

CHAPTER-I

INTRODUCTION

1.1 Concept of Public Debt

Debt, National, also public debt, sum total of governmental pecuniary obligations, the result of a state's borrowing from its population, from foreign governments, or from international institutions such as the International Bank for Reconstruction and Development. Public debts tend to be large-scale credit operations and are contracted on a national scale by central governments and on a lesser scale by provincial, regional, district, and municipal administrative bodies (Encarta, 2009).

Public debt is not yet defined uniformly. Some economists have focused on all kinds of financial obligations including the currency of the states, while others have excluded it. It includes all kind of financial liabilities on the part of the government to pay the money back to the person and the institution from whom it has been obtained.

Government of any country gets income from two sources namely, public revenue and public borrowing. Public revenue consists of money that the government is under no obligation to return to the very individuals from whom it is obtained. Public borrowing, on the contrary, carries with it the obligation on the part of the government to pay money back to the person form that it has been obtained.

Public borrowing is surrounded by awe, ignorance and fear and it has been often said about it that “Never have so many understood so little about so much”(Singh, 2001:361).

The public debt includes five types of obligations:

-) Currency as a public debt
-) Short-term obligation

-) Floating debts, permanent and funded debts
-) Financial obligations
-) Bilateral and multilateral agencies

In the view of A.H. Hanson “Public debt is the debt owed by a government to people and institution within its own borders (internal debt) and or to foreign creditors (external debts)” (Hanson, 1941:205).

Classical economist James Stuart’s view as presented by Walter F. Stettner is as under: “Public borrowing must be adjusted to the conditions of trade at the particular time. Government borrowing is inappropriate as long as ‘circulation is full’ because then it would only raise the rate of interest and have undesirable consequences for commerce. On the other hand, when circulation is stagnating in one part of the economy and there is unemployment and a slackening of trade and industry the state should absorb this excess and through its expenditures throw it into new channels of circulation. Thus the use of public credit is conceived as the balance wheel in the economy. It keeps resourcefully employed, and prevents stagnation in any part of the economy from having an adverse effect elsewhere. In addition public credit is a necessary instrument of war finance” (Singh, 2001:363).

Thus, public debt is the financial obligation of the state for which the government is committed to pay back its interest and principal within stipulated time period.

Deficit financing means an increase in public debt. Since it is an easy method of obtaining income, government is likely to be extravagant and irresponsible. Consequently, public debt will become a definite burden on the economy.

Payment of interest on public debt and refund of the principal will require additional taxation. It might prove to be difficult since government’s power to tax is not unlimited. Deficit financing might produce currency deterioration and price inflation (Singh, 2001: 362).

In various sectors in developing countries, government has to make huge investment. Limitation in revenue collection imposes government for deficit budget. Nepal is also not an exception to this. Since Nepal first presented its budget in the year 2008 B.S, there has been a continuous growth in the size of budget. Both the expenditure as well as the revenue has been increasing over time, expenditure exceeding the revenue. To fulfill the deficit budget, government borrows from public. Although it is easy to borrow through bilateral and multilateral agencies, there is problem in management. If debt is not properly managed it keeps on mounting, causing burden for the future generation. For the repayment of debt, debt is again borrowed, in this way nation can fall into debt trap. Till date, Nepal government has Rs.362990.5 million (see table no. 4.8) to repay as debt. This is an indication that Nepal is slowly getting into debt trap.

1.2 Historical Background

1.2.1 International

In earlier times debts contracted by heads of state had the legal status of personal debt; public debt emerged as a systematic element in a country's economy when regular sources of income became available to provide funds to repay loans, a monetary system became fully formed, and an organized money market came into operation. The first examples of public debt surfaced in the late 17th century in Europe and became more prevalent with the rise of the modern state and the banking and credit system that grew out of the Industrial Revolution (Encarta 2009.)

The classical economists in 18th century were generally against public borrowing. They advocated for the balance budget. They assumed full employment in the nation and held the view that to expand more on behalf of the state was unnecessary and unproductive. They argued the magnitude of the public debt gradually initiate the nation to heavily imposed taxation, by which

the entrepreneurship of the people would be suppressed. In other words they stood for the Laissez faire policy.

It was Keynes who presented a truly significant revision in the theory of public debt. After the great depression of 1929's Keynes did not accept the classical notion of self-equilibrating free enterprise economy, at full employment level, and propounded the concept of under-employment level. Further, he advanced the view that state should borrow the debt from the lender to meet its deficit incurred in the annual budget. He marked that public borrowing need not be unproductive, inflationary and burdensome. He also deliberated that it is better to hold the debt internally rather holding it externally.

Post Keynesian economists disputed the concept in favor of Keynesian ideas. AP Learner, a post-second world war economist and propounder of the functional finance approach said – “Public debt maintains that government should borrow only when it wants to make people hold more bonds in place of money” (Singh, 2000). He added that more public borrowing should have its effect on aggregate demand, and the government should not be disturbed over the size of the debt.

“The idea of public debt was originated in the Great Britain in the 17th century, where a group of city merchants provided grants and loans to the government” (Joshi, 1982). In return they received the privilege of royal charter to fund the bank of England, which later became the country's central bank. Government borrowing has developed simultaneously with the needs of the state's development. Historically, during the world wars government's borrowing increased with the large amount of loans to meet its expenditure.

After the First and Second World War large amount of loans were borrowed for the reconstruction and maintenance. Previously state only had to maintain the internal peace, and prevent external disruption. But now every state should look after economic development and public welfare in addition to the previous work. Therefore, public debt has become as one of the most useful instruments

to generating needed funds to maintain the welfare state and economic development.

However, “a fear is expressed that unless restricted by some means a government may resort to excessive borrowing and get into a ‘debt trap’, a situation in which it has to borrow afresh to service its expenditure. In case of foreign debt, the country’s resources also get drained. In any case government loses much of its budgetary maneuverability like those on investment, economic stability and balance of payment.” (Bhatia, 2003: 204)

1.2.2 Public Debt in Nepal

Developed countries were provided the loans from their people even in 18th century in a very systematic way. In case of Nepal, people had no power and inclination to provide the money as a loan. They traditionally provided the human labour and goods to their ruler. People had to compulsorily contribute to overcome several emergency situations.

The earlier king of Malla dynasty had borrowed the assets from the renowned temple and social trust to hold the battle and overcome many emergency situations. The great king Prithivi Narayan Shah was also indebted by the people at the time of unification of the nation.

“An instance of government borrowing in Nepal can be hold during the time of Rana Bahadur shah who borrowed a large sum of money (Rs.60,00,000) from Indian merchants to meet internal administrative needs” (Khanal, 2000:27).

In 1803 the government was forced to borrow money from some Indian merchants to meet its internal expenses. A cash levy was imposed in a country wide basis on 1804-1806 to finance the repayment of debts incurred by king Rana Bahadur Shah. Prime Minister Junga Bahadur Rana came in power and the development work was not incurred out. They used to collect the revenue for their own expense in order to lead a luxurious life. There was no concept of economic welfare for the people. Thus, 104 years passed in this way,

development activities were not launched. After the democracy, the first five year plan was introduced in the year 1956. In this plan most of the expenditure was incurred with the foreign grants. During that period some deficit amount of Rs.27.8 million was covered by withdrawing from surplus balance account and loan from Nepal Rastra Bank.

The government for the first time issued securities (Treasury Bills) in the fiscal year 1961/62, and in the fiscal year 1963/64, the government floated securities (long term loan) for mobilizing saving to finance the country's economic development program and for giving compensation of forests and Birta Land. On 12th February 1964, the government floated development bond of Rs.13.1 million which carried an interest rate of 6 percent per annum with maturity period of five years. In the same period the government issued compensation bonds for land acquisition amounting Rs.407 thousand with the interest rate of 3 percent per annum with the maturity period of 10 years. Other compensation bonds worth 5.56 million for land acquisition with one percent interest rate per annum with the maturity period of 20 years was also issued. The other component of the borrowing was from NRB as guaranteed loans and special bonds. The government also started borrowing since 1984, by issuing national saving certificate which amounted to Rs.500 million. Similarly, in 1991 the government started to borrow by issuing CB pass and other bonds which amounted to Rs.8,478.1 million. Treasury bills, development bonds, national saving certificates and special bonds are the main source of internal borrowing. In the year 2006, government sold Treasury Bills amounting Rs.9.3 billion having maturity period of 194 days with interest 4.0060% (Kantipur, 18th March, 2006).

1.3 Statement of the Problem

Government expenditure is increasing rapidly each year, but government revenue is not growing at the same pace in Nepal. It is common that rise in the magnitude of public debt must be accompanied by an increase in the debt

servicing capacity so that there may not appear an adverse effect on the balance of payment owing to outflow of funds. It is generally observed that the present increasing size of Nepal's public debt is a matter of great concern for all the educated people.

There is an ever increasing trend of financial resources gap, which needs more loan. It makes the outstanding public debt in increasing trend.

Some of the debt burden indicators such as the percentage share of debt service obligation in GDP, export earning, revenue and government expenditure show an increasing trend and are likely to increase further the level or degree of indebtedness of the country. Thus, the per capita debt is increasing over the years. Owing to the poor inadequate domestic resources mobilization for meeting the growing needs of the development fund, reliance of external borrowing is increasing rapidly. Both the scarcity of internal resources as well as requirement of foreign capital have caused for such massive increase in expenses for army and police organization, donation and charity or on many other unproductive programs. Public debt may cause economic decrepitude of the nation. However, government of Nepal is still borrowing a large amount of debt.

In Nepal, after the restoration of multi-party system public debt is increasing rapidly but servicing capacity is not accompanying the debt burden. This has resulted into unfavorable balance of payments. The current situation of public debt in our country makes us to think seriously about it and has become a major concern of government. This study has tried to answer the following questions:

1. What is the system and practice of Public Debt in Nepal?
2. How is the trend and pattern of Public Debt in Nepal?
3. What are the problems and prospectus of Public Debt in Nepal?

1.4 Objectives of the Study

The main objective of this study is to examine into the structure and management of public debt in Nepal. Specifically, we would like:

- 1) To examine system and practice of public debt in Nepal.
- 2) To analyze the trend and pattern of public debt.
- 3) To examine the problems and prospectus of public debt Nepal.
- 4) To provide suggestions and recommendation for the betterment of public debt management in Nepal.

1.5 Limitation of the study

The study has the following limitations:

1. The study covers a period of 20 years from 1988/89 to 2007/08
2. The study is based on secondary data, and no attempt has been made to examine the reliability of the secondary data.
3. The study does not analyze the macro economic aspects such as money supply, price level, inflation, employment and poverty alleviation.

1.6 Organization of the study

The proposed study is organized into the following five chapters:

Chapter I: Introduction

The introduction chapter deals with the background of public debt, statement of the problem, objectives, significance, limitation and organization of the study.

Chapter II: Review of Literature

This chapter reviews the available literature on public debt, and its relevance to the present study. We have attempted to incorporate the classical Keynesian, Post Keynesian and modern thinking on public debt Related research report, journals and articles are reviewed.

Chapter III: Research methodology

Chapter III is related to research methodology. This chapter explains the research design, method of data collection, and tools and techniques used in the analysis of data.

Chapter IV: Data Analysis and Presentation

Keeping in mind the objectives outlined above (1.4), collected data are tabulated and analyzed using various financial and statistical tools. Collected data have been arranged in order that, it can be tabulated properly. Tabulated data are presented and analyzed. During the analysis system and practice of public debt management in Nepal has also been studied. An empirical analysis of growth trends of both the internal as well as internal debt has also been undertaken.

Chapter V: Summary, Conclusion and Recommendation

Final chapter summarizes the main conclusions that flow from the study on public debt in Nepal. An attempt has also been made to offer suggestions for necessary action to improve the management of public debt in Nepal.

Bibliography, appendix and other supporting documents have also been incorporated at the end of the study.

CHAPTER-II

REVIEW OF LITERATURE

2.1 Background

Earlier government followed the policy of non intervention in economic activities. However, especially after the depression of 1929, the public authorities started to take keep interest in economic development of their respective country. Thus, public borrowing has 'essential condition for the economic development of the nation'.

Public debt in the modern time is necessary to meet some of the crucial objectives. Sometimes, due to un-expected and unplanned events the taxation or other source of revenue may not meet the annual expenditure proposed by the government. The state should also conduct general administrative functions and development programs. The state is also bound to address the natural calamities, disasters, epidemic and other unexpected daily lives of the people. Besides, the people sometimes also show no interest in paying tax and participate in the national development. In such cases the public debt plays a vital role in the national economy. It is also the best way to curve public spending and stop inflation in the market economy.

Apart from this, public loans in modern times are necessary to remedy the business depression, to check the cyclical fluctuation, to finance on public enterprises for public welfare, to create the infrastructure for the establishment of socialistic state and even for meeting the current and regular expenses. It should be noted that different types of loan will be raised for different type of objectives.

Nepal is a developing country with US \$ 484(Economic Survey, 2008/2009) per capita income. More than 80% of economically active population is engaged in agriculture. About one third of the population lives below the

poverty line. Government has the responsibility to reduce poverty and meet the pressing need of its people. It has to invest a huge amount on the development of overheads like transportation, communication, power and other basic infrastructure. However, the government of Nepal lacks necessary resources. For this, government needs to borrow from both the internal as well as external sources.

2.2 Review of Books

Generally, attitude of the classical, Keynesian and Post Keynesian economists differ regarding public debt. Attitude of the classical economists towards public debt is not favorable. They were not in favor of increasing economic role of people. According to them, state has to perform limited activities like maintenance of law and order, justice and security. Classical economists forwarded the argument that public debt creates burden in the economy because of its unproductive nature. However, the classical theory is criticized mainly on two grounds. Firstly, government expenditure is not always unproductive. Hence, public borrowing is not always a burden upon the country. Secondly, the traditional view regarding the shifting of the debt burden is not correct because classical economists thought upon the ability and willingness to work and on the capacity and willingness to save which is the real burden to the public debt.

After 1929s Great Depression, new wave of thinking appeared with the writing of J.M. Keynes, he advocated for increasing government role in the economic activities by adopting deficit financing so that effective demand is created in the economy ensuring employment opportunities. In 1950s development process started in developing countries in a significant manner. The great depression of 1929s and the Keynesian revolution paved the way for the development of a modern theory. It states that public debt is income generating, and not a burden upon the community.

The level of government borrowing is a function of the ability and willingness of persons and business to lend and the government's power and intention to tax.

Government debt management now affects vitally and directly the nation entire financials system, the degree of its prosperity, the level of its prices, and the relative welfare of its citizens (Shultz and Harris 1954:588).

Public finance is a field of study in economics concerned with the economic behavior of government. It is an inquiry into the facts, techniques, principles, theories, rules, and policies shaping, directing, influencing, and governing the use of scarce resources of government (Sharp and Sliger, 1970:5)

Generally public debt refers to loans raised by a government within the country or outside the country. Every government like individuals has to borrow when its expenditure exceeds its revenue. But it is not a source of revenue like taxes. Of course, in wider sense, the term public revenue covers all types of income. Hence public revenue includes the money borrowed by a government. The amount borrowed by the government during any given year constitutes the income of that year. We may call, therefore, public debt as 'revenue' of the government. The loans raised or any debt incurred or received in a year constitute the income of the government like other taxes levied or collected. But the basic difference between the public debt and other sources of revenue is that while public debt has to be paid back by the government; the other types of income are not to be paid back (Lekhi 1999:343).

Samulson and Nordhaus, however, say that a large public debt creates an adverse effect on national income – a large government debt can clearly be detrimental to long - run economic growth. As the debt accumulates over time, more and more private capital is displaced. People save by purchasing (1) government debt and (2) assets like houses, shares, stocks and bonds of corporations, savings accounts, etc. With growing public debt, people accumulate government debt instead of private capital. This leads to the

displacement of private capital stock by public debt resulting in lower national output. Secondly, additional taxes are levied to pay interest on rising debt stock resulting in inefficiencies. This leads to further lower output. Rise in external debt also lowers national income by raising the proportion of national income going to servicing the external debt. “Taking all the effects together, output and consumption will grow more slowly than they would have there been no large government debt and deficit” (Singh, 2000: 383/84).

Bowen-Davis-Kopf approach defines burden in terms of the cut in lifetime consumption of different generations of tax payers. At many point of time, society consists of several generations of people. The total burden of public outlay is the reduction in the lifetime consumption of each generation of tax payers. Under debt finance generation I can shift part of the needed cut in consumption to future generation such as II and III. The later generations (i.e. II and III) were not present at the time of debt financing, but would be present in future at the time of debt serving. When the debt is retired Generation I consumes the proceeds but Generations II and III would pay taxes for debt-servicing. In other words, the older generation increases its consumption, while the decrease occurs in the consumption of the newer generation. Thus the burden of debt, in terms of “the total consumption of private good foregone during the lifetime of a generation”, falls on the generation alive at the time the loan is repaid (Singh, 2000:385).

Public debt is a term used for all short-term and long-term borrowings of the government from the people. Different forms of borrowing have different effects on the economy. It is, therefore, necessary to choose a source of public borrowings carefully, keeping in view the overall national objectives (Mankar and Sarma, 2003:211).

Bhattarai (2005), in his book “Invest: Theory and Practice” mentions about government securities as government issues securities to finance their activities. Revenues collected by the government seldom cover expenses and

the differences have been financed primarily by issuing debt instruments are issued to raise necessary fund, some securities have short term where as other are long term. Treasury bills, treasury notes, treasury bonds, saving bonds, zero coupon treasury bonds, saving bonds, zero coupon treasury development bond etc. are some example of government debt instrument.

Managing public debt in one of the critical financial functions. It is critical to minimize the costs to the government public debt is the money raised by government from various sources which is subject to return. It is indirectly the various sources which is subject to return. It is indirectly the debt of the people. It is raised to bridge the gap between expenditure and income. It can be internal and external and from banking and non banking sector. Public debt has serious implication on money supply, interest rates and lending capacity of financial institutions. “The main objective of public debt management is to ensure that the government’s financing needs and its payment obligations are met at the lowest possible cost over a medium to the long-run consistent with a prudent degree of risk.” Government should carefully analyze the impact of public debt in national economy because it affects savings, investments and consumption pattern (Nepal, 2007:301).

2.3 Research Report/Thesis

Public borrowing started in 1952 AD. Prior to this, there was no provision for borrowing. However, historical evidences show that it is not a new concept in Nepal; several rulers of Nepal have borrowed from both the national and international sources, it was necessary to uplift the economy.

A number of studies have been conducted on public debt. The relevant studies have been reviewed here.

Acharya (1968) on his thesis entitled “A Case Study on Public Debt in Nepal” includes different kinds of debts, features, problems and pattern of public debt and loan. To the conclusion that the public debt is most popular but during that

time people lacked habit of purchasing bonds issued by the government. This was because they had no idea about it and also it was due to the lack of purchasing power. Thus, he recommended that people should be made aware about it.

Joshi (1982), in his thesis entitled “Structure of Public Debt in Nepal”, has analyzed the taxation and mobilization of resources, public borrowing and contribution of public debt. He concludes that internal debt can play pivotal role to develop money and capital market whereas external debt is useful mainly for rapid economic development and to full up the resources gap in the country. He also described a healthy growth in ownership pattern of the internal public debt in banking sector but the contribution of others seemed insignificant in the internal public development activities in Nepal.

Singh (1983), in his report entitled “A Study on the Impact of Internal Borrowing in Nepal”, has analyzed the trends of revenue, expenditure and deficit, effects of under borrowing on money supply and inflation, etc. He reached on the conclusion that availability of more profitable scope for the investment in private sector, such as constructions of house, purchase of land, business and trade, speculative activities and return of fixed deposit in the commercial banks are the main factor contributing to be decreasing trend of the real borrowing. Besides this the lower rate of interest, longer maturity period and under developed security market seemed to have discouraged in segment in the purchase of government bonds.

Upadhyay (1985), in his thesis entitled “Debt and Debt Servicing in Nepal” analyses Nepal’s debt situation, external borrowing and budgeting in Nepal. He has included the source of debt structure and determinants of external borrowing in Nepal and debt servicing ability. He concluded that the government should use its external borrowing in productive purpose. If this can be done the national income will increase and consequently that servicing ability will also increase.

Sharma (1987), in his thesis entitled “Public Debt in Nepal” has tried to show the relationship between public borrowing development expenditure and budgetary deficit. In the work, Sharma argues that “The Expansionary Impact of the Ownership Pattern of Securities” has contributed to the inflationary spiral in the country.”

Rajbanshi (1987), in his thesis entitled “External Borrowing in Nepal” has analyzed the indebtedness of the country on the one hand and the other hand he also analyzed the development external borrowing.

Guru Gharana (1996), in his article “The Role of Foreign Aid in Economy Development and Poverty Alleviation” presents data on the share of outstanding foreign debt in GDP at a factor cost and of foreign debt servicing in regular expenditure (1984/85-1993/94). He found long term upward increasing trend on public debt. He concludes that “Although foreign loan is relatively much softer terms for Nepal compared to India and China, the foreign aid implies that aid is slowly pushing Nepal towards a debt crisis in the coming years.”

Adhikari (1996), in her article entitled “Foreign Debt Servicing” analyzed the foreign debt servicing problem in Nepal. She found out substantial increase in foreign servicing between the periods of 1974/75 to 1993/94. She prescribed effective implementation of liberalization policy in all areas of investment. This can bring a great relief to the country by creating capacity for foreign exchange earning which can reduce burden of debt servicing substantially in the years to come.

Koirala (1997), has written an article entitled “Public Debt in Nepal” in this article he has analyzed trend and structure of public debt in Nepal. He concluded that the government should try for maximum mobilization of interest resources for development purpose and excessive dependency upon foreign assistance for development programs should be gradually reduced and it should be contained within the desired extent.

Acharya (1998), in his article “Burden of Public Debt in Nepal” has analyzed that internal debt is more predictive, effective than external debt.

Sharma (1998) in his article “The Growing Imbalances in Nepal: Are We Really Falling into Debt Trap?” has analyzed the increasing trend of public debt in Nepal and its servicing has really created a situation which leads the country towards debt trap because of the following reason:

-) Huge amount of loan is allocated for meeting expenses within the development expenditure.
-) A good amount of borrowed fund is for debt servicing.
-) Volume of borrowed amount exceeds the maximum legal limit of borrowing.

Khanal (2000), in his thesis entitled “Public Debt in Nepal” has analyzed the crucial points about public debt. He described that the external borrowing is increasing more rapidly than internal borrowing in the developing countries like Nepal. Increasing trend of public borrowing and debt servicing obligations are also increasing rapidly but debt servicing capacity of the country has not increased at the same pace.

Sharma (2001), in his thesis paper entitled “Public Debt: System and Practice in Nepal” has analyzed trend and structure of public debt, impact of public debt and studied the attitude of the investors towards the government securities. He used chi-square test of hypothesis to know about interest and awareness of Nepalese people on government securities. According to him the magnitude of public debt and its interest is mounting rapidly, but the addressing capacity for redemption the debt is not increasing in the same pace.

Basnet (2003), in his thesis entitled “Public Debt of Nepal: Trend and Pattern of Public Borrowing from 1984/85-2000/01” has analyzed the trend and structure of public debt in Nepal. He has expressed increased government borrowing has been used in financing mostly on the unproductive sector uncertainties, lack of a well trained civil service, inadequate checks and

balances in the political and budgetary process and corruption, high current expenditure and hence government always lacks the resources than borrows ones.

Basnet (2003) in his thesis mentions that due to the increasing trend of resources problem external as well as internal borrowing has been increasing. Nepal's budgetary deficit is growing rapidly which increased dependency on foreign assistance, the share of external borrowing is 63.24 percent of the total debt and rest by internal debt in 2000/01. "The trend of continuously increasing borrowing and debt servicing obligation is not good economic indicator for developing country like Nepal. Obviously, there is no any alternative source for financing budgetary deficit so that government is unable to reduce size of debt." He further emphasized that effective mechanism should be implemented to complete the development program funded by public debt on time, so that interest burden should be minimized. He provided some suggestions and recommended to get rid of the heavy burden of debt, tax system should be improved, and the borrowing should be minimized. He provided some suggestion and recommended to get rid of the heavy burden of debt, tax system should be improved, and the borrowing should be effectively used on the productive purpose. Effective supervision and legal system must be set to control increasing corruption. The saving and investment rate should be increased pursuing appropriate policy measure.

Ghimire (2005), in article 'Deficit Financing: Implication and Management' entitled "Foreign Capital in Nepal", has analyzed the role of most of the developing and developed countries are facing proper management of debt. A developing country like Nepal is also facing the same problem like uniqueness of topic, tools, relevancy in Nepalese context. These are some of the special features of the proposed study. Thus, the researcher has focused on the management of public debt in Nepal.

Thapa (2005), in his article mentions that public debt management may be defined as those official policies, which alter the size and composition of

government debt. It is a peculiar area of public finance and strict monetary policy. The public debt raises finance for government expenditure, as do taxes, but in so doing it influences the rate of interest and liquidity in the economy. Public debt can be defined in various other ways. The most comprehensive definition would encompass all claims against the government bonds, treasury bills, saving certificates, post office saving accounts, the deposit obligation of the central bank and finally all currency which is the most liquid claim on the government. This broad definition of the national debt focuses our attention on a most important characteristics of debt-its liquidity. The national debt can cover the wholly liquid or it can be almost totally illiquid. And he further adds the objectives of the debt management are as follows:

- To influence the size and maturity of debt;
- To influence the appropriate pattern of interest rate;
- To affect the types of holder of the debt;
- To affect the type of holder of the debt;
- To achieve short-term stabilization of bond prices'
- To limit debt service cost;
- To create capital market;
- To give priority to domestic over foreign issues on domestic market, and
- To give priority to public sector borrowing.

The following instruments are used to achieve the above-mentioned objectives of the debt management:

- Timing of issues;
- Coordination among authorities and banks on issues;
- Bonds innovations tailored for issues;
- The privileges;
- Queuing;
- Pressure to favor government bonds, and,

- Restrictions on foreign access to the market.

Thapa further adds in Nepal, the domestic debt management is mainly being carried out with the objectives of maintaining appropriate interest rates, affecting certain type of holder of the debt and short-term stabilization of bond prices. The size is not currently being considered. The maturity of debt is sometimes taken care of. And to achieve these objectives, the first three instruments are being used. Open market operations of government treasury bills are being effectively conducted in the Nepal Rastra Bank. The debt management committee represented also by the ministry of finance considers also the timing and the size of the bills to be transacted.

Thapa (2007), in his thesis entitled “Public Debt: Its Trend Pattern and Impact in Nepalese Economy” mentions that the main goal of the developing countries like Nepal is to stimulate the growth of the economy with stability. The public debt should be used in productive sectors to escape from the vicious circle of poverty for a country like Nepal. It has small capacity of saving because of low level of income which reflects low level of investment. Hence the poverty sequence moves like inadequate capital, low level of purchasing power and huge resource gap. These problems can be solved only by large scale of investment from public sector as well as private sector. Nepalese private sector has not well developed so the government of Nepal has invested huge amount of money. The expenditure of government of Nepal has been increasing day by day because of development activities and insurgency as a result public debt also has been increasing.

Pant, (2008) in his thesis entitled “Trend and Structure of Public Debt in Nepal” has analyzed public debt has been playing key role in the development process. Underdeveloped countries like, Nepal is facing a serious problem of growing financial resource gap and the government cannot fully depend upon tax revenue, surplus of public understanding and deficit financing and internal financial resources. The volume of the public expenditure has been increasing

and so the budgetary deficit has been increasing. To fulfill these increasing deficits, government has been raising funds from both internal and external sources. External sources include foreign loan grants from bilateral and multilateral agencies.

Public debt is also sometimes referred to as government debt. It is a term for all of the money owed at any given time by any branch of the government. It encompasses public debt owed by the federal government, the state government and even the municipal and local government (www.google.com).

Public debt is, in effect, an extension of personal debt, since individuals make up the revenue stream of the government. Public debt accrues over time when the government spends more money than it collects in taxation. As a government engages in more deficit spending, the amount of public debt increases (Encyclopedia, 2009).

Public debt can be made up of all sorts of different types of debt. A great deal of public debt is external debt, which is money that is owed by the government to foreign lenders, either in the form of international organizations, other governments, or groups like sovereign wealth funds which invest in government bonds. Public debt is also made up of internal debt, whether citizens and groups within the country lend the government money to continue operation. In some ways, this is a lot like lending to oneself, since ultimately the responsibility for public debt falls back on the very people lending money (Google, 2009).

Governments with strong economies, who are well trusted in the world, are able to raise funds by issuing their own securities, usually called government bonds. Individuals other nations, and groups buy these bonds, and the government promises to pay them back at a certain, usually fairly good, interest rate. Less robust governments, who do not have the trust from the world to be able to issue bonds and expect people to buy them, may turn to international

institutions, or even normal banks, to give them loans, usually at less favorable rates (Google, 2009).

Public debt is usually broken down not only by an internal and external divide, but also by the length of the loan made. Short-term public debt is foreseen to last only one or two years, so the turnover rate is fairly high. Long-term public debt is designed to last more than ten years, with some long term debt lasting considerably longer than that. Mid-term public debt lasts anywhere between three and ten years (Encarta, 2008).

2.4 Research Gap

Most of the research studies are concentrated on the study of debt burden, debt-trap structure and importance of government securities. They have not paid due attention on the management aspect of the public debt. Due to the development of multilateral agencies (IMF, WB, ADB) the external borrowing is becoming more easier day by day. But the management of those funds is becoming most controversial. In case of Nepal, public debt has long history but the management aspects of public debt has not been taken seriously. The basic principle of public debt should be focused on maximum utilization of internal resources and to fulfill capital deficiency but very few of internal resources and to fulfill capital deficiency but very few amount are invested on these sector. Political instability, internal conflict, lack of national consensus are the basic constraints for the proper utilization of internal and external borrowing.

Most of the developing and developed countries are facing proper management of debt. A developing country like Nepal is also facing the same problem like uniqueness of topic, tools, relevancy in Nepalese context. These are some of the special features of the proposed study. So, this study will be fruitful to those interested person, scholar, students, teachers, civil society, stake holders, businessman and government for academically as well as policy perspective.

CHAPTER-III

RESEARCH METHODOLOGY

3.1 Introduction

In order to achieve the objectives of the study mentioned in chapter one keeping in the view objectives obtained in this chapter deals with the research design, nature and sources of data, collection techniques, data analytical tools and limitation of the methodology.

3.2 Research Design

To achieve the objectives of the study, descriptive as well as analytic research design has been used.

3.3 Sources of Data

This study heavily depends upon secondary sources of data. These are compiled from various sources including books, internet, booklets, magazine and reports. Most of the data are taken from the publications of HMG, MOF, NRB, CBS, WDR, IMF, World Bank etc.

The secondary data have been collected through various published and unpublished documents of the concerned authorities. The sources of secondary data are as:

-) Official publications of the concerned offices
-) Publications of government relating to this field
-) Books and journals related to public debt
-) Periodicals, magazines and newspaper
-) Brochures and booklets related to this research

3.4 Period Covered

The study covers a period of twenty years (1988/89 to 2007/08).

3.5 Data Collection and Processing Technique

Data collected from secondary sources are coded, tabulated and presented in a meaningful manner. Then it is arranged in the tabular form with the observed and expected frequencies.

3.6 Presentation and Analysis of Data

As per the need of the study data are presented in proper tabular forms, and relevant tools and techniques used. The result obtained from the analysis has been clearly interpreted. Detail calculations are presented in appendices at the end of the thesis.

3.7 Tools for Analysis

The following statistical tools are used in the study.

3.7.1 Statistical Tools

The appropriate statistical tools are used where ever required to extract the result from the data collected. The different tools used are as follows:

-) **Percentage Analysis:** The percentage analysis is done to compare two or more data for general information. It is used to find out the portion of sample in favor of different choices.
-) **Ratio:** It obviously helps to study the trend and structure of public debt. Statistical tools like percentage, regression, correlation equation have been used in this dissertation. Some ratios calculated are as follow:
 - a) Ratio of annual total debt to government revenue.
 - b) Ratio of internal and external debt to fiscal deficit.
 - c) Ratio of annual total debt services to government revenue/expenditure.

3.7.2 Correlation and Regression

Correlation may be defined as the degree of linear relationship existing between two or more variables. Two variables are said to be correlated when the change in the value of one variable is accompanied by the change of another variable. For example, changes in prices are accompanied by the quantity demanded. The correlation like regression shows the degree and direction of relationship between variables but, unlike regression, it does not show cause and effect relationship.

3.8 Definition of Terminologies

Public Debt: The public debt includes and external obligation of a public debtor and national government.

Internal Debt: Internal debt is the government's borrowing from domestic banking sector and individual.

External Debt: External debt is the government's borrowing from external sources or autonomous public bodies through bilateral and multilateral sources.

Gross Domestic Product (GDP): GDP is the measure of the total domestic output at factor price.

Debt Servicing: Debt servicing refers to the principle payment and interest payment on loan after maturity.

Debt Trap: Debt trap is the situation when new fresh loans are taken to redeem the previously taken loan.

Burden of Debt: Burden of debt is the sacrifice of the community through a rise in taxation at the time of payment and for pang the annual interest on the government loans.

Bilateral Debt: Bilateral debt means the debt units acquires money or a quantity of goods and services from the government of other country or debt based on a direct arrangement between two countries.

Multilateral Debt: Multilateral debt means the debt unit acquires money or goods and services from the union of nations or governments' institutions, businessmen and consumers or international organization.

CHAPTER IV

PRESENTATION AND ANALYSIS OF DATA

4.1 Trends and Structure of Public Debt in Nepal

A number of research works are available on public debt in Nepal. However a few are related to the management aspects of public debt. Our review in the previous chapter revealed that some of them focused on its structure and importance while others have shown interest on burden and impact, inflation, employment, national solvency etc. It is to be noted here that the term management of public debt is a controversial one. In the section that follows we would first of all present the historical background of public debt in Nepal and then proceed further.

Public debt is interrelated with the basic governmental fiscal flows of taxation and spending. If the volume of government expenditure exceeds the volume of tax and other (non-tax) revenues a deficit budget exists. Such a deficit budget provides the fundamental pre-condition for debt creation. Having once been created, debt requires interest payment to maintain the debt and refinancing operations if the debt is to beyond the maturates of exiting securities (Bernard 2000; 436).

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 government expenditure . The loan operation of the modern government especially in LDCs has been increased due to the government active participation in the economic development on one hand and the limited availability of funds for investment from the private sectors on the other hand. Thus, the investments for accelerating the role of capital formation for development purpose have led the

government to expand resources through public borrowing internally and externally.

An underdeveloped economy is an economy in which the available stock of capital goods is not sufficient to employ the available labor force. Underdeveloped country is one, which has the potential for development. But underdeveloped country has low rate of saving, investment, income and low living standard due to the low per capita income and poverty, dualistic economy, unutilized natural resources, lower health and education condition of the people, deficiency of capital etc. Resource gap is burning problem of the underdeveloped economy due to the deficiency of capital so that public debt is only one solution to fill the lack of capital deficiency. Increased in tax rate can be solved the problems of resource deficient of the government but it is not easy in LDCs because of poor tax paying capacity (Pant, 2008).

Underdeveloped country like Nepal has to depend upon foreign assistance and external borrowing. Domestic resource like taxation and borrowing have their own constraints and foreign loan can act as an important instrument for raising additional finance within a short period of time. This assistance can help in achieving the objective of developing economy stability and growth, if the funds are properly utilized on productive purpose.

Nepal has accepted the foreign loan since the formulation of first plan (1956/57-1961/62) but it has systematically started to raise the debt since the FY 1961 / 62 beginning through the means of the treasury bill that amounted Rs.7 million and carried one percent interest rate. After this, the government firstly floated the development bond Rs.131 million in FY 1963/64. In the same way, it has increased to Rs.21735.4 million by the end of the FY 2007/08. There are few reason for raising public debt.

1. To meet budget deficit.
2. To restrain inflation.
3. For economic growth.

4. Un popularity of taxation.

Nepal has been borrowing mainly to balance budgetary deficient. A large number of infrastructures are essential for the development of the economy. Besides that the availability of the conscious people, reasonable tendency of natural resources, a technically efficient civil servants and well behaved and dedicated citizens are essential. At the same time, the capital availability and mobilization of the resource is one of the fundamental causes of the development of any nation. Besides, physical capital is required and also human capital is equally essentials for development endeavor.

4.2 Trend of Revenue and Fiscal Deficit

Public debt in Nepal rose rapidly since the FY 1984/85 when the government started to raise the debt with new long term security named 'National saving certificate'. After then the amount of public debt has been fluctuating in its size but in aggregate it has increase tremendously up to the year 2001. The net outstanding public debt was Rs.32462 million in FY 1987/88 but it amounted to Rs.318993.9 million in FY 2006/07. The world bank has suggested Nepal to maintain the internal debt with in 2 percent of GDP.

The scarcity of adequate internal resources has been the main constraint in the realization of development programs in Nepal . The annual growth rate of budgetary expenditure and its revenue are not increasing in the same pace. The public expenditure is growing more rapidly than the revenue collection and has resulted in capital shortage. This can be seen in the following table.

Table 4.1
Trend in Revenue and Fiscal Deficit

FY	Revenue	Expenditure	Deficit	Grants	External loan	Internal Loan	Cash Balance
1988/89	7776.7	18005.2	10228.1	1680.6	5666.4	1330	1551.1
89/90	9287.5	19669.3	10381.8	1975.4	5959.6	2150	296.8
90/91	10729.9	23549.8	12818.9	2146.8	6256.7	4552.7	(154.3)
91/92	13512.7	26418.2	12905.5	1643.8	6816.9	2078.8	2366
92/93	15148.47	30897.7	15749.3	3793.3	9620.9	1620	3415.1
93/94	19580.8	33597.4	14016.6	2393.6	9163.6	1820	639.4
94/95	24575.2	39060	14484.8	3937.1	7312.3	1900	1335.4
95/96	27893.1	46542.4	18649.3	4825.1	9463.9	2200	2160.3
96/97	30373.5	50723.7	20350.2	5988.3	9043.6	3000	2318.3
97/98	32937.9	56118.3	23180.4	5402.6	11054.5	3400	3323.3
98/99	37251	59579.0	22328	4336.6	11852.4	4710	1429
99/2000	42893.7	66272.5	23378.7	5711.7	11812.2	5500	354.8
2000/01	48893.9	79835.1	30941.5	6753.4	12044	7000	5144.1
01/02	50445.6	80072.2	29626.8	6686.2	7698.7	8000	7241.9
02/03	31225.6	84006.1	52780.4	11339.1	4546.4	8880	3010.8
03/04	62331.0	89442.6	27111.6	11283.4	7629	5607.8	259.1
04/05	70122.7	102560.4	32437.7	14391.2	9266.1	8938.1	(157.7)
05/06	72282.1	110889.2	38607.1	13827.5	8214.4	11834.2	4731.1
06/07	87717	133604.6	45887.6	15800.8	10053.5	17892.3	2145.9
07/08	107622.5	161349.9	53727.4	20320.7	8979.9	20496.4	3930.4

Source: MoF, Economic Survey, Various Issues.

From the above table, it is clearly seen that the budgetary deficit is increasing every fiscal year. The deficit has increased from Rs.10228.1 million in the FY 1988/89 to Rs.53727.4 million in the year 2007/08, which is 5.253 times. The revenue has been increased from Rs.7776.7 million in the FY 1988/89 to Rs.107622.5 million in FY 2007/08. On the other hand, the government

expenditure has increased from Rs.18005.2 million to the starting of the review period to Rs.161349.9 million in FY 2007/08.

In absolute terms the table shows the horrible increment of budget deficit. The main reason for increasing deficit budget are that the country has to make provisions for development works, such as roads, electricity, education etc. and the revenue is not increasing as in the increasing ratio of expenses. Because of lack of managing of all this expenditure properly deficit budget is increasing rapidly and other hand government of Nepal always wants to keep pleased the traders, industrialists, farmers, professional employees and many others. By hence, government always has to face the problem of budgetary deficit. And tax and customs administration is not fair, transparent, and agile to some extent so government cannot collect revenue as it predicts.

There are three elements for the deficit recovery. Firstly, grant is the most potential source of foreign currency, this instrument enables the government to import capital goods, and restructure of administration and development work. Moreover, it can be used on capitalization itself. It does not put direct burden on the government. The table shows the decreasing tendency of growth from FY 1996/97 to next two years but then after it is increasing for the remaining years of review period. In numerical measurement, government had got Rs.5988.3 million in FY 1996/97 but it received Rs.4336.6 million in FY 1998/99.

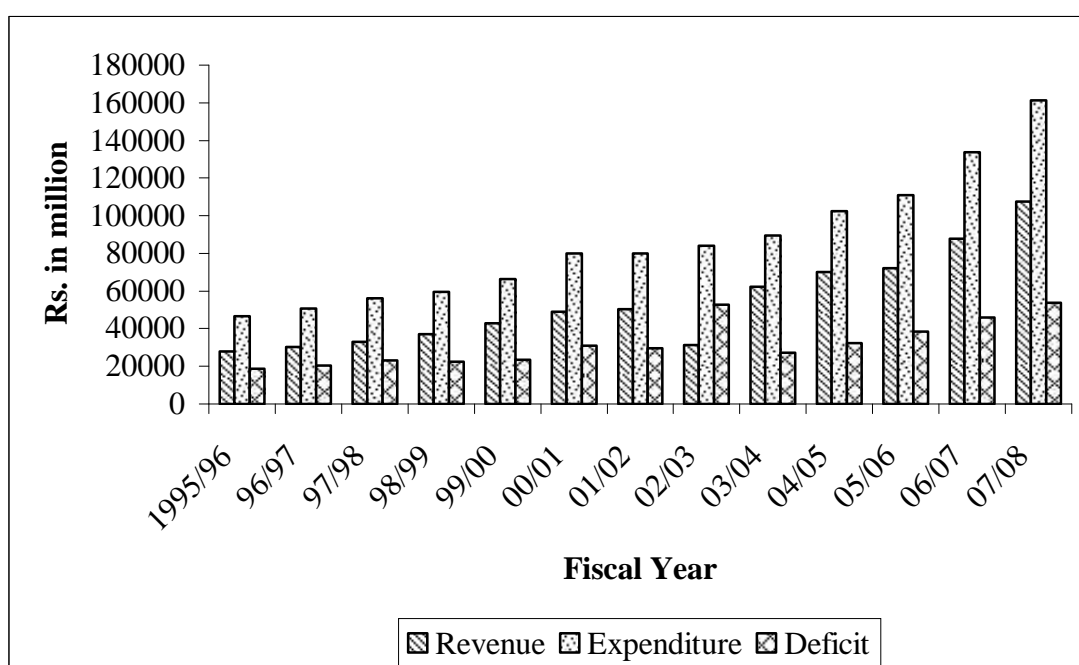
About the second element of recovery, the external loan was raised to only Rs.5666.4 million in 1988/89 but it was raised to Rs.12044 million in FY 2000/01 which is 2.125 times greater than starting year of review period. On the other hand, Rs.8979.9 million was raised during the FY 2007/08, which is 1.574 times greater than the starting year of reviewed period.

The third element of recovery is the internal loan, which is the easy way to raise the fund for the government. But sometimes it affects to the monetary policy of government. In the beginning year of review period 1989/90 it was

Rs.1330 million and the trend is inconsistent up to fiscal year 2002/03 by Rs.8880.0 million. But in the FY 2003/04 it has decreased to Rs.5607.8 million. After that it is increasing up to the FY 2007/08.

The final column shows the difference between the determined deficit to sum of its every recoveries [deficit-(grants + internal debt + external debt)]. The amount more than necessity are shown without brackets are called the domestic resource gap and these are to be financed from the government's cash balance.

Figure 4.1
Trend in Revenue and Fiscal Deficit (1995/96-2007/08)



The increasing budget deficit in the first twelve years with increasing external loan has shown that Nepal is heading towards debt trap. But the situation seems some what favourable in the last three fiscal years. In these, fiscal year external loan has slide down abruptly in comparison to previous years. But the budget deficit remained increasing and financed by internal loan. Thus, the possibility of debt trap has not been completely discard in near future. In calculating deficit, if such trend remains there will be Rs.50027.18 million in FY 2008/09 and Rs.52527.6 million will be in FY 2009/10.

4.3 Annual Growth Rate of Grants and Government Borrowing

The capital generation through internal resources mobilization is a difficult task in the Nepalese economy. The revenue and grants from home and abroad is not increasing as required to meet the development expenditure. As the tax and custom administration is not fair, transparent and agile, government could not collect the revenue as estimated in the annual budget. All these reasons lead to the budgetary deficit.

Table 4.2
Annual Growth Rate of Grants and Government Borrowing

FY	Total Debt	Annual Growth Rate of Total Debt (%)	Grants	Annual Growth in Rate of Grants (%)	Internal Debt	Annual Growth Rate of Internal debt	External debt	Annual growth rate of external debt (%)
1988/89	6996.4	-	1680.6	-	1330	-	5666.4	-
89/90	8109.6	15.91	1975.4	17.54	2150	61.65	5959.6	5.17
90/91	10809.4	33.29	2146.8	9.58	4552.7	111.75	6256.7	5.0
91/92	8895.7	-17.70	1643.8	-24.06	2078.8	-54.34	6816.9	8.95
92/93	8540.9	-4.00	3793.3	130.76	1620	-22.07	6920.9	1.53
93/94	10983.6	28.43	3937.1	-36.89	1820	12.34	9163.6	32.40
94/95	9212.3	-16.12	4825.1	64.48	1900	4.4	7312.3	-20.20
95/96	11663.9	26.61	5988.3	22.55	2200	15.79	9463.9	29.42
96/97	12043.6	3.25	5402.6	24.10	3000	36.36	9043.6	-4.44
97/98	14454.5	20.01	5402.6	-9.78	3400	13.33	11054.5	22.24
98/99	16562.4	14.58	4336.6	-19.73	4710	38.53	11852.4	7.22
99/2000	17312.2	4.53	5711.7	31.71	5500	16.77	11812.7	-0.34
2000/01	19044	10.00	6753.4	18.24	7000	27.27	12044	1.96
01/02	15698.7	-17.57	6686.2	-1.0	8000	14.29	76987	-36.08
02/03	13426.4	-14.47	11339.1	69.59	8880	11.0	4546.4	-40.95
03/04	13236.8	-1.41	11283.4	-0.49	5607.8	-36.85	7629	67.80
04/05	18204.2	37.53	14391.2	27.54	938.1	59.38	9266.1	21.46
05/06	20048.5	10.13	13827.5	-3.9	11834.2	32.40	9214.3	-11.35
06/07	27945.8	39.39	15800.8	14.27	17892.3	51.19	10053.5	22.39
07/08	29476.3	5.48	20320.7	28.60	20496.4	14.55	8979.9	-10.68
Annual Average Growth Rate	-	9.36	-	19.11	-	21.46	-	5.34

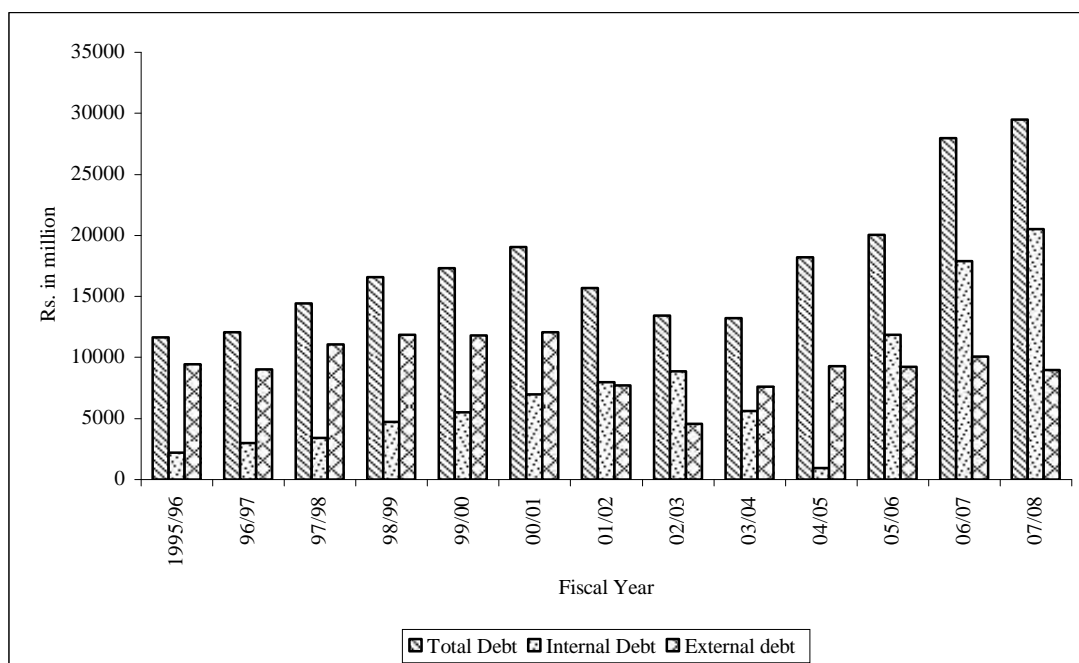
Source: Economic Survey, Various Issues, MoF.

The above table shows tendencies of heavy reliance on foreign grants. Indeed the grants are not the debt but everlasting reliance on it is not proper. Grants have reached Rs.20320.7 million in the FY 2007/08 from Rs.1680.6 million in 1988/89.

Similarly, internal borrowing has increased to Rs.20496.4 million in the year 2007/08 from Rs.1330 million in 1988/89. It has annual growth rate of 21.46 percent. Furthermore, external borrowing is increasing more remarkably than internal borrowing. External debt stood at Rs.5666.4 million only in FY 1988/89 increased to Rs.8979.9 million in year 2007/08. It has 5.34 percent of average annual growth rate. It is due to the decrease in last two years of external debt of review period.

Figure 4.2

Annual Growth Rate of Grants and Government Borrowing (1995/96-2007/08)



The main reason of increasing growth rate of internal loan than external loan is that, country expends external loan in an always un-productive sector, Nepal is not fulfilling the agreement and facing political instability. Because of this

reason foreign lenders do not believe on giving loan. When the country lacks loan from foreign lender than only way to raise from internal sector. So the growth rate of internal debt is higher than external debt. The total debt (internal and external debt) has increased to Rs.29476.3 million in FY 2007/08 from Rs.6996.4 million in FY 1988/89. The government in the FY 2007/08 has raised 4.21 times more than the FY 1988/89. This trend clearly shows the government borrowing is increasing tremendously year by year. This increment in borrowing is burden to the nation. Such burden may generate serious problem for future generation. Therefore, the increasing trend should have to be managed soon. If this trend persists, the amount of total debt in FY 2008/09 will be Rs.30745.73 and in FY 2009/10 it will be Rs.33502.28 million.

The amount of grant is lower in comparison to internal and external debt but growth rate is high. The amount of debt is higher but economic growth rate is lower, it causes instability in fiscal sector. Share of total debt in GDP is increasing, it may create problem to the fiscal sector in long-run. Therefore, management of growing debt should be considered as soon as possible.

4.4 Debt as Percentage in Fiscal Deficit and Total Debt

The yearly budgetary expenses of the government is increasing rapidly, but the revenue of government has not increased at the same pace. Government of Nepal always wants to keep pleased the traders, industrialists, farmers, professionals and employees and many others. As a consequence of this it could not collect revenue as much as it has to spend and faced the problem of budgetary deficit. To meet such a gap, government has been relying on drawing down foreign exchange reserve, borrowing from home and abroad and grants from home and abroad.

Table 4.3
Annual Percentage in Fiscal Deficit and Total Debt

FY	Deficit	Total Debt	% of total debt in deficit	Internal Debt	External Debt	Debt as % in deficit		Debt as % in total debt	
						Internal Debt	External Debt	Internal debt	External debt
1988/89	10228	6996.4	68.4	1330	5666.4	13	55.4	19	81
89/90	10381.8	8109.6	78.11	2150	5959.6	20.71	57.4	26.51	73.49
90/91	12819.9	10809.4	84.32	4522.7	6256.7	35.51	48.8	42.12	57.88
91/92	12905.5	8895.7	68.93	2078.8	6816.9	16.11	52.82	23.37	76.63
92/93	15749.3	8540.9	54.23	1620	6920.9	10.29	43.94	18.97	81.03
93/94	14016.6	10983.6	78.36	1820	9363.6	12.48	65.38	16.57	83.43
94/95	14484.8	9212.3	63.60	1900	7312.3	13.12	50.48	20.62	79.38
95/96	18649.3	11663.9	62.54	2200	9463.9	11.80	50.75	18.86	81.14
96/97	20350.2	12043.6	59.18	3000	9043	14.74	44.44	24.91	75.09
97/98	23180.4	14454.5	62.36	3400	11654.5	14.67	44.69	23.52	76.48
98/99	22328	16562.4	74.18	4710	11852.4	21.09	53.08	28.44	71.56
99/2000	23378.7	17312.2	74.05	5500	11812.2	23.53	50.53	31.77	68.23
2000/01	30941.5	19044	61.55	7000	12044	22.62	38.93	36.76	63.24
01/02	29626.8	8498.7	28.69	8000	7698.7	27.0	25.99	94.13	5.87
02/03	52780.4	13426.4	25.44	8880	4546.4	16.82	8.61	66.14	38.86
03/04	27111.6	13236.8	48.82	5607.8	7629	20.68	28.14	42.37	57.63
04/05	32437.7	18204.2	56.12	8938.1	9266.1	27.55	28.56	49.10	50.90
05/06	38607.1	20048.5	51.93	11834.2	8214.3	30.65	21.28	59.03	40.97
06/07	45887.6	27945.8	60.90	17892.3	10053.5	38.99	21.90	64.02	35.97
07/08	107622.5	29476.3	27.39	20496.4	8979.9	19.04	8.34	69.53	30.47
Average Annual %	-	-	59.45	-	-	20.52	39.97	38.77	61.23

Source: Economic Survey, Various Issues, MoF.

The table 4.3 shows the annual budgetary deficit and debt components for recovering the deficit. It means increasing budget deficit and public debt in between the period of 1988/89 to 2007/08. The budgetary deficit was limited to Rs.10228 million in the starting year of review period 1988/89, but it immensely increased to Rs.107622 million in the FY 2007/08. It clearly shows our heavy reliance on grants and debts, as these both are easy instruments for financing and deficit budget. It, in one extreme, indicates our capital resource

scarcity and at other extreme, it shows our inefficiency on proper mobilization of internal resources. On the other hand, the total debt also simultaneously increased o Rs.29476.3 million in FY 2007/08 from Rs.6996.4 million in FY 1988/89. Hence the total debt increased by 4.21 times during the review period 1988/89 to 2007/08

Similarly, the table presents the average annual percentage of total debt to total deficit. It is average measured 59.45 percent out of total deficit. Rest of this 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 externally held grants because externally this may cause adverse impact on national sovereignty. Internal debt had occupied 13 percent of total deficit in 1988/89 but it is increased to 38.99 percent in 2006/07 after then it is decreased to 19.04 percent in final year. In aggregate, internal debt has contributed 20.52 percent of share out of total deficit in overall calculation of data of review period. Mean while, external debt rose to Rs.8979.9 million in 2007/08 from Rs.5666.4 million in FY 1988/89. It is likely 1.58 time more in 2007/08 than in FY 1988/89. It clearly shows our reliance on foreign loan, where it occupies 39.97 percentage of share out of total deficit in average.

It shows heavy dependency on external debt. Due to different factor (obligation imposed by agencies) external loan has not been increasing as expected. So management of external loan should be taken seriously.

4.5 Pattern of Public Debt in Nepal

A wide disparity between government income and expenditure is largely responsible for the country's widening gap between saving and investment. A small proportion of development expenditure is met by the revenue surplus and the remaining large segment of development expenditure is met from the growing internal and external borrowings. Though the external borrowing was provisioned since the first budget speech in 1956/57, it was not properly used till the FY 1961/62. The systematically recorded first external borrowing was

from the then USSR for establishment of Birgunj Sugar Factory and Janakpur Cigarette Factory in 1963/64. Only the bilateral debt was borrowed previously than the FY 1961/62. After then both bilateral and multilateral debt have been borrowed till now (Thapa, 2002: 7).

4.5.1 Pattern of Internal Public Debt in Nepal

Pattern of internal public debt is mainly divided into four parts. They are treasury bills, development bonds, national saving certificates and special bonds as debt borrowing instrument in Nepal. The pattern of public debt under the review period (1989-2008) is tabulated below.

Table 4.4
Pattern of Net Outstanding Internal Debt in Nepal

Year	Total outstanding internal debt	Treasury bills	Development bonds	National saving certificate	Special bonds
1989	12887.9	1171	5088.6	2196.5	4431.8
1990	14673.1	1821	5388.6	2896.5	4567
1991	20885.9	2351	5482.3	3646.5	9376.1
1992	23234.9	3483.2	5132.2	4546.3	10073.2
1993	25456.1	4403.2	5132.2	4901.5	11019.2
1994	30631.2	5216.3	4732.2	5691.5	14991.2
1995	32057.8	6396.5	4122.2	6076.4	15466.7
1996	34241.9	7142.5	3672.2	7376.5	16650.7
1997	35890.9	8092.5	3042.2	8736.5	16019.7
1998	38406.7	9182.5	3302.2	9886.4	16035.6
1999	49669.6	17586.9	3872.2	10426.4	17784.1
2000	54357	21027.0	4262.2	11526.5	17541.3
2001	60043.7	27610.8	5962.2	12476.4	13994.3
2002	72992.6	41106.5	11090.7	11536.1	9259.3
2003	83714.2	48860.7	16059.2	9629.8	9164.5
2004	84953.8	49429.2	17549.2	9029.8	8946.2
2005	86135.3	51383.1	19999.2	6576.7	8176.3
2006	93031.7	62970.3	17959.2	3876.6	8225.6
2007	102365.0	74445.3	19177.1	1516.9	7225.7
2008	113025.1	85033.0	21735.4	1116.9	5139.8
Average Annual %	1068654.4	528712.9	163166.5	133666.7	224088.3
	-	49.49	15.28	12.65	21.97

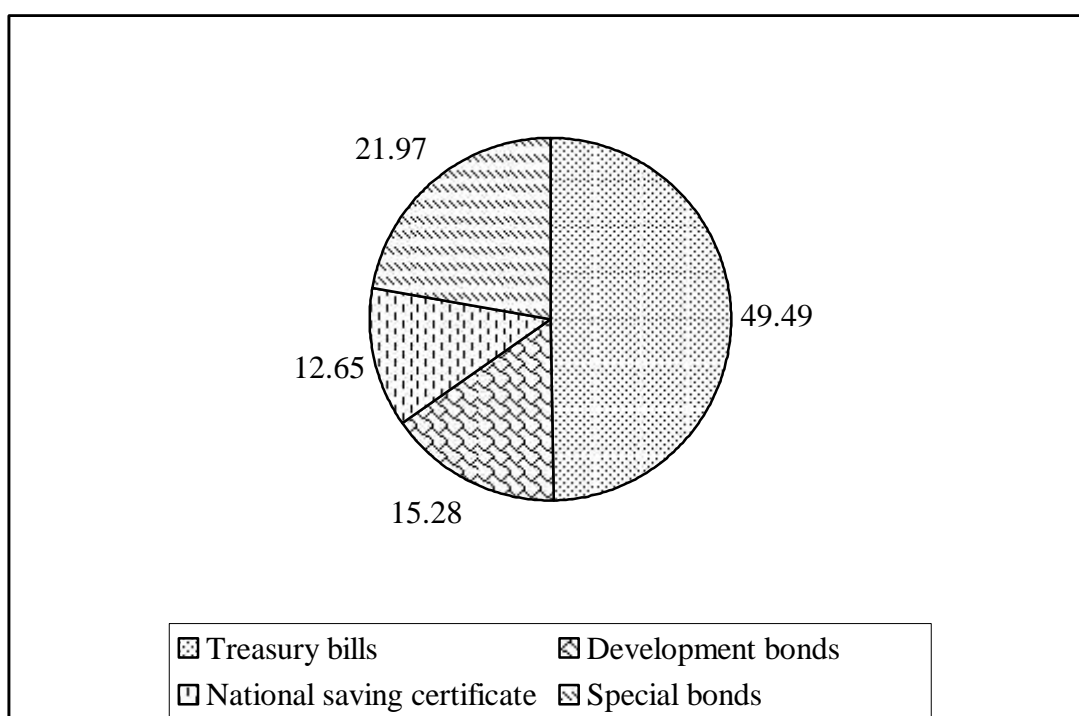
Source: Economic Survey, Various Issues, MoF.

In above table the annual net outstanding internal public debt and its division into treasury bills, development bonds, national saving certificates and special bonds has been presented.

Treasury bill is the short-term loan raised for a period of less than one year. Other securities are called long-term securities as they are issued for a period of more than one year. Normally treasury bills are floated for the period of 91 days, however, sometimes government issues the bills for 364 days. Government bonds and notional saving certificates have 3-15 years period of maturity, accordingly these are identified as long-term securities. In the year, 1989, Rs.12887.9 million stood as net outstanding internal debt. However, it amounted to a tremendous volume of Rs.113025.1 million in the final year of review period 2008.

The net outstanding internal debt has increased by 8.77 times within a period of 20 years. It clearly shows our economy is heavily indebted. On the other hand, per capita income has not increased in the same proportion. Thus, we are listed as poor and agencies are avoiding to provide loan.

Figure 4.3
Pattern of Net Outstanding Internal Debt in Nepal (1995/96-2006/07)



Treasury bills increased to Rs.85033 million in 2008 from Rs.1171 million in 1989. Similarly, development bonds increased to Rs.21735.4 million in 2008 from Rs.5088.6 in 1989. Amount of National Saving Certificate is inconsistent, it was issued Rs.12476.4 million in the year 2001. But decreased to Rs.1116.9 million in the last year of review period. In case of special bonds we can see the not big difference between 1989 and 2008. This shows the investors attraction towards the riskless securities. The treasury bills have been dominating in the structure of total outstanding internal debt in the study period. These are mostly owned by commercial banks, financial institutions, and Nepal Rastra Bank itself. The treasury bills are most inflationary short-term maturity period, issue on discount and secure investment.

Due to the higher maturity period of development bond, national saving certificate, special bond, most of the investors choose the treasury bills in comparison to others. Considering the increasing internal public debt, it is concluded that the government became lethargic in managing its finance prudently also there is easy access to funding the source of finance in the term of borrowing and grants.

4.5.2 Pattern of External Public Debt in Terms of Disbursement by Major Sources

The foreign assistance, grants and loan are the major sources of foreign currency (i.e. capital goods) for us. Since Nepal is quite backward to earn sufficient foreign currency through its entire sectoral efforts. Nepal started borrowing the foreign loan in 1964/65 and now, we have the burden of Rs.36600 million (Economic Survey, 2008/09) foreign loan. But thanks to the remittance, which has taken away Nepal from liquidity crisis.

External loan are divided between multilateral loans and bilateral loans. Bilateral loans are those loans from government and their agencies (including the central bank), loans from autonomous bodies and direct loans and credits from multilateral agencies as world bank, IMF, regional development banks

and other multilateral and intergovernmental agencies. The following table shows the pattern of external public debt in terms of disbursement of major sources.

Table 4.5
Pattern of External Public Debt in Terms of Disbursement
by Major Sources

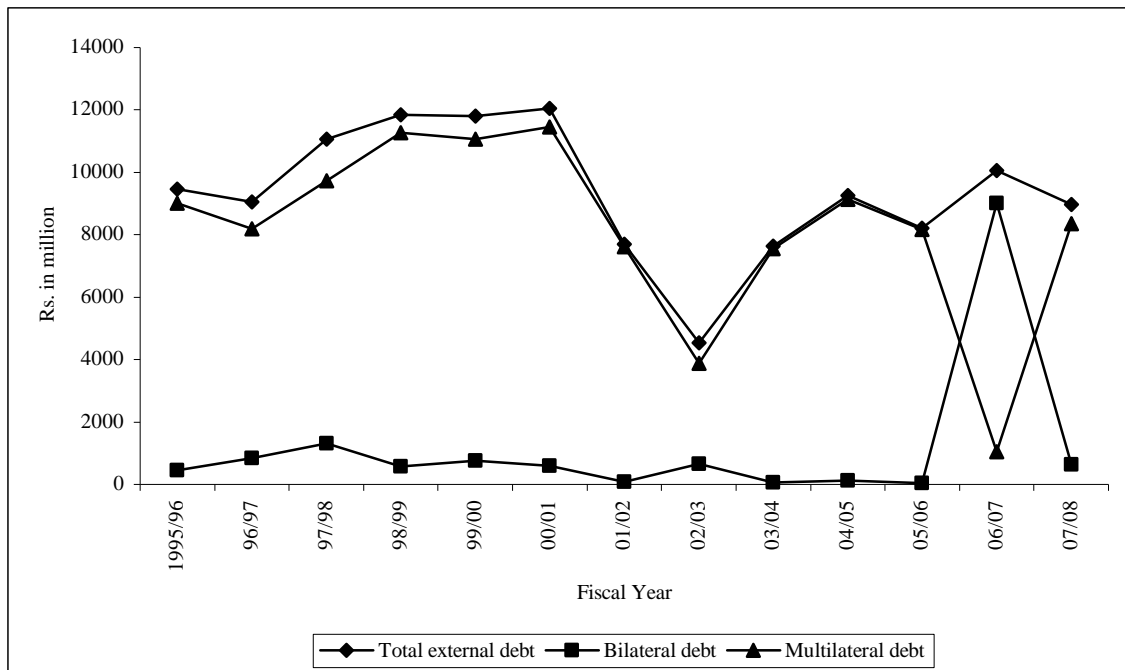
Year	Total external debt	Bilateral Debt	Multilateral Debt	% of bilateral external debt	% of multilateral external debt
1988/89	4188.7	507.8	3680.9	12.12	87.88
89/90	4628.3	1000.6	3627.7	21.62	78.38
90/91	4360	1602.8	2757.2	36.76	63.24
91/92	6269.4	2389.8	3879.6	38.12	61.88
92/93	5961.7	1307.6	4654.1	21.93	78.07
93/94	9163.6	582.9	8580.7	6.36	93.64
94/95	7312.3	717.3	6595	9.81	90.19
95/96	9463.9	460.0	9003.9	4.86	95.14
96/97	9043.6	850.7	8192.9	9.41	90.59
97/98	11054.5	1314.5	9740	11.89	88.11
98/99	11852.4	584.0	11268.4	4.93	95.07
99/2000	11812.2	757.9	11054.3	6.42	93.58
2000/01	12044.0	586.7	11457.3	4.87	95.13
01/02	7698.7	87.4	7611.6	1.13	98.87
02/03	4546.4	657.2	3889.2	14.46	85.54
03/04	7629	66.0	7563.0	0.87	99.13
04/05	9266.1	126.5	9139.6	1.365	98.635
05/06	8214.3	40.6	8173.7	0.487	99.513
06/07	10053.5	9004.6	1048.9	89.57	10.43
07/08	8979.9	632.1	8347.8	7.04	92.96
Average Annual %				15.35	84.65

Source: Economic Survey, Various Issues, MoF.

During the period between the 1988/89 and 2007/08 the multilateral external debt has dominated the bilateral external debt in the structure and composition of external debt in Nepal. In the beginning the bilateral and multilateral loan stood at 15.35 percent and 84.65 percent respectively. During the period 2005/06 the portion of bilateral loan was 0.487 percent only. But in the year (06/07) of review period there is drastic change in that and grown up to 89.57 percent. Because bilateral loans are more concessional than multilateral.

Above table clearly shows the growth rate of multilateral debt is dominant than the bilateral debt. If country could not use effectively the bilateral loan which is provided by bilateral agencies, they stop to provide bilateral loan. When country could not receive the bilateral loan, grants from other countries it should borrowed from multilateral agencies. So, multilateral debt is higher than bilateral loan. At the last of the review period (06/07) it shows the glimpse of goodness.

Figure 4.4
Pattern of External Public Debt in Terms of Disbursement
by Major Sources (1995/96-2006/07)



Increase in multilateral debt effects the development program of the country because obligation of interest payment, and should follow their plan and policies. It affects the fiscal policy also in long-run. So, Nepal is falling in stringent condition of multilateral agencies like WB and IMF due to interfere even in internal policies.

4.6 Trend of Debt Servicing in Nepal

In economic terminology, the repayment of principal along with the interest there of is referred to as debt servicing. Generally, in Nepal, the new securities and bonds are issued to pay back the previous loan. It consequently burdens the nation disbursing the Nepalese and foreign currency in the form of interest. International donors and developed partners have been quite supportive to Nepal to provide the foreign grants and loans. Recently the donor agencies have shown the keen interest in providing the assistance and loan for the peace and reconstruction program.

4.6.1 Share of External and Internal Debt Servicing in Total Debt Servicing

The annual and average annual growth of total debt servicing, external debt servicing, internal debt servicing and the share of external and internal debt servicing in total debt servicing during the period of 1988/89-2007/08 are presented in the following table.

Table 4.6
Trend of Debt Servicing

Year	Total Debt Servicing	Growth Rate of TDS%	Internal debt servicing	Growth rate of IDS%	External Debt servicing	Growth rate of EDS%	% of IDS to TDS	% of EDS to TDS
1988/89	1720.7	-	1019.4	-	701.3	-	59.24	40.76
89/90	2279.2	32.46	1155.6	19.84	1123.6	60.22	50.70	49.3
90/91	2407.4	5.62	1320.9	13.36	1086.5	-3.30	54.87	45.12
91/92	3797.1	57.73	2132.2	14.30	1664.9	53.24	56.15	43.85
92/93	4560.5	20.10	2428.6	61.42	2131.9	28.05	53.25	46.75

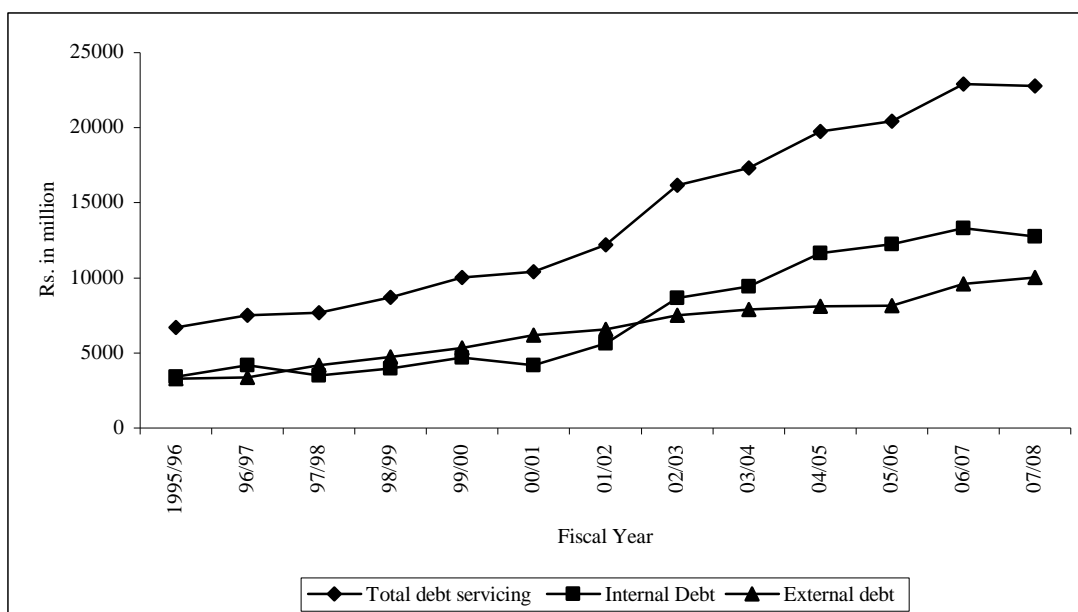
93/94	4855.1	6.46	2366.4	13.90	2488.7	16.74	48.74	51.26
94/95	6083.3	25.30	3098.6	-2.56	2984.7	19.93	50.94	49.06
95/96	6715.4	10.39	3411.1	30.94	3304.3	10.71	50.80	49.20
96/97	7527.2	12.09	4177.8	10.09	3349.4	1.36	55.50	44.50
97/98	7682.8	2.07	3481.6	22.98	4201.2	25.43	45.32	54.68
98/99	8723	13.54	3977.5	-16.66	4745.5	12.96	45.60	54.40
99/2000	10032.8	15.02	4711.4	14.24	5321.4	12.14	46.96	53.04
2000/01	10388.4	3.54	4187	18.45	6201.4	16.54	40.30	59.70
01/02	12205.2	17.49	5637.7	-11.13	6567.5	5.90	46.19	53.81
02/03	16181.3	32.58	8662.1	34.65	7519.2	14.49	53.53	46.47
03/04	17338.8	7.15	9429.9	53.65	7908.9	5.18	54.39	45.61
04/05	19751.3	13.91	11651.3	23.57	8100	2.42	58.99	41.01
05/06	20423.5	3.40	12263.4	5.25	8160.1	0.742	60.04	39.96
06/07	22916.3	12.20	13321.8	8.63	9594.5	17.58	58.13	41.87
07/08	22760.6	-0.68	12745.9	-4.32	10014.7	4.38	55.99	44.01
Average Annual growth rate %	-	15.28	-	16.35	-	16.04	52.28	47.72

Source: Economic Survey, Various Issues, MoF.

Table clearly shows that the internal debt servicing has increased from Rs.1019.4 million to Rs.12745.9 million and it is 12.50 times more than that of beginning year of review period. It has average annual growth rate of 16.35 percent. On the other hand, the external debt servicing amount has increased to Rs.10014.7 million in 2007/08 from Rs.701.3 million in FY 1988/89. In the final year external debt servicing has increased more rapidly than internal debt servicing.

Figure 4.5

Trend of Debt Servicing (1995/96 - 2007/08)



Above figure clearly shows that growth rate of external debt servicing is dominant than the internal debt servicing. The government has to pay both the principal as well as interest on time in order not to be recorded as defaulter. If payment is not done in stipulated time it will be tough to borrow further. Disagreement to give loan country will fall into debt trap further, which directly affects on development programs of the country and also face the budgetary deficit.

4.6.2 Percentage of Principal and Interest Servicing to Total Debt Servicing

In the recent years total government expenditure continued to show increasing trend. Revenue mobilization, foreign grant and loan, internal loan and the change in cash balance continued to be major sources in contribution to meeting government expenditure. Foreign aid committed is increasing every year. To enhance the trust among lenders servicing is necessary in time so the trend of internal and external debt servicing is shown in following table.

Table 4.7
Percentage of Principal and Interest Servicing in
Total Debt Servicing

Year	Total debt servicing	Principal servicing		Interest servicing	
		Internal debt	External debt	Internal debt	External debt
1988/89	1720.7	145.5	388.6	873.9	312.7
89/90	2279.2	100.5	701.8	1055.1	421.8
90/91	2407.4	150	589.0	1170.9	497.5
91/92	3797.1	264.8	942.2	1867.4	722.7
92/93	4560.5	345	1252.9	2083.6	879.0
93/94	4855.1	430	1468.2	1936.4	1020.5
94/95	6083.3	825	1828.2	2273.6	1156.5
95/96	6715.4	859.8	1987.7	2551.3	1316.6
96/97	7527.2	1350.9	2102.4	2826.9	1247
97/98	7682.8	1151	2780.2	2330.6	1421
98/99	8723.0	1446.2	3196.5	2531.3	1549
99/2000	10032.8	1531.6	3681.1	3179.8	1640.3
2000/01	10388.4	1190	4500.6	2997	1700.8
01/02	12205.2	1683.6	4751.4	3954.2	1816.1
02/03	16181.3	4063.3	5496.2	4600.1	2021.7
03/04	17338.8	5029.1	7765.8	4402.1	2141.8
04/05	19751.3	7580.1	5953.2	4071.2	2146.8
05/06	20423.5	7277.3	6987.5	4986.1	1172.6
06/07	22916.3	9213.5	7538.8	4108.3	2055.7
07/08	22760.6	8517.5	7869.4	4228.4	2145.3
Total servicing under review period	208349.9	53154.7 (25.51%)	69781.7 (33.49)	58028.2 (27.85)	27385.4 (13.15)
		59		41	

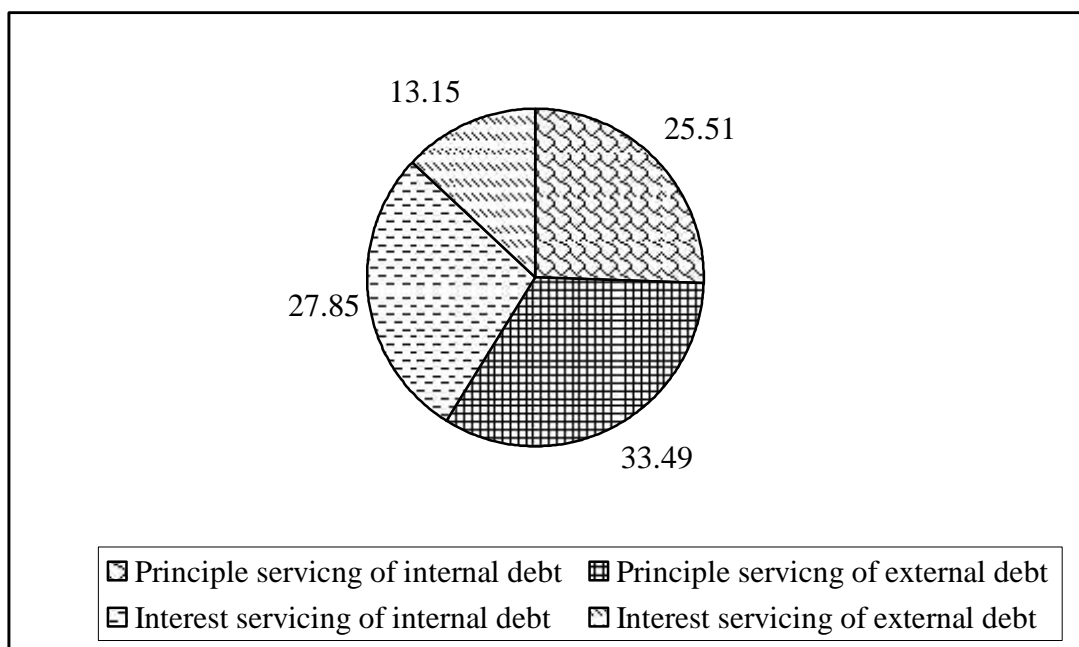
Source: Economic Survey, Various Issues, MoF.

From the table, it shows that Nepal's total debt servicing till the FY 2007/08 amounted to Rs.208349.9 million. Out of this 59 percent has been disbursed as principal and rest repayment of interest. The table shows the portion of principle servicing is high. Here interest of external debt servicing has shared by 13.15 percent of total servicing which is nominal percent of our export. Of

course, the portion of principal servicing of external debt is quite enough than of internal debt.

If interest are not rapid in time it will accumulated according to change in rate of currency every year. This gives negative impacts to multilateral agencies so, interest servicing is dominant than principal servicing.

Figure 4.6
Percentage of Principal and Interest Servicing in
Total Debt Servicing (1995/96-2007/08)



4.7 Net Outstanding Public Debt in Nepal

Taxing and spending, of course, are the nucleus of the fiscal or budgetary process; debt is merely a means of meeting a particular budgetary situation, namely a deficit budget caused by the exceeds of government spending over receipts. The fiscal flows of taxation and spending as such, as well as debt creation and retirement alike may exerts on the public economic functions of allocation, distribution and stabilization (Bernard, 1988: 431).

The public debt is merely used means of meeting the government budgetary expenditure, but in case of Nepal it is the main and reliable resources of meeting the government expenditure. Public debt has been contributing with the share of 21 percent of the total expenditure in FY 2007/08. Hence, public debt is the important part meeting the government expenditure. The following table clearly presents the net outstanding public debt in Nepal.

Table 4.8
Net Outstanding Public Debt in Nepal

FY	Total public debt	Internal public debt	External public debt	% of internal debt in total debt	% of external debt in total debt
1988/89	42104.8	12887.9	29216.9	30.61	69.39
89/90	51474	14673.1	36800.9	28.51	71.49
90/91	80361.2	20855.9	59505.3	25.95	74.05
91/92	94158.8	23234.9	70923.9	24.68	75.32
92/93	112876.9	25456.1	87420.8	22.55	77.45
93/94	132598	30631.2	101966.8	23.10	76.90
94/95	145058.7	32057.9	113000.8	22.10	77.90
95/96	162286.3	34241.9	128044.4	21.10	78.90
96/97	167977.7	35890.9	132086.8	21.37	78.63
97/98	199614.7	38406.7	161208	19.24	80.76
98/99	219135.5	48596.5	169465.9	22.67	77.33
99/2000	245028.2	54337	190691.2	22.18	77.82
2000/01	260448.1	60043.7	200404.4	23.05	76.95
01/02	293746.3	73620.7	220125.6	25.06	74.94
02/03	308078.5	84645.3	223433.2	27.27	72.52
03/04	318913.0	86133.7	232779.3	27	73.00
04/05	305777.2	86135.3	219641.9	28.17	71.83
05/06	327837.3	93031.7	234805.6	28.38	71.62
06/07	318993.9	102365.0	216628.9	32.09	67.91
07/08	362990.5	113025.1	249965.4	31.14	68.86
Average annual growth rate %	-	-	-	25.35	74.65

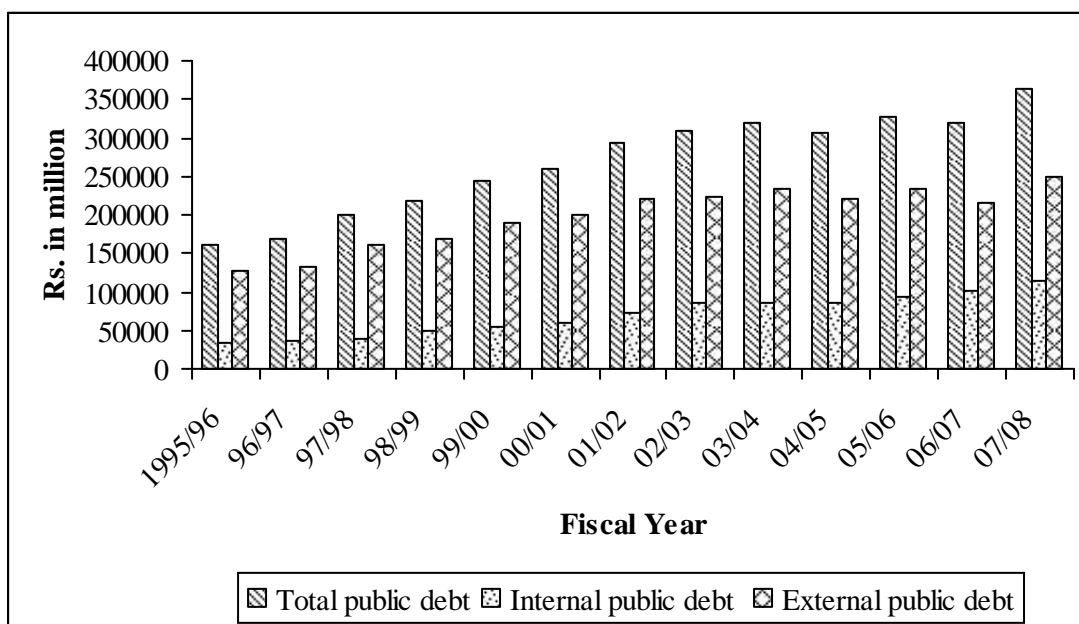
Source: Economic Survey, Various Issues, MoF.

We had Rs.362990.5 million debt in FY 2007/08. On an average annual basis the domestic and external loan has 25.35 and 74.65 percent share in total net outstanding debt respectively. The more and most remarkable fact is that we have been indebted by foreigner to considerable extent. The government therefore, should take the grim attention towards the burden of external debt.

On the basis of government borrowing, by 2008/09 every Nepali citizen has been indebted by Rs.14 thousand. Moreover, the debt will impose a burden upon the future generation. Internal debt, however does not cause a direct variation in resources availability for the country. But, it may have adverse impact on the economic phenomena of the nation, in case debt is too large and misused. In such cases we fall into a debt trap where in fresh borrowing are needed for servicing the existing debt.

Figure 4.7

Net Outstanding Public Debt in Nepal (1995/96 - 2007/08)



Nepal is heavily dependent upon external sources for financing. The continuous growth in the share of external debt indicates that government is unable to increase in revenue significantly through mobilization of internal sectors.

4.8 Empirical Analysis of Growth Trends

The above analysis, we know broadly about the public debt specially external as well as internal debt. In the following section researcher will present the growth trend empirically between external and internal debt using regression tools, and also a relationship between external debt and internal debt by using correlation tools. These two tools help the researcher to verify above analysis more clearly and accurately.

4.8.1 Regression Analysis of for External Debt

Regression equation of external debt on year,

Let, external debt in Rs. million = Y

Fiscal year = X

The regression equation of y on x is, expressed as:

$$y = a + bx \dots\dots\dots (i)$$

Where,

a = Numerically constant which determines the distance of the fitted line directly above or below the origin (i.e. intercept form)

b = Annual growth rate (i.e. slope of line)

The normal equation for estimating a and b are:

$$\sum Y = Na + b\sum X \dots\dots\dots (ii)$$

$$\sum XY = a\sum X + b\sum X^2 \dots\dots\dots (iii)$$

Where,

N is the total number of years and $\sum X$, $\sum Y$, $\sum XY$ and $\sum X^2$ indicates total which should be computed observed pair of values.

Researcher obtained the value of a and b by solving the above simultaneous equation (ii) and (iii)

We get,

$$a = \frac{\phi X^2 \cdot \phi Y - \phi X \cdot \phi XY}{|\rho \phi X^2 - (\phi X)^2}$$

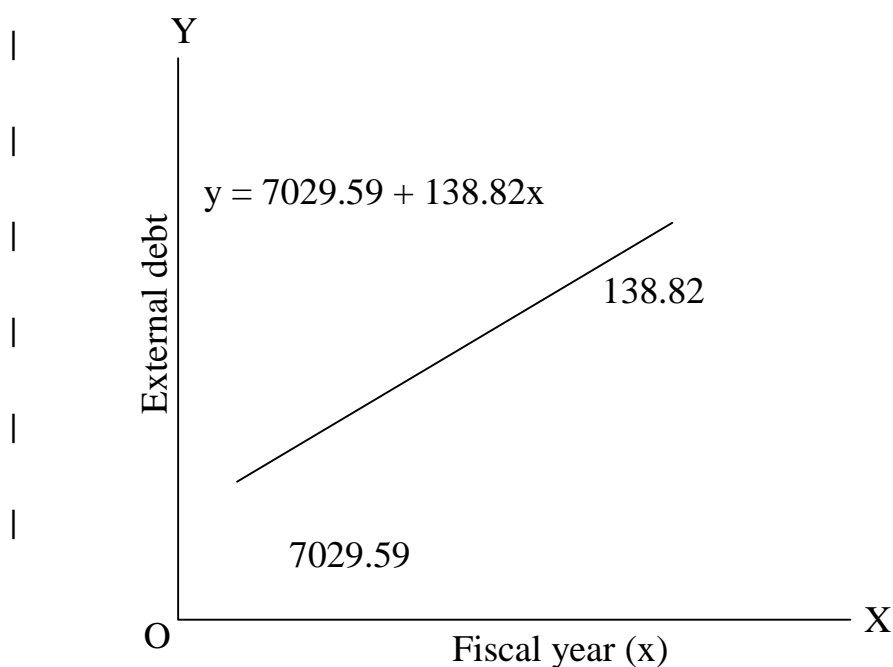
$$b = \frac{\phi XY - \phi X \cdot \phi Y}{|\rho \phi X^2 - (\phi X)^2}$$

Here, we can easily observed that annual growth rate of external debt is 138.82. Calculation have been included in Appendix.

Increase in external debt means Nepal is going to fall in debt trap in near future. The above calculated figure clearly shows heavy reliance upon external debts. This may generate serious problem for future generations. The innocent children have to bear loan taken before their birth. Therefore, the increasing trend should have to be managed soon.

Figure No. 4.8

Diagrammatic Representation of Regression Line of External Debt



4.8.2 Regression Analysis of Internal Debt

Regression equation of internal debt on year

Let, Internal debt in Rs. million = Y

Fiscal year = X

The regression equation of y on x is, expressed as: $y = a + bx$ (i)

Where,

a = Numerically which determines the distance of the fitted line directed above or below the origin (i.e. intercept form)

b = Annual growth rate (i.e. slope of line)

The normal equation for estimating a and b are:

$$\sum Y = Na + b\sum X \text{ (ii)}$$

$$\sum XY = a\sum X + b\sum X^2 \text{ (iii)}$$

Where,

N is the total number of years and $\sum X$, $\sum Y$, $\sum XY$ and $\sum X^2$ indicates total which should be computed observed pair of values.

Researcher obtained the value of a and b by solving the above simultaneous equation (ii) and (iii)

We get,

$$a = \frac{\sum X^2 \cdot \sum Y - \sum X \cdot \sum XY}{\sum X^2 - (\sum X)^2}$$

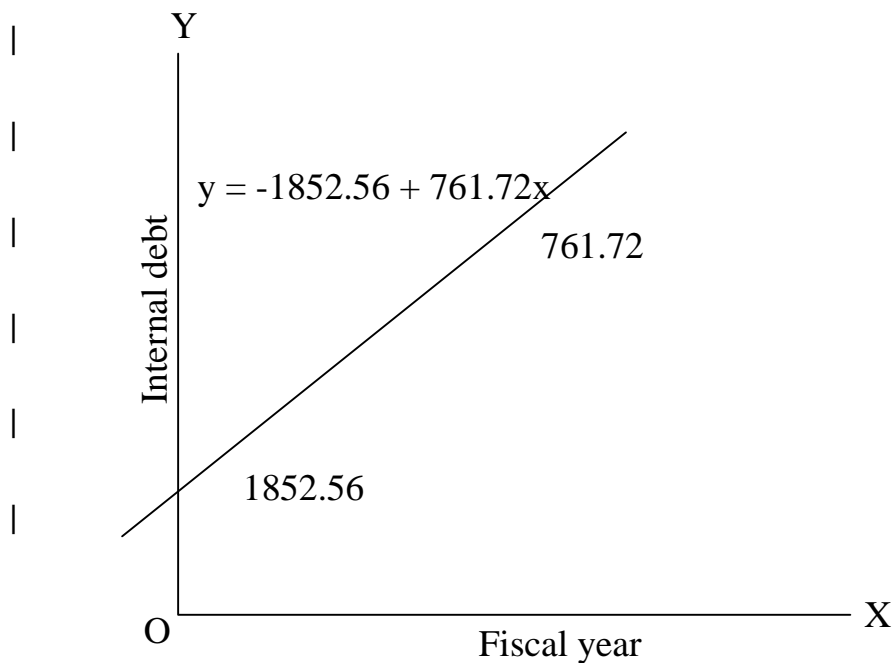
$$b = \frac{\sum XY - \sum X \cdot \sum Y}{\sum X^2 - (\sum X)^2}$$

Here, we can easily observed that annual growth rate of external debt is 761.72. Above two different regression equation clearly shows that internal debt is increasing than external debt.

If the same growth rate persist, forecasted internal debt for the FY 2008/09 will be Rs.204484.14 million. Similarly, in FY 2009/10 it will be Rs.22689.145 million.

Above calculated figure shows that amount of external debt is less than internal debt. This is due to change in political scenario, nation has got rid from a decade long insurgency. In the later years the portion of development expenditure has exceeded the general expenditure.

Figure No. 4.9
Diagrammatic Representation of Regression Line of Internal Debt



4.8.3 Correlation Analysis of External and Internal Debt

Let, Internal debt in Rs. million = X_1

External debt in Rs. million = X_2

Then, simple correlation coefficient is,

$$r = \frac{\text{Cov}(X_1, X_2)}{\sqrt{\text{Var}(X_1)} \sqrt{\text{Var}(X_2)}}$$

But, we have a simplified formula is,

$$r X \frac{N\phi X_1\phi X_2 Z\phi X_1\phi X_2}{\sqrt{[N\phi X_1^2 Z(\phi X_1)^2]} \sqrt{[N\phi X_2^2 Z(\phi X_2)^2]}}$$

We have easily observed that there is positive correlation between internal debt and external debt.

Reason for this is government's heavy reliance upon external debt rather than internal debt. Since government should have take serious concern to create favorable environment to borrow the internal loan. Issue of managing the public debt is serious matter. So, ratio of internal debt can be increased and external debt can be decreased in the total debt as expected proportion.

4.9 Public Debt: System and Practice in Nepal

4.9.1 Nature of Public Debt

a. Treasury Bill

Treasury bills (T-bills or just bills, for short) are the most marketable of all money market instruments. T-bills represent the simplest form of borrowing. The government raises money by selling bills to the public. Investors buy the bills at a discount from the stated maturity value. At the bill's maturity, the holder receives from the government a payment equal to the face value of the bill. T-bills extremely liquid, short term notes that mature in 13, 26 or 52 weeks from the date of issue. The treasury usually offers new bills every week, auctioning them on a discount from face value basis. T-bills are only sold on a discount basis. The discount to investors is the difference between the price they have paid and the face amount they receive at maturity.

b. Floating Debt

The floating debt can be divided into the bonds and notes. These both are issued for the special purpose like, to provide the funds for sustainable development of the nation, to make the people contemplative to the pride of

participation in nations development and welfare to draw the liquidity from the market for a long run so that inflation and such like impacts of over dispatched cash would be minimized etc.

c. Externally Provided/committed loan

Financial obligation owed to foreigners (governments, institutions, firms, central bank, multilateral agencies, regional banks and world banks etc) are called external loan. Government can borrow the foreign loan in two ways firstly, it collects the external loan by selling its securities to foreigners. Secondly, it receives the debt from abroad through the agreement done in between the government and lender. In Nepal most of the external loan are being resorted with the agreement.

4.9.2 Instruments of Internal Debt in Nepal

Internal debt means the debt raised by the government from its people, funds, bank and financial institution. Government generally raise internal debt to fulfill budget deficit, to mobilize financial source for development plan. To manage money inflation effectively in the country and to find out financial sources in the emergency period. from the side of the government, Nepal Rastra Bank Act 2058 and Public Debt Act 2058 provides the full responsibility to NRB on debt management of the country. According to Public Debt Act Sec(3) "for the effective mobilization of government fund, government can raise public debt as per requirement being under the present law, one at a time or time to time". In this way in the form of internal debt instrument various types of securities/bonds are issued.

- a) Treasury Bills
- b) Bonds
 - i. Development Bonds
 - ii. Special Bonds
 - iii. National saving certificates

iv. Citizen Saving Certificates.

a. Treasury Bills

The Treasury Bills are issued on the auction as specified in the issue calendar. The treasury bills are most of the time purchased by commercial banks as competitive bidder and others rarely as a non competitive bidders. Treasury Bills are issued on multiple price format or pay your bid format. Thus, the Treasury Bills auction could be divided into competitive and non-competitive categories, allocating at least 15 percent of offered amount for the non-competitive bidders.

While issuing Treasury Bills, the notice of auction could be published in the national daily news paper mentioning the necessary terms like series number, offered amount, taxable non-taxable and maturity period, earnest money, issue date, bidding time procedure and other conditions. These information would also be disseminated via website of NRB.

Treasury Bills are issued as promissory note so that the buyer of TBs could purchase and sale these bills by endorsement as well as through the commercial banks. The face value will be repaid by the Nepal Rastra Bank at the maturity. the government has issued 28 days, 91 days, 182 days and 364 days bills under this category.

b) Bonds

Long-term securities are issued as per the issue calendar. The government of Nepal issued long-term securities such as Development Bond, National Saving Certificate as stock or promissory note. For the issuance of these bonds, the notice would be published in the daily newspaper by mentioning the special features like type of bonds, amount to be issued, interest rate, maturity period, time limit, procedure and required condition.

Development Bonds:

The Development Bonds have been issued in face value at predetermined interest rate. A notice would be published in the newspaper by mentioning the special features like type of bonds, amount, interest rate, issue date, taxable/nontaxable , application time limit and others. These information would also be released in the central bank's website. These instruments generally issued for 3 years or more than 3 years maturity period for financing the development projects having long gestation period.

Special Bonds

These are conditional promises to pay specific sum on specific dates these instruments are specially issued in the case of position in the government's cash flow. These days the Special Bonds fare issued for the duty drawback settlement.

National Saving Certificate and Citizen Saving Certificate

Generally, these are non-marketable and tax exempted debt instruments usually issued for the retail public (household sector). However, National Saving Certificate and Citizen Saving Certificates in Nepal are marketable as well as taxable securities at determined interest rate. For the issuance of the certificates, the notice would be published in the newspaper focusing the necessary terms and conditions.

4.9.3 Characteristics of Internal Debt Instrument

- I. Investment can be done on different bonds by not increasing or decreasing on issued amount.
- II. All kind of debentures can be sold fastly as per wants in time, so these instruments remain as near competitors of money.

- III. Interest can be withdrawn from bank or financial institution at specified time semi annually, annually
- IV. Return of principal is in specified time.
- V. Contribution can be done by capital formation for economic development of nation.

4.10 Practice of Internal Debt in Nepal

Under the public Debt Act 1960, the first issued the treasury bill of Rs.0.7 million which has incurred on percent interest rate. In fiscal year 1963/64 the government floated the long-term security called Development Bond of Rs.13.1 million carrying on 6 percent of interest rate with maturity of five years. In the same period the government issued the land compensation bond for land acquisition with the interest rate of three percent and maturity of 10 years amounting Rs.0.407 million and compensation bond for the forest acquisition was carried out with one percent interest rate per annum with the maturity period of 20 years amount Rs.5056 million. Both of compensation bonds were sold to them who had contributed the nation by providing compensation. Their own land and jungle in course of campaigning for eradication of "Birta System" and nationalizing the forest.

The government floated the prize Bond of Rs.0.9 million only for individuals in 1967 with zero percent of interest rate but certain prizes were given to randomly selected holders twice a year. In the same period government issued the special bond of Rs.0.1 million. Due to lack of required data regarding this part and no details from the concerned bodies of government and NRB, the interest rate and maturity period of issued special bond cannot be dealt here.

The formally issued development bonds were mostly purchased by the organized bodies and institutions. One of the objectives of floating the development bond is to draw the wide spread liquidity throughout the country and to make involve the people in nation development. That is why the

government started issuing the new sort of security with terms and conditions similar to described development bond named "National Saving Certificate" in 1984 which provided the privilege of purchasing the certificate to individuals at first. Banking sector and even organized body and institution may apply for the certificate for only remaining amount, which is not purchased by the individuals. The National Saving Certificate was firstly issued in FY 1984/85 amount Rs.500 million that year. It has been issuing the certificates with the interest rate ranging for 8 percent to 15.5 percent. Nowadays the nominal tax is being charged on the interest gained from a few National Saving Certificates, otherwise most of them are free of taxes.

Similarly, "The government started to borrow by issuing CB pass bond in 1986 which amounted to Rs.18 million that year"(Khanal, 2000). After this NRB had issued the NRB bond to draw the over flowed liquidity in 1991. It was the effective measure to curb the inflation. But it was not the instrument of raising the public debt since the accumulated fund by this process would be used only NRB. Currently Treasury Bills, Development Bonds, National Saving Certificates and special Bond as the main instruments of internal borrowing.

4.11 Practice of External Debt in Nepal

Nepal is a yam between two boulders. India from the southern and China from the northern side have bound Nepal so tightly that is bound to keep both the huge boulders at equidistant. Nepal seemed to receive no financial aid from East India Company except defense against it in warfare attack. In the past, Nepal did not seem to ask for financial aid with the foreigners. It was the tradition to lead the daily lives by utilizing internal resources and means and to fight firmly when the question of existence of the state appears before them.. Nepal had accepted financial aid only after the victory in the war. According to the treaty (Shrawan 12, 1846 BS) of Kerung and Thapathali (1912 BS), Nepal received Rs.5001 from Tibet and Rs.10000 annually from Indian respectively and from the origin of financial aid to Nepal.

Similarly, after the establishment of diplomatic relationship between Nepali and Chinese representative in Wangdung in 1955 and late king Mahendra's visit to China in 2018 BS various trading and other treaty had been signed including construction of Kodari Highway, establishment of various industries, etc. In fact, there was no any kind of relation developed between Nepal and the world before 2005 BS. After, when East India Company fled away from India, then only the international relation and foreign policy had been developed along with the UNO membership in Feb 12, 1949. Nepal had very narrow field in international arena before 2007 BS. It was influenced only after the establishment of democracy in Nepal. The history of foreign aid is not so old in Nepal. The financial aid received in 1951 through American government and in 2007 BS Indian government to the construction of airport is the first foreign aid receive in the history of Nepal's economy. After that, Chinese government in 2013 BS has started to provide economic aid. The institutional foreign aid started only after economic plan (2013).

In the initial phase, the foreign aid was accepted in simple agreement between two states. The effect of the aid started to seen in the political and administrative sector after 1980s. Within the period, Nepal had to bear a great loss in balance of payment and public expenditure increased widely; hence it heavily stimulated inflation. As a result, Nepal had to surrender to international Monetary Fund (IMF) and World Bank (WB) to get out of this crucial state.

4.12 Theoretical Aspects of Issuing the Government Securities

1. No one should be imposed for lending the loan to the government.
2. The management should keep its interest cost to the minimum possible. The government, therefore, should issue the securities with minimum interest rate as far as possible and practicable.

3. It should not impact adversely upon the target of sustainable economic development of the nation. Rather, the all practice regarding to public borrowing should assist the state's economic welfare as whole.
4. The securities should not be floated at the time of deflation as well as increasing the interest rate in the market. And the state ought to be able to raise the loan at the period of decreasing or stagnating the interest rate in the market.
5. The state should pay the proper attention towards the legal and ethnical restrictions on public borrowing.
6. However, the government may change the terms and conditions of payment of debt at any time it likes for public welfare, but it is expected everywhere that the government would abide by a self imposed and indulged limitations so that it does not loose the confidence of people in regard to refunding the loan in the time set previously.

4.13 System for Borrowing the Debt

4.13.1 The Borrowing System through the Treasury Bills

1. The Public Debt Department of NRB prepares the schedule of borrowing through the treasury bills.
2. The department calls the sealed tenders for offered amount through national daily news papers and websites.
3. The tender form can be obtained at any branches of NRB and it is to be submitted to the department in the valley and to the branch of NRB out of the valley.
4. The party (lender/investor) should enclose the original credit voucher as for 'earnest money' amounting 2.5 percent of required amount for an

auction deposited in 'Sundry creditors main account'. The deposits can be made at any (banking) branches of NRB.

5. The accepted competitive tenders, which are under the rule, are presented in the meeting of BOD. The selected tenders as per necessities and this notice will be published the selected party will be noticed to deposit the cash instantly while on the other hand rejected parties would get their respective earnest money which was deposited in the bank in course of applying.
6. Fifteen percent of offered amount is allocated for non-competitors. They should purchase the bill at average discount rate. It should be noted that the commercial banks are not allowed to take part as non-competitors.
7. Treasuring bills are issued at the discount rate declared by the auction system and redeemed at par (value) that is the offered amount would be paid off at the maturity of the bill.

The 13 weeks treasury bills are most popular in Nepal these days. However, 364 days treasury bills are also issued frequently. The government also floats 182 days treasury bills, but data on such bills are not available.

4.13.2 The Borrowing System through the Long-term Security

Public Debt Regulation of 1963, Section 4, consists the process and procedure of borrowing the loan through the long-term securities. The system of borrowing through the bonds are given below.

1. After presentation of budget and getting consent from the legislative bodies (parliament) the government schedules for borrowing from non banking sector through the long-term securities. It forwards the program to NRB for further functioning. The interest rate for the bonds is determined by Nepal Government in general, but it may be maneuvered to some extent on the recommendations of NRB.

2. Public Debt Department of NRB publish the notice in reputed national dailies containing the principal features, terms and conditions related to the bonds to be floated generally providing 15 days time duration for the submission of application. If whole of the bonds are sold before due date, the sales would be stopped.
3. If that could not be sold during the stipulated period of time. NRB will purchase the whole or remaining portion. The issuance of security there by be stopped exactly at previously scheduled date.
4. In case of both National Saving Certificate and Development Bonds, the holder are provided the securities in the form of either the promissory notes or the stocks as per the request by the holder, where as the special bonds are issued in the form of stock only.
5. People may apply for the bonds at any branches and agencies of NRB. Similarly, the certificates would be dispatched through the same body involved having the application for bonds.
6. Only the individuals may apply for the bonds at its initial floatation but in case of bonds owned by NRB, that is, under the provision aforementioned at no.3, might be sold both to individuals and institutions.
7. The ownership of bonds may be registered into the account of minors with the reference of their guardians.
8. The bonds are issued in the amount of Rs.100 at minimum and divisible by Rs.100 thereafter.

4.13.3 The Borrowing System for External Debt

In case of external loan the government corresponds with the probable lender countries, agencies, donors, describing the detailed account of projects to be

launched. The lenders study the proposal and make the decision either on favor of the proposal or disapprove it. If the proposal would be accepted they include themselves their terms and conditions and suggestions in regard of debt's timing, servicing, redemption, grace period and even of human resources management of the project.

Government prudently studies the terms and conditions included by the lenders and considering on it government further consists the inherent components as the terms of agreement. Therefore, they both come into the negotiations and Nepal gets the foreign debt.

4.14 System for Servicing the Public Debt

The term 'servicing' simply means the payment of interest on periodic basis to the investors for their investment. The government makes the payment of interest mostly on periodic basis on its borrowing so that the compromise between the lender and itself would be renewed time to time and it does not bear the tremendous burden of interest, occurring from in case. If it is to be paid off in a single installment. The periodical payment of interest is quite beneficial than the payment at once due to the various aspects regarding to state's economic betterment.

Anyway, the system that is, what does it function for debt servicing is summarized here with point-wise basis.

1. Firstly, the government, in its annual budget that is presented in the parliament, under the distribution of regular expenditure allocates the certain amount of principal and interest of borrowing is included separately.
2. In case of internal debt servicing NRB is responsible to maintain the entire process and procedure as it is clearly mention in NRB Act 1995 at section 20 and in public debt 1960 in detail.

3. Treasury bill was also issued at the par value and used to carry the certain percentage of interest before the fiscal year 1987/88. During this year, the 'open market system' come into use and it started to float the treasury bill at discount rate basis and redeemed to par value.
4. As previously mentioned all government securities holders are provided the facility that they can collect their interest of investment at any branches of NRB and commercial banks they want. NRB and commercial bank charges the certain commission as prescribed rate for operating the transaction concerned with the public debt NRB receives the amount of interest and commission from Nepal Government financial controller General office and make the realization for many aid cash. Then credits its account itself with realizing the cheques from Nepalese government and makes the deposits upon their respective account, which performed the transaction connected to the public debt and advices them immediately.
5. NRB obtains 0.2% of total transacted amount while other commercial banks get 0.25% of total transaction regarding to public borrowing and redemptions. They further, get the sales commission at prescribed rate for the transaction they made in relation to selling the public debt.
6. In case of external loan, the maturity period is generally longer than we except and it carries the nominal interest rate lesser than an internal debt. Further more, we are being provided the grace period for maturity and interest rebate.

4.15 System for Redemption of Public Debt

Debt once borrowed has to be redeemed in/on stipulated period of maturity of debt. The government mostly pays the interest rate at periodic (half annually/annually) basis and redeems the principle either the partial payment basis or payment at maturity or at its will with a single installment. Nepalese

government, in case of internal debt, has been redeeming the loans at maturity. On the other hand, government may imply the various methods like as serial bond redemptions, conservations of loans, sinking fund, buying up and buying off loans, capital levy upon borrowed amount and finally it may seldom imply the repudiation method for redemption of long term debt.

Government of Nepal has been redeeming its debt applying the serial bond redemption method mostly and convertibility of loan method alternatively. The Nepal Government has never repudiated its debt till now.

4.15.1 System for Redemption of Short-term Debt

1. Being a bank of the government, NRB is fully consented to handle the system and practice of redemption of debt. Accordingly, it receives the par amount of treasury bill from government at just the previous of maturity of the bill.
2. NRB redeems the debt by crediting the concerned account for those who get the par value prescribed in the bill and bank with it. The investors who does not have the transaction with NRB get the amount in cash.
3. The amount prescribed in the treasury bill would be cashed at any branches of NRB after the maturity of the bill. But no commercial banks and other financial bodies are consented to transact about the redemption of treasury bill.

The investor should pay the income tax at stipulated rate according to their income received through the treasury bill.

4.15.2 System for Redemption of Long-term Debt

Long-term security has the life of more than one year. In Nepal, generally it represents the Special Bonds, Development Bonds, Compensation Bonds, Prize Bonds, National Saving Certificates, etc. Most of them are repayable in a long

period, say after 15 years or more. These bear higher rate of interest in comparison with the short-term debt.

1. The government allocates the amount in its annual budget for redemption of a small portion of total debt every year. The floatation of long term securities are arranged so systematically that loans be paid every year are staggered well.
2. NRB receives the amount from government, financial comptroller general office and provides the principal and even also the outstanding interest (if any) after verifying the signature of security holder.
3. No claim for principal and also the accumulated interest. If left, till after the five year of maturity, the amount would be transferred to government's revenue account. If the investor claims his principal after than it will be paid as per the decision made by the government.

Another method of redemption of public debt is known as 'conversion of loan' that is conversion into a new loan. when it has not sufficient funds for redemption and the current (interest) rate in the market is lower than the rate at which the government is paying for existing debt, the government employs the ironical method to reduce its interest payment. The conversion of loan is a bit different from the actual redemption in a way that in case of conversion of loan the holders are required either to receive money in cash even before the maturity or to convert their old bonds into a new one which lessens their interest from the security. They simultaneous redemption and issuance of old and new Treasury Bill brings the semblance conversion of loan but these are not actually converted.

The government has been floating the new securities for the target of redemption of old debts but current investors are not required to have the new securities with low rate of interest of existing securities.

4.15.3 Redemption of External Public Debt

External borrowing is generally committed for a long period of maturity. Further, most of the lenders provide the long grace period in addition of maturity for the redemption of debt. Due to the various factors including our financial mismanagement, bureaucratic inefficiencies and red-tapism and lack of the conscientious setting of priority of projects and programs, the external borrowing does not seem the resultant at every angle of aspects. Consequently, it is becoming a great challenge to maintain the servicing and redemption of external debt during the definitive maturity.

The government should take the permission of the parliament to redeem the external debt. The redemption proposal is included in the annual budget under regular expenditure.

The timing and terms in relation to paying off the external borrowing depends upon the mutual understanding and compromise between government and the lender country/agency.

The government had made the redemption of foreign debt of Rs.22760.6 million (principal + interest) in the final year of study period 2007/08. This type of redemption method is known as serial and partial payment method and it is most common and sensible method to redeem a portion of public debt every year so that the debt may not go on burden.

4.16 Findings

The issue of treasury bills is easy and effective measure to control the inflation. But it is only for the short-term. This should be redeemed with in short maturity period. If long-term securities like National Saving Certificate, Development Bond and Special Bond would be applied, it would be better to invest for the fruit-giving project.

New bonds like land compensation bond; forest acquisition bond, and prize bond should be brought in practice to meet the lack of fund.

But, in practice, government securities are issued only in bulk amount. Only financial institutions and commercial investors have approach to them. Individual investors should encourage to invest in government securities.

Theoretical aspect of public debt is traditional so as to fulfill the new trends, borrowing system accompanied by Nepal is un-systematic and in accordance with the term and condition imposed by the lenders, that interferes the internal policies. New mechanism should be developed so as to make the redemption systematic. If all these aspects are taken seriously, that makes the effective management of debt.

1. Nepal has been passing through the budget deficit every year due to inadequate resources. Increase in administrative expenses has dominated the development expenditure. Budget deficit refer to total estimated expenditure minus total estimated revenue to existing sources and new proposals plus foreign aids. Budget deficit has been considered as an important and useful fiscal weapon in an underdeveloped economy in order to create more employment opportunities and mobilize physical as well as human resources through higher level of government spending. However, larger deficit do not always produce desired effect in the economy rather it creates undesirable effect on economic growth and development. Larger budget deficits pose real threats to macro economic stability, economic growth and development. Larger deficits tend to have exerted inflationary pressure in the economy in the long run.
2. Developing countries like Nepal use external borrowing as a mechanism to address the gap between the government revenue and its investment and export and import gap. Since very beginning of the development process, Nepal receiving grants for the poverty alleviation, infrastructure development, and empowerment of local people. Donor agencies are

drawing back the grants and providing only loans, so portion of loan is greater than grant in external borrowing. Recent trend of grant is decreasing due to the lack of appropriate utilization.

3. To fulfill the budgetary deficit government has to borrow either internal or external loan when it has not sufficient funds for the redemption that is converted into a new loan. That is accumulated year by year. For the external borrowing it should be returned principal with interest. Due to lack of another resources next borrowing should be made again. So, debt is in increasing trend.
4. The treasury bills are issued on the auction as specified in the issue calendar. Treasury bills are issued as promissory note so that buyer could purchase and sale these bills by endorsement as well as through the commercial banks. Nepal government issues 28 days, 91 days bills under this category. It has major role in total outstanding internal debt. Treasury bills are most inflationary in nature. Most of the institutions are attracted to the Treasury Bills rather than others are long-term and complicate in nature. So, most investor are attracted to this.
5. In recent years, bilateral loan is dominated by multilateral loan. Agreement on bilateral is easy but multilateral is quite complicative. Bilateral loans can be converted into grant and subsidy whether it can not be repaid in time while multilateral loan should redeemed in time while multilateral loan should redeemed in time so as to continue further. Otherwise, country can be listed as defaulters. Although such circumstances are persistent there is still huge amount of multilateral loan.
6. Foreign loan plays vital role to fulfill the budget deficit. Since, last few years huge amount of government expenditure is occupied by the unproductive sector. After the change of political scenario in 2046 B.S. government increased investment towards social and economic sector.

Due to the conflict and weak security condition a larger part of the budget were provisioned for peace keeping and internal security. Development expenditure depends mainly on foreign loan rather than revenue. Major portion of the budget allocated for the redemption of the principal and interest of foreign loan. Internal loan can be converted into new loan but servicing of external loan new loan is borrowed again so that external loan is accumulating and increasing every year rather than rate of servicing.

7. The magnitude of external public debt and amount disbursed for the servicing of external public debt is a matter of serious concern. Servicing of external debt needs, either the foreign currency or the loan. More responsive measure, from the lenders, may be imposed upon us if we could not pay them by the schedule. The percentage of interest servicing has occupied 41 percent of share out of total servicing and rest is by the principle servicing.
8. In practice government securities are issued only in bulk amount. Only financial institutions and commercial investors have approach to them.

Although, Nepal's debt burden and its servicing should not be called as excessive, on the basis of its level of development, it is quite burdensome. In the FY 2007/08 the total public debt is Rs.362990.5 million which includes 25.35 percent internal debt and 74.65 percent external debt. In other words, debt burden has reached this level even to achieve such meager development. Nepal has not taken high growth path so far and once it takes it will require enormous amount of investment and that investment will have to be made through borrowing from both domestic as well as the external sources. At that time Nepal will have to borrow an unlimited amount of financial resources from both the sources. Time of heavy borrowing is coming to Nepal a little latter. Therefore, until our growth takes momentum, we should be quite judicious while borrowing to finance the budget deficit. Another worrying

issue in this regard is that we have not, so far, developed and introduced debt management system in Nepal. Now, it should not be delayed even a single minute to introduce this system to remain safe from paying heavy price sooner or later.

CHAPTER V

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary

Economic development is the main goal of under developed countries but due to the lack of financial resources it cannot be easily achieved. To minimize the lack of financial resources public debt can play vital role.

After the political change in 1951, the then government could not mobilize sufficient financial resources even to maintain regular expenditure. The government was compelled to present a deficit budget. Till the beginning of 1960's the deficit was met mainly by bilateral grants.

Government started raising internal loan from the FY 1961/62 by issuing treasury bills, and external loan in FY 1963/64 from UK and USSR. Later Nepal borrowed from international agencies.

The public debt is neither worse nor it impairs the economy. The government has been borrowing debt from people and international agencies to maintaining smooth and sound economic condition of the country and meeting deficit budget and sometimes even for keeping the public belief to its currency. Indeed, the borrowing debt financing on productive programs and redemption will be made through the return of such programs, the public debt may be the quite beneficial to the nation as it outstrip the national economy as a whole.

In the fiscal year 2007/08 revenue of the government is Rs.107622.5 million and expenditure is Rs.161349.9 million. Over the years, the budget deficit has increased tremendously. This may generate serious problems for future generation. The innocent children have to bear loan taken before their birth. Therefore, it is high time that the increasing trend should have to be managed properly. The country must have fair bureaucracy, sustainable economic growth, investment in productive sector etc.

Government issues various securities to collect funds, such as treasury bills, Development Bonds, National Saving Bonds, Special Bonds and Citizen Saving Certificates. Government borrows huge amount by issuing Treasury Bills. It is generally issued for 91 days maturity period. Others are long term securities they are issued to collect long term capital. But, in case of special bonds, it has special provisions. Thus government issues various types of securities both internally and externally. Many economists believe that borrowing internally is better than borrowing externally. Internal investors are the people and the institutions within the country.

Internal debt should not generally exceed 1 to 2 percent of GDP. Total debt is Rs.29476.3 million but grant is only Rs.20320.7 million and so the remaining part should be collected either from external or internal debt. So, the management aspect should be considered properly to convert the loan as grant. The grant which are not the debt but are everlasting reliance definitely raises the question upon the capability on internal resource mobilization.

External loans are divided into two parts multilateral and bilateral. Bilateral loan is provided according to agreement between two countries multilateral loan terms and conditions should be fulfilled by the receiving country. In case of Nepal, multi-lateral loan is increasing during the study period. Beside, the FY 2007/08, on this year position of multilateral loan is only 10.43 percent but bilateral loan is 89.57 percent. Total debt servicing includes principal with interest. Average total debt servicing is consists of internal as well as external. External debt servicing has dominated the internal debt servicing government should pay off external debt in time not to be recorded as defaulter. If so happens, results the nation tough to get loan in future.

Total servicing in interest is 41 percent and principal is 59 percent. Principal is dominant here because interest should be paid every year to give positive impression to the donor country and agencies. Nepal has Rs.362990.5 million debt outstanding at the FY 2007/08. From the total debt 46.64 percent is of

external debt and 53.36 percent is internal debt. If external debt is increased to such a extent nation will fall in to debt trap. So fresh borrowings are to be needed for servicing the existing debt.

5.3 Conclusion

Nepal is a developing country with US \$ 484 (Economic Survey, 2008/09) per capita income. External borrowing is necessary for the utilization and mobilization of natural resources, infrastructure development and overall development of nation. Main challenges for this is management and utilization of external loan and grants. Sustainable profit with liability can be delegated to next generations if grants and loans utilized to the productive sector. But, progress, outcomes and present situation does not show as our concern. Now, it should not be delayed even a minute to introduce the management system to remain safe from paying heavy price later.

The trend of government expenditure is higher than the GDP. Regular is dominating the development expenditure so all amount of budget have been allocated towards the unproductive sector. Government is facilitating private sector for investment after the adoption of liberalization policy. Although private sector investment is increasing still government expenditure has not decreased rather increasing.

It will have a negative impact in long-term due to the greater portion of external debt than grant and subsidy in the development expenditure. Repayment of principle and interest raises the size of general expenditure each year. Limited area of tax and revenue increased gap between government income and expenditure so weakening the economy.

5.4 Recommendations

No country is complete in itself. No taking of public debt or grant is bad in itself. But certain boundaries and measures should be aptly drawn. While

studying on the topic of public debt same recommendations are suggested to address the problem of public debt in Nepal.

1. The government's revenue collection is very low and expenditure is very high which creates fiscal imbalance. To maintain fiscal balance and strong discipline through control of unproductive expenditure and maximize the revenue mobilization. Government should adopt transparent, improving tax administration and effective tax policy. This helps to reduce dependency on loans for financing development expenditure.
2. Borrowed fund from external sources must be spent on those projects, which are highly productive in nature and can produce exportable items and powerful committee should be constituted to supervise, monitor and control foreign borrowing.
3. Government should give equally importance to maintain between urban and rural sector, agriculture, industry and trade of the country. So that the economy will be capable to move in a self-sustaining growth path.
4. To break the vicious circle and uplift a country with self sustaining growth a large amount of initial investment is necessary. Thus, underdeveloped countries should emphasize to stimulate and accelerate capital formation. For this, internal as well as external borrowing should be given emphasis to utilize properly.
5. The government should try their best to get grants if selection between debt and grant is provided. Because debt is liability and should be refunded which is in the increasing trend. It is appropriate to take foreign debt on the basis of primary needs of the policy of accepting debt should be adopted only after determining the sector and amount focused by the donor agencies.

6. The external debt if invested in the productive and returnable sector, it flourishes the economic development and if grant is invested in the construction of physical prerequisite, it proves to be the milestone of economic development by attracting internal and external investors.
7. After the proposal of foreign debt and grant other agreement should be performed in favor of the state. No agreement should be made in compulsion and obligation and such agreement and condition should be made transparent.
8. To reduce the foreign dependency various measures must be applied such as export promotion, import substitution and tourist attraction policy, increase employment opportunities are sources of foreign exchange in Nepal.
9. In Nepal, the capital market is in primitive stage and the organized private sector is not enough to fulfill the necessary amount of money to spend in securities and bonds like insurance bonds, pension bonds, provident fund bonds, municipalities bonds and other special bonds would be the major achievements for strengthening the debt market. So government should concentrate to develop money and capital markets. Individual investor should encourage to invest in government securities.
10. Government should give priority for debt management and the resources from public debt should be used in those areas only where the economy will get higher rate of return.

The government should adopt appropriate economic policy to accelerate nation development. Good environment is needed for foreign direct investment and proper attention should be given to the macro-economic stability of the nation. The government should give attention in all sectors of the economy with high economic growth rate by

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Encarta, 2009.

Encyclopedia

www.nrb.org.np

www.google.com.

www.mof.gov.np.

Appendix-I

Questionnaires

Dear Respondents

I am ARUN RAJ NEPAL student of Master of Business Studies at Central Department of Management Tribhuvan University Conducting a Study to Examine your opinion regarding public debt carried out by government to fulfill the budget deficit.

So you are kindly requested to tick the following statement to show your opinion.

1. What will be the main source to fulfill the budget deficit ?
(a) Grant [] (b) External loan [] (c) Internal loan []
2. If grant is not possible all the time what will be next ?
(a) External loan [] (b) Internal loan []
3. Government uses various instruments to collect loan internally, which one is better for economy ?
(a) Short term debt [] (b) Long term debt []
4. If you are a investor / potential investor which one will you prefer to invest ?
(a) T Bills [] (b) Bonds []
5. Why do you choose government securities than other investment instruments ?
(a) Risk free [] (b) More profit []
6. Are you satisfied with investment mechanism incurred by government ?
(a) Yes [] (b) No []

7. Should the rule and regulation be changed regarding issuance and investment of government securities ?

(a) Yes [] (b) No []

8. Give your opinion regarding public debt management if any

1.

2.

3.

Thank You !

Appendix-II
Regression Analysis of External Debt

FY	No. of years (x)	External Debt (y)	x ²	xy
1988/89	1	5666.4	1	5666.4
89/90	2	5959.6	4	23838.4
90/91	3	6256.7	9	56310.3
91/92	4	6816.9	16	109070.4
92/93	5	6920.9	25	173022.5
93/94	6	9163.6	36	329889.6
94/95	7	7312.3	49	358302.7
95/96	8	9463.9	64	605689.6
96/97	9	9043.6	81	732531.6
97/98	10	11054.5	100	1105450
98/99	11	11852.4	121	1434140
99/2000	12	11812.2	144	1700957
2000/01	13	12044	169	2035436
01/02	14	7698.7	196	1508945
02/03	15	4546.4	225	1022940
03/04	16	7629	256	1953024
04/05	17	9266.1	289	2677903
05/06	18	8214.3	324	2661433
06/07	19	10053.5	361	3629314
07/08	20	8979.9	400	3591960
Total	210	169754.9	2870	25715824

Here,

$$\begin{aligned} \phi X &= 210 & \phi X^2 &= 2870 \\ \phi Y &= 169754.9 & \phi XY &= 1874776.3 \end{aligned}$$

$$\begin{aligned}
a &= \frac{\phi X^2 \cdot \phi Y - \phi X \cdot \phi XY}{|\rho \phi X^2 - (\phi X)^2|} \\
b &= \frac{\phi XY - \phi X \cdot \phi Y}{|\rho \phi X^2 - (\phi X)^2|} \\
a &= \frac{2870 \times 169754.9 - 210 \times 1874776.3}{20 \times 2870 - (210)^2} \\
&= \frac{487196563 - 393703023}{57400 - 44100} \\
&= \frac{93493540}{13300} \\
&= 7029.59 \\
b &= \frac{20 \times 1874776.3 - 210 \times 169754.9}{20 \times 2870 - (210)^2} \\
&= \frac{37495526 - 35649159}{13300} \\
&= \frac{1846367}{13300} \\
&= 138.82
\end{aligned}$$

Hence regression equation is

$$y = 7029.59 + 138.82x$$

Annual growth rate of external debt is 138.82.

Appendix-III

Regression Analysis of Internal Debt

FY	No. of years (x)	External Debt (y)	x ²	xy
1988/89	1	1330	1	1330
89/90	2	2180	4	8720
90/91	3	4552.9	9	40976.1
91/92	4	2078.8	16	33260.8
92/93	5	1620	25	40500
93/94	6	1820	36	65520
94/95	7	1900	49	93100
95/96	8	2200	64	140800
96/97	9	3000	81	243000
97/98	10	3400	100	340000
98/99	11	4710	121	569910
99/2000	12	5500	144	792000
2000/01	13	7000	169	1183000
01/02	14	8000	196	1568000
02/03	15	8880	225	1998000
03/04	16	5607.8	256	1435597
04/05	17	8938.1	289	2583111
05/06	18	11834.2	324	3834281
06/07	19	17892.3	361	6459120
07/08	20	20496.4	400	8198560
Total	210	122940.5	2870	29628786

Here,

$$\phi X = 210 \quad \phi X^2 = 2870$$

$$\phi Y = 122910.3 \quad \phi XY = 1797103.1$$

$$\begin{aligned}
a &= \frac{\phi X^2 \cdot \phi Y - \phi X \cdot \phi XY}{|\rho \phi X^2 - (\phi X)^2|} \\
b &= \frac{\phi XY - \phi X \cdot \phi Y}{|\rho \phi X^2 - (\phi X)^2|} \\
a &= \frac{2870 \times 122910.3 - 210 \times 1797103.1}{20 \times 2870 - (210)^2} \\
&= \frac{352752561 - 377391651}{57400 - 44100} \\
&= \frac{-24639090}{13300} \\
&= -1852.56 \\
b &= \frac{20 \times 1797103.1 - 210 \times 122910.3}{20 \times 2870 - (210)^2} \\
&= \frac{35942062 - 25811163}{13300} \\
&= \frac{10130899}{13300} \\
&= 761.22
\end{aligned}$$

Here, we can interpret that annual growth rate of internal debt is 761.72. From the above calculation it can be conclude that in recent years proportion of internal debt is increasing more than external debt.

Appendix-IV

Correlation Analysis of External and Debt

FY	Internal Debt (x_1)	External Debt (x_2)	$x_1 \cdot x_2$	x_1^2	x_2^2
1988/89	1330	5666.4	7536312	1768900	32108089
89/90	2180	5959.6	12991928	4752400	35516832
90/91	4552.9	6256.7	28486129	20728898	39146295
91/92	2078.8	6816.9	14170972	4321409	46470126
92/93	1620	6920.9	11211858	2624400	47898857
93/94	1820	9163.6	16677752	3312400	83971565
94/95	1900	7312.3	13893370	3610000	53469731
95/96	2200	9463.9	20820580	4840000	89565403
96/97	3000	9043.6	27130800	9000000	81786701
97/98	3400	11054.5	37585300	11560000	122201970
98/99	4710	11852.4	55824804	22184100	140479386
99/2000	5500	11812.2	64967100	30250000	139528069
2000/01	7000	12044	84308000	49000000	145057936
01/02	8000	7698.7	61589600	64000000	59269982
02/03	8880	4546.4	40372032	78854400	20669753
03/04	5607.8	7629	42781906	31447421	58201641
04/05	8938.1	9266.1	82821328	79889632	85860609
05/06	11834.2	8214.3	97209669	140048290	67474724
06/07	17892.3	10053.5	179880238	320134399	101072862
07/08	20496.4	8979.9	184055622	420102413	80638604
Total	122940.5	169754.9	1084315301	1302429062	1530389135

Here,

$$\sum X_1 = 122940.5$$

$$\sum X_2 = 169754.9$$

$$\sum X_1 X_2 = 1084315301$$

$$\sum X_1^2 = 1302429062$$

$$\sum X_2^2 = 1530389135$$

$$\begin{aligned}
& a \quad X \frac{N\phi X_1\phi X_2 \quad Z\phi X_1\phi X_2}{\sqrt{[N\phi X_1^2 \quad Z(\phi X_1)^2]} \sqrt{[N\phi X_2^2 \quad Z(\phi X_2)^2]}} \\
& X \frac{20 \mid 1084135262 \quad Z(181271.4 \mid 103543.9)}{\sqrt{[20 \mid 1302297341 \quad Z(181271.4)^2]} \sqrt{[20 \mid 1530389135 \quad Z(103543.9)^2]}} \\
& X \frac{2168270524.0 \quad Z1876954771}{\sqrt{52091893640 \quad Z3285932046} \sqrt{3060778270 \quad Z1072133923}} \\
& X \frac{291315753}{\sqrt{1923257318} \sqrt{1988644347}} \\
& X \frac{291315753}{43854.95 \mid 44594.22} \\
& X \frac{291315753}{1955677234} \\
& X0.149
\end{aligned}$$

We have easily observed that, there is positive correlation between internal debt and external debt. But these frequencies are lowly correlated.

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