

CHAPTER-ONE

INTRODUCTION

1.1 General background

Nepal is a small land locked country wedge between two economically strong neighbouring countries, India and China. Agriculture is the main source of livelihood of the people of Nepal. About 80 percent of the people are engaged in this sector. The contribution of this sector to GDP is estimated to be 38 percent (Kharel, 2007). Only 42 percent of the agriculture land is irrigated. Nepal is one of the poorest countries in the world with the GNP per capita of \$250 in 2002/03. About 42 percent of people are estimated to be below absolute poverty line. Only 53.7 percent of the population (six years and above) are literate. In recent years economic growth rate is confined to 3 to 4 percent per annum which exhibits that the economic progress is far below the expectation. (Dahal, 2004)

Majority of the people are deprived of basic needs such as food, clothing and shelter. So other facilities like education, health, nutrition, pure drinking water, industrialization etc. are beyond the expectation. Although Nepal is second richest country in the world on water resources after Brazil, a small percentage (just more than 20 percent) of the population have access to electricity. About 90 percent of the population lives in rural area. There is wide disparity in income distribution. (Kharel & Bhandari, 2007)

In Nepal the private sector is not well-developed. Lack of modern technology, technical knowledge, skilled and trained manpower, political instability, lack of appropriate government policy and its implementation are the major factors that are discouraging the private sector. Beside these, due to the absence of strong and effective financial institution and modern banking system, the collection of scattered saving has become very difficult. So to lead the economy to the pace of development the government has to invest a huge amount in the field of socio-economic services

like school, roads, bridges, drinking water, health facilities, irrigation, hydro power etc. as well as in the field of direct productive activities. For all these tasks, the government needs a large amount of money which is not possible to collect through taxation.

Nepal is facing a growing financial resource gap on the one hand and problem of increasing inflation and rapid population growth on the other. To mitigate and avoid the resource gap and to mobilize the financial resources there is need of public debt.

The government gets its income from two sources namely, public revenue and public debt. Public revenue consists of all incomings or receipts (tax and non- tax) and public debt carries with its obligation to pay money back to persons, institutions or countries from whom it has obtained. “The accumulated amount of what the government has borrowed to finance past deficit is called public debt” (Samuelson 1992; 628)

Public debt is a legal obligation of the government to make interest and/or amortization payment to holders of designated claims in accordance with a defined temporal schedule (Palgrave Dictionary).

There are two major sources of public debt (borrowing); the borrowing from the internal sources and the borrowing from the external sources. Former includes individuals, financial institutions, non financial institutions, commercial banks and central bank etc. Similarly the later includes bilateral and multilateral agencies such as Asian Development Bank (ADB), International Monetary Fund (IMF) and World Bank (WB) etc. These provide short term and long term loans to the member countries to cover the temporary balance of payment deficit and to finance development projects respectively.

At present, public debt is regarded as a major source through which the public enjoys the benefits of public expenditure. After the Second World War, public debt has become vital source of development expenditure for underdeveloped countries.

In the recent years the subject matter of public debt is concerned with the socio-economic development of the country. It is considered as an effective tool of fiscal and monetary policy that assists to raise revenue, saving mobilization and control of inflation. Due to the limited availability of internal resources, shortage of foreign exchange and unfavourable balance of payment etc. external debt is more essential than internal debt for underdeveloped countries. This shows that external borrowing remains an alternative source to finance the economic development of underdeveloped countries.

Developing country like Nepal is always facing the problem of fund. The taxable capacity of the people of Nepal is very low due to low level of income. This leads to low level of government revenue. Hence the developing countries are taking public debt as a main source of resource mobilization to meet the budgetary deficit. At present, public debt is widely accepted as a means for financing deficit.

Studying the situation of the public debt in Nepal, it is heavily dependent upon external debt. The trend of external debt is increasing rapidly than internal debt. So, in the Nepalese context, there is no doubt that if the trend of external debt goes on like this, Nepal will fall in the 'debt trap'.

1.2 Statement of the Problem

In the Nepalese economy, the private sector is less developed. Due to low per capita income, private saving rate is low; consequently the private sector investment is also low. Moreover, due to scattered saving and lack of effective mechanism for mobilizing the scattered saving, it has become very difficult to induce the private sector. This results the deficiency of capital and low rate of capital formation. So, to accelerate the economy to the pace of development capital formation from the public sector is essential. But as being the underdevelopment country, such a required capital can not be obtained from the internal sources only for investment purpose. Hence external borrowing has been the ultimate source to finance the investment works and hence to bridge the gap of capital deficiency in developing countries.

In Nepal, government expenditure is increasing rapidly in each and every fiscal year. The government revenue is not increasing in the same way. The

government expenditure was Rs.19669.3million in 1989/90 and has gone up to Rs.104560.4 million in 2004/05. whereas the government revenue was Rs. 9287.5 million in 1989/90 and has gone up to Rs. 70122.7 million in 2004/05. So to fulfill the gap between revenue and expenditure the trend of taking public debt has been increasing in every fiscal year. Both the internal and external borrowing have been increasing. The internal loan was Rs.2150 million in 1989/90 and Rs.8938.1 million in 2004/05. On the other hand, the external debt was 5959.6 million in FY 1989/90 and became Rs 9266.1 million in 2004/05. The total debt servicing in the fiscal year 1989/90 was Rs. 2279.2m and with the annual average increment of 15.2 percent it has become Rs. 18366.8m in the fiscal year 2004/05. The external debt servicing reached to Rs. 10786.7m in 2004/05 and the internal debt servicing was Rs. 7580.1 million in the fiscal year 2004/05. It is very common to know that, a rise in the magnitude of public debt must be accompanied by an increase in the debt servicing capacity. Though public debt is a tool that assists to mobilize resources but it is necessary to be very aware on its increasing magnitude and proper care must be taken to raise the debt servicing capacity of the economy (Economic Survey, 2004/05).

In the context of Nepal there is an increasing imbalance between government revenue and government expenditure. Government expenditure exceeds the government revenue. This imbalance creates deficit in budget which is ever occurring in the Nepalese budgetary system. So it has become a matter of problem. The major parts of deficit have been financed by external and internal borrowing. If the borrowed fund is utilized properly and effectively, especially in the sectors of income earning projects and in the projects which can increase employment and productivity, the socio-economic transformation can easily be achieved. This leads the economy towards the prosperity. Opposite to this, if the fund is misused that becomes the burden. Moreover, huge amount of external debt plays adverse role on the balance of payment.

In Nepal, scarcity of internal resources, poor management of available resources as well as requirement of external resources etc. inspire to increase external borrowing. But the debt servicing capacity has not increased in the same pace. If this situation goes on, Nepal will fall in the 'debt trap'.

Nepal has insufficient capacity to develop its economic and social condition by itself from the present level of domestic saving. To break the vicious cycle of poverty and to improve socio-economic status of the people, there is a greater demand of public debt. But it should be always remembered that government borrowing is not a panacea, if it is not utilized properly.

Ever increasing debt will create a serious problem in the economy like debt trap, colonization, internal instability etc. In fact, if public debt increases and not utilized properly there will be macro economic imbalance which creates excessive dependency upon foreign assistance. For this purpose, the study has made an attempt to identify the following problems.

- 1) What is the situation of public debt since 1989/90 to 2004/05?
- 2) What is the trend of external and internal debt?
- 3) What is the condition of resource gap in Nepalese context?
- 4) What is the relationship between public debt and Gross Domestic Product in Nepal?

1.3 Objectives of the Study

The main objective of the study is to investigate and analyze the trend and pattern of public debt in Nepal with following specific objectives.

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

1.4 Hypothesis

- 1) H_{01} : There is no significant relationship between external debt and GDP

in Nepal.

H_{A1}: There is significant relationship between external debt and GDP in Nepal.

2) H_{O2}: There is no significant relationship between internal debt and GDP in Nepal.

H_{A2}: There is significant relationship between internal debt and GDP in Nepal

3) H_{O3}: There is no significant relationship between total debt and GDP in Nepal.

H_{A3}: There is significant relationship between total debt and GDP in Nepal.

1.5 Significance of the Study

At present economic planning is taken as the main tool of economic development. In economic planning various objectives are made. Due to low level of taxable capacity of the people, public debt is essential to meet the objectives of economic development in Nepal. Hence debt has become a reliable and common instrument for resource mobilization and hence to break the vicious circle of poverty in underdeveloped countries like Nepal.

In the context of underdeveloped countries like Nepal, government has to invest a huge amount in socio-economic sectors as well as in direct productive sectors. For this there is need of heavy investment due to which the scope and importance of public debt has been increasing day to day.

This research provides updated information in regards with public debt. This study explores and analyzes the resource gap in the Nepalese context and the trend and structure of public debt which may be helpful for the future economic plans and policies. Hence its significance is obvious.

External debt is increasing, so it is more relevant to study. Scholars and economists are highly concentrated in this issue. So it is equally important to study this issue. This study will focus on the existing scenario of public debt, requirements of borrowing, trend and structure of public debt. So the readers who are interested in knowing about the public debt and debt servicing in Nepal, and the share of total debt servicing to Gross Domestic Product and government revenue, foreign debt and Gross

Domestic Product will be benefited and can get a clear cut idea about various aspects of public debt.

1.6 Limitations of the Study

This study has following limitations:

- 1) This study covers only the time period from 1989/90 to 2004/05.
- 2) This study is completely based on secondary data and informations.
- 3) This study has not attempted to examine the effect of public debt on macro economic variables.
- 4) This study gives emphasis only on trend and pattern of public debt in Nepal.
- 5) Though there are various factors that affect the GDP of Nepal, such as – Agriculture, Water and forest resources, Industry, Tourism sector, contribution made by Small and Cottage Industry and income from biodiversity but only the relationship between GDP and public debt has been taken under this study.

1.7 Organization of the Study

This thesis has been organized into five major chapters and each chapter contains some sections. The first chapter presents the general background of the study, introduces the problems, sets objectives, hypothesis, significance and limitations of the study.

The second chapter entitled "Literature Review" provides some theories relating to the topic and also discusses some relevant literatures written on public debt. Research methodology has been presented in the third chapter which gives information about the sample size and statistical tools, which are used in this study.

The fourth chapter gives data presentation and analysis. This chapter provides a brief discussion of the composition and type of public debt and also its contribution in financing fiscal deficits and development expenditure. This chapter analyzes the debt-burden and debt-servicing problem in Nepal. This chapter also examines the relationship between internal debt, external debt, total debt and Gross Domestic

Product. Finally the summary, conclusions and recommendations are presented in the fifth chapter.

1.8 Working definition of terminologies:

The definitions of some terms which are used in this study are as follows;

Public Debt: It refers to a loan raised by a government within the country or outside the country.

Internal Debt: It is the government borrowing from domestic banking sectors individuals, and other institutions.

External Debt: It is the government borrowing from International sources.

Budget Deficit: It is the revenue gap between the total expenditure minus total revenue plus foreign grants.

Fiscal Deficit: The gap between total expenditure and total revenue of the government is called fiscal deficit.

Debt trap: If the government takes new loan to pay the previous loan, it is called debt trap.

GDP: It is the monetary measure of the total domestic output at producers' price.

GNP: The money value of final goods and services produced during a year in a country is called GNP. It includes the net income from abroad.

$$\text{i.e. } \text{GNP} = \text{GDP} + (\text{X} - \text{M}) + (\text{R}_F - \text{P}_F)$$

R_F = Factor income from abroad

P_F = Payment made to foreign factors.

X = Export of goods and services. M = Import of goods and services.

Resource Gap: It is the difference between government's total revenue and total expenditure.

Debt Burden: It refers to the extra tax imposed by the government on the citizens to repay public debt including interest.

CHAPTER TWO

REVIEW OF LITERATURE

2.1 Introduction

In this chapter attempts have been made to review the related literatures which have been divided into two parts- theoretical review and research review. In the theoretical review attempts have been made to review the theoretical aspects of the study, especially Classical, Keynesian, Post Keynesian and recent thinking on government borrowing and in the research review a vigorous attempt has been made to review the relevant research studies being done so far.

2.2 Theoretical Review

Public debt is a modern invention. It was not heard prior to the eighteenth century. In those days the living way was very simple and there were limited economic activities. The government budgets were very small and there was the policy of Laissez faire in economic system. But after the great depression of 1929-33, the public authorities started to take interest in the economic stability and development of their countries. So, public borrowing has become a tool for the proper development of the country. In modern time, the government activities have grown rapidly. The government has to spend a big amount on day to day activities and development functions. In such a situation any other sources of revenue or taxes are not sufficient to utilize and mobilize the resources and to obtain the macro economic objectives. Hence it has become an effective instrument of fiscal policy to stabilize and enhance the economic development of underdeveloped economics. (Risal, 1994)

Generally, the fund or capital taken in the form of loan by the state from various sources is called public borrowing. In other words, public debt refers to loan raised by a government within the country or from 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.

Public debt is a very common and popular method of solving the problem of deficit financing of any government of developing countries. Generally, governments of developing countries borrow to meet their deficit budget. Sometimes it is also taken to meet the expenditure of war, natural calamities etc. It is a temporary source of government revenue since; it must be paid back with interest and principal after maturity.

There are two sources of public borrowing:

- 1) Internal borrowing
- 2) External borrowing.

Internally, the government can borrow from individuals, commercial banks, financial institutions, charitable trusts and the central banks of a country. Externally, the government may borrow from individuals, banks, and international financial institutions and foreign governments.

External public borrowing is the acceptance by a government or government agency of real or financial resources from an external source with the obligation or relinquishing such resources in specified future dates. The accumulated liabilities resulting from such external borrowing are external debt.

A report jointly published by the World Bank, the International Monetary Fund and Organization for Economic Co –Operation and Development has recommended the following core definition of debt:

"Gross external debt is the amount at any given time of disbursed outstanding contractual liabilities of residents of a country to non – residents to repay principal with or without interest or to pay interest with or without principal" (Rajaswa, 1984: 212)

This definition states that the external debt of a country also includes the external obligations of the private sector.

The borrowed fund can be used to finance war expenditure or to buy defense equipment or to pay for the development project or to pay off adverse balance of payments. Generally, there are two important external sources of government borrowing. Firstly, International financial institutions like International Monetary Fund, International Development Association, World Bank, Asian Development Bank etc, which are called multilateral sources. These institutions give loans to member countries for a short –term period in order to improve the temporary difficulties of balance of payments and for long –term to development projects and secondly, government borrows from bilateral sources which is mainly used for development projects. In modern times, external source of borrowing has become significant so developing countries like Nepal has been received massive assistance from the Nepal aid group.

2.2.1 Classical, Keynesian and Post- Keynesian View

2.2.1.1 Classical View

It consists of the thought as expressed by economists of the 19th century and their followers. Generally, the classical economists were against public borrowing and favoured the minimum expenditure from the government side. They assumed that individual consumer and business firm employ resources more efficiently. Under a fully employed economy, government can acquire resources by borrowing only at the cost of private sector where they are more fruitfully engaged. In this way, classical economists had negative attitude towards public borrowing and they did not plead for increasing economic role of government. In stead they said, “Let money fruiting on the pockets of the people”. According to them state has to perform its limited activities, maintenance of law and order, justice and social security. Classical economists like J. B. Say, J.S Mill, and T.R Malthus have given their argument that "Debt creates burden in the economy because of its unproductive nature" (Singh, 1982).

Adam Smith disfavoured public debt. He was of the opinion that public debt leads to extravagance, encouraged resort to war and induces generally disadvantageous economic conditions for the nation, which employed it.

Accordingly, C.E Bastable, “A nation can not do any more than an individual keep adding continuously to its liabilities without at least coming to the end of its resources”. Hence, public debt was considered hazardous for the economy. It is no longer a cake eating feast but rather need a careful and efficient brain to handle the management of the public debt. (Singh, 1982: 322)

Classical economist considered public debt as dead weight in the sense of wasted opportunity, but modern economists consider public borrowing as an important technique of public finance. Public loans in modern times are necessary to met financially unfavourable situations like deficit in budget, flood and famine; warfare has become so costly that the normal income through taxation falls short of the actual war expenditure. Many economists like J.M. Keynes have advocated increased public expenditure financed through borrowings and not through taxation as means to remove depression and unemployment. Public borrowings are considered very useful for the development of natural resources of developing countries (Tyagi, 1976).

In the opinion of Findlay Shirras, “government must remember that borrowing is not a short cut to prosperity and a policy of borrowing must be retreated except for what cash reasonably be regarded as productive expenditure“ (Lekhi ,2002).

It is not that the classical writers were against any form of debt. They favoured minimum public expenditure and between taxation and borrowing, they favoured taxation for the following reasons:

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

- c) Deficit financing might produce currency deterioration and price inflation.

From the above statements, it can be said that classical economists were not against all types of public debt. They agreed that public debt should be used for productive purposes, that is, for capital projects since the fruits of such projects could be sold to buyers so debt servicing and refund of principal did not necessitate additional taxation. These are called self – liquidating projects. In the words of R.A Musgrave, “self –liquidation projects may be defined narrowly as investment in public enterprises that provide a fee or sales income sufficient to service the debt incurred in their financing, or they may be defined broadly as expenditure projects that increase future income and tax base permit servicing (interest and amortization) of the debt incurred in their financing without requiring an increase in the future level of tax rates” (Singh, 1982: 321).

The classical economists Edgeworth viewed the government should not raise the public debt for consumption on activities. Economists R.A Musgrave and P.B Musgrave hold, “Tax raised to finance this payment imposes a burden on economy.” They further say “This burden does not arise because resources are withdrawn from the economy “ In this context they also state that “ Debt accumulation during war may be so drastic as to lead to fiscal and debt repudiation in the post war period (Musgrave 1989:689).

2.2.1.2 Keynesian View

In the classical system, all private income is spent on either consumption or investment. Full employment is secured automatically. Price level stability is maintained if the money supply is held stable or is increased at the same rate at which real income grows. After the great depression of the 1930’s new wave of thinking took place in the writing of J. M Keynes who 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.

Keynes stood against the concept of classical economists and propounded different view in his book “General Theory” in 1936. He did not accept the classical notion of a free enterprise economy, which is self-equilibrating at a full employment

level. He advanced the concept of underemployment equilibrium and who effected a truly significant revision in theory of public debt. Keynes argued that if debts are internally held, there is nothing to worry about their size. Such debt involves merely a series of transfer payments and they cancel out for the economy as a whole. Hence the only concern should be about economic stability at high level of income. Keynes also stressed and challenged the version of classical economists and hold opposite opinion on the subject of burden of public debt. He submits that there is no shift of the basic burden to the future generation because the same posterity that pays the additional taxes will be benefited from the repayment of the debt.

A.P Learner, a propounder of the functional finance approach to public debt, maintains that government should borrow only when it wants to make people hold more bonds in place of money. This action will raise the rate of interest by lowering the value of bonds and will prove to be anti- inflationary. In the event of falling aggregate demand and shortage of funds for productive investments, government should lend to the private sector or increase its own expenditure to arrest the fall in real income and employment. Debt servicing poses no problem since it is always open to the government to borrow from the central bank. Since the function finance maintains a correct level of aggregate demand corresponding to available output, there is no danger of inflation (Singh, 1982: 323).

Lastly, it can be said that many Keynesians carried out views with the support of public debt that if they are normally held, there is nothing to worry about their size.

2.2.1.3 Post Keynesian View

During World War II and the post – war years, the size of public debt increased enormously. The increase in the size of public debt has caused some revision in economists thinking on the subject. The post – Keynesian economists accept a large part of the modifications of the classical debt theory as brought about by Keynesian economics. It emphasizes, however, the transfer and management aspects as well as the interrelationship between public debt and money supply.

Post – Keynesian economists advanced their idea that government borrowing does not always deprive the private economy of resources as, for instance, in a period

of widespread unemployment. It is also not accepted that borrowing in a period of full employment must be inflationary. It depends on these circumstances if borrowing taps funds otherwise spent in consumption; it is not more inflationary than taxation. A large public debt, if internally held, poses many problems for the economy. It complicates monetary policy and creates difficulties of management. They think that the developing countries have very low income, saving and investment. They further says that without increasing the rate of these three crucial factor, no country could achieve steady growth so the over – all aim of borrowing is not to equalize income in different countries but to provide every country with an opportunity to achieve steady growth, on the other side, people of the developed countries are enjoying high prosperity, high standard of living, high educational facilities etc ... Population problem is also not so serious in such economics. Post – Keynesian economists Goode views that borrowed money when used to finance public investment causes no such reductions, all that will happen is the change in the consumption of capital will happen is the change in the consumption of capital formation. According to him “the inference is that failure to restrict borrowing to the finance of investment will retard economic growth. A weakness of the argument is that not all outlays classified as investment actually contribute to growth, while some expenditure usually classified as government consumption promotes growth”.

In this way, different economists in different periods have expressed their own views on public debt and they are conscious of the burden as well. The situation of foreign debt and internal debt is different because for foreign debt needs foreign exchange for its debt servicing for which foreign exchange earning sector must be created effectively. The true burden of debt servicing on the debtor country thus depends to a substantial degree on how far the loans can be transferred into productive investment.

The case of shifting the burden to the future generation is one of the burning issues of debate between the economists. Classical economists state that through debt financing, it is the present generation, which suffers a loss of resources. They further argue that if the present generation reduces it’s saving in order to meet the debt finance and leave a smaller amount of capital resources for the future. This will reduce the productive capacity of the coming generations and they will accordingly

lose. In this way, burden of public debt may pass on to the future generation but on the other hand modern economists including J. M Keynes, Harris, Hansen, Buchanan, Bowen Davis, Musgrave have challenged the version of classical economists and hold opposite opinion on the subject of burden of public debt. They argue that there is no shift of the basic burden to the future generation because the same posterity that pays the additional taxes will be benefited from the productive use of the debt. Thus, the question of shifting the burden of public debt to the future generations has remained an unsettled problem. However, the burden controversy depends upon the nature of investment, productive or unproductive. If it is productive, there will be no burden because of creation of real asset in the economy, which further generates income of the people thereby increasing national income. If it is unproductive, the situation will be burdensome for the government.

Even though public debt imposes burden into the economy, Samuelson has suggested for the use of foreign capital in the process of economic development of developing countries. He has said that if there are many difficulties in the way of domestic financed capital formation, why not rely more heavily on foreign sources.

2.3 Recent Thinking on Government Borrowing

Now a days government borrowing is connected with development purpose of the underdeveloped countries in wider prospective. It is used for recovering the deficiency of the effective demand. Government borrowing can be used as an instrument of fiscal policy for mobilizing saving for the development purposes. Besides, it also acts as a balancing wheel that controls the tempo of the business cycle. In a period of depression, when aggregate demand is not enough to accelerate the level of production and employment, compensatory theories of fiscal policy suggest to increase public expenditure on public works by mobilizing idle saving at the hands of the people through public borrowing to create effective demands and to promote an economic recovery (Barman, 1986: 12).

According to post Keynesians and Second World War economists, public borrowing plays a prominent role in underdeveloped countries. It helps the mobilization of resources for the economic development. In such countries, sources of

revenue are inadequate and insufficient for the heavy expenditures that have to be incurred on the development schemes.

Michael Posner points out that growth in the debt ratio causes alarm for two reasons. First, growth in debt ratio might lead to crowd out of private investment, second and more important, is the assumption that government spending out of the borrowed funds might be unproductive (Posner, 1992:204).

Raja J. Chelliah points out that the ideal situation is one in which first, revenues will meet subsidies, other transfer, interest payments and the greater part of current expenditure, debt finance will be used for meeting the governments non remunerative capital formation, a propositions of current expenditure designed to increase social capital and productive requirements of financial investments and second, the total of domestic borrowing will be determined in such a way that it gives the rate of domestic saving, the non – government sector will be to obtain borrow from the central bank that current account seignior age (Chelliah, 1992: 20).

In recent years, the objective of the government borrowing in developing countries is that it should be used as an instrument to mobilize saving of people which would otherwise have gone to idle or wasteful consumption. Public debt should be advocated for creating additional capacity and producing capital equipment. Generally, government borrows for the creation of infrastructures in the economy since it requires huge investment initially which cannot be meet only through revenue collection. The aim of the government borrowing policy should help in strengthening the money and capital market, which in turn accelerate development and price stability. The government of a developing country tries to mobilize the saving of the community partly through the device of public borrowing in order to meet the financial need of its development program.

A discussion paper was prepared by United Nations Conference on Trade and Development 'Multilateral debt of least developed countries' – It has reviewed development in multilateral debt of least developed countries since the debts crises o f the early 1980s. This paper has discussed on problem of multilateral debt as sustainability, liquidity and accumulations of large-scale arrears. The discussion paper has also evaluated recent schemes to provide debt relief and suggested possible

measures to strengthen and improve existing schemes as well as present other innovative obtains. The analysis focused mainly on the least developed countries. The World Bank and IMF classify 37 of these countries registered multilateral debt arrears in 1993, 29 of them as heavily indebted poor countries. These are 48 countries classified in 1995 by the United Nation as least developed countries. (Sablater, 1995:2-20)

E. D Domar has defined the burden of public debt as the ratio of the total debt to the national income. He lays down the conditions under which the burden may increase or decrease over time. Let

$$T = Di$$

$$\text{And } t = tY$$

Where,

D = amount of debt outstanding at the beginning of a year.

i = rate of interest paid on debt.

T = amount of taxes necessary to cover the interest change on debt.

t = fraction of income (ty) taken through tax to pay interest.

$$t = T / Y$$

$$t = D \cdot i / Y$$

$$I \cdot D / Y$$

From the above equation, it follows that the tax rate necessary to pay interest on debt depends on the ratio of the size of debt multiplied by the rate of interest to income. This tax may be related to growth of income and the budget deficit. This relevant equation shows the burden of public debt,

$$t = 1 / (1/I) (G / b)$$

$$= i \cdot b / G$$

Where,

G = rate of growth of income

b = ratio of deficit to income

This equation shows the burden of debt that would increase or decrease. When either ratio of deficit to income or rate of interest paid on debt increases then the

burden of debt will also be increased. Or the burden of debt (t) and ratio of deficit to income (b) and rate of interest paid on debt (i) has positive relationship. (ii) Likewise, the burden of debt (t) and rate of growth of income (G) has negative relationship.

2.4 History of Public Borrowing in Nepal

In the Nepalese economic history, public debt is not so old. In history text books there are discrete reference to great king Prithivi Narayan Shah, raising revenue and even borrowing from the public for the purpose of unifying the kingdom of Nepal. But the information in terms of debt and amount of borrowing is missing in those references. Even Chandra Shamsar is reported to have borrowed money from Pashupati Nath temple to resettle the emancipated slaves around A.D. 1925.

M.C. Regmi has written in his book Nepalese economic history that there was no public debt but the government provided some regulation to maintain public finance before 18th century. Some instances of public debt in Nepal can be seen existed in the period of Rana Bahadur Shah who borrowed a large amount of fund from Indian merchants. At the same time in 1803 government had taken borrowing for internal finance. (Regmi, 1971)

In Nepal government obtained external debt from 1963/64 and internal debt from 1964. In fiscal year 1963/64 the government took debt for the mobilization of saving and to finance the country's economic development program. So, systematic internal debt services have been found out from 1964 in the budgetary provision of Nepal government. Mainly in the Nepalese context, it is budgetary development that precisely governs the size and composition of public debt.

Evolution of budgetary development in Nepal is a factor to increase in government expenditure, which pushed government borrowing. Until 1975, public expenditure amounted 11 percent of GDP. In 1980's there was heavy increase in public expenditure from 1990's onwards expenditure had exceeded one fifth of GDP. Revenue remained around 9% of GDP till 1993. Another interesting feature of Nepalese budgetary development has increasing magnitude of regular expenditure to compare with that part of development expenditure, particularly in the 1990's.

Foreign aid consists of both grants and loans. Nepal has been receiving foreign aid since 1951. The first donor country was U.S.A. It flows under point four agreements for technical co-operation in January 23, 1951. Then first Indian aid in 1951/52 for the construction of Tribhuvan International Airport. Now a days several countries are providing foreign aid in the form of grants and loans. Basically higher proportion of grants is receiving through the bilateral sources and most part of loans are receiving through the multilateral sources.

Foreign aid has been entirely in grants upto 1960/61. Then after this the share of grants has been declining but still it continued to account for a large proportion of total aid (more than 50% upto 1982/83). The share of loan in total aid started to increase since 1983/84. Now a days government is receiving foreign aid to meet the regular government expenditure too.

In 1999/2000 the share of loan in total aid was eighty percent. In fiscal year 2001/02 Nepal received Rs.14384.8 million total foreign aid through bilateral and multilateral sources. In which Rs.6686.2 million and Rs.7698.6 million were grants and loans respectively. Till now, the amount of grants is higher but the increasing trend of grants is lower as compared to loans. All these informations show that the burden of public debt of Nepal is increasing due to growing share of foreign loans. So, public debt is increasing at faster rate.

2.5 Research Review in the Nepalese Context

Some writers and students of Masters Level have tried to express their views on public debt in the Nepalese context. Some of them have focused on its structure and importance whereas other have emphasized on its burden and impact in inflation, employment and national solvency etc. These thesis paper and articles have also enriched the importance, role, need and scope of public debt in economy. This section presents review of various research studies - dissertation and articles related to the government borrowing in Nepal.

2.5.1 Review of Dissertations

Joshi (1982) has submitted a dissertation entitled "Structure of Public debt in Nepal ". He, in his thesis, has pictured the poor economic performance of the nation, which is due to nation's natural topography and human behavioural limitations. He concludes the internal borrowing as most essential to develop the money and capital market in the nation and external borrowing is mainly for the rapid economic development. He describes the external debt as supplementary tool for the resource gap in the countries' budgetary expenditure.

Upadhya (1985) has prepared dissertation paper entitled "External debt and debt servicing in Nepal" in 1985. He analyzed indebtedness of the country with increasing external borrowing and the determinants of external borrowing in Nepal.

Sharma (1988) in his dissertation paper entitled "Public Debt In Nepal " has dealt with the positive role of government borrowing for the sound economic growth and prosperity on the one hand and on the other hand he has alarmed the state not to disburse the debt unproductively. He has focused on increasing public debt because only richer section of the society gets double benefits from the public debt. According to him one benefit is in the form of the interest in the debt and other benefit from the development it self. But if there is any increase in small saving, ownership of debt is defused and the problem of inequality in the distribution of wealth and income is minimized." He further maintains, "The expansionary impact of the ownership pattern of government securities has contributed to the inflationary spiral in the country. And hence it has caused several real burden of public debt."

Wagle (1999), in his dissertation entitled, "An analysis of public debt situation in Nepal," concluded that macro economic imbalance such as widening trade deficit that the debt servicing capacity of Nepal is very poor which is also responsible for increasing debt obligations and financial resource gap.

2.5.2 Review of Research Articles

Hanson (1941) has written an article on effect of public borrowing on redistribution of income and net transfer of resources from lower income groups to upper income groups. He states:

"In so far as the government can borrow from small savers and increase in the public debt it will not prove unfavourable to an equitable distribution of wealth. But if the growth in public debt is very rapid, it will not be possible for relatively small savers to take any large proportion of new securities issued. They will be absorbed by the rich and the well- to – do by large corporations. A rapid growth in public debt is therefore likely intensifying inequalities in wealth distribution ".

Munla (1992) in his article entitled “External Debt Policy "has analyzed the origin of debt problems and explained about it. The debt crisis had its origin in the substantial rise in the external liabilities of the developing countries during the second half of the 1970s and early 1980s, in an environment of large - scale recycling of the oil exporter's surpluses, rising world inflation, and negative real interest rate. At the time many viewed that this recycling of funds as a positive development: creditors were able to identify new investment and debtors could acquire funds needs for development purposes ".

He again explained that an external debt crisis was due to:

- a) A drastic deterioration in external economic environment in the form of higher interest rates, lower commodity price and severe recession in industrialized economies;
- b) Economic mismanagement and policy errors in debtor countries ; and
- c) Excessive lending by commercial banks to some countries, with little regard to country risk limits.

In this article Munla contributed towards principle of debt strategy and pointed out three fundamental principles which are:

- i. Debtor countries need to pursue strong adjustment programs, supported by determined structural reforms, aimed at increasing domestic resource

mobilization. Attracting non – debt creating flows, and reducing impediments to growth;

- ii. Creditors and donors need to ensure to provision of adequate external financing in support of such programs on a case – by – case basis; and
- iii. The international economic environment must be conducive to the success of these efforts.

Adhikari (1996) in her article entitled, " Foreign Debt Servicing: A Case Study" analyzed the foreign debt servicing problem in Nepal. 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.

Gurugharana (1996), in his article entitled "The Role of Foreign Aid in Economic Development and Poverty Alleviation" analyzed the burden of public debt, as debt servicing cost in Nepal and has come to the view that the long term upward trend of increasing debt burden inflict greater burden. He finally said that through the loan component of foreign aid, Nepal is suffered more than other countries like India and China though rate of return is very low and rapidly increase volume of debt slowly brings the Nepalese economy towards crisis of debt trap.

Sharma (1998) in his article entitled, “The growing fiscal imbalance in Nepal, Are we falling into the Debt Trap?” has analyzed that the even increasing debt in Nepal and its servicing has really created a situation which is driving the country towards debt – trap because of the following reasons:

- 1) Large amount of loan is allocated for meeting current expenses within the development expenditure.
- 2) A good amount of borrowed money is used for debt servicing.

In the context of the Nepalese situation, Nepal is facing a paradoxical situation in that she can neither promote her economy without aid, nor has she been able to avoid the risk of becoming the victim of aid intoxication. Meanwhile, aid for long periods has created a separate social group, namely, the rental class.

Khatiwada (1998) in his article entitled "Public debt management and macro economic stability" basically dealt with monetary implication of public debt. He found that public debt has:

-) Exerted excess monetary expansion, which has indirectly resulted in high rate of inflation and deterioration of current account situation.
-) Crowd out resources available for private sector investment.
-) Exerted upward pressure on the market rate of interest.
-) Pressurized on debt servicing to the government resulting in higher budgetary deficit which further contributes to monetary expansion having subsequent repercussion on the internal as well as external sector stability.

He has further analyzed the situation more alarming, as foreign loan of the long- term nature is maturing out at faster rate and exchange rate of Nepalese Rupee has been depreciated very fast.

Acharya (1998) in his article entitled "Burden of Public Debt in Nepal " has analyzed the debt situation in Nepal. He has also pointed out the various factors that cause excessive internal and external debt burden. In which internal factors are:

- a) Inappropriate or expansive fiscal policy
- b) Very low tax effort
- c) Poor maturity mix of the debt burden
- d) Over-regulated prices that dampen incentives to export oriented production resulting in falling exports and revenue, and increased import.

External factors to lead excessive debt burden are:

- a. Adverse external conditions such as deterioration in the terms of trade (e.g. Oil shocks)
- b. Over leading by creditors commercial banks.

Acharya also analyzed the situation of widening saving-investment gap, persistently growing share of regular expenditure, GDP and government revenue, per

capita debt burden increasing trade gap. These factors clearly indicate the ever-increasing debt burden.

Koirala (2001), in his article entitled, “Effective public debt management in Nepalese perspective” analyzed the impact of public debt on socio-economic development. He has also discussed on the problem, challenges and policy of debt management in Nepal. In this article, he concluded that debt crises is not only an economic issue but also political. Therefore it should be handled politically with an economic perspective.

From the articles and thesis reports mentioned above it can be concluded that governments of developing countries like Nepal have to borrow due to low rate of saving. This in turn, is resulted from the low level of investment. This brings inadequate capital, low productively, low income, low purchasing power etc. This justifies that Nepal is facing the problem of deficiency of capital in relation to her population and natural resources.

From the above literature review, it can be concluded that economists are not against all types of public debt. They agreed that public debt should be used for productive purposes, that is, for capital projects since the fruits of such projects could be sold to buyers so debt servicing and refund of principal did not necessitate additional taxation. Previous researchers analyzed the trend of debt by using secondary source of information in terms of internal and external borrowing. But actually speaking, debt can be determined by various factors. Among them, country’s environment and fiscal policy in terms of debt servicing and refund of principal may be the strong determinant for debt management in the country. At present, these are the heart issues in Nepalese economy. The scholars mentioned above could not present the facts. Present study tries to define the trend and structure of public debt in Nepal by applying those various facts in the context of the Nepalese economy. It can be very useful or important in debt management. Thus, present study will be fruitful to those interested person, parties, scholars, professors, students, businessman and government for academic as well as policy perspective. I hope this study will be helpful to those who are interrelated in the study of the Nepalese debt issue.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

A systematic research study needs to follow a proper methodology to achieve the pre-determined objectives. Research methodology is a sequential procedure and methods to be adopted in a systematic study.

3.2 Research Design

This study is based on secondary data of the public debt and the approach of this study is historical, analytical as well as descriptive. In fact, the research design is the conceptual structure within which the research is conducted. This study analyzes the trend and pattern of public debt of Nepal. For this purpose, we have estimated some models. Variables used in the models have been explained analytically. The statistical models have been estimated by using Ordinary Least Square method.

3.3 Source of Data

This study is primarily based on secondary data and information are collected from various sources such as government's budget speeches (1989/90 to 2004/05), various Economic surveys, and publications of Ministry of Finance (MOF), Nepal Rastra Bank, Central Bureau of Statistics, National Planning Commission etc.

3.4 Size of Sample

In order to show the trend and structure of public borrowing, 16 years data (1989/90 to 2004/05) have been taken into account. This is because we are interested in examining the relationship between public debt and GDP of Nepal.

3.5 Tools and Techniques

In order to support the study, different statistical and mathematical tools such as percentage, ratio, arithmetic mean, and hypothesis testing have been used. It is, therefore, evident that the subjective patterns of analysis guided by theoretical tools and statistical as well as mathematical tools have collectively been exercised to explain the different component of the study raised basically through the major issues related to external debt in Nepal.

3.6 Statistical Methodology

It attempts to establish the nature of relationship between dependent and one or more independent variables. It also provides a mechanism for prediction or forecasting. The regression of Y_{GDP} on X_{debt} is used to estimate the value of the dependent variable Y_{GDP} for any given value of independent variable and vice versa.

To examine the relationships between independent and dependent variables, the estimated equation is

$$Y = a + bx$$

Y = dependent variable

X = independent variable

a = constant

b = growth rate

The regression equation of GDP on total public debt has been estimated. The estimated equation is given by:

$$Y = a + bX$$

$$Y = \text{GDP}$$

X = Total Public debt

a = regression constant

b = regression co-efficient

Regression equation of Y_{GDP} on $INTTD_{debt}$

$$Y_{GDP} = a + b INTTD_{debt}$$

Where Y_{GDP} = Gross Domestic product, $INTTD_{debt}$ = Internal debt

Regression equation of Y_{GDP} on $EXTD_{debt}$

$$Y_{GDP} = a + b EXTD_{debt}$$

Where Y_{GDP} = Gross Domestic product, $EXTD_{debt}$ = External debt

3.6.1 Statistical Test of Significance

Standard errors of estimates SEE, like standard deviation, measure the reliability of the estimating equation and estimating coefficients. The larger the SEE, the greater happens to be the dispersion of scattering of given observations around the regression line (or coefficients) and no better the estimate. On the other hand the smaller value of SEE, the better will the regression line (or coefficients) and the better the estimated based on the equation for this line. With help of SEE, it is possible to ascertain how good and representative the estimated regression line (or coefficients) are as a description of the average relationship between two series. For this study, the SEE, for regression coefficients have been calculated by using package software.

3.6.2 Test of the Goodness of Fit (R^2)

After estimating the Regression parameters, R^2 is used for judging the explanatory power, which measures the dispersion of observation around the regression line. It is essential, because the closer the observation to the line, the better the goodness of fit, that is the better explanation of the variations of Y by the change in the explanatory variables. R^2 shows the percentage of the total variation of the dependent variable that can be explained by the independent variables of the multiple determinations and is the square of the correlation co-efficient. The formula to derive R^2 is mentioned below:

$$R^2 = \frac{\sum_{x=1}^n \hat{a}_x y_{x1} \Gamma \hat{a}_2 y_{x2} \Gamma \dots \Gamma \hat{a}_n y_{xn}}{\sum y^2}$$

Where, $y = Y - Z \bar{Y}$

$$x = X - Z \bar{X}$$

3.6.3 Test of Significance of the Parameter Estimates

It is applied for judging the statistical reliability of the estimates of the regression co-efficient. The following tests have been performed to test the hypothesis of the study.

t-Test

This test will be performed in order to identify the statistical significance of an observed sample regression co-efficient and the formula for calculating the value is:

$$t = \frac{\hat{a}_i}{SE(\hat{a}_i)}$$

where, \hat{a}_i = estimated value of a_i

$SE(\hat{a}_i)$ = standard error of a_i

$$SE(\hat{a}_i) = \sqrt{\text{Var}_{a_i}}$$

The calculated t-values have been compared with tabulated t-values at a certain level of significance, for a given degree of freedom. If the calculated t value exceeds the table value, it is inferred that estimated co-efficient is significantly different from zero.

F Test

F test is used to examine the overall significance of the model

$$\text{The formula for calculation is } F = \frac{R^2 / K}{(1 - R^2) / (N - K)}$$

R^2 = Co-efficient of determination

K = Number of explanatory variable

N = Number of observation in the sample

The calculated F-Variance ratio is compared with the tabulated value at a specific level of significance with $(K - 1)$ and $(N - K)$ degree of freedom.

If $F_{\text{cal}} < F_{\text{Tab}}$, we accept null hypothesis

If $F_{\text{cal}} > F_{\text{Tab}}$, we reject null hypothesis.

CHAPTER FOUR

DATA PRESENTATION AND ANALYSIS

4.1 Introduction

Public debt is a modern invention and was not heard prior to 18th century. Concepts and needs of public debt arose simultaneously with the need of community development. After the Second World War it became a vital source of development expenditure. The government may borrow because current revenue may not be enough to meet its expenditure. It is obvious that government borrows when its annual expenditure exceeds its revenue and the general objectives of government borrowing are: a) revenue objective, b) to fight depression, c) to curb inflation, d) to finance development plans, e) to finance public enterprises and f) to finance war expenditure. Objectives of public debt in Nepal are: a) to control depression, b) to control inflation, c) to finance immediate problems like natural calamities, d) to reduce poverty, e) to finance development plans and f) to finance the deficit budget. It also borrows because of some sudden and unforeseen expenditure, when tax revenue cannot be increased to the same extent. It may also borrow to finance capital expenditure, as current revenue is usually insufficient for the purpose. Wars and growth of defence expenditure have also led to increase in public expenditure. In fact, increased public expenditure has been responsible for vast increase in public debt everywhere.

In modern time public borrowing is considered as an effective tool of fiscal operation of the government. Thus as a fiscal weapon, it has to play the role of revenue generation and also to mobilize savings for development purpose. Similarly as a fiscal measure it helps to control inflation/deflation and ensure growth with stability. As Bhargava observes, "the government borrowing is also useful to combat inflation because in this situation effective demand is more than the available supply of goods and services and by way of internal borrowing the government transfers extra purchasing power from the hands of the people to government treasury. In order to fight against depression, the government can borrow from the external sources and it can spend the borrowed fund in public works which generate opportunities of employment for the unemployed people. Similarly internal borrowing can be used to

check boom. Thus a sensible debt policy can be used to check depression or a boom.” (Bhargava, 1956:191).

Nepal has accepted foreign loan since the first five-year plan (1956/57-1959/60) but it has systematically started to raise the debt since the fiscal year 1961/62 through the means of Treasury bill that amounted Rs. 7 million and carried one percent of interest rate. After this, the government firstly floated the development bond of Rs. 131 million in FY 1963/64. In the same year, the government issued the public debt regulation and practice was still managed with this regulation.

Public debt is interrelated with the basic government fiscal flows of taxation and expenditure. If the volume of government expenditure exceeds the volume of tax revenue and other non-tax revenues then a deficit budget exists. Such deficit budget provides the fundamental precondition for debt creation. Having once been created debt requires interest payments to maintain the debt and refinancing operations of the debt is beyond the maturities of existing securities.

The government of Nepal has been borrowing new fresh loan mainly to balance its deficit budget however, other causes may exist with it. It is applied for the maintenance of the balance between the expenditure and revenue. It is also applied for financing economic development since under developed countries always face the problems of adequate funds, which is reflected in a large extent as ever increasing financial resource, gap in the government budgetary operations.

There are mainly four reasons for raising the government borrowing.

1. To recover the deficit budget.
2. To tackle the emergency period of crisis.
3. To maintain the economic and monetary stability.
4. To accelerate the pace of economic development.

Government borrowing in Nepal is rapidly increasing since the FY 1984/85 the government started to raise borrowing with new long term security named 'national saving certificate'. Therefore the amount of public debt has been fluctuated in its size but in aggregate, it has been increased tremendously under the review period 1989/90 to 2004/05, but it amounted to Rs. 13236.8 million in F/Y 2003/04.

4.2 The Financial operation of the government of Nepal

Resource gap is the gap between total expenditure and total revenue of the government. Resource gap in Nepalese economy has always been a common phenomenon since the start of the systematic budgetary system. Nepal is experiencing a serious and growing resource gap because the annual growth rate of total expenditure and that of its revenue are not increasing in the same pace. In the past few years (i.e. 1951/52 to 1961/62), the government used to finance such gap with foreign grants. However, since the fiscal year 1964/65, the government started to borrow from domestic as well as foreign sources to fill up the gap.

The extent of financial resource gap is shown in Table 4.1.

Table 4.1
Different Scenario of Resource Gap (1989/90 to 2004/05)
(Rs. In Million)

Fiscal year	Government Revenue. (a)	Government Expenditure (b)	Scenario 'I' Revenue deficit (b-a)	Foreign Grants (c)	Scenario 'II' Fiscal deficit (a+c-b)	External Loans (d)	Scenario 'III' Domestic R.D. (II-d)
1989/90	9312.8	19670.1	10357.3	1975.4	8381.9	5959.6	2422.3
1990/91	10729.0	23553.8	12824.8	2164.8	10660.0	6256.7	4403.3
1991/92	13512.7	26418.2	12905.5	1643.8	11261.7	6816.9	4444.8
1992/93	15148.4	30897.7	15749.3	3793.3	11956.0	6920.9	5035.1
1993/94	19580.9	33597.4	14016.5	2393.6	11622.9	9163.6	2459.3
1994/95	24605.1	38795.4	14190.3	3937.1	10253.2	7312.3	2940.9
1995/96	27893.1	46544.0	18650.9	4825.1	13825.8	9463.9	4361.9
1996/97	30373.5	53423.7	20350.2	5988.3	17061.9	9043.6	8018.3
1997/98	35751.0	56118.3	20367.3	5402.6	14964.7	11054.5	3910.2
1998/99	37251.3	59579.0	22327.7	4336.6	17991.1	11852.4	6138.7
1999/00	42893.7	66272.5	23378.8	5711.7	17667.1	11812.2	5854.9
2000/01	48893.9	79835.1	30941.2	6753.4	24187.8	12044.0	12143.8
2001/02	50445.6	80072.2	29626.6	6686.2	22940.4	7698.6	15241.8
2002/03	56229.7	84006.1	27776.4	11339.1	16437.3	4546.4	11890.9
2003/04	62331.0	89442.6	27111.6	11283.4	15828.2	7629.0	8199.2
2004/05	70122.7	102560.4	32437.7	14391.2	18046.5	9266.1	8780.4
Average Annual Growth Rate	13.8	10.8	7.6	18.6	5.9	5.0	18.5

Source: Adopted and computed from Nepal Government, MOF, Economic Survey, FY 2003/04 and 2005/06, Table No. 2.1, Page- 5

In the table 4.1, three scenarios, revenue deficit, fiscal deficit and domestic resource gap are shown. This table shows that the revenue deficit is increased by the average annual growth rate of 7.6%. Similarly the average annual growth rate of fiscal deficit is 5.9% and the average annual growth rate of domestic resource gap is 18.5%. The three scenarios are explained below.

Scenario 'I'

First scenario exhibits the revenue deficit. Revenue deficit is the gap between total expenditure and total revenue that shows an excess of total expenditure over total revenue. This gap is shown in column 4 of table 4.1. In this table we can see the increasing tendency of revenue deficit. It is due to the increase in the volume of total expenditure. The amount of total expenditure was Rs. 19670.1 million in the FY 1989/90 which has gone up to Rs. 102560.4 million in the FY 2004/05, whereas total revenue has increased from Rs. 9312.8 million in FY 1989/90 to Rs. 70122.7 million in FY 2004/05 during the same period of time. This shows that the revenue gap has widened tremendously.

The average annual growth rate of total expenditure over the review period is 10.8 percent per annum whereas the annual growth rate of total revenue is 13.8 percent. It shows the growth rate of revenue is greater than expenditure but in absolute terms the table shows the horrible increment of revenue deficit that was increased from Rs. 10357.3 million (in 1989/90) to Rs. 32437.7 million (in 2004/05) and the average annual growth rate of this gap is 7.6 percent over the revenue period..

Scenario 'II'

The second scenario exhibits the fiscal deficit. Fiscal deficit is the gap between total revenue (revenue plus grant) and total expenditure which is shown in column 6. The result even in this case is not encouraging. It is also called fiscal budgetary deficit. Grant is a potential source of foreign currency, which is used in importing capital goods from abroad and paying the interest and principle of external debt. Foreign grants are not increasing as desired. It increased from Rs. 1975.4 million in 1989/90 to Rs. 14391.2 million in 2004/05. The condition of foreign grants was good in two years (i.e., FY 2002/03 and 2004/05). Due to these types of

condition, fiscal deficit was 8381.9 million in 1989/90 and Rs. 18046.5 million in 2004/05. Where we can see the average annual growth rate of fiscal deficit is 5.9 percent. It is due to the fluctuations in the foreign grants.

Over the review period, amount of bilateral and multilateral loans has increased tremendously which created some sort of constraints in the performance of the economy as a whole. In the FY 1989/90, the external loan was Rs. 5959.6 million and it has gone up to Rs. 12044.0 million in the FY 2000/01. But in the last four fiscal years i.e 2000/01 to 2004/05 the amount of external loan has decreased. Due to this, the average annual growth rate of external debt is 5.0%. The causes of decreased external loan may be due to the increment in foreign grants and reduction in the development activities.

Scenario ' III'

The third scenario shows the domestic resource gap. Domestic resource gap is the difference between total expenditure and total revenue (revenue +grant+ external loan) or fiscal deficit and external loan which is shown in column 8 of table 4.1. The third type of resource gap is also increasing which was RS. 2422.3 million in FY 1989/90 and has gone up to Rs. 8780.4 million in 2004/05. It was largest in the FY 2001/02 i.e., 15241.8 million.

Table 4.2
Resource Gap as Percentage of GDP (1989/90 to 2004/05)

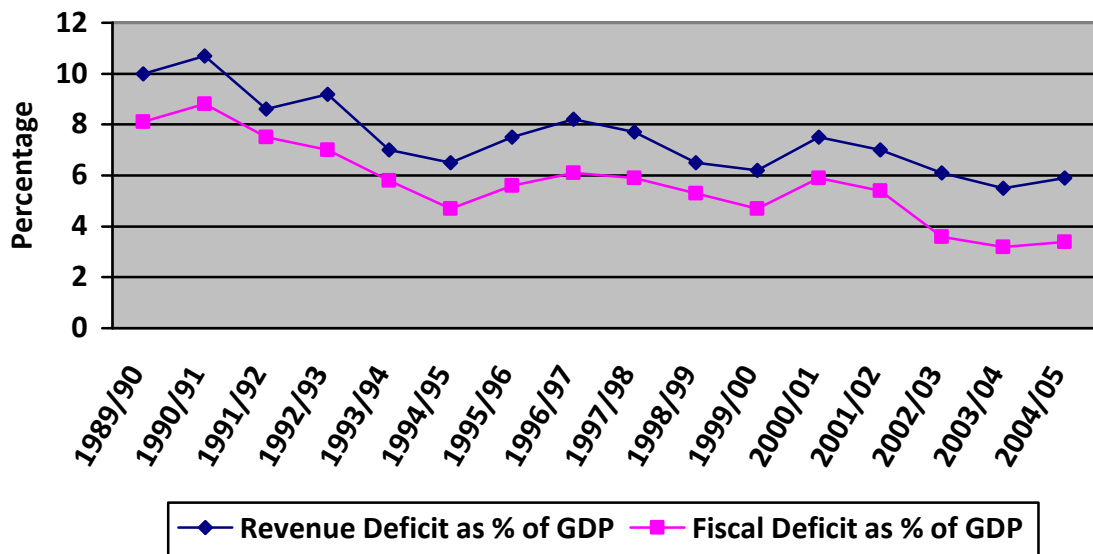
(Rs. In Million)

Fiscal Year	GDP at Producer's price	Revenue deficit	Revenue Deficit as % of GDP	Fiscal deficit	Fiscal Deficit as % of GDP
1989/90	103416	10357.3	10.0	8381.9	8.1
1990/91	120370	12824.8	10.7	10660.0	8.8
1991/92	149487	12905.5	8.6	11261.7	7.5
1992/93	171492	15749.3	9.2	11956.0	7.0
1993/94	199272	14016.5	7.0	11622.9	5.8
1994/95	219175	14190.3	6.5	10253.2	4.7
1995/96	248913	18650.9	7.5	13825.8	5.6
1996/97	280513	20350.2	8.2	17061.9	6.1
1997/98	300845	20367.3	7.7	14964.7	5.9
1998/99	342036	22327.7	6.5	17991.1	5.3
1999/00	379488	23378.8	6.2	17667.1	4.7
2000/01	411275	30941.2	7.5	24187.8	5.9
2001/02	422807	29626.6	7.0	22940.4	5.4
2002/03	456675	27776.4	6.1	16437.3	3.6
2003/04	496745	27111.6	5.5	15828.2	3.2
2004/05	533538	32437.7	5.9	18046.5	3.4
Average Annual Rate		7.6	7.3	5.9	5.7

Source: Adopted and computed from Nepal Government, MOF, Economic Survey, FY 2003/04 and 2005/06, Table No. 1.4, Page- 4

Table 4.2 reveals the revenue deficit as percent of GDP and fiscal deficit as percent of GDP. To analyze the revenue deficit as percent of GDP is more important as the GDP is the main indicator of the performance of the economy, which includes different components of the economy, and shows their performance. In this context, revenue deficit as percent of GDP has decreased from 10.0 percent in 1989/90 to 5.9 percent in 2004/05, and average annual growth rate is 7.3 percent.

The fiscal deficit as percent of GDP also decreased from 8.1 percent in 1989/90 to 3.4 percent in 2004/05. The inclusion of grants in government's revenue may not be appropriate because the amount of grants depends upon political considerations of donor countries and agencies and the expected amount of grant may differ from actual amount which may differ from year to year. The trend of revenue deficit as percent of GDP and fiscal deficit as percent of GDP is shown in the graph.



4.3 Trend and Pattern of Public Debt in Nepal

Public debt has been the main source for financing fiscal deficit in Nepal. Although for financing the fiscal deficit both internal and external sources of borrowing have been used in any under developed economy. The total public debt has been increasing rapidly since the restoration of multiparty system in Nepal for meeting the requirement of fiscal deficit.

Table 4.3

Internal and External Debt as Percentage of Fiscal Deficit.

(Rs. In Million)

Fiscal year	Fiscal Deficit (1)	Total Debt	Total Debt as % of fiscal Deficit	Internal Debt (2)	2 as % of Total Debt	External Debt (3)	3 as % of Total Debt	Loan as a % of fiscal deficit	
								Internal loan	External loan
1989/90	8381.9	8109.6	96.1	2150.0	25.7	5959.6	73.5	25.7	71.1
1990/91	10660.0	10809.4	101.4	4552.7	42.1	6256.7	57.9	42.7	58.7
1991/92	11261.7	8895.7	79.1	2078.8	23.4	6816.9	76.6	18.5	60.5
1992/93	11956.0	8540.9	71.4	1620.0	18.5	6920.9	81.0	13.5	57.9
1993/94	11622.9	10983.6	94.5	1820.0	16.6	9163.6	83.4	15.7	78.8
1994/95	10253.2	9212.3	89.8	1900.0	20.6	7312.3	79.4	18.5	71.3
1995/96	13825.8	11663.9	84.3	2200.0	18.9	9463.9	81.1	15.9	68.4
1996/97	17061.9	12043.6	7.6	3000.0	25.0	9043.6	75.1	17.6	53.0
1997/98	14964.7	14454.4	96.6	3400.0	23.5	11054.5	76.5	22.7	62.2
1998/99	17991.1	16562.4	92.0	4710.0	28.4	11852.4	71.6	26.1	73.9
1999/00	17667.1	17312.2	98.0	5500.0	31.8	11812.2	68.2	31.1	66.9
2000/01	24187.8	19044.0	78.7	7000.0	36.8	12044.0	63.2	28.9	49.8
2001/02	22940.4	15698.7	68.4	8000.0	51.0	7698.6	49.0	34.9	33.6
2002/03	16437.3	13426.4	81.7	8880.0	66.1	4546.4	33.9	54.0	27.7
2003/04	15828.2	13236.8	83.6	5607.8	42.4	7629.0	57.6	35.4	48.2
2004/05	18046.5	18204.2	100.8	8938.1	49.09	9266.1	50.90	49.5	51.3
Average Annual Growth Rate	5.9	4.6		10.4		5.0		7.1	0.4

Source: Adopted and computed from Nepal Government, MOF, Economic Survey, FY 2003/04 and 2005/06, Table No. 2.1, Page- 5

The Table 4.3 indicates the increasing trend of public debt from both internal and external sources. The total debt was Rs. 8109.4 million in FY 1989/90 and has increased to Rs. 18204.2 million in the FY 2004/05. Once it became so high in FY 2000/01 i.e. 19044.0 million. Its average annual rate of growth over the review period is 4.6 percent. The table shows the increasing trend of public debt in which the increasing trend of external debt is so rapidly then internal debt.

Internal debt was only Rs. 2150.0 million in the FY 1989/90 and has gone up to Rs. 8880.0 million in 2002/03, but in 2003/04 it has decreased up to 5607.8 million again it has gone up to Rs. 8938.1 in 2004/05. Where as external debt was Rs. 5959.4 million and increased tremendously up to Rs. 12044.0 million in 2000/01 and

since then it has decreased to 7629.0 in 2003/04 and again it has increased up to 9266.1 million in 2004/05.

Table 4.3 shows the percentage share of internal and external debt to fiscal deficit, in which the contribution of both internal and external debt to their fiscal deficit has been fluctuating. The contribution of internal debt to fiscal deficit was 25.7 percent in the FY 1989/90 whereas external debt was 71.1 percent. But the share of internal debt is 49.52 percent in the FY 2004/05 which shows the increasing contribution and external is 51.34 percent in the same fiscal year, which shows the decreasing contribution to the fiscal deficit.

The absolute terms of the above table show our growing reliance on external loan for meeting the ever-increasing fiscal deficit. This absolute term also shows that (during the last 16 years) our economic performance has not been conducive enough to reduce growing reliance on external loan. This situation has led us to think seriously about the alarming situation. The trend of internal loan as percent of fiscal deficit and external loan as percent of fiscal deficit is shown in the graph.

4.4 Growth Trend of Public Debt in Nepal

After the restoration of multiparty system, the financial operations of the government of Nepal have been increased and accordingly the volume of government expenditure is increasing. The reliance on taxation is not possible in view of the large amount of financial resources required for the government expenditure. Therefore,

Nepal is facing large and growing financial resource gap in the government budgetary system. In this context, the government borrows from both external and internal sources to bridge the resource gap. The government has borrowed large amount of loans to bridge meet the fiscal deficit. The growth trend of public debt is shown in Table 4.4

Table 4.4
Trend of Public Debt and Its Annual Growth Rate

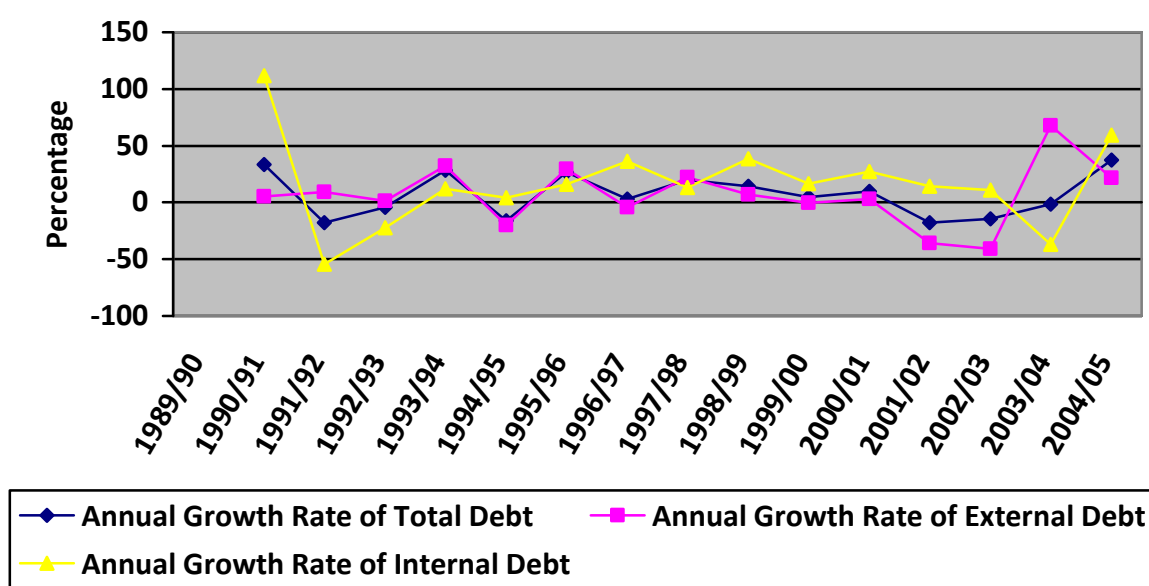
(Rs. In Million)

Fiscal Year	Total Debt (I)	External Debt (II)	Internal Debt (III)	Annual Growth Rate of (I) %	Annual Growth Rate of (II) %	Annual Growth Rate of (III) %	% Share of (II) in 'I'	% Share of (III) in 'I'
1989/90	8109.4	5959.4	2150.0	-	-	-	73.5	26.5
1990/91	10809.4	6256.7	4552.7	33.3	5.1	111.7	57.9	42.1
1991/92	8895.7	6816.9	2078.8	-17.7	9.0	-54.3	76.6	23.4
1992/93	8540.9	6920.9	1620.0	-4.0	1.5	-22.1	81.0	19.0
1993/94	10983.6	9163.6	1820.0	28.6	32.4	12.3	83.4	16.6
1994/95	9212.3	7312.3	1900.0	-16.1	-20.2	4.4	79.4	20.6
1995/96	11663.9	9463.9	2200.0	26.6	29.4	15.8	81.1	18.9
1996/97	12043.6	9043.6	3000.0	3.2	-4.4	36.4	75.1	25.0
1997/98	14454.4	11054.4	3400.0	20.0	22.2	13.3	76.5	23.5
1998/99	16562.4	11852.4	4710.0	14.5	7.2	38.5	71.6	28.4
1999/00	17312.2	11812.2	5500.0	4.5	-0.3	16.8	68.2	31.8
2000/01	19044.0	12044.0	7000.0	10.0	3.0	27.3	63.2	36.8
2001/02	15698.7	7698.7	8000.0	-17.6	-36.0	14.3	49.0	51.0
2002/03	13426.4	4546.4	8880.0	-14.5	-41.0	11	33.9	66.1
2003/04	13236.8	7629.0	5607.8	-1.4	67.8	-36.8	57.6	42.4
2004/05	18204.2	9266.1	8938.1	37.52	21.45	59.38	50.90	49.09
Average Annual Growth Rate	4.6	5.0	10.4	7.1	6.5	16.5	-	-

Source: Adopted and computed from Nepal Government, MOF, Economic Survey, FY 2003/04 and 2005/06, Table No. 2.1, Page- 5

Table 4.4 shows the government borrowing (internal and external) and their annual growth rate between the period 1989/90 and 2004/05. The table shows, that over the review period total government borrowing has increased with an average annual growth rate of 7.1 percent from Rs.8109.4 million to Rs.18204.2 million, which is about 1.6 folds. Similarly external borrowing also increases with an average annual growth rate of 6.5 percent from Rs.5959.4 million to Rs.9266.1 million during the period of study. It was at the peak in FY 2000/01, (i.e.12044 million) which was, about two times. But in FY 2003/04, it became Rs.7629.0 million, which is about 1.3 times from the beginning. And the average annual growth rate of internal debt is 16.5 percent and increasing in trend from Rs.2150.0 million to Rs.8938.1 million.

Table 4.4 also indicates that the external debt increased more than the internal debt in absolute term during the period of review. Although the trend clearly shows that the government borrowing is increasing in both absolute and relative terms. The percentage share of external and internal debt in total debt is 50.90 and 49.09 percent respectively in 2004/05. It indicates that external loan is in decreasing rate and internal loan is in increasing rate. In the FY 2001/02 to 2003/04, both the internal and external debt has decreased which affects the total debt i.e. total debt has also decreased. It might be due to the political instability i.e. Maoist insurgency and ineffective use of loans to achieve the goals which enforced to think over the faith of government of Nepal by the internal as well as external donors. The annual growth rate of total debt, external debt and internal debt is shown in the graph.



4.5 Outstanding Public Debt in Nepal

The government of Nepal has to borrow large amount of public debt to meet ever increasing financial resource gap. Usually public debt is used as a means of meeting government budgetary deficit, but in case of Nepal, it has become main and reliable source of meeting the government's budget deficit over the last years. So the volume of outstanding public debt is continuously increasing.

In Nepal, Public debt is used as a means of financing the government expenditure. There was a target of 20.79 percent of total expenditure to be financed through public debt in 2004/05 but about 24 percent of total expenditure was financed by public debt in FY 2000/01. And about 15 percent of total expenditure was fulfilled by public debt in 2003/04. It shows that slightly decreasing direction but increasing trend in practice (Gorkhapatra, July 17, 2005).

Table 4.5 shows that the net outstanding debt in Nepal, over the review period. The table shows that total outstanding public debt of the government of Nepal has increased from Rs. 51474.0 million in 1989/90 to Rs. 307200.0 in 2004/05 with the average annual growth rate of 13.6 percent. The table also shows that the outstanding external debt and outstanding internal debt. The outstanding external debt has increased from Rs. 36800.9 million in 1989/90 to Rs. 232779.3 million in 2003/04. Its share in total outstanding debt was 71.5 percent in 1989/90 that has gone up to 73.0 percent in 2003/04 and 71.49 percent in 2004/05. On the other hand internal outstanding debt has increased from Rs. 14673.1 million in 1989/90 to Rs. 87560 million in 2004/05, where its percentage share in total outstanding debt was 28.5 in 1989/90 and 28.51 in 2004/05. The average annual growth rate of external outstanding debt is 19.9% and the average annual growth rate of internal outstanding debt is 13.0%. Table 4.5 shows that during the review period the percentage share of external debt to the total outstanding debt was above 70% and that of the internal debt was below 30% in each year. One of the factors responsible for rapid increase in the external debt is depreciation of Nepalese currency. Some other attributing factors are growing needs of foreign currencies, to bridge the current account deficits and capital deficiency in the economy. The average annual share of internal outstanding debt and external to total outstanding debt is 23.4 and 75.9 percent respectively over the period of study. This table also indicates that the share of external debt to total outstanding public debt is higher than that of internal. So, in reality we have been indebted to

external debt to a considerable extent. The government of Nepal should, therefore make a rigorous attempt to reduce the increasing debt burden.

Table 4.5
Outstanding Public Debt

(Rs. In Million)

Fiscal Year	Total Outs. Debt (1)	External Outs. Debts (2)	(2) as a Percentage of (1) (3)	Internal Outs. Debts (4)	(4) as a Percentage of (1)
1989/90	51474.0	36800.9	71.5	14673.1	28.5
1990/91	80361.2	59505.3	74.0	20855.9	26.0
1991/92	94158.8	70923.9	75.3	23234.9	24.7
1992/93	112876.8	87420.8	77.0	25456.1	22.5
1993/94	132598.0	101966.8	76.9	30631.2	23.1
1994/95	145058.8	113000.9	77.9	32057.8	22.1
1995/96	162286.3	128044.4	78.9	34241.9	21.1
1996/97	167977.7	132086.8	78.6	35890.9	21.4
1997/98	199614.7	161208.0	80.8	38406.7	19.2
1998/99	219135.5	169465.9	77.3	49669.6	12.7
1999/00	245048.2	190691.2	77.8	54357.0	22.2
2000/01	260448.1	200404.4	76.9	60043.7	23.0
2001/02	293746.3	220125.6	74.9	73620.7	25.1
2002/03	308078.5	223433.2	72.5	84645.3	27.5
2003/04	318913.0	232779.3	73.0	86133.7	27.0
2004/05	307200.0	219640.0	71.49	87560.0	28.51
Annual Average Growth Rate	13.6	19.9	75.9	13.0	23.4

Source: Adopted and computed from Nepal Government, MOF, Economic Survey, FY 2003/04 and 2005/06, Table No. 2.11, Page- 15

The trend of external outstanding debt and internal outstanding debt as percentage of total debt is shown in the graph.

4.6 Sources of Internal Debt

The government can borrow internal debt from banking and non-banking sources. Borrowing from banking sources is the borrowing from the central bank and commercial banks etc. This type of borrowing may be inflationary because it assists to increase the demand of goods. Borrowing from non-banking source is the borrowing from general public of the country like citizen saving bond, national saving bond etc. This type of borrowing assists to reduce the disposable income of the general people and hence it may not be inflationary. Hence the efforts should be made toward internal debt mobilization through non-banking system. The volume of internal debt from banking and non-banking source has been shown in the table 4.6.

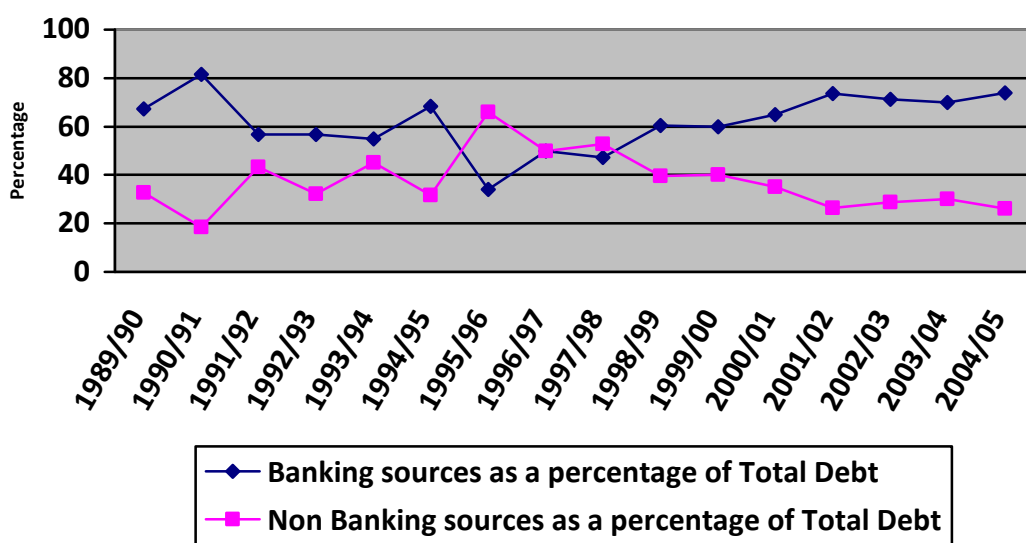
Table 4.6
Sources of Internal Debt

(Rs. In Million)

Fiscal year	Banking Sources (I)	Non-banking Sources (II)	Total Debt (III)	(I) as a percentage of (III)	(II) as a percentage of (III)
1989/90	1450.0	700.0	2150.0	67.4	32.6
1990/91	3713.2	839.5	4552.7	81.6	18.4
1991/92	1178.8	900.0	2078.8	56.7	43.3
1992/93	920.0	700.0	1620.0	56.8	32.2
1993/94	1000.0	820.0	1820.0	55.0	45.0
1994/95	1300.0	600.0	1900.0	68.4	31.6
1995/96	750.0	1450.0	2200.0	34.1	65.9
1996/97	1500.0	1500.0	3000.0	50.0	50.0
1997/98	1600.0	1800.0	3400.0	47.1	52.9
1998/99	2850.0	1860.0	4710.0	60.5	39.5
1999/00	3300.0	2200.0	5500.0	60.0	40.0
2000/01	4550	2450	7000	65.0	35.0
2001/02	5886	2114	8000	73.57	26.43
2002/03	6316	2564	8880	71.12	28.88
2003/04	3925.4	1682.4	5607.8	70.0	30
2004/05	6600	2338.1	8938.1	73.84	26.16

Source: Adopted and computed from Nepal Government, MOF, Economic Survey, FY 2003/04 and 2005/06, Table No. 2.1, Page- 5

Table 4.6 clearly shows the contribution of the sources of internal debt i.e. banking and non banking sources. The total internal debt from banking sources was Rs.1450.0 million in the FY 1989/90 and it has gone up to Rs.6600.0 million in the FY 2004/05. Similarly the total internal debt from non-banking sources was Rs.700.0 million in 1989/90 and has reached to Rs.2338.1 million in 2004/05. In the last two columns of the table percentage share of banking and non-banking sources to total internal debt are shown. The percentage share of banking source to total internal debt has increased from 67.4 % (in 1989/90) to 73.84% (in 2004/05) which shows the contribution of banking sources to total internal debt is slightly increasing. On the other hand, the percentage share of non-banking source to total internal debt has reduced from 32.5% (in 1989/90) to 26.16 % (in 2004/05). This indicates that the contribution of non-banking sources has been slightly decreasing. The trend of sources of internal debt is shown in the graph.



4.7 Pattern of Internal Net Outstanding Debt

Internal borrowing programme carried since 1961 in Nepal. Nepal has been borrowing internally under the different plans to bridge the resource gap on the budgetary system and mobilizing financial resource for development.

Now the government receives the internal borrowing by issuing mainly treasury bills, development bonds, National Saving Certificate, Public Saving Card

and special bonds, where public saving card is new concept and has issued since 2001/02. The pattern of internal debt is shown in table 4.7.

Table 4.7
Structure of Internal Net Outstanding Debt

(Rs. In Million)

Fiscal Year	Treasury Bills	Development Bonds	National Saving Certificate	Public Saving Card	Special Bonds	Total Internal Outs. Debt
1989/90	1821.0	5388.6	2896.5	----	4567.0	14673.1
1990/91	2351.0	5482.3	3646.5	----	9376.1	20855.9
1991/92	3483.2	5132.2	4546.3	----	10073.2	23234.9
1992/93	4403.2	5132.2	4901.5	----	11019.2	25456.1
1993/94	5216.3	4732.2	5691.5	----	14991.2	30631.2
1994/95	6392.5	4122.2	6076.4	----	15466.7	32057.8
1995/96	7142.5	3672.2	7376.5	----	16050.7	34241.9
1996/97	8092.5	3042.2	8736.5	----	16019.7	35890.9
1997/98	9182.5	3302.2	9886.4	----	16035.6	38406.7
1998/99	17586.9	3872.0	10426.4	----	17784.1	49669.6
1999/00	21027.0	4262.2	11526.5	----	17541.3	54357.0
2000/01	27610.8	5962.2	12476.4	----	13994.3	60043.7
2001/02	41106.5	11090.7	11536.1	628.1	9259.3	73620.7
2002/03	48860.7	16059.2	9629.8	931.1	9164.5	84645.3
2003/04	49429.6	17549.2	9029.8	1178.9	8946.2	86133.7
2004/05	51383.1	19999.2	6576.7	1428.9	8176.3	87560.0

Source: Adopted and computed from Nepal Government, MOF, Economic Survey, FY 2003/04 and 2005/06, Table No. 2.11, Page-17

Internal Outstanding = TB + DB + NSC + PSC + special Bonds.

Table 4.8**Structure of Internal Net Outstanding Debt in Percentage**

(Rs. In Million)

Fiscal Year	Total Internal Outs. Debt (1)	% share of Treasury Bills to (1)	% share of Development Bonds to (1)	% share of National Saving Certificate to (1)	% share of Public Saving Card to (1)	% share of Special Bonds to (1)
1989/90	14673.1	12.4	36.7	19.7	----	31.1
1990/91	20855.9	11.3	26.3	17.5	----	44.9
1991/92	23234.9	15.0	22.0	19.5	----	43.3
1992/93	25456.1	17.3	20.1	19.2	----	43.2
1993/94	30631.2	17.0	15.4	18.6	----	48.9
1994/95	32057.8	20.0	12.9	18.9	----	48.2
1995/96	34241.9	20.8	10.7	21.5	----	46.9
1996/97	35890.9	22.5	8.5	24.3	----	44.6
1997/98	38406.7	23.9	8.6	25.7	----	41.7
1998/99	49669.6	35.4	7.8	21.0	----	23.7
1999/00	54357.0	38.7	7.8	21.2	----	32.2
2000/01	60043.7	46.0	9.9	18.7	----	23.3
2001/02	73620.7	55.8	15.0	15.7	8.5	12.6
2002/03	84645.3	57.7	19.0	11.4	11	10.8
2003/04	86133.7	57.4	20.3	10.5	13.6	10.4
2004/05	87560.0	58.7	22.8	7.5	16.3	9.3

Source: Adopted and computed from Nepal Government, MOF, Economic Survey, FY 2003/04 and 2005/06, Table No. 2.11, Page-17

Internal Outstanding = TB + DB + NSC + PSC + special Bonds.

Table 4.8 shows the structure of internal net outstanding debt in which the government mainly receives the internal resources by five sources. Among them Public Saving Card was started from 2001/02. Before this, there were only four sources, which contributed much more in the field of internal net outstanding debt

where the contribution of Treasury Bills is larger because its percentage share to total internal outstanding debt is increasing trend over the study period.

After the enforcement of public debt Act 1960, internal debt for the first time was issued by Nepal in 1962 through Treasury Bills amounting Rs. 7.0 million. The next instrument of internal debt as development bonds was first issued in FY 1963/64, amounting Rs. 250.0 Million.

Table 4.8 shows the share of Treasury Bills, Development Bonds, National saving Certificate, Public Saving Card and Special Bonds to total net internal outstanding debt which are 12.4%, 36.7%, 19.7%, and 31.1% respectively in 1989/90. Which has increased over the review period in case of treasury bills and there is fluctuating trend in case of Saving Certificate, Public Saving Card and Special Bonds over the review period.

The percentage share of Treasury Bills is 58.7 and of Development Bonds, National Saving Certificate, Public Saving Card and special bonds are 22.80 percent, 7.5 percent, 16.3 percent and 9.3 percent respectively in FY 2004/05. This shows that more than half of internal net outstanding debt has mobilize through Treasury Bills.

Studying the above table we can conclude that the volume of internal borrowing is increasing without increasing in tax revenue collection in proportion to the growth in the government expenditure. This action also will create the inflationary situation, which may leads us into debt crisis in future.

4.8 Sources of External Debt

Nepal has borrowed the external loan through bilateral and multilateral sources. Bilateral loans are the, loans from foreign individuals, governments and their agencies, loans from autonomous bodies etc. Multilateral loans are the loans from multilateral agencies such as World Bank, International Monetary Fund, Asian Development Bank, United Nation Development Programme, World Health Organization etc. and other multilateral and intergovernmental agencies. (WB, 1996)

In recent years, most of the prime sectors of the economy are receiving foreign aid, and almost in every sector several bilateral and multilateral donors are involved. The

Nepal Aid Group, now Nepal Development Forum (NDF) includes countries like Australia, Canada, France, UK, USA, Switzerland, Germany, Japan and international agencies such as ADB, UNDP, IMF, IDA. Other major donors for Nepal are China and India.

Both types of assistance programs have advantages and disadvantages in providing aid to developing countries. From a development perspective, the strengths of bilateral aid programs include an ability to render effective technical assistance, build institutions, and develop close, relationship with recipients.

Bilateral donors appear to have more practical experience in helping developing countries build various institutions that foster development such as a judicial system and they also provide loan in functional specialities like as strengthening and investing in public utilities, electrification, poverty alleviation, promoting export crops, conducting researches and training in agriculture etc. All of these assist to achieve steady growth. But the donor policies that may hinder the usefulness of aid include giving aid for political reasons, trying aid to the purchase of the donor's goods and services and adopting other economic policies such as import quotas that undermine the objectives of an aid program. On the other hand, multilateral donors do not have some of the disadvantages of bilateral donors. Their aid is less politically motivated; they tend to give aid to the poorest countries. Multilateral donors can establish systems of international competitive bidding to purchase goods and services at the lowest possible cost and maximize the real value of aid flows. The next advantage is that they will not undermine the objective of an aid program through other economic policies such as- import quotas. "The central functional speciality of the multilateral organization is promoting and supporting the economic reforms necessary for creating a policy environment that is conducive to economic growth. Those activities include opening trade regimes, minimizing restrictions on the private sector and building economic infrastructure." (Acharya G. K., 2005)

Finally multilateral loan seems better on the flowing grounds:

-) Delivering aid in time
-) Less politically motivated
-) Committing for the long term

) Fitting in with the government budget cycle

The structure of bilateral and multilateral loan is shown in table 4.9

Table 4.9
Structure of External Debt in Terms of Disbursement by Major Sources
(Rs. In Million)

Fiscal Year	Total External Debt (1)	Bilateral Debt(2)	Multilateral Debt(3)	(2) as a percent of (1)	(3) as a percent of (1)
1989/90	4628.3	1000.6	3627.7	21.6	78.4
1990/91	4360.0	1602.8	2757.2	36.8	63.2
1991/92	6269.4	2389.8	3879.6	38.1	61.9
1992/93	5961.9	1307.8	4654.1	21.9	78.1
1993/94	9163.6	582.9	8580.7	6.4	93.6
1994/95	7312.3	717.3	6595.0	9.8	89.8
1995/96	9463.9	460.0	9003.9	4.9	95.1
1996/97	9043.6	850.7	8192.9	9.4	90.6
1997/98	11054.5	1314.5	9740.0	11.9	88.1
1998/99	11852.4	584.0	11268.4	4.9	95.1
1999/00	11812.2	757.9	11054.3	6.4	93.6
2000/01	12044.0	586.7	11457.3	4.9	95.1
2001/02	7698.6	87.0	7611.6	1.1	98.9
2002/03	4546.4	657.2	3889.2	14.5	85.5
2003/04	7629.0	66.0	7563.0	0.9	99.1
2004/05	9266.1	126.5	9139.6	1.37	98.63
Average Annual Growth Rate	7.6	37.8	10.4	12.2	87.8

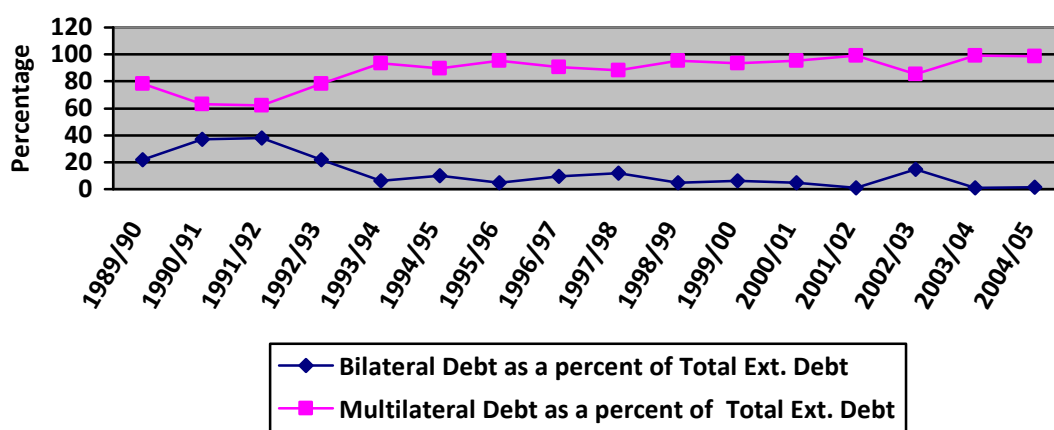
Source: Adopted and computed from Nepal Government, MOF, Economic Survey, FY 2003/04 and 2005/06, Table No. 2.7, Page- 11 and Table 2.8, Page-13

Table 4.9, clearly shows the decreasing trend of bilateral loans and increasing trend of multilateral loans over the review period.

In the beginning of the review period the share of bilateral loans to total external loan was Rs. 1000.6 million (21.6 %) and that of the multilateral was Rs. 3627.7 million (78.4 %) and at the end of the year of this study the bilateral loan decreased to Rs. 126.5 million (1.37 %) and multilateral loan increased to Rs. 9139.6 million (98.63%). But it was high in the FY 2000/01 with Rs. 11457.3 million (95.1%). The average annual growth rate of bilateral and multilateral loan is 37.8 percent and 10.4 percent respectively over the study period.

Table 4.9 shows the multilateral external debt has dominated the bilateral debt in the structure of external debt of Nepal. Where, average annual growth rate of multilateral loan is 10.4 percent and bilateral loan is 37.8 percent. Over the period of review, the amount of grants did not sufficiently increase; where it has gone up Rs. 1975.4 million in 1989/90 to Rs. 14391.2 million in 2004/05, which was not enough to cover the budgetary deficit (see Table 4.1). During this period, the amount of bilateral and multilateral loan has increased tremendously which has created some sort of constraint in the performance of the economy as a whole.

Due to the delay in timely implementation of the projects, donors are reluctant to disburse the committed amount of foreign aid. The main cause of the delay in the disbursement is the time lag because aid for the many project are committed in one year, and the committed aid is being disbursed in the subsequent years. When the returns from the investment in the economy were not obtained on time, the foreign assistance could not be fully utilized. The trend of bilateral debt and multilateral debt as percent of total external debt is shown in the graph.



4.9 Burden of Public Debt in Nepal

The debt burden refers to the extra tax imposed by government on the citizens to repay public debt including interest. Every government is bound to repay the public borrowing whether internally or externally with interest. This burden of public debt may be direct, indirect, monetary or real and it may tend to fall on the present or sometimes on the future generation.

The total burden of public debt can be divided into two parts: (1) burden of internal public debt, (2) burden of external public debt. The internal public debt means the total part of the debt which is held internally. Dalton (1949) takes internal public debt burden as not much significant as the payment of principle amount and its interest involves taxation. It is simply a transfer of purchasing power from one person to another. Similarly, Lerner (1955) points out that the internal debt may not have any direct monetary burden on a community as a whole, since the payment of interest and increased taxation to meet the burden of debt involved simply transfer of the purchasing power from one group of people to another. To the extent that creditors and tax payer are the same, there may not be any net burden to all the community. But to the extent of creditors and tax payers belong to different income groups, the changes in the distribution of income among different sections of the community may take place.

In case of external debt burden it is however, completely different. External debt imposes real burden on the economy because it reduces national welfare. External debt is paid not in monetary terms but in real terms, in terms of goods and services which are exported to the creditor country for the settlement of debt. The process will have to continue during the whole period of loan because the borrower country has to pay interest charges, but if external loans are used for increasing the productive capacity of the economy, the debt repayment may not be a serious burden. The debtor country may pay off the debt and interest without any difficulty because of increased capacity of export oriented industries. If debtor country does not sufficiently increase the production and export, it will have to face the balance of payment problem.

Therefore, any borrower country has to spend the borrowed fund on creation of new productive capacity, which further generates income and increases the rate of capital formation then it is quite possible that the debt would not be burden to the society. If the borrowed fund is spent otherwise and the government would have to borrow again to meet the requirements of development funds and for meeting the charge of debt servicing, it is quite possible that this process leads to bankruptcy of the government or debt crisis in the future.

Regarding the shift of the debt burden to the future generation, there is debate among the economists. A group of economists argues that if the present generation reduces current saving in order to repay the debt and leaves a smaller amount of capital resources for future, it will not create sufficient capacity for the coming generation. In this way, burden of public debt may pass on to the future generation. But on the other hand, another group of economists has challenged the above version and expressed opposite opinion on the subject of burden of public debt. They argue that here is no shift of the basic burden to the future generation because the state posterity, which pays the additional taxes, will be benefited from the repayment of the debt with interest. In my opinion if additional taxes are imposed on present generation to repay the debt, it is paid partly by reducing current consumption and partly by reducing current saving. The former lowers the standard of living of the present generation. This is the real burden of debt on present generation. Reduction in current saving means reduction in future consumption which will become real burden on future generation. Thus the part of current saving used in paying tax reduces saving and future consumption and to that extent the debt burden is shifted to future generation.

On the basis of the above discussion, we can say that it is difficult to conclude a specific opinion in the issue. Thus, the question of shifting the burden of public debt to the future generation has remained an unsettled riddle so far.

In case of Nepal, public debt is increasing rapidly each year which was 57.57 percent of GDP in 2004/05. Large scale public debts have been incurred in the past for financing development programs, but debt servicing capacity is not increasing in the same pace, that may cause undue strain in the balance of payment owing to

outflow of funds through debt services. Nepal has been borrowing fresh loan to repay old loans. This also has alarmed the situation of 'debt trap' in the future.

4.10 National Outstanding Debt and Its Share in GDP

The ratio of public debt to GDP is an important indicator of the manageability of public debt in an economy. The relative shares of the public debt in the GDP should be taken into consideration for assessing the burden of growing public indebtedness. Nepal has to borrow huge amount of external as well as internal loans for meeting the budget deficit. And on the other hand, the tax revenue and non-tax revenue are not increasing as it is predicted and improper utilization of public debt and corruption, debt servicing capacity is not increasing as a result burden of outstanding debt is increasing. Table 4.10 shows the burden of debt through the method of measure of burden of debt as the ratio of public debt to GDP.

Table 4.10
Outstanding Debts and Its Share in GDP

(Rs. In Million)

Fiscal Year	External Outs. Debt	Internal Outs. Debt	Total Public Debt	GDP at Producer's price	Percentage Share of debt in GDP		
					External Debt	Internal Debt	Total
1989/90	36800.9	14673.1	51474.0	103416	35.6	14.2	49.8
1990/91	59505.3	20855.9	80361.2	120370	49.4	17.3	66.7
1991/92	70923.9	23234.9	94158.8	149487	47.4	15.4	62.8
1992/93	87420.8	25456.1	112876.8	171492	51.0	14.8	65.8
1993/94	101966.8	30631.2	132598.0	199272	51.2	15.4	66.6
1994/95	113000.9	32057.8	145058.8	219175	51.6	14.6	66.2
1995/96	128044.4	34241.9	162286.3	248913	51.4	13.8	65.2
1996/97	132086.8	35890.9	167977.7	280513	47.1	12.8	59.9
1997/98	161208.0	38406.7	199614.7	300845	53.6	12.8	66.4
1998/99	169465.9	49669.6	219135.5	342036	49.5	14.5	64.0
1999/00	190691.2	54357.0	245048.2	379488	50.2	14.3	64.5
2000/01	200404.4	60043.7	260448.1	411275	48.7	14.6	63.3
2001/02	220125.6	73620.7	293746.3	422807	52.1	17.4	69.5
2002/03	223433.2	84645.3	308078.5	456675	48.9	18.5	67.4
2003/04	232779.3	86133.7	318913.0	496745	47.0	17.4	64.4
2004/05	219640.0	87560.0	307200.0	533538	41.16	16.41	57.57

Source: Adopted and computed from Nepal Government, MOF, Economic Survey, FY 2003/04 and 2005/06, Table No. 2.10, Page- 16 and Table 1.2, Page-2

Observing Table 4.10, it shows the magnitude of outstanding debt, GDP and their ratio, which also assesses the burden of public debt. This Table shows the ratio of internal and external debt to GDP in the Year between 1989/90 to 2004/05. The share of external debt in GDP was 35.6 percent, which has increased to 41.16 percent in the year 2004/05, showing gradual increase. Similarly, this Table also shows the share of internal debt in GDP. It has also increased from 14.2 percent in 1989/90 to 16.41 percent in 2004/05. It means burden of public debt is increasing, where total outstanding public debt has increased from Rs. 51474.0 million in 1989/90 to Rs. 307200 million in 2004/05 and share of it in GDP has increased from 49.8 percent to 57.57 percent.

This indicates an alarming situation of burden of debt in Nepal. Table also shows that the burden of external outstanding debt is greater than that of internal debt which may be a danger for the future generation. This magnitude of the burden of public debt may increase to alarming situation if productive capacity is not created in the economy for increasing production. Here, comparing the Table 4.9 we can see that growth rate of GDP is less than the growth rate of outstanding debt and the part of GDP used in repaying debt is continuously increasing. It may lead to a situation of bankruptcy. The percentage share of external outstanding debt and internal outstanding debt in GDP is shown in the graph.

4.11 Debt Servicing Issues in Nepal

The payment of interest and principle of public debt is known as debt servicing. In Nepal, the share of foreign loan is in increasing trend that ultimately increases financial and real burden on future generation.

Table 4.11 shows the ratio of internal and external debt servicing to total debt servicing and their average annual growth rate and percentage share of external and internal debt servicing to total debt servicing.

Table 4.11
Share of External and Internal Debt Servicing in Total Debt Servicing
(Rs. In Million)

Fiscal Year	Total Debt Servicing (I)	External Debt Servicing (II)	Internal Debt Servicing (III)	'II' as a percentage of (I)	'III' as a percent of (I)
1989/90	2279.2	1121.9	1157.3	49.2	50.8
1990/91	2407.4	1086.5	1320.9	45.1	54.9
1991/92	3797.1	1664.9	2132.2	43.8	56.1
1992/93	4560.5	2131.9	2428.6	46.7	53.2
1993/94	4855.1	2488.7	2366.4	51.3	48.7
1994/95	6083.3	2984.7	3098.6	49.1	50.9
1995/96	6715.4	3294.3	3421.1	49.0	50.9
1996/97	7527.2	3349.4	4177.8	44.5	55.5
1997/98	7682.8	4201.2	3481.6	54.7	45.3
1998/99	8723.0	4745.5	3977.5	54.4	45.6
1999/00	10032.8	5321.4	4711.4	53.0	47.0
2000/01	10388.4	6201.4	4187.0	59.7	40.3
2001/02	12205.2	6567.5	5637.7	53.8	46.2
2002/03	16181.3	7519.2	8662.1	46.5	53.5
2003/04	17338.8	7908.9	9429.9	45.6	54.4
2004/05	18366.8	10786.7	7580.1	58.7	41.3
Average Annual Growth Rate	15.2	14.6	16.8	---	---

Source: Adopted and computed from Nepal Government, MOF, Economic Survey, FY 2003/04 and 2005/06, Table No. 2.10

External Debt Servicing = Repayment + Interest Payment

Internal Debt Servicing = Total Debt Servicing - External D.S.

Total Debt Servicing = Interest Payment + Principle Repayment

On observing Table 4.11, the amount of total debt servicing was Rs. 2279.2 million in 1989/90 and has increased to Rs. 18366.8 million in 2004/05 with average annual growth rate of 15.2 percent. This shows as an increasing trend of total debt

servicing. The volume of external debt servicing was Rs. 1121.9 million in 1989/90 and has increased to Rs. 10786.7 million in 2004/05 and the internal debt servicing was Rs. 1157.3 million in 1989/90 and has gone up to Rs. 7580.1 million in 2004/05. The average annual growth rate of total and internal debt servicing is higher than external debt servicing. The average annual growth rate of total, internal and external debt servicing are 15.2%, 14.6% and 16.8% respectively. Till FY 2000/01, the annual growth rate of external debt servicing is higher than that of internal, since then, internal debt servicing is increasing at higher rate than external debt servicing. In 2004/05 the percentage share of external and internal debt servicing to total debt servicing was 58.7 percent and 41.2 percent respectively. At the end of the year, government is doing well because it has increased its internal source to the debt servicing. It shows a happy signal of improvement in Nepal's debt servicing situation. The trend of external debt servicing and internal debt servicing as percent of total debt servicing is shown in the graph.

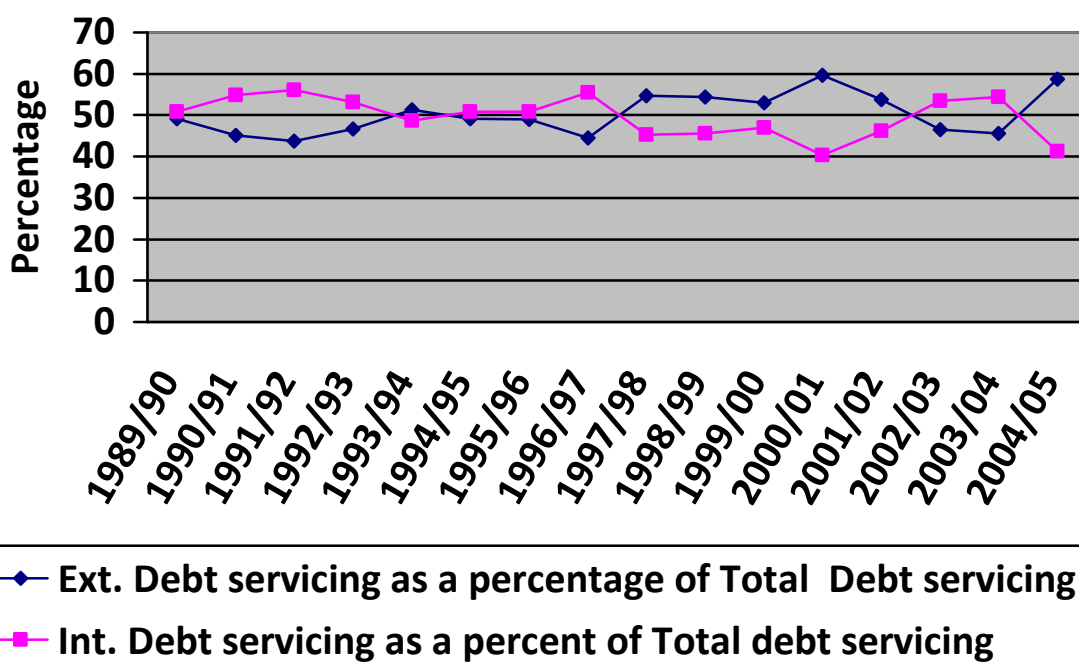


Table 4.12**Share of Interest and Principal Payments in Total Debt Servicing**

(Rs. In million)

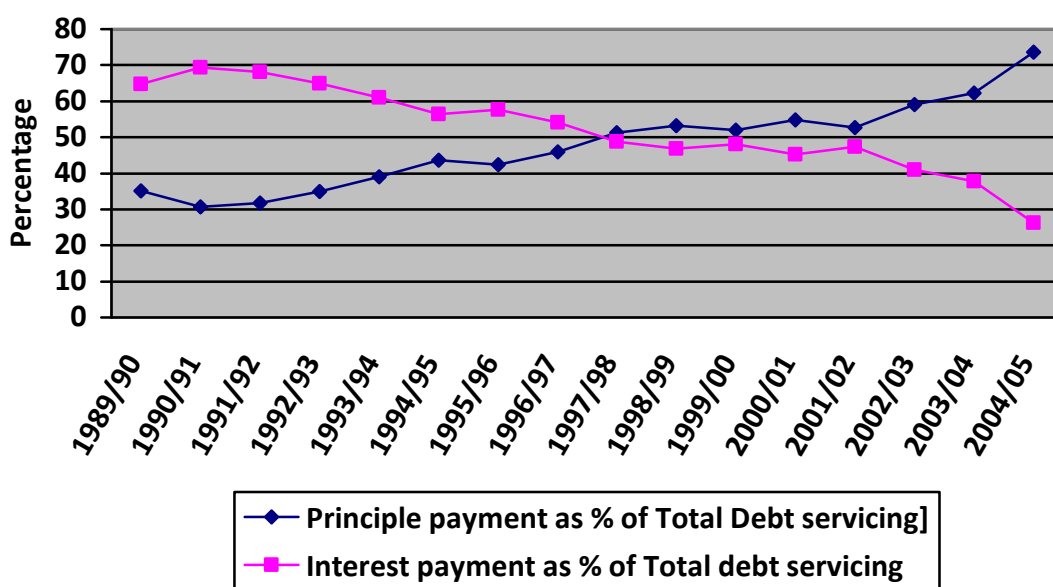
Fiscal year	Total Debt Servicing (I)	Principle Payments (II)	Interest Payments (III)	'II' as a Percentage of (I)	'III' as a percentage of (I)
1989/90	2279.2	802.3	1476.5	35.2	64.8
1990/91	2407.4	739.0	1668.4	30.7	69.3
1991/92	3797.1	1207.0	2590.1	31.8	68.2
1992/93	4560.5	1597.9	2962.6	35.0	65.0
1993/94	4855.1	1898.2	2956.9	39.0	61.0
1994/95	6083.3	2653.2	3430.1	43.6	56.4
1995/96	6715.4	2847.5	3867.9	42.4	57.6
1996/97	7527.2	3453.3	4073.9	45.9	54.1
1997/98	7682.8	3931.2	3751.6	51.2	48.8
1998/99	8723.0	4642.7	4080.3	53.2	46.8
1999/00	10032.8	5212.7	4820.1	52.0	48.0
2000/01	10388.4	5690.6	4697.8	54.8	45.2
2001/02	12205.2	6435.0	5770.2	52.7	47.3
2002/03	16181.3	9559.5	6621.8	59.1	40.9
2003/04	17338.8	10794.9	6543.9	62.3	37.7
2004/05	18366.8	13533.3	4833.5	73.69	26.31
Average Annual Growth Rate	15.2	20.2	11.3	----	----

Source: Adopted and computed from Nepal Government, MOF, Economic Survey, FY 2003/04 and 2005/06, Table No. 2.10, Page- 16

Similarly Table 4.12 shows the servicing amount of interest payments and principal payments in total debt servicing amount. While observing Table 4.12, it shows the 15.2 percent of average annual growth rate of total debt servicing over the study period, where share of interest amount was Rs. 1476.9 million in FY 1989/90 and has gone up to Rs. 4833.5 million in FY 2004/05. Similarly share of principal amount was Rs. 802.3 million in FY 1989/90 and has gone up to Rs. 13533.3 million in FY 2004/05 over the review period. The table shows that increasing trend of principal payments is higher than interest payments.

The share of interest payments in total debt servicing is greater than principal payments till 1996/97. Thereafter, the share of principal amount to total debt servicing is greater than interest payments under the review period.

The servicing amount of interest and principal payments indicates that large proportion of regular expenditure has gone to creditor countries, which has hampered regular expenditure as well as development expenditure. In 2003/04, 15 percent of regular expenditure has gone to service of principle payments and interest payments; this indicates the serious situation of debt servicing and burden of public debt of Nepal i.e. the burden of debt servicing is increasing that may adversely affect the growth process. The trend of principle payment and interest payment as percent of total debt servicing is shown in the graph.



4.12 Ownership Pattern of Internal Debt Servicing Situation

The burden of public debt is measured by the ratio between the debt servicing and aggregate tax revenue and non-tax revenue or total revenue and the ratio between servicing cost and national income (GDP). This has been shown in Table 4.13

Table 4.13
Share of Internal Debt Servicing in Total Revenue, Regular Expenditure and GDP

(Rs. In Million)

Fiscal Year	Regular Expenditure	Total Revenue	GDP	Internal Debt Servicing	D.S as % of Regular Expenditure	D.S. as % of Total Revenue	D.S. as % of GDP
1989/90	6672.5	9312.8	103416	1157.3	17.3	12.4	1.1
1990/91	7573.9	10729.0	120370	1320.9	16.2	12.3	1.0
1991/92	9905.4	13512.7	149487	2132.2	21.5	15.8	1.4
1992/93	11484.1	15148.4	171492	2428.6	21.1	16.0	1.4
1993/94	12409.2	19580.9	199272	2366.4	19.1	12.1	1.2
1994/95	19245.4	24605.1	219175	3098.6	16.1	12.6	1.4
1995/96	21563.8	27893.1	248913	3421.1	15.9	12.3	1.4
1996/97	24181.1	30373.5	280513	4177.8	17.3	13.7	1.5
1997/98	27174.4	35751.0	300845	3481.6	12.8	9.7	1.1
1998/99	31047.7	37251.3	342036	3977.5	12.8	10.7	1.2
1999/00	34523.3	42893.7	379488	4711.4	13.6	11.0	1.2
2000/01	42769.2	48893.9	411275	4187.0	9.8	8.6	1.0
2001/02	48590.0	50445.6	422807	5637.7	11.3	11.2	1.3
2002/03	54973.0	56229.7	456675	8662.1	15.7	15.4	1.9
2003/04	55552.1	62331.0	496745	9429.9	16.97	15.1	1.9
2004/05	61686.4	70122.7	533538	7580.1	12.28	10.80	1.4
Average Annual Growth Rate (%)		13.8	11.1	16.8	15.6	12.5	1.3

Source: Adopted and computed from Nepal Government, MOF, Economic Survey, FY 2003/04 and 2005/06, Table No. 2.1, Page- 5 and Table 1.2, Page-2

The expenditure heads till FY 2002/03 were classified as regular and development. During FY 2003/04 and 2004/05, such expenditure has been classified as recurrent expenditure amounted to Rs. 55552.1 million and Rs.61686.4 million and capital expenditure amounted to Rs. 23095.6 million and Rs.27340.7 million. Here researcher did not submit the regular and development expenditure in FY 2003/04 and

2004/05. So comparison is done between 1989/90 to 2002/03 in the regular and development expenditure.

Table 4.13 shows the average annual growth rate and volume of regular expenditure, Total Revenue, GDP and internal debt servicing. It also shows the share of TR, RE and GDP as percentage of internal debt servicing. Over the period of the study, the magnitude of regular expenditure, total revenue, GDP and Internal debt servicing were Rs. 6672.5million, Rs. 9312.8 million, Rs. 103416.0 million and Rs. 1157.3 million in 1989/90 and has increased up to Rs. 55552.1 million, Rs. 62331.0 million, Rs. 496745 million and 9429.9 million respectively in the FY 2003/04. Similarly the recurrent expenditure in FY 2004/05 is Rs. 61686.4 million. Total revenue is Rs. 70122.7 million, Gross Domestic Product is Rs. 533538 million and internal debt servicing is Rs.7580.1 million in the FY 2004/05 respectively. But due the classification of the expenditure head into regular and development expenditure its actual data could not find in FY 2003/04 and 2004/05.

Table 4.13 also shows the average annual growth rate of regular expenditure (i.e. 13.6 percent till FY 2002/03), total revenue (i.e. 13.8 percent), GDP (i.e. 11.1 percent) and internal debt servicing was 16.8 percent. It shows that the growth rate of internal debt servicing is higher than growth rate of regular expenditure, total revenue and GDP till FY 2000/01 but in FY 2003/04 the growth rate of internal debt servicing is high (i.e. 16.8 in average). It indicates that from FY 2001/02 to FY 2003/04, debt servicing rate is becoming high.

The trend of debt servicing as percentage of regular expenditure, total revenue and GDP has been decreasing and fluctuating. Debt servicing as percentage of regular expenditure was 17.3 percent in 1989/90 and decreased to 15.7 percent (in FY 2002/03), and debt servicing as percent of total revenue was 12.4 and increased to 15.1 percent in FY 2003/04. Likewise, share of debt servicing to GDP was 1.1% and increased to 1.9 percent in FY 2003/04.

Table 4.14
Outstanding Public Debt, Development Expenditure and Debt Servicing
(Rs. In Million)

Fiscal Year	Total Outs. Debt (I)	Development Expenditure (II)	Total Debt Servicing (III)	'I' as a percent of (II)	' III ' as a percentage of (II)
1989/90	51474.0	12997.6	2279.2	396.0	17.5
1990/91	80361.2	15979.3	2407.4	502.9	15.1
1991/92	94158.8	16512.8	3797.1	570.2	23.0
1992/93	112876.8	19413.6	4560.5	581.4	23.5
1993/94	132598.0	21188.2	4855.1	625.8	22.9
1994/95	145058.8	19550.0	6083.3	742.0	31.1
1995/96	162286.3	24980.2	6715.4	649.7	26.9
1996/97	167977.7	29242.6	7527.2	574.4	25.7
1997/98	199614.7	28943.8	7682.8	689.7	26.5
1998/99	219135.5	28531.3	8723.0	768.0	30.6
1999/00	245048.2	31749.2	10032.8	771.8	31.6
2000/01	260448.1	37065.9	10388.4	702.7	28.0
2001/02	293746.3	31482.2	12205.2	933.0	38.8
2002/03	308078.5	29033.0	16181.3	1061.1	55.7
2003/04	318913.0	23095.6	17338.8	138.08	75.07
2004/05	307200.0	27340.7	18366.8	112.3	67.17
Average Annual Growth Rate	13.6	5.0	15.2	-----	-----

Source: Adopted and computed from Nepal Government, MOF, Economic Survey, FY 2003/04 and 2005/06, Table No. 2.10, Page- 16

The expenditure heads till FY 2002/03 were classified as regular and development. During FY 2003/04 and 2004/05, such expenditure has been classified into recurrent expenditure and capital expenditure amounted Rs. 55552.1 million and Rs. 61686.4 million, capital expenditure amounted to Rs. 23095.6 million and Rs. 27340.7 million and principal repayment expenditure amounted to Rs. 10794 million and Rs. 13533.3 million in FY 2003/04 and 2004/05 respectively. That's why here researcher

has taken into account the regular and capital expenditure of FY 2003/04 and 2004/05. So comparison between regular expenditure and development expenditure is being made between 1989/90 to 2002/03 in the regular and development expenditure.

Observing Table 4.14, we can see the volume of outstanding debt which was Rs. 51474.0 million in 1989/90 and has increased to Rs. 318913.0 million in 2003/04 with the 13.6 percent of average annual growth rate. These, show the real burden of debt of Nepal, where total outstanding public debt as percentage of development expenditure was 396.0 percent in 1989/90 and has gone up to 1061.1 percent in FY 2002/03. This shows Nepal is going year by year into the depth of the debt burden.

Development expenditure has also gone up to Rs. 29033.0 million in FY 2002/03, which in the beginning of the study period was Rs. 12997.6 million. Table also shows that development expenditure is in decreasing trend at the end of the study period. It may be due to the Maoist insurgency. Till FY 2000/01, its annual average growth rate was 10.0 percent, but it has decreased down to 5.0 percent in FY 2002/03. It clearly shows us that our development process is not increasing at growing path. In the FY 2003/04 our total expenditure is classified into three heads where capital expenditure is Rs. 23095.3 million, it is less than the recurrent expenditure i.e. Rs. 55552.1 million. This shows that the development expenditure is less than outstanding public debt.

Likewise, total debt servicing was Rs. 2279.2 million in 1989/90 and has gone up to Rs. 18366.8 million in 2004/05 with 15.2 percentage of average annual growth rate. It is greater than outstanding public debt. But, till FY 2000/01 annual growth rate of outstanding public debt was greater than the growth rate of debt servicing. But at the end of the year, it is improving. If the same situation continues for long run, Nepal would be free from dependency. Total debt servicing as percentage of development expenditure has increased from 17.5 to 55.7 percent during the period of study.

While discussing about the burden of internal debt, the analysis of internal debt and annual internal borrowing is an important aspect. The Table 4.15 has shown the proportional relationship between annual internal debt servicing and internal annual borrowing.

Table 4.15**Annual Internal Debt Servicing as Percentage of Annual Internal Debt**

(Rs. In Million)

Fiscal Year	Internal Debt	Internal Debt Servicing	IDS as percent of ID
1989/90	2150.0	1157.3	53.8
1990/91	4552.7	1320.9	29.0
1991/92	2078.8	2132.2	102.6
1992/93	1620.0	2428.6	149.9
1993/94	1820.0	2366.4	130.0
1994/95	1900.0	3098.6	163.1
1995/96	2200.0	3421.1	155.5
1996/97	3000.0	4177.8	139.3
1997/98	3400.0	3481.6	102.4
1998/99	4710.0	3977.5	84.4
1999/00	5500.0	4711.4	85.7
2000/01	7000.0	4187.0	59.8
2001/02	8000.0	5637.7	70.5
2002/03	8880.0	8662.1	97.5
2003/04	5607.8	9429.9	168.1
2004/05	8938.1	7580.1	84.8
Average Annual Growth Rate	10.4	16.8	--

Source: Adopted and computed from Nepal Government, MOF, Economic Survey, FY 2003/04 and 2005/06, Table No. 2.1, Page- 5 and Table 2.10, Page-16

Observing the above table, we can find out the volume of internal debt which was Rs. 2150.0 million in 1989/90 and has gone up to Rs. 8938.1 million in 2004/05 with 10.4 percent of average annual growth rate over the period of study. Likewise, internal debt servicing has also gone up from Rs. 1157.3 million to Rs. 7580.1 million with average annual growth rate of 16.8 percent.

The volume of internal debt is larger than that of internal debt servicing in 1989/90 to 1990/91, but after 1990/91 the magnitude of internal debt servicing exceeds the amount of internal debt till FY 1997/98. But at the end of the study

period, volume of internal debt servicing is less than the volume of internal debt. Till FY 2002/03, this situation indicates that the internal borrowing is being spent on debt servicing and also shows that the government's ability to borrow from internal sources is not conducive to raise enough funds for development requirement and this also shows that the increasing proportion of internal debt servicing is the manifestation of unproductive use of borrowed fund. But at the end of the study period, it became hopeful to develop capital formation by borrowing funds. Even, the proportion of internal debt servicing to the internal debt is fluctuating from the year. Which declined from 102.4 percent to 97.5 percent, it became 168.1 percent in 2003/04. This indicates that the internal loan is going up.

However, this is good at the end of the year but in the past year, it was not good. Thus, the high reliance on internal borrowing for financing budgetary deficit may have the following effects.

1. Huge amount of development fund was diverted to meet debt-servicing charges, which comes under regular expenditure.
2. Borrowing from Nepal Rasta Bank in the form of over draft will have effect on expansionary money supply and that may create inflationary pressure.
3. Likewise borrowing from commercial Banks may crowd out the private investment.

4.13 Issues of Foreign Loans

Underdeveloped countries like Nepal are facing a serious problem of scarcity of domestic capital formation, which is more essential for development process. And these countries are also facing the shortage of foreign exchanges. So, these countries have to borrow public debt from within the country as well as from the external sources like foreign countries and foreign agencies to breakout the vicious circle of insufficient capital formation and development bottlenecks. The scope of domestic borrowing in these countries is very limited, because internal resources are scarce. So, only external borrowing remains the alternative to be undertaken by these countries.

Nepal is facing various problems like poverty, unemployment and Nepal's macro economic indicators show declining economic performance. In FY 2005,

Nepal's Human Development Indicator is below 0.5, it proved the poverty of Nepal. During the study period, Nepal has to invest a huge amount of expenditure for security, which is not productive. Every year's Budget is more than preceding year's budget but revenue is not increasing in the same pace. Due to this reason, Nepal has to depend upon foreign assistance and external loans. Owing to heavy reliance on external assistance in the form of borrowing in public accounts, Nepal's external public indebtedness has increased in geometric progression. A rise in external indebtedness should be accompanied by an increasing debts servicing capacity. An ever increasing debt with out similar increase in debt servicing creates undue strain in the Balance of Payment, because an increasing external debt servicing implies outflow of capital which may lead the country to the heavy burden of debt and debt crisis in the future.

Although foreign loans are main pillars for development process and to break out vicious circle of insufficient domestic capital formation, it has adverse effect on national economy when it's servicing, means that the scarce foreign exchange resources have to be transferred to creditors' countries.

When an external debt service has obvious impact on domestic capital formation and reduces the domestic standard of living, unless the loans are used for financing profitable investment, the whole yield is enough to satisfy creditor's claims for debt servicing, therefore, the true burden of debt service depends on profitable investment. In which the borrowed fund from external sources can be transformed into productive investment. If the foreign loans are used for financing unproductive investment projects that provide present consumption with more goods then foreign debt servicing is impossible.

For the purpose of foreign debt servicing, foreign currency has to be earned through increasing volume of exportable goods and services. If this is not done then the purpose of external loan is not fulfilled and it really becomes burden on next generation. Therefore, it is very essential that the real income of the national economy should grow faster than the transfer of resources through its external debt servicing. This requires ever-growing flow of export trade and proper utilization of foreign loans.

Samuelson (1964) has suggested for use of foreign capital in the process of development of developing countries. He argues, "If there are many difficulties in the way of domestic capital formation, why not rely more heavily on foreign sources". He further said, "Economic theory tells that a rich country has used up all its own high investment projects can benefit itself and at the same time benefit a poor country abroad. If it has shifted investment to the high internal project, it will be benefited to the investor or indebted country

4.14 Foreign Outstanding Debt and GDP

While discussing on the burden of external debt, it is important to pay attention on the trends of external debt and GDP to make a comparison between the two. This comparison gives the position of external debt in the country's GDP. This comparison is being made in the following table 4.16.

Table 4.16
Annual Growth of External Outstanding Debt and GDP

(Rs. In Million)

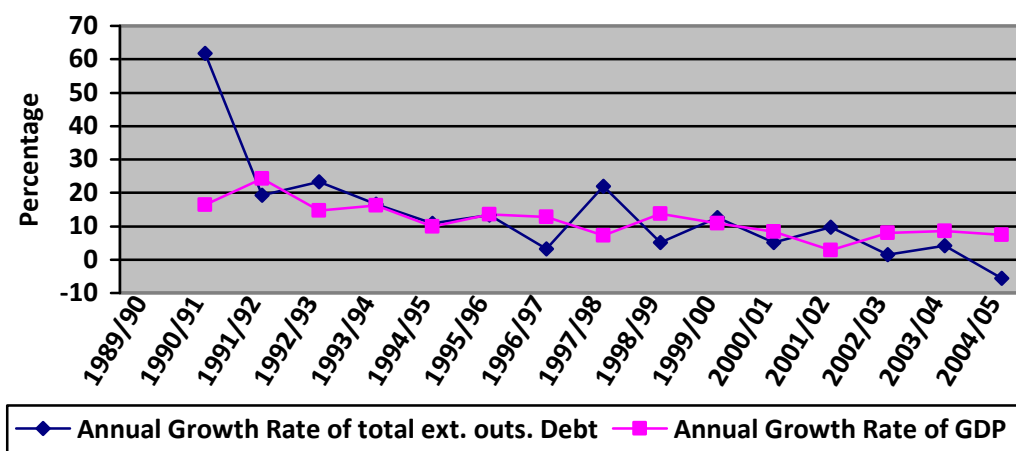
Fiscal Year	Total External Outs. Debt	Annual Growth Rate %	GDP at producers price	Annual Growth Rate %	External Debt as Percentage of GDP
1989/90	36800.9	-	103416	-	35.6
1990/91	59505.3	61.7	120370	16.4	49.4
1991/92	70923.9	19.2	149487	24.2	47.4
1992/93	87420.8	23.3	171492	14.7	51.0
1993/94	101966.8	16.6	199272	16.2	51.2
1994/95	113000.9	10.8	219175	10.0	51.5
1995/96	128044.4	13.3	248913	13.6	51.4
1996/97	132086.8	3.2	280513	12.7	47.1
1997/98	161208.0	22.0	300845	7.2	53.6
1998/99	169465.9	5.1	342036	13.7	49.5
1999/00	190691.2	12.5	379488	10.9	50.2
2000/01	200404.4	5.1	411275	8.4	48.7
2001/02	220125.6	9.8	422807	2.8	52.1
2002/03	223433.2	1.5	456675	8.0	48.9
2003/04	232779.3	4.2	496745	8.5	47.0
2004/05	219640.0	-5.6	533538	7.4	41.16
Average Annual Growth Rate	19.9	13.5	11.1	11.6	-----

Source: Adopted and computed from Nepal Government, MOF, Economic Survey, FY 2003/04 and 2005/06, Table No. 2.10, Page- 16 and Table 1.2, Page-2

Observing table 4.16, there is increasing trend of growth rate of outstanding external debt and GDP. The amount of external outstanding debt was Rs. 36800.9 million and has gone up to Rs.219640.0 million in 2004/05. This has increased with 13.5 percent of average annual growth rate. Its annual growth rate was 61.7 percent in 1990/91 but thereafter it is declining to 1.5 percent in FY 2002/03 and slowly increasing to 4.2 percent in 2003/04 and was negative by 5.6 percent in 2004/05. But the rate of increase in GDP is diminishing though GDP is increasing. It also shows

unsatisfactory economic performance because GDP is a pillar of National economy. Where, GDP has increased from Rs. 103416.0 million in FY 1989/90 to Rs. 533538 million with 11.6 percent of average annual growth rate over the review period, which is smaller than growth rate of external outstanding debt. After the restoration of multiparty system, the annual growth rate of GDP is not satisfactory and became 2.8 percent in 2001/02 and again it rose to 8.5 percent in 2003/04 in the producers' price.

While comparing the increasing trend of external indebtedness with increase in GDP or external debt to GDP the external debt as percent of GDP was 35.6 percent in 1989/90 and has gone up to 47.0 percent in 2003/04 with 49.0 percent of average annual rate. This shows clearly the burden of external debt was quite heavy. Table 4.16 also shows the average annual percentage share of external outstanding debt is 49.0 percent of GDP, which may lead the country to external debt crisis in future. So, external loans have to be used for productive sector or think about proper utilization. Annual growth rate of external outstanding debt and GDP is shown in the graph.



4.15 External Debt Flow and Its Annual Servicing

One of the main features of budgetary system in Nepal is deficit budget in which large proportion of it is fulfilled by external loan. This is also proved by the increasing trend of average annual growth rate of external debt by 5.0 percent over the period of the study. Here the ratio of external outstanding debt to GDP has grown up creating adverse situation in the economy, which requires effective measures of control.

Table 4.17
External Debt Flow and Its Servicing

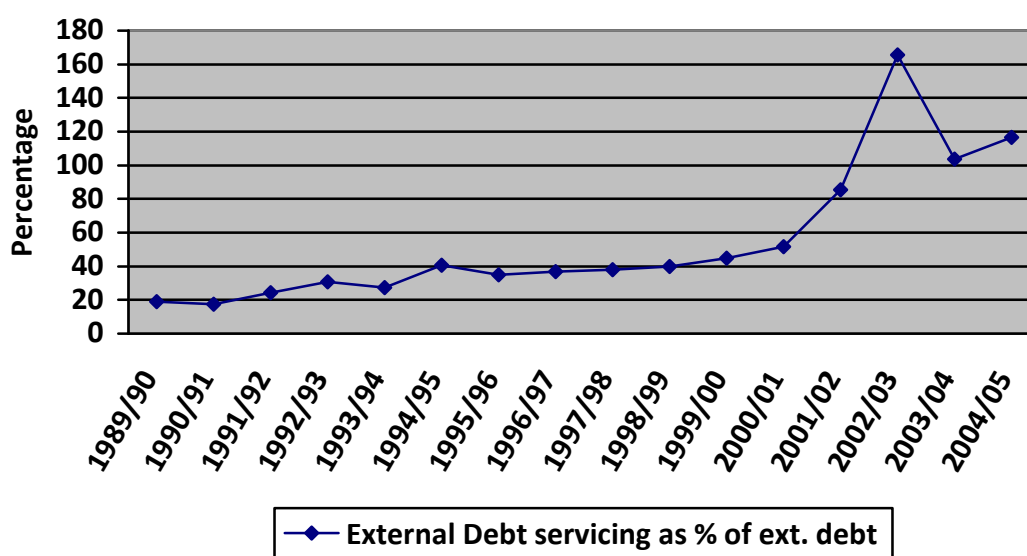
(Rs. In Million)

Fiscal Year	External Debt (1)	External Debt Servicing (2)	' 2 ' as a Percentage of (1)
1989/90	5959.4	1121.9	18.8
1990/91	6256.7	1086.5	17.4
1991/92	6816.9	1664.9	24.4
1992/93	6920.9	2131.9	30.8
1993/94	9163.6	2488.7	27.2
1994/95	7312.3	2984.7	40.8
1995/96	9463.9	3294.3	34.8
1996/97	9043.6	3349.4	37.0
1997/98	11054.4	4201.2	38.0
1998/99	11852.4	4745.5	40.0
1999/00	11812.2	5321.4	45.0
2000/01	12044.0	6201.4	51.5
2001/02	7698.7	6567.5	85.3
2002/03	4546.4	7519.2	165.4
2003/04	7629.0	7908.9	103.7
2004/05	9266.1	10786.7	116.4
Average Annual Growth Rate	5.0	14.6	-----

Source: Adopted and computed from Nepal Government, MOF, Economic Survey, FY 2003/04 and 2005/06, Table No. 2.1, Page- 5 and Table 2.10, Page-16

Table 4.17 shows the comparison between the annual flow of external debt and annual external debt servicing obligations. Here, the new borrowing external debt was Rs. 5959.4 million in 1989/90 and has gone up to Rs. 12044.0 million in 2000/01 and decreased to 9266.1 million in 2004/05. This is the great improvement in Nepalese History. The amount of external debt servicing has increased from Rs. 1121.9 million in 1989/90 to Rs. 10786.7 million in 2004/05 with 14.6 percent of average annual growth rate during the period of the study. By the table it is clear that, till 2000/01, more than half of new annual external borrowing or 51.5 percent of new

borrowing is transferred to the creditor countries to service the external debt per annum. But in FY 2004/05 more than 100% of external debt servicing is transferred to external debt. It proved that if we use foreign loan in the productive sector then it is possible to repayment and remittance has played a vital role to develop our economy in the current year. Due to need for internal security maintenance, the external debt in the last three years has been increasing at a very high rate. The trend of external debt servicing as percent of external debt is shown in the graph.



4.16 Relationship between Public Debt and GDP in Nepal

To examine the effect of external debt, internal debt and total debt are the major objectives of this study. There is no unanimous agreement among the economists about the productivity of debt, so this section explores the empirical relationship between external debt and aggregate GDP. It also examines the relationship between internal debt & GDP, and total debt & GDP.

- GDP : Gross Domestic Product
- INTTD : Internal Debt
- X : Total Debt
- EXTD : Total External Debt

If external debt can be shown to have had a tremendous effect on the economic growth and the overall welfare of the country, then the increasing level of external debt can be argued to be necessary for further growth of the economy. The basic starting point is the examination of direct relationship between the GDP and the amount of the external debt, internal and total debt. In all statistical analyses, number in parenthesis, below the coefficients for variables, indicate their respective t-values. All regressions in this chapter are conducted by using SPSS Computer Software.

4.16.1 Relationship between External Debt and GDP

The flow of External Debt is growing over the time whether this growing flow of external debt is contributing for output growth or not? This situation explores the answer of this question. Let us consider the following estimated relationship between change in external debt and change in GDP. This equation is estimated by Ordinary Least Square method.

The model is

$$Y_t = a + b \text{EXTD}_t$$

Where Y_t = Gross Domestic product and

EXTD_t = total external debt

The fitted equation of the regression model is

$$Y_t = -4922.759 + 2.094 \text{EXTD}_t \dots\dots\dots(1)$$

(-0.282) (19.153)

$$R^2 = 0.963 \qquad F = 366.831 \qquad D-W = 0.985$$

Equation one shows a positive relationship between nominal GDP and total external debt inflows. The coefficient of total external debt is significant, as indicated by its high t-value (19.153). The equation itself is a good fit, with 96.3 percent of the variations in dependent variable being explained by the independent variable. The theoretical value of F at the 5% level of significance with $V_1=1$ and $V_2 = N-k=15$ degree of freedom is found from the f-table ($F_{0.05}=4.54$). Since $f^*(\text{calculated}) 366.831 > F_{0.05}=4.54$, we conclude that there is a significant change in the average GDP of Nepal due to total external debt obtained from the data from 1989/90 to 2004/05 i.e. the GDP changed in the given periods due to total external debt.

The D-W 'd' statistics from the data is $d = 0.985 = d^*$. From D-W table with 5% level of significance, $n = 16$ observation and $K = 1$ independent variable, the significance point of d_L and d_U are $d_L = 1.106$, $d_U = 1.371$. Since $0 < d^* = 0.985 < d_L$. We conclude that there is the positive autocorrelation in the GDP function. In conclusion, growth in external debt has a significant positive impact over the growth in GDP.

The lag effect of external debt can be examined from the following equation two. The fitted equation of the regression model is

$$Y_t = 37249.457 + 0.398 \text{EXTD}_t + 2.398 \text{EXTD}_{t-1} \dots \dots \dots (2)$$

(3.134)
(-0.928)
(5.868)

$R^2 = 0.99$
 $F = 638.671$
 $D-W = 1.515$

All the estimated coefficients in equation (2) are statistically significant with positive sign. The lag effect of external debt is also statistically significant at five percent level of significance. The value of R^2 is increased to 0.99 and the value of DW statistics is moderate. Examining both the equation, we conclude that total external debt has positive impact in GDP growth of Nepal. Hence, it is positively contributing to the growth of National output. Thus our hypothesis one H_{A1} is justified and one, H_{o1} is rejected by this study.

4.16.2 Relationship between Internal Debt and GDP

The Internal Debt is growing over the time whether this growing of internal debt is contributing to output growth or not? This situation explores the answer of this question. Let us consider the following estimated relationship between change in internal debt and change in GDP. This equation is estimated by Ordinary Least Square method.

The fitted equation of the regression model is

$$Y_{GDP} = -25208.55 + 1.98 \text{INTTD}_t \dots \dots \dots (3)$$

(-0.448)
(14.270)

$R^2 = 0.942$
 $F = 105.728$
 $D-W = 1.127$

The estimated coefficients of equation (3) have expected sign. Both the coefficients are statistically significant at 5 percent level. R^2 is high. The equation itself is good fit, with 94.2 percent of the variations in dependent variable being explained by the independent variable. Value of DW indicates that there is no serious problem of autocorrelation. Total internal debt is significantly affecting the GDP and relationship between these variables is positive.

The lag effect of internal debt can be examined from the following equation. The fitted equation of the regression model is

$$Y_{GDP} = 71058.90 + 2.75 INTTD_t + 3.81 INTTD_{t-1} \dots \dots \dots (4)$$

(1.978) (-3.791) (5.780)

$R^2 = 0.932$ $F = 48.690$ $D-W = 2.192$

The result still shows that there is positive relationship between total internal debt and GDP. The value of R^2 is increased to 0.932. The equation itself is a good fit, with 93.2 percent of the variations in dependent variable being explained by the independent variable. DW indicates there is no serious autocorrelation. Coefficient of $INTTD_t$ and lagged variable is significant at five percent level of significance. Conclusion drawn is that growth in internal debt have positive impact over growth of output, this relationship is statistically significant. Thus our hypothesis two, H_{A2} is justified and two H_{O2} is rejected by this study.

4.16.3 Relationship between total dept and GDP

The Total Debt is growing over the time whether this growing of debt is contributing for output growth or not? This situation explores the answer of this question. Let us consider the following estimated relationship between change in total debt and change in GDP. This equation is estimated by Ordinary Least Square method. To answer this empirical question, following empirical equation is estimated.

The fitted equation of the regression model is

$$Y_{GDP} = -89765.17 + 3.87 X_t \dots \dots \dots (5)$$

(-2.16) (23.61)

$R^2 = 0.975$ $F = 390.71$ $D-W = 1.75$

Slope coefficients of equation are statistically significant and have positive sign as expected. The equation itself is a good fit, with 97.5 percent of the variations in dependent variable being explained by the independent variable. The Value of DW indicates no serious problem of autocorrelation. This estimated equation indicates that there exist the significant positive relationship between total debt and output.

The lag effect of total debt can be examined from the following equation six. The fitted equation of the regression model is

$$Y_{GDP} = 95350.47 + 3.45 X_t + 4.15 X_{t-1} \dots \dots \dots (6)$$

(2.13) (-3.16) (7.62)

$R^2 = 0.984$ $F = 475.45$ $D-W = 1.75$

The estimated empirical relationship indicates that total debt has positive impact on GDP. Estimated slope coefficients of current and one year lagged values of total debt variable is significant (i.e, significantly different from zero). Value of R^2 is improving in comparison to equation (5). The equation itself is a good fit, with 98.4 percent of the variations in dependent variable being explained by the independent variable. F statistics indicates overall fitness of the model is very good. This empirical investigation concludes that total debt is significantly affecting GDP. Thus our hypothesis three H_{A3} is justified and three H_{O3} is rejected. The analysis of this chapter reveals that there exist significant positive relationship between External Debt, Internal Debt and Total Debt with Gross Domestic Product (GDP). Higher external debt is associated with higher Domestic output and vice versa.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary

Public debt is taken with the obligation of future repayment including with certain rate of interest. When government requires funds for development programme and security it is taken by selling borrowing instrument. So, it is the result of mismatch between revenue and expenditure. It is widely accepted measure for financing fiscal deficit.

In the context of developing countries, it is playing vital role for socio-economic development because they have limited size of funds which is not sufficient for development financing. So, in case of Nepal, it is playing crucial role for development and fulfil the gap between income and expenditure. The study shows that government borrowing is growing year by year along with the rise in public expenses.

Nepal has started to take borrowing after the establishment of democracy in 1950. It is increased with initiation of economic planning in Nepal. Similarly after the budgetary development in Nepal, importance and needs of borrowing is increasing year to year.

Basically, the study shows that there is lack of adequate fund for development financing. We have limited resource, small size GDP, lower per capita income, lack of infrastructure, saving investment gap, export import gap, revenue expenditure gap etc. All these factors are major causes to increase external dependency.

Our government is taking loan from two sources, internal and external. Internal source includes development bonds, treasury bills, national saving certificate and saving certificates. Similarly, in external sources Nepal is receiving debt by two sources, bilateral and multilateral. In the initial study period the share of bilateral is higher as compared to multilateral but in recent year multilateral sources like World Bank, United Nation Development Programme, Asian Development Bank,

International Monetary Fund and World Health Organization etc are dominating the bilateral sources.

Due to poor and insufficient domestic resource mobilization to meet the growing needs of financial resources for financing development expenditure, dependency on foreign assistance has been increasing. Foreign aid has contributed to 50.7 percent of development expenditure and the share of external borrowing in total deficit is found to be about 61 percent in 2003/04. External assistance is necessary to bridge the growing fiscal deficit. And developing economy like Nepal needs foreign currency in order to fulfil most essential capital goods for development projects.

Burden of public debt and debt servicing has been increasing continuously which in fact is the accumulation of net borrowing of different years. Now, Nepal is indebted by external and internal loans but further more by external outstanding debt. Consequently, external debt servicing has become a current issue. In the context of Nepalese economy question may arise whether our country's revenue and foreign exchange availability can sustain or not that increasing external debt service payment. If our country's sources cannot meet external debt service payment, there will be need to borrow again external loan for debt servicing i.e. "Debt for debt servicing".

Resource gap in the Nepalese finance has been always a common phenomenon since the systematic budgeting system in Nepal, which is only due to mismatch between the annual growth rate of the government expenditure and that of its revenue. The widening resource gap in recent years has been cumulative effective of the deficiencies in the investment areas and continues absence of government's fiscal norms.

Internal public debt has played a significant role in the financial resources for development expenditure as well as in the growth of money and capital market, and it facilitates the effective implementation of monetary policy. The domestic resources are not sufficient to promote the rapid development of the Nepalese economy. Therefore, external assistance (loan and grant) plays all obvious functions in the development force for financial resources. Concerning foreign assistance, grants have big role to play in solving the resource gap for the country's budgetary expenditure.

5.2 Conclusion

Nepalese economy is characterized as three kinds of macroeconomic imbalances viz.-saving-investment gap, export-import gap and revenue-expenditure gap. These fundamental gaps represent the foreign dominance in Nepalese economy, while saving-investment and revenue expenditure gap are mainly the consequence of excess government activities in economic matters. To fill up these gaps public debt in the form of either internal or external is inevitable. The volume of external debt is excessively rising in the recent years under liberalization policy. As globalization concept is wide spreading all over the world, aid is gradually decreasing and emphasis goes on loans, technology transfers and trade which have created high degree of indebtedness and, consequently, debt servicing obligations are increasing. In the meanwhile, the loan is not self-liquidating i.e., the debt repayment capacity is not increasing in the same pace. During the study period, average annual growth rate of GDP, revenue and merchandise export earnings are out stepped by annual growth rate of debt and debt servicing obligations.

The ultimate effect of lower capacity to debt servicing falls on capital formation and development process. Mismanagement of fund resulted on lack of self-liquidating projects. After the study, it can be concluded that Nepal has not really fallen into the debt trap but if the process continues for years, there will be no other result. Both the internal and external loans are in increasing trend but debt servicing amount is increasing annually and its growth rate is higher than GDP growth rate and revenue growth rate. Such condition suggests to better utilization of fund.

The analysis of this study reveals that there exist significant positive relationship between External Debt, Internal Debt and Total Debt with Gross Domestic Product (GDP). Higher external debt is associated with higher Domestic output and vice versa. The analysis of the effect of external debt on output reveals that there exist significant positive relationship between external debt and GDP. It is concluded that external debt in Nepal over the period 1989/90 to 2004/05 is some extent productive. Therefore it is necessary to have a careful look on the increasing magnitude of external debt and proper care must be taken to increase the debt servicing capacity of the country.

5.3 Recommendations

The following are the proposed recommendations on the basis of above study:

-) Government must use external and internal borrowing on such projects which are highly productive and can produce exportable items and these projects are to be kept under constant supervision and monitoring process. Government should move towards fiscal balance and strong fiscal discipline through control of unproductive expenditure and maximizing revenue mobilization. Government's efforts should be directed towards mobilization of internal resource and thus to reduce dependency on loans for financing development expenditure.
-) The size of overall budgetary deficit excluding grants has remained high mainly due to low revenue and very high expenditure. This has led to heavy borrowing from internal and external sources. So, for reducing the volume of borrowing revenue collection is to be increased substantially in order to attain self-sufficiency in the long run. Improving effective tax policy and tax administration can do this. This also includes simplification of tax rates, rationalization of tax structure and expansion of tax base.
-) Loan assistance should be utilized selectively, after careful scrutiny of the purpose, content and benefits of such projects and programmes in order to reduce the burden of external debt while contributing to accelerate growth and to meet the socio-economic objectives. Therefore, borrowed fund from both internal and external sources is to be spent on those projects, which are capable of producing exportable commodities within shortest gestation period. Otherwise, the large volume of loan obtained from external sources would be remained unutilized creating additional burden of debt servicing.
-) Large proportion of internal borrowing comes from banking sector particularly from the central bank, which is expansionary in nature and enhance non banking sectors which stimulate domestic saving and investment. Internal borrowing from central bank has been kept within limitation of 5% of previous year revenue collection. But limitation rule is not being followed by government. Therefore, in order to reduce the inflationary pressures in the economy, this aspect of internal borrowing rule should be followed.

-) Government should try to collect foreign assistance through the grants as far as possible by applying effective foreign aid policy. The government should try to get the grants amount more and more as far as possible; there is more domination of bilateral grants. The government also should maintain such external policy so that more of grants should be received rather than the loans.
-) Viewing increasing indebtedness of public debt, mainly external outstanding debt, and government should increase its debt servicing capacity by increasing GDP growth, revenue growth (increasing its share of GDP) and export earning. Here growth rate of national outstanding debt, debt servicing obligations, Gross Domestic Product, revenue and export earnings must go together in a sustainable path so that country will not be trapped by debt servicing problem.
-) The policy to discourage capital flight should be developed and conducive environment need to be made for foreign direct investment to accelerate national development and at last, proper attention should be given by NRB to the macro-economic stability of the country while accepting external loans.
-) To reduce the foreign dependency various measures must be applied such as export promotion, tourist attraction and import substitution policy.
-) Proper attention should be given to maintain macro economic stability of the country while taking borrowing.
-) Tax revenue is the main source of government revenue. In this regard, it is a need to raise the tax revenue by widening the tax base, refining the tariff structures at regular intervals. This can contribute to more revenue mobilization on one hand and efficient, competent and improved revenue administration can contribute to increase revenue mobilization on the other hand.

APPENDICES

Relationship Between Public Debt and GDP.

Regression

Relationship between External Debt and GDP.

Model Summary

	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
Model					R Square Change	F Change	df1	df2	Sig. F Change	
1	.981	.963	.961	27260.7300	.963	366.831	1	14	.000	.985

a Predictors: (Constant), External Outs. Debt

b Dependent Variable: Gross Domestic Product

ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	272609249748.564	1	272609249748.564	366.831	.000
	Residual	10404063582.373	14	743147398.741		
	Total	283013313330.938	15			

a Predictors: (Constant), External Outs. Debt

b Dependent Variable: Gross Domestic Product

Coefficients

		Unstandardized Coefficients	Std. Error	Standardized Coefficients	t	Sig.
Model		B		Beta		
1	(Constant)	-4922.759	17426.092		-.282	.782
	External Outs. Debt	2.094	.109	.981	19.153	.000

a Dependent Variable: Gross Domestic Product

Model Summary

	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
Model					R Square Change	F Change	df1	df2	Sig. F Change	
1	.995	.990	.988	14809.8565	.990	638.671	2	13	.000	1.515

a Predictors: (Constant), LAGG External Outs. Debt, External Outs. Debt

b Dependent Variable: Gross Domestic Product

ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	280161999288.771	2	140080999644.386	638.671	.000
	Residual	2851314042.166	13	219331849.397		
	Total	283013313330.938	15			

a Predictors: (Constant), LAGG External Outs. Debt, External Outs. Debt

b Dependent Variable: Gross Domestic Product

Coefficients

		Un-standardized Coefficients		Standardized Coefficients	t	Sig.
Model		B	Std. Error	Beta		
1	(Constant)	37249.457	11885.791		3.134	.008
	External Outs. Debt	.398	.429	-.186	-.928	.370
	LAGG External Outs. Debt	2.398	.409	1.179	5.868	.000

Relationship Between Internal Debt and GDP.

a Dependent Variable: Gross Domestic Product

Model Summary

	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
Model					R Square Change	F Change	df1	df2	Sig. F Change	
2	.970	.942	.906	38712.911	.942	105.728	1	14	.002	1.127

a Predictors: (Constant), Internal Debt

b Dependent Variable: GDP

ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
2	Regression	60050021055.486	1	70050021055.487	10.472	.006
	Residual	83652104522.450	14	6689436045.246		
	Total	153702125677.963	15			

a Predictors: (Constant), Internal Debt

b Dependent Variable: GDP

Coefficients

		Un-standardized Coefficients		Standardized Coefficients	t	Sig.
Model		B	Std. Error	Beta		
2	(Constant)	-25208.55	42281.412		-.448	.301
	Internal Debt	1.98	.124	.758	14.270	.001

a Dependent Variable: GDP

Model Summary

	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
Model					R Square Change	F Change	df1	df2	Sig. F Change	
2	.965	.932	.915	50735.2751	.932	48.69	2	13	.000	2.192

a Predictors: (Constant), LAGG Internal Debt, Internal Debt

b Dependent Variable: GDP

ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
2	Regression	106277454208.147	2	48138527441.547	48.69	.000
	Residual	37425451478.745	13	2647782422.478		
	Total	263442125677.245	15			

a Predictors: (Constant), LAGG Internal Debt, Internal Debt b. Dependent Variable: GDP
Coefficients

Model		Un-standardized Coefficients	Std. Error	Standardized Coefficients	t	Sig.
		B		Beta		
2	(Constant)	71058.90	35525.145		1.978	.106
	Internal Debt	2.75	1.745	-2.145	-3.781	.001
	LAGG Internal Debt	3.81	1.145	4.836	5.780	.002

Relationship Between Total Debt and GDP.

a Dependent Variable: GDP

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics	F	df1	Sig. F Change	Durbin-Watson
					R Square Change	Change			
3	.987	.975	.941	12311.945	.975	390.71	1	.000	1.75

a Predictors: (Constant), Total Debt

b Dependent Variable: GDP

ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
3	Regression	114562037758.444	1	112342037814.123	390.71	.000
	Residual	3457899612.244	14	244145686.325		
	Total	104560076599.121	15			

a Predictors: (Constant), Total Debt

b Dependent Variable: GDP

Coefficients

Model		Un-standardized Coefficients	Std. Error	Standardized Coefficients	t	Sig.
		B		Beta		
3	(Constant)	-89765.172	2013.659		-2.16	.130
	Total Debt	3.87	.003	.972	23.61	.000

a Dependent Variable: GDP

Model Summary

	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
Model 3					R Square Change	F Change	df1	df2	Sig. F Change	
	.991	.984	.947	7945.145	.984	475.45	2	13	.000	1.75

a Predictors: (Constant), LAGG Total Debt, Total Debt

b Dependent Variable: GDP

ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
3	Regression	101245692274.3421	2	53414546127.625	475.45	.000
	Residual	1042585560.456	13	78337322.125		
	Total	108526077481.691	15			

a Predictors: (Constant), LAGG Total Debt, Total Debt

b Dependent Variable: GDP

Coefficients

Model		Un-standardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
3	(Constant)	95350.47	6144.145		2.13	.110
	Total Debt	3.45	.152	-.121	-3.16	.120
	LAGG Total Debt	4.15	.136	2.742	7.62	.000

a Dependent Variable: GDP

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