

**PUBLIC DEBT IN NEPAL: A STUDY ON ITS TREND AND
PATTERN**

A Thesis

Submitted to Department of Economics, Prithvi Narayan Campus,

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MASTER OF ARTS

In

ECONOMICS

BY

OM PRAKASH DUMRE

Department of Economics

Prithvi Narayan Campus, Pokhara

Nepal

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LETTER OF RECOMMENDATION

The thesis entitled **Public Debt in Nepal: A Study on its Trend and Pattern** is prepared by Mr. Om Prakash Dumre under my supervision. I hereby recommend this thesis for approval in partial fulfilment of the requirements for the Degree of MASTER OF ARTS IN ECONOMICS by the thesis committee.

Gorakh Raj Ojha
Associate Professor
Thesis supervisor

Date: 15 December, 2008

APPROVAL SHEET

We certify that the thesis entitled **Public Debt in Nepal: A Study on its trend and Pattern** submitted by Mr. Om Prakash Dumre to the Department of Economics, Prithvi Narayan Campus, Pokhara, faculty of Humanities and Social Sciences, Tribhuvan University, in partial fulfilment of the requirements for the Degree of MASTER OF ARTS in ECONOMICS has been found satisfactory in scope and quality. We, therefore, accept this thesis as a part of the said Degree.

Thesis committee:

Head

Dr. Nagendralal Srivastava

External Examiner

Dr. Kedar Basnet

Reader, Department of Geography

Supervisor

Gorakh Raj Ojha

Date: 21 December, 2008

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Om Prakash Dumre

Roll No. 42/2059

T.U. Reg. No. 4615-95

Date:

Abstract

This study is based on trend and pattern of public debt in Nepal. The major objectives of this study are:

- a) To show and analyze the resource gap in the financial operation of the government of Nepal.
- b) To analyze the trend and pattern of public debt in Nepal.
- c) To analyze the burden of debt in Nepal
- d) To discuss the debt servicing issue in Nepal.
- e) To show analyze the relationship between public debt and GDP in Nepal.
- f) To recommend ways of optional utilization of public debt in Nepal.

This research provides updated information for the existing study. Unlike the past studies it explores and analyzes the effect of external debt on the output growth of Nepal.

Nepal is facing the problem of serious and growing financial resource gap on one hand and increasing inflation and population growth on the other and for this the government can not rely entirely upon the tax revenue and deficit financing resource. These sources of finance have to be supplemented by borrowing from the banking sector and other financial institutions internally and externally. Therefore the need of public debt for mobilizing additional financial resource is a comparatively modern phenomenon and has come into existence with the development of a democratic form of government.

The government gets its income mainly from two sources, namely, public revenue and public debt (borrowing). It is not obligatory for the government to return public revenue to anyone else. On the contrary, public debt carries with it the obligation to pay money back to person, institution or countries from whom it has been obtained. The accumulated amount of what the government has borrowed to finance past deficit is called public debt. An internal debt is owed by a nation to its own citizens and it poses no burden. An external debt is owed by a nation from foreigners and it is burdensome.

Public debt is defined as a kind of tax through which public enjoys the advantage of public expenditure. After the Second World War, public debt seemed a vital source of development expenditure, most of the countries in the world started to borrow systematically and still borrowing to develop their economies at a faster pace. After the first and Second World War large amount of loans were borrowed for the reconstruction, rehabilitation and maintenance.

Both internal and external public debt of Nepal has been increasing rapidly each year. The trend of external debt is increasing more rapidly in absolute terms than internal debt. Since developing countries like Nepal always need foreign currencies to import many capital goods required for development. These countries have to depend more on external borrowing than on internal for favourable balance of payments maintaining the availability of foreign exchange.

Nepal is characterized by capital deficiency as well as the low rate of capital formation. No significant capital formation is taking place from private sector. This is to say that capital is not available from the private sector for productive investment. Thus, capital formation from the public sector is a must, regarding the acceleration of pace of development. But as the economy is underdeveloped, such capital can not be raised from internal sources for the investment. Therefore, external borrowing has been the ultimate source to finance large investment projects and thus to bridge the gap of capital deficiency in a developing economy like Nepal.

The Nepalese economy is characterized by three kind of macroeconomic imbalances viz. saving-investment gap, export-import gap and revenue- expenditure gap. Due to these fundamental gaps, Nepal has been relying on foreign borrowing, while saving investment and revenue expenditure gap are mainly the consequences of excess government activities in economic matters. To fill up these gaps public debt in the form of either internal or

external is inevitable. The volume of external debt is excessively rising in the recent years under liberalization policy. As globalization concept is wide spreading all over the world, aid is gradually decreasing and emphasis goes on loans, technology transfers and trade which have created high degree of indebtedness and consequently, debt servicing obligations are increasing. In the meanwhile, the loan is not self-liquidating i.e., the debt repayment capacity is not increasing in the same pace.

During the study period, average annual growth rate of GDP, revenue and merchandise export earning are out stepped by annual growth rate of debt and debt serving obligations.

The ultimate effect of low capacity to debt servicing falls on capital formation and development process. Mismanagement of fund resulted on lack of self-liquidating projects. These conditions are compelling the researchers to ask a question that “Is Nepal really falling in debt trap?” After the study, it can be concluded that Nepal has not really fallen into the debt trap but if the process continues for years, there will be no other result. Loan component, through internal and external sources both are under the ceiling but debt servicing amount is increasing annually and its growth rate is higher than GDP growth rate and revenue growth rate. Such condition suggests to utilize the borrowed fund in the productive projects.

The analysis of the effect of external debt on output reveals that there exists significant positive relationship between external debt and GDP. Higher external debt is associated with higher domestic output and vice versa. So, it is necessary to have a careful look on the increasing magnitude of external debt and proper care must be taken to increase the debt servicing capacity of the country.

It can be concluded that governments of underdeveloped countries have to borrow due to low saving. This in turn results low level of investment, in adequate capital, low productivity, low real income and low purchasing power, inadequate capital formation.

From this study, it can be concluded that economists are not against all type of public debt. They agree that public debt should be used for productive purposes, that is, for capital projects since the fruits of such projects could be sold to buyers so debt servicing and refunding of principal do not necessitate additional taxation.

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ABBREVIATIONS

ADB	:	Asian Development Bank
CBS	:	Central Bureau of Statistics
ED	:	External Debt
FY	:	Fiscal Year
GDP	:	Gross Domestic Product
NG	:	Nepal Government
ID	:	Internal Debt
IMF	:	International Monetary Fund
LDCS	:	Least Developed Countries
MOF	:	Ministry of Finance
NPC	:	National Planning Commission
NRB	:	Nepal Rastra Bank
SAARC	:	South Asian Association for Regional Co-operation
TD	:	Total Debt
TED	:	Total External Debt
TU	:	Tribhuvan University
UK	:	United Kingdom
UN	:	United Nations
UNDP	:	United Nations Development Programme
UNESCO	:	United Nations Educational Scientific and Cultural Organization
UNICEF	:	United Nations Children's Fund
VDC	:	Village Development Committee
WB	:	World Bank
WDR	:	World Development Report
WHO	:	World Health Organization