http://www.mof.gov/publication(2011/12))

Table 4.17 and 4.9 figure we can see the ratio of EDO to export. EDO/E was 4.68 in the fiscal year 2002/2003, which fluctuates during the study period and comes to 4.09 in the fiscal year 2011/12. In comparison to the beginning year the EDO/E is higher which is not good for the economy. The higher the EDO/E ratio indicates that earning of the country from the export is not sufficient to repay the debt.

Figure 4.9
Ratio of EDO to Export



Source: Table 4.17

4.10 Major Findings

The major finding of the study is as follows:

- Revenue deficit (TE-TR) has increased with an average rate of 11.56%. The revenue deficit has increased from Rs. 22940.6 million in the starting year 2002/03 and reached to Rs 49622.2 million in the last year 2011/12 and fiscal deficit (TE-(TR+ Grants) has decreased from Rs. 16254.4 million in the starting year of the review period 2002/03 to 3700 million in the final year of the review period 2011/12. Nepal is passing through a critical phase of inadequate mobilization of internal sources, thus managing public finance has been challenging proportional as a result of the extreme situation fiscal deficit is widening day by day.
- The share of external debt servicing in total debt servicing during the study period (2002/03 to 2011/12) has decreased from 53.8% to 46.02%. Similarly the share of internal debt servicing to total debt servicing in the fiscal year 2002/03 was 46.2% which comes to be 53.98% in the fiscal year 2011/12. This indicates

that the share of internal debt servicing has been greater than that of the external debt servicing throughout the period.

- The share of annual internal debt servicing in fresh borrowing has decreased from 70.5 in the starting year of the review period 2002/03 to 36.09 % in the last year of review period 2011/12. Similarly the share of external debt servicing in new external debt has increased from 85.3% to 121.28% in the fiscal year 2002/03 to 2011/12.
- According to the sturdy per capita debt for every Nepalese people is Rs2.022 million (0.00370%)
- Average annual growth rate of total debt servicing (TDS) has remained 10.87% over the review period. Likewise, the external debt servicing increased considerably with an annual growth rate of 9.48 %. Similarly the internal debt servicing has increased significantly with an average annual growth rate of 12.91% over the review period.
- At present, up to the fiscal year 2011/12 the total debt outstanding of the government amounts to Rs. 443757.5 million that consist Rs. 359551.8 million as an external debt outstanding and Rs. 184205.7 million as a internal debt outstanding.
- During the study period 2002/03 to 2011/12 multilateral loan has dominated in the structure of total loan. On an average, multilateral loan and bilateral loan has covered 80.55% and 19.45% of total external debt respectively.
- From the study it has been found that there are few instruments to raise the internal debt in Nepal. These instruments consist of TB, DB, NSC and SB. Under this practice Treasury bills and development bonds were targeted instruments for raising debt from banking system and saving bonds from non-banking system. The proposition of TB and DB have stood 83.38% and other instruments stood 16.62%
- The ratio EDO to Export in the fiscal year 2011/12 is 4.03, which implies that the earning from export is not sufficient to cover the increasing borrowing of capital from abroad.

CHAPTER - V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

The capital generation by internal resources mobilization is one of the complex tasks in Nepal. The government expenditure is increasing rapidly in each and every year but the revenue is not growing in the same pace. So, Nepalese economy has been passing through a critical phase of inadequate financial resources. But public funds availability for filling up the resource gap is limited. Therefore, government adopts the policy of borrowing internally and externally.

After introduction of democracy in 1951, Nepal could not maintain the sufficient financial resources even to meet its regular expenditure. Accordingly it was compelled to present the deficit budget at the very commencement of the budget system. But fortunately the deficit was made up by the bilateral grants till the 1960s. The government started to raise the internal loan in FY 1961/62 by issuing the Treasury bill and was indebted by external loan in FY 1963/64, which was from U.K. and USSR. We are indebted incessantly till now and it obviously indicates towards our hereditary indebtedness for a long period to come. This has led to borrow the new loan for the redemption of old ones.

Internal debt plays a significant role in the development expenditure as well as in the growth of financial market standing the effective implementation of monetary policy. As the domestic resources are not sufficient to meet the development needs of the under developed countries like Nepal, external assistance (both loans and grants) plays obvious role. They help to solve the resource gap in the country's budgetary system.

Due to poor and insufficient domestic resources, dependency on foreign assistance has been increasing rapidly. It has contributed 50.8 percent of development expenditure. It is necessary to bridge the growing fiscal deficit and to import most essential goods for development projects.

Burden of public debt and debt servicing has been increasing continuously which is in fact the accumulation of net borrowing of different years. The total outstanding debt is Rs. 443757.5 million by the end of 2011/12 external debt servicing has become a current issue. In this context question may arise whether Nepal can sustain or not with the alarming increasing in debt servicing obligation. If Nepalese internal resources cannot meet external debt payment, there will be need to borrow again and the country is likely to fall into debt trap, i.e. new debt for servicing old debt.

5.2 Conclusion

The size of overall budgetary deficits excluding grants has remained high mainly due to low revenue and very high expenditure. This has led to heavy borrowing from internal and external sources. In fact the public debt itself is neither worse nor it impairs the economy. The financing of accumulated fund on productive programs and redemption made through such like programs, the public debt may be the quite beneficial to the nation as it outstrip the national economy as whole. But situation is quite adverse because the impact of the investment of borrowed fund on output has remained unsatisfactory.

Nepalese economy is characterized by three kinds of macro economic imbalances viz- saving-investment gap, export-import gap and revenue expenditure gap. These fundamental gaps represent the foreign domination in Nepalese economy. The saving-investment and revenue-expenditure gap are mainly the consequence of excess government activities. To fill up these gaps public debt (external and internal) is required. As other sources are limited, emphasis goes on loans for transfer technology and trade, which has created high degree of indebtedness and consequently, debt servicing obligations increasing. In the meanwhile, the loan is not self-liquidating. The debt repayment capacity is not increasing in the same pace. The ultimate effect of lower capacity falls on capital formation and development process. Mismanagement of fund has resulted on lack of self-liquidating project. These conditions create a question that "Is Nepal really falling in debt traps?" After the study, it is concluded that Nepal has not fallen in debt trap yet but if the process continues for years, there will be no other's result.

5.3 Recommendations

On the basis of above finding the following recommendations are suggested to address the problem of public debt in Nepal.

- Government should maintain fiscal balance and strong fiscal discipline through control of unproductive expenditure and maximizing revenue mobilization. Government efforts should be directed towards mobilizing internal resources and thus to reduce dependency on loans for financing development expenditure.
- Due to low revenue and very high expenditure, the size of overall budgetary deficit has remained high. This has led to heavy borrowing from internal and external sources. So, for reducing the volume of borrowing, the tax administration should be active, agile and transparent.
- The debt to GDP ratio of Nepal is not in favorable condition and if such type of situation continues in the future than the country may fall in high debt trap situation. Therefore, there should be continuous review on the existing debt and set a long-term debt management planning and strategies by the government.
- Revenue mobilization needs to be enhanced through measures directed as simplified sales taxes, effective implementation of VAT and expanding the tax net and base.
- Excessive dependency upon foreign assistance for development expenditure is persistence due to poor mobilization of internal borrowing and internal revenue. The internal borrowing mobilization for development purpose has also been fluctuating and banking sector has dominated the total internal borrowing. Government should initiate policies to attract maximum borrowing from non-banking sector, as it is considered as anti-inflationary measures of fiscal policy because it only transfers ideal saving from people to the government for development purpose.
- The loan assistance should be utilized selectively, after careful scrutiny of the purpose, content and benefits of such project and programs in order to reduce the burden of external debt while contributing to accelerating growth and meeting socio-economic objectives.
- Investment is regarded as a prime factor to increase the level of production, which is only possible through increase in the saving. In order to raise the present saving-GDP ratio, is necessary to crate favorable environment. Nepalese

economy is passing through huge domestic saving- investment gap due to mismatch between growth rate of saving and investment. Thus, there is need to reduce such gap by increasing the rate of total domestic saving.

- To avoid the debt-servicing burden and also to cope with the existing level of fiscal deficit, government should try to get more grants as far as possible. This efforts, however, depends upon the policy of the donor country but the government also should maintain such an external policy that the more grants should receive rather than the external loans.
- The level and direction of export is limited to few products and a few countries. Emphasis should be given on spending for the growth of export and diversifying trade both countrywide and commodity wise. There is need to formulate long term plan for export promotion and to coordinate various export related activities such as product development, market promotion, export stabilization, quality improvement, export diversification etc. It will help to minimize huge trade deficit by promoting to export-oriented industries and there by narrowing the ever-increasing gap between total export and import..
- In order to reduce the debt problems, government should increase GDP growth, revenue growth and export earnings growth in sustainable manner so that country will not be trapped on debt servicing problem.
- And, proper attention should be given to the macro-economic stability of the country while accepting short-term and long-term loans.
- As revenue mobilizing is based on the efficiency of tax administration, effectiveness and professionalism, imparting the training for the human resource to effect structural changes in tax administration seems inevitable.

APPENDICES

Appendix -1 Different Scenarios of Resource Gap

(Rs. In million)

Fiscal Year	Total Revenue	Growth Rate Of T.R. (%)	Total Expenditure	Annual G.R. Of T.E. (%)	Deficit	A.G. Rate Of Deficit (%)	Foreign Grants	A.G. Of F.G. (%)	Fiscal Deficit [T.E. - (T.R. + F.G.)]
2002/03	57131.6		80072.2		22940.6		6686.1		16254.4
2003/04	67568.9	18.67	84006.1	4.91	16437.2	-28.35	11339.1	69.6	5098.1
2004/05	73614.4	8.95	89442.6	6.08	15828.2	-3.71	11283.4	-0.49	4544.8
2005/06	84513.9	14.81	102560.4	12.8	18046.5	14.01	14391.2	27.54	3655.3
2006/07	86109.6	1.89	110889.2	8.12	24779.6	37.31	13827.5	-3.91	10952.1
2007/08	103513	20.21	133604.6	20.48	30091.6	21.47	15800.8	14.27	14290.8
2008/09	127943.2	23.6	161349.9	20.76	33406.7	11.02	20320.7	28.61	13086
2009/10	169857.3	32.76	219661.9	36.14	49804.7	49.09	26382.8	29.83	23421.9
2010/11	259689.1	28.63	259689.1	18.22	41197.4	-17.28	38545.9	46.1	2651.5
2011/12	245741.2	12.47	295363.4	18.22	49622.2	20.45	45922.2	19.14	3700
Average Annual G.R. (%)		17.99		15.69		11.56		25.63	

Source: www.mof.gov.np/publication (2011/12)

Growth Rate (Total Revenue) : $\frac{\text{Current Years} - \text{Previous Year}}{\text{Previous Year}}$

$$(2003/04) = \frac{6768.957131 - 57131.6}{57131.6} = 18.67\%$$

$$(2006/07) = \frac{86109.6 - 84513.9}{84513.9} = 1.89\%$$

$$(2010/11) = \frac{218491.7 - 169857.3}{169857.3} = 28.63\%$$

Growth rate (Total Expenditure)

$$(2003/04) = \frac{84006.1-80072.2}{80072.2} = 4.91\%$$

$$(2009/10) = \frac{219661.9-161349.9}{161349.9} = 36.14\%$$

$$(2010/11) = \frac{259689.1-219661.9}{219661.9} = 18.22\%$$

Fiscal Deficit: = [T.E. - (T.R. + F.G)]

$$(2002/03) = [80072.2-(57131.6+6686) \\ = 16254.5 \text{ millions}]$$

$$(2009/10) = [219661.9-(169857.3+26382.8)] \\ = 23421.9 \text{ millions}]$$

$$(2010/11) = [259689.1-(259689.1+38545.9)] \\ = 2651.5 \text{ millions}]$$

Average Annual G.R. (%) : $\frac{\text{Sum of the Growth Rate}}{\text{No. of Periods}}$

$$\text{Total Expenditure} = \frac{4.91+6.08+12.8+.12+20.48+20.76+36.14+18.22+18.22}{9}$$

$$= 15.69\%$$

Appendix -2

Debt as Percentage in Government Deficit and Total Debt

Fiscal	Deficit	Total	% Of T.	Grants	Internal	External
--------	---------	-------	---------	--------	----------	----------

2002/03	22940.6	15698.7	68.34	6686.1	8000.0	7698.7
2003/04	16437.2	13426.4	81.68	11339.1	8880.0	4546.4
2004/05	15828.2	13236.8	83.63	11283.4	5607.8	7629.0
2005/06	18046.5	18204.3	100.87	14391.2	8938.2	9266.1
2006/07	24779.6	20048.5	80.91	13827.5	11834.2	8214.3
2007/08	30091.6	27945.8	92.87	15800.8	17892.3	10053.5
2008/09	33406.7	29476.3	88.23	20320.7	20496.4	8979.9
2009/10	49804.7	28386	56.99	26382.8	18417.1	9968.9
2010/11	41197.4	41137.4	99.85	38545.9	29914.0	11223.4
2011/12	49622.2	54591.4	110.01	45922.2	42515.8	12075.6
Average Annual %			86.34			

(Rs. in million)

Source: [www.mof.gov.np/publication\(2011/12\)](http://www.mof.gov.np/publication(2011/12))

$$\% \text{ Of T. D. In Deficit: } = \frac{\text{Total Debt}}{\text{Deficit}} \times 100$$

$$(2002/03) = \frac{15698.7}{22940.6} \times 100 = 68.34\%$$

$$\text{Internal Debt as \% of Deficit : } = \frac{\text{Internal Debt}}{\text{Deficit}} \times 100$$

$$= \frac{8000}{22940.6} \times 100 = 34.87\%$$

$$\text{External Debt as \% of Deficit : } = \frac{\text{External Debt}}{\text{Deficit}} \times 100$$

$$= \frac{7698.7}{22940.6} \times 100 = 33.56\%$$

Debt as Percentage in Government Deficit and Total Debt

(Rs. in million)

Internal Debt	External Debt	Debt as % of Deficit	Internal & External Debt as % of T.D.
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		Internal Debt	External Debt	Internal Debt	External Debt
8000.0	7698.7	34.9	33.56	50.96	49.04
8880.0	4546.4	54.02	27.66	66.14	33.86
5607.8	7629.0	35.43	28.2	42.37	57.63
8938.2	9266.1	49.53	51.34	49.10	50.90
11834.2	8214.3	47.76	33.15	59.03	40.97
17892.3	10053.5	59.46	33.41	64.03	35.97
20496.4	8979.9	61.56	26.88	69.54	30.46
18417.1	9968.9	36.98	20.01	64.88	35.12
29914.0	11223.4	72.61	27.24	72.72	27.28
42515.8	12075.6	85.68	24.33	77.88	22.12
Average Annual %		53.77	32.58	61.67	38.33

Source: [www.mof.gov.np/publication\(2011/12\)](http://www.mof.gov.np/publication(2011/12))

$$\begin{aligned} \text{Internal Debt as \% of T.D.:} &= \frac{\text{Internal Debt}}{\text{Total Debt}} \times 100 \\ &= \frac{8000}{15698.7} \times 100 = 50.96\% \end{aligned}$$

$$\begin{aligned} \text{External Debt as \% of T.D.:} &= \frac{\text{External Debt}}{\text{Total Debt}} \times 100 \\ &= \frac{7698.7}{15698.7} \times 100 = 49.04\% \end{aligned}$$

$$\begin{aligned} \text{Average Annual G.R. (\%):} &= \frac{\text{Sum of the Growth Rate}}{\text{No. of Periods}} \\ &= \frac{34.9+54.2+35.43+49.53+47.76+59.46+61.56+36.98+72.61+85.68}{10} \\ &= 53.77\% \end{aligned}$$

Appendix -3

Correlation Analysis between Govt. Deficit and Total Borrowing

Fiscal	Govt.	Total Debt	x=X-X	y= Y-Y	XY	X ²	Y ²
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Year	Deficit (X)	(Y)					
2002/03	22940.6	15698.7	-7274.87	-10516.5	76505806.6	52923733.5	110595721
2003/04	16437.2	13426.4	-13778.3	-12788.8	176206850	189840724	163552127
2004/05	15828.2	13236.8	-14387.3	-12978.4	186723026	206993538	168437569
2005/06	18046.5	18204.2	-12169	-8010.95	97485010.2	148083831	64175319.9
2006/07	24779.6	20048.5	-5435.87	-6166.65	33521107.7	29548682.7	38027572.2
2007/08	30091.6	27945.8	-123.87	1730.65	-214375.616	15343.7769	2995149.42
2008/09	33406.7	29476.3	3191.23	3261.15	10407079.7	10183948.9	10635099.3
2009/10	49804.7	28386	19589.23	2170.85	42525279.9	383737932	4712589.72
2010/11	41197.4	41137.4	10981.93	14922.25	163875105	120602787	222673545
2011/12	49622.2	54591.4	19406.73	28376.25	550690222	376621169	805211564
	ΣX 302154.7	ΣY 262151.5			1337725112	1518551690	1591016256

(Rs. in Million)

Source: [www.mof.gov.np/publication\(2011/12\)](http://www.mof.gov.np/publication(2011/12))

Correlation analysis between Govt. Deficit and Total borrowing:

$$(\bar{X}) = \frac{\sum X}{N} = \frac{302154.7}{10} = 30215.47$$

$$\bar{Y} = \frac{\sum Y}{N} = \frac{262151.5}{10} = 26215.15$$

Correlation coefficient according Karl Pearson's

$$R = \frac{N \sum XY}{\sqrt{N \sum X^2} \sqrt{N \sum Y^2}} = \frac{10 * 1337725112}{\sqrt{10 * 1518551690} \sqrt{10 * 1591016256}}$$

$$= \frac{13377251120}{15543617418} = 0.86$$

Appendix -4

Annual Internal Debt Servicing as Percentage of

Fresh Annual Internal Borrowing

(Rs in million)

Fiscal Year	Internal Debt (Fresh)	Internal Debt Servicing	IDS as %of ID
2002/03	8000	5637.7	70.5
2003/04	8880	8662.1	97.5
2004/05	5607.8	9431.2	168.2
2005/06	8938.1	11651.3	130.4
2006/07	11834.2	11272.1	95.3
2007/08	17892.3	13321.77	74.5
2008/09	20496.4	12745.88	62.2
2009/10	18417.10	14494.40	78.70
2010/11	29914.0	15064.50	50.36
2011/12	42515.8	15345.88	36.09
Average Annual Growth rate %			86.38

Source: www.mof.gov.np/publication(2011/12)

IDS as % of T.D.: $\frac{\text{Internal Debt Servicing}}{\text{Internal Debt (Fresh)}} \times 100$

$$(2002/03) = \frac{5637.7}{8000} \times 100 = 70.5$$

$$(2011/12) = \frac{15345.88}{42515.8} \times 100 = 36.09$$

Appendix -5

Per Capita Debt in Nepal

Fiscal Year	Population in Thousand	Total Debt in Million	Per Capita Debt	
			Million	%
2002/03	23800	15698.7	0.659	0.00420
2003/04	24100	13426.4	0.557	0.00415
2004/05	24500	13236.8	0.540	0.00408
2005/06	24800	18204.2	0.734	0.00403
2006/07	25200	20048.5	0.796	0.00397
2007/08	25500	27945.8	1.096	0.00392
2008/09	25900	29476.3	1.138	0.00386
2009/10	26300	28386	1.079	0.00380
2010/11	26600	41137.4	1.547	0.00376
2011/12	27000	54591.4	2.022	0.00370

Source: [www.mof.gov.np/publication\(2011/12\)](http://www.mof.gov.np/publication(2011/12))

$$\begin{aligned}
 \text{Per Capita Debt in Million} &= \frac{\text{Total Debt in Million}}{\text{Population in Thousand}} \\
 &= \frac{15698.7}{23800} \\
 &= 0.659 \text{ Million}
 \end{aligned}$$

$$\begin{aligned}
 \text{Per Capita Debt\%} &= \frac{\text{Per Capita Debt in Million}}{\text{Total Debt in Million}} \\
 &= \frac{0.659}{15698.7} \\
 &= 0.00420\%
 \end{aligned}$$

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