CHAPTER-I
INTRODUCTION

1.1 General Background

This thesis is related with financial securities market. More concern with central bank and government borrowing through financial market.

Finance is essential for the all sector like individual, household, business as well as for government also to fulfill their revenue and expenditure as borrowing and lending. Government of any of the country in the world gets its financing income mainly from two sources one internal and other is external based on geographical classification. Internal source can be categories in two types namely tax revenue and public debt (internal borrowing). Government financing through foreign country's fund (either aid or debt) is known as external source of financing. And on the basis of income source it can be also classified in two ways are Government revenue and Government borrowing (debt)? It is not obligation public revenue (i.e. from tax and custom duties) to return anyone else. On the contrary, public debt carries with it the obligation to pay money back to lenders (Persons, institutions, or countries) from whom it has been obtained. Debt borrow from citizens of own country is called internal debt and debt borrow from other than internal source i.e. foreign country is called external debt. An internal debt is owed by a nation to its own citizens and it poses no burden but an external debt is owed by a nation to foreigners and it is burdensome.

Different economist and professionals have defined the public debt in different ways. "The accumulated amount of what the government has borrowed to finance past deficits is called public debt."[1] Public Debt refers to the process of

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[1] Paul A. Samuelson and William D. Nordhaus, ***Economics (Fourteenth edition),*** Mc Graw Hill Book Company, Tronoto, London, 1992, P 628.

raising loans from internal as well as external sources. Therefore, the public debt is the total amount of debt raised through internal and external sources. “Public debt carries with its obligation on the part of the government to repay the loan together with interest to the people from whom it has been taken.”[2] The government of a country can go to domestic or and\ or international capital market and borrow funds from there. In this context, MC Vaish and Agrawal have further elaborated that “Internal debt is raised by the government from the individuals and institutions within the country while external debt is taken by the government from individuals, institutions and/ or governments of foreign countries.”[3]

The relationship between government and public is interdependent and correlated. Governments are preparing all policies, strategy and plans to social stability, development and national sovereignty. In other words all government moves are public oriented. In order to fulfill social needs government require money or funds. That money for government could be arisen from tax collection, custom duty, revenue from investment on development sector and public enterprises. Most of the developing countries also get the foreign aid to fulfill their deficit. Despite these collections government could not meet the gap between revenue and expenditure or if government have to spend more money than budgeted then it could be fulfill through internal public debt. This is collected by issuing bonds and notes.

In developing and under developed countries financing government budget is the main problem. One easy way of financing for the government is increase tax rate which may results unbalanced economy through increase in price level. To escape from this complex situation the government can utilize the public borrowing methods. Public debt can be collected through market borrowing

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[2] Mc Vaish and HS Agrawal, ***Public Finance (Fifth Edition),*** Willy Eastern Ltd., Delhi, 1992,p 192
[3] Mc Vaish and HS Agrawal, ***Public Finance (Fifth Edition),*** Willy Eastern Ltd., Delhi, 1992,p 196-197

and non-market borrowing. Government securities and bills are the example of market borrowing, which have fixed repayment time and interest rate. Non-market borrowing covers the small savings of the people in banks as well as post offices and co-operatives, which may be used in investment indirectly.

The Governments of developing countries are facing many problems relating to the public borrowing. First, the source of debt is narrowing due to low and unorganized level of domestic savings and inadequate banking facilities in rural areas rather than urban areas to assemble the saving for national development. Second, the capital market is in a preliminary stage and the organized private sector is not enough to fulfill the necessary amount of money to spend in securities and bond. In addition, investment in the developing countries which occurs in real estate (such as land, buildings and precious metals) which reduces the liquidity of the people and in turn, hinders the borrowing from non-banking sector.

Nepalese economy is based on mixed economy. Nepalese economy was always facing economic instability from earlier stage of economic development. Government is always struggling for control and fulfills the deficit budget but they have still facing similar type of problem and also in developing stage. History of public debt in Nepal is not such a long one. Though there are some traces of public borrowing in history, however the scientific borrowing in Nepal has started in 1962 after the promulgation of Public Debt act 1962. After promulgation of these acts the process of raising internal debt has been started in systematic manner in Nepal. Treasury bills are auctioned every week and long-term bonds are issued within the various months within a year. The trend of public borrowing is (often) increasing each and every year. Similarly, in the process of obtaining external debt the first foreign creditors being USSR and UK in 1963/64. Gradually, the process of raising loans from internal and external sources is come out like basic needs of government budget of Nepal.

During the plan periods the government initiated to pay the public in the form of debt securities as well as to lunch some programs. The government issued compensation bonds for land acquisition with the interest rate of 3% per annum and with the maturity periods of 10 years, amounting Rs. 407 thousands and compensation bonds with one percent interest rate for 20 years of maturity, amounting Rs. 5.56 million. The other components of the borrowing were also made from Nepal Rastra Bank and it was provided against special bonds to the government. The government started to borrow by issuing national saving certificate since 1984, which amounting Rs. 5 billion.

Borrowing fill the gap between revenue and expenditure, when expenditure exceeds revenue government can borrow through increase tax, internal debt, external debt etc.

Central bank has a major task and responsibility to stabilize the economic growth and financial system. Thus all the major government fiscal, monetary and economic policies are being smoothly implemented in the country with the active support and help of the central bank. The Nepal Rastra Bank (NRB) fulfills the role of the central bank in Nepal. It also serves as a banker to the government. It also regulates and control foreign exchange operation, banking system and financial institutions and serves as lender of last resort. It is actively involved in the development and reform of the financial sector.[4]

To tackle the deficit budget, (of Nepal) NRB issues various types of securities to collect the funds from public.

[4] Manohar K. Shrestha and Dipak B. Bhandary, ***Financial Markets and Institutions,*** Asmita Books and Publishers & Distributors, Kathmandu, 2008

Short term securities

- Treasury Bill
- Promissory Notes

Long term securities

- Development Bond
- National Saving Bond
- Citizen Saving Certificate
- Special Bonds

1.2 Statement of the Problem

The government expenditure is increasing rapidly each year, but government revenue is not growing in the same pace. It is very common to know that rise in the magnitude of public debt must be accompanied by an increase in the debt servicing capacity. So that there may not be under strain on the balance of payments owing to outflow of funds through debt servicing and there may not be unnecessary increase in the rate of taxes for meeting the requirement of internal debt servicing.

It is generally observed that the present increasing size of Nepal's public debt is matter of concern. Though, public borrowing as a means of rising fund is applied in a wider perspective, it is necessary to have a careful loose on the increasing magnitude of public debt and proper care must be taken to increase the debt servicing capacity of the country.

The present feature of Nepal's budget is that there exists a huge fiscal and budget deficit. The trend in revenue saving is decreasing in fiscal year 061/062 only 24.5 % of total development expenditure was financed by revenue supplies. On the years, only about 20-30 percent of development expenditure has been financed through revenue saving and rest through mobilizing external assistance and internal borrowing. This shows that our development expenditure is mostly depended on borrowing.

Our country has become aid dependent country; there is increasing reliance on external assistance. Foreign assistance has become major source of financing development expenditure. Similarly, foreign borrowing has become the major source of financing deficits in the government budget. The increasing dependency of the country upon external borrowing is due to poor and inadequate resource mobilization. Both the scarcity of internal resources as well as necessity of external resources have caused for such massive increasing in external borrowing. Ever increasing debt and debt servicing obligations will create a serious problem in the economy like 'debt trap ', colonization, internal public instability etc. In short there may be appear macroeconomic imbalances and this makes excessive dependency upon foreign assistance, all the factors have forced to increase foreign dependency.

1.3 Objectives of the Study

The study will be confined on the following objectives:

1. To, Analyze the trend and structure of the Government securities in Nepal,
2. To, Find out whether collected internal debt amount being used for capital expenditure or not
3. To, Describe system and practice of government securities in Nepal
4. To, Examine the beneficiary of internal debt with comparison to external debt
5. To, Recommend for the improvement based on research finding.

1.4 Significance of the Study

This study is expected to make a clear concept on government securities while making investment. Government securities are safe, marketable and liquid instrument to invest the funds. Only government securities have systematic market for the prospective investors. Therefore, an independent study in this sector is significant to give information about the government security market by analyzing the trend of investment and their yields. This study gives information about short-term government securities and long-term government securities. The government issues are less risky issues. So, risk averter investors normally invest in the government securities. This study will prove helpful to the individual person, a group, and any institutions who want to know about government issues. This study will be useable and valuable for academician, teachers, students and any institutions who want to know about government issues.

1.5 Importance of the Study

The huge fiscal deficit in Nepal resulted from small resource base and huge development requirements made the government depend upon the foreign assistance. In recent trend the donor countries do not want to give money directly rather they prefer to business activities. So, the direct foreign assistance is declining and the loan component is increasing. The development requirements have increased because of globalization process. All these factors have increased the volume of debt. Hence, the existing scenario of public debt is very discouraging.

This study will focus on the existing scenario of public debt, necessity of borrowing, trend and structure of public debt and the consequences of debt in the overall performance of economy. So, this study will be beneficial for the readers, who are interested in international relationships, the institutions involved in financial market etc. They all can get a clear cut idea about various aspects of public debt.

1.6 Limitation of the Study

1. This study covers a time span from the F.Y. 2001 through F.Y. 2009
2. This study is not related to external government debt.
3. This study is not related to macro economics like inflation, monetary policy etc.

1.7 Organization of the Study

This study is organized into five chapters. Each denoted to some aspect of the study of clearing and settlement system. The title of each of these chapters is as follows:

Chapter I	: Introduction
Chapter II	: Review of Literature
Chapter III	: Research Methodology
Chapter IV	: Presentation and Analysis of Data
Chapter V	: Summary, conclusion & Recommendations

The rational behind this kind of organization is to follow a simple research methodology approaches. The contents of each of the five chapters of the study are briefly mentioned below:

Chapter one consists of introductory part of the study. The chapter consists of background, statement of problem, objective of the study, significance of the study, limitation of study and organization of study.

Chapter two includes the brief review of available literature on related topic. It includes a discussion on the conceptual frame work and review of major studies.

Chapter three includes the research methodology employed in the study. This chapter deals with the nature and serious of data research design, population and sample, data collection procedure and method of analysis.

Chapter four deals with the presentation and analysis of relevant data with the help of various financial and statistical tool and techniques.

Finally, chapter five incorporates summary, conclusion & recommendations of the study which are the important aspects to solve the problems associated to the present analysis and offers recommendation for the improvement in future.

CHAPTER-TWO
REVIEW OF LITERATURE

2.1 Introduction

Nepalese economy is passing through the critical phase of low-income level equilibrium trap, vicious circle of poverty and huge resource gap. These problems can be solved not only by the investments from the private sector but also by the deliberate actions of the government in the field of socio-economic infrastructure and directly productive activities. The regular sources of government revenue are insufficient to meet the required expenditure. So, government has to rely upon debt.

Public debt is a modern invention and was not heard prior to 18th century. Economists have been arguing and discussing for and against of it. Particularly, the classical economists such as Pigou, T.R. Malthus, J. B. Say, Adam Smith and Ricardo opposed public debt saying, nations once they began to borrow, would be able to resist until they reached the point of bankrupt". Where as post Keynesian and the modern economists including J.M. Keynes, Harris, Hansen, Buchanan, Musgrave, Davis, Kopt and others have challenged the version of classical economists and holds opposite opinion on the subject of public debt, it's size and use.

In Nepalese context, government started to use deficit financing from 1964. The deficit was fulfilled by printing money, issuing HMG securities, borrowing from internal and external sources etc. Many development projects also initiated with the assistance of foreign countries and agencies. On the other hand the internal causes of increased government expenditure and inflation made government compel to accept and take debt.

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

With the increasing role of government, public debt is sharply increasing from the last four decades. In this context, the theoretical aspect underplaying the need and use of public debt will be reviewed.

2.2 Classical View

Classical economists advocated for a balanced budget and therefore, in their analysis public borrowing found no significant place. They were of the view that as for as possible public borrowing should be avoided and if the government is compelled to borrow, government should finance its current expenses entirely out of the taxes and only that project should be financed through public borrowing which is productive in nature so that debt would be liquidated ultimately and the whole process will be self liquidating.

In the worlds of R.A. Margrave "self liquidating project may be defined narrowly investment in public enterprises that provide a fee or sales income sufficient to service that debt incurred in their financing, or they may be defined broadly as expenditure projects that increase future income and the tax base. Such projects permit servicing (interest and amortization) of the debt incurred in their financing without requiring an increase in the future level of tax rate."

J.J. Mill propounded the view that public debt should functions as the balance wheel of the economy. Following Mill, Sweetener states that public borrowing is the equalizer depending upon the conditions of trade in the short-run but in the long run it is inappropriate because it will raise the rate of interest and puts undesirable burden to the economy as a whole. In the long run, it is assumed that economy will be in full employment equilibrium level. Only on the short run, public debt can rationalize the resources to generate more employment opportunities and favorable terms of trade. Therefore, the use of public borrowing is conceived as the balance wheel in the economy. It keeps resources fully employed, and prevents stagnation in any part of the economy from having and adverse effect elsewhere. In addition public debt is a necessary instrument of war finance."

Adam Smith also favored balance budgeting and rejected unrestricted borrowing. Two conditions were put by smith to adopt debt, which are:

- For war finance
- For establishing social and economic infrastructures.

For all the rest conditions, classical economists preferred taxes than debt for the following reasons.

- Deficit financing means an increase in public debt. Since it is an easy method of obtaining income which leads government to be extravagant and irresponsible that's why public debt imposes definite burden on the economy.
- Debt servicing (payment of interest) and refund of the principle will require additional taxation. It might prove to be difficult since government power to tax is not unlimited.
- Deficit financing might produce currency deterioration and rise inflation.

Distinguishing between loan and tax, C.F. Bastable has clearly wrote, "A loan is voluntary, and supplied by willing givers, taxation is levied on the willing and unwilling alike. To make things smooth for the present at the cost of the future is not the duty of the wise and far-seeing statement".

Harris pointed out that 'Debt creates burden on the economy because of its unproductive nature".

2.3 Keynesian View

In the analysis of their public debt, classical economists assumed the existence of full employment, inelasticity of money supply and the unproductive nature of public expenditure. They were afraid of the fact the public borrowing will compel the government to tax the public and thus the economic system will be disturbed the optimum allocation of recourses.

But the economics of depression or Keynesian economics reflected a truly significant revision on the theory of public debt. The economic condition created by the great depression of 1930's gave way to the development of the new theory of public debt. Keynes did not accept the classical notion of a free enterprise economy, which is self-equilibrating at full employment level. He advanced the concept of underemployment equilibrium. Private sector alone is not capable to utilize the resources optimally. So, compensating action must be taken by the government, which raises the level of aggregated demand and income. Hence, public borrowing need not necessarily be unproductive, inflationary and burdensome. Separating public debt into internal and external debt, many Keynesians hold the view that if debts internally held, there is nothing to worry about their size. Such a debt involves merely a series of transfer payments and they cancel out for the economy as a whole. Hence, only concern should be about economic stability at high levels of income and employment.

Holding the same argument, Samuelsion states that "an internal debt is owned by a nation to its own citizens and it poses no burden. An external debt is owed by a nation to foreigners and it is burdensome."

S.E. Harris maintains; "It assumes elasticity in money supply and agreed that government expenditure could be productive and need not necessarily be wasteful, and so case for public borrowing is strengthened. Those who follow can take into account the income generating aspects of the public debt and reject any possibility of internal debt being burdensome upon the community."

2.4 Post-Keynesian View

During Second World War and in 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 position accepts a large part of the modifications of the classical debt theory as brought about by Keynesian economics. It emphasizes on the transfer and management aspects as well as the interrelationships between public debt and money supply. According to such thinking, public borrowing does not always deprive the resources of private sector and not accepted that it creates inflationary situation in a period of full employment. It depends on the circumstances. If borrowing taps funds otherwise spent on consumption, it is not more inflationary than taxation. A large public debt, if internally held, posed many problems for the economy. It complicated monetary policy and creates difficulties of management.

Post-Keynesian Economist Richard Goode views that internal borrowing should be avoid to pay for government consumption expenditure, which will cause a curtailment of national saving and investment. On the other hand borrowed money when used to finance public investment causes no such reduction: all that will happen is the change in the composition of capital formation." 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 government consumption promoted growth."

A. H. Hanson has written an article on effect of public borrowing on redistribution of income where net transfer of resources from lower income groups to upper income groups.

He further states "If government borrowing is taken from the small savers, the increase in the size of public debt will not prove unfavorable to an equitable distribution of wealth. But if the growth of it 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 and by large corporations. A rapid growth in public debt is therefore likely to intensify inequalities in wealth distribution".

2.5 Recent Thinking on Public Debt

Now a day, especially in developing country, public debt is used as fiscal instrument to raise the effective demand, which ultimately leads to accelerate the pace of economic development. It also acts as an effective instrument of monetary policy for combating with inflation generated in the process of growth and ensures growth with stability. Therefore, it is known as a balancing wheel that controls the tempo of business cycle. The compensatory fiscal policy suggests increase in public expenditures and public works by mobilizing idle saving through public borrowing to create effective demand and to promote economic recovery.

Michael posner points out that growth in the debt ratio causes alarm for two reasons. First, growth in debt ratio to crowding out of private investment. Second and more important is the assumption that government spending out of borrowed funds might be unproductive.

In a book published in 1964, Avramovic and colleagues at the World Bank approached external borrowing in terms of a country’s debt servicing capacity. They provided as useful framework for the examination of external borrowing: assuming that country borrows only to help finance well - conceived development programmers. A vramovic and his co-authors visualize three stages in the external debt cycle. In stage one, the country’s saving is below the desired level of investment. It borrows from abroad to finance part of its investment and also to service the external debt. The burden of debt serving is continuously deferred and the debt increases rapidly. In stage two, saving has grown enough to finance all domestic investment however, the country continuous to borrow abroad to cover service cost of the debt. The external debt grows but ate slower rate in stage one, at the end of the stage two it reaches a maximum. In stage three, the country stops borrowing abroad to cover interest payments and being to reduce the external debt. A very poor country may take a long time to move through stage one and two, if the return on capital obtained by foreign borrowing is low relative to the interest rate, it may never reach stage three.

Chelliah observes that the idle situating is one which first, revenues will meet subsides, other transfer payments and the greater part of current expenditure, debt finance will be used for meeting the government's non remunerative capital formation, a proportion of current expenditure designed to increase social capital and productivity and the requirements of financial investments and second, the total of domestic borrowing will be determined in such a way that given the rate of domestic saving, the non-government sector will be to obtain a due share of saving and that there will be no need to borrow from the central bank more than current amount of seignior age.

E.D. Domar in his classic article has defined Public debt as the ratio of the total debt to the national income. He lays down the conditions under which the burden would decrease or increase over time.

2.6 Literature Review in Nepalese Context

Acharya Purushottam (1968), first exercise on debt was submitted to Tribhuvan University. He includes features, problems and pattern of public debt and reached the conclusion at public debt was most popular in these days because of the payment of debt on maturity can be adjusted through the issue of fresh public debt. But the fact of that habit of purchasing bond issued by the government should be developed among the people so that no difficulty may be faced in getting the bonds purchased by the people.

Joshi Mahesh Raj (1982) examined the structure of public debt in Nepal and the importance of public debt in financial development. Separating public debt into internal and external debt, he concludes that internal debt can play pivotal role to develop money market and capital market and external debt is mainly for rapid economic development and to fill up the resource gap in the country.
Upadhaya Kamal Prasad (1985) analyzed indebtedness of the country with increasing external borrowing and analyzed the determinants of external borrowing in Nepal.

Sharma Briju Prasad (1987) examined the positive as well as negative impact of public borrowing in the process of economic development. He further maintains, "The expansionary impact of the ownership pattern of securities has contributed to the inflationary spiral in the country. And hence it has caused several real burden of public debt."

An article by Dr. K.K. Guru Gharana presented data on the share of outstanding foreign debt in GDP at factor cost and of foreign debt servicing in regular expenditure (1984/85-1993/94. He found long-term upward increasing trend of such ratios. He concluded that "Although foreign loan is relatively much softer terms for Nepal compared to India and China, the very low rate of return and increasing share of loan in foreign aid implies that aid is slowly pushing Nepal towards a debt crisis in the coming years.

Acharya Keshav Prasad (1998) analyzed that the internal debt is more productive than external debt, Dividing GDP growth rate by the growth rate in internal debt; he found that there are seven out of eleven observations when GDP growth rate exceeds the growth rate in domestic public debt. There is only on instance when GDP growth rate exceeds the growth rate in external public debt.

Sharma Guna Nidhi (1998) analyzed that the increasing trend of debt in Nepal and its servicing has really created a situation which, leads the country towards debt-trap because of the following reasons.

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

Khatiwada Yuba Raj (1998) in his Article entitled "Public debt management and macroeconomic 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.
- Debt obligation to the government resulting in higher budgetary deficit which further contributes to monetary expansion having subsequent repression on the internal as well as external sector stability.
- Has crowed out resources available for private sector investment.
- Has upward pressure on the market rate of interest.

Koirala Laxmi Bilas (2002) has viewed that if debt is not handle properly, our generation to generation may tire paying back ancestral earnings. In this perspective, he prescribed some policies to mitigate the pain and adverse effects of ever-increasing trend of public debt in Nepal.

- Loan assistance should be utilized selectively, after careful scrutiny of the purpose. Cost and benefits of such projects and programmes should be carefully analyzed in order to reduce burden of external debt while contributing to accelerating growth meeting socio-economic objectives.
- The MTEF should be implemented effectively.
- Increase the share of tax and reduce the dependency on foreign debt for the financial resource mobilization.
- Unproductive expenditure should not be made out of foreign grant or loan.
- Proper attention should be given to the macro-economic stability of the country while accepting short - term and long -term loans.
- Proper attention should be given to cost benefit analysis when using public debt.

Kunwar Keshar Bahadur (2002) reached the conclusion that "Government borrowing has been increased unlikely and financed mostly on the unproductive sector and hence government always lacks the resources, then borrows the new loan to pay the previous ones". He argued that "such excessive dependency upon external loan may lead the nation into a debt trap, if the terms of trade are nit improved. Therefore, extra care should be exercised in procuring such loans".

2.7 Review of Master Degree Thesis

- A study done by **Mr. Purshotam Acharya** (2003) entitled *"A Case Study on Public Debt in Nepal "*his study includes different kinds of debts. Feature of different bonds and redemption of bonds, pattern ownership of binds and aims and effects of public debts in the economy. He described that the issue of public debt puts idle money lying with the people put into active use by channeling it into productive purpose for spending up the economic development of the country. He reached on the conclusion that public debt is most popular these days because of the repayment of debt on maturity can be adjusted through the issue of public debt, but the fact is the habit of purchasing bonds issued by the government, should be developed among the people so that no difficulty may be faced in getting the bonds purchased by the public.

- A study done by **Mr. R.M Sivakoti** (2003) *entitled "The Issuances and Payment Process of Public Debt in Nepal".* Has analyzed government should not borrow the public debt to meet even a minor budgetary insufficiency as far as possible. However the government should raise the debt internally if it is imposed to maintain the capital without levying and charging the additional taxations. He further considers the internally raised debt is preferable instead of external debt for strong and sound economic betterment. He has understanding explained the following.
    - Theoretical aspects and principles of issuance of public debt.
    - Action system that has been followed by NRB to collect the debt internally.
    - Issuance and payment process of short – term government securities as well as long term securities.

A study done by **Mr Hari Krishna Koirala** (2009) *"Public Debt in Nepal"* analyzed the trend and structure in Nepal. He expressed his view that excursive dependency on foreign loan for development expensiture is persistent because of poor mobilization of internal resources and ever increasing resource gap in the Nepalese economy is not possible to fill up only with domestic resources. These all have reinforced to increase the external borrowing of the government should try for maximum mobilization of internal resources for development purpose and exorbitant upon foreign assistance for development programs should be reduced and it should be contained within the desired extent.

A study done by **Mr. Yaba Raj Khatiwada** (2007) entitled *"Public Debt Management and Macro Economic Stability"* basically dealt with monetary implications public debt. He has found that public debt has:

- Exerted excess monetary expansion, which has indirectly resulted in high rate of inflation and deterioration of current account situation.
- He has pressure on debt servicing to the government resulting in highest budgeting deficit which further contributes to monetary expansion having subsequent repercussion on the internal as well as external sector stability.
- Has crowed out resources available for private sector investment.
- He exerted upward pressure on the market rate of interest. He has further analyzed the situation move alarming as foreign debt of the long term nature is maturating out faster rare and exchange rate of the Nepalses Rupee is depreciation very fast multiplying the debt obligation as well as the debt servicing requirement source of foreign grant is drying up which is property accumulation of foreign debt with lrge development spending of the government through aid, interest rate on domestic borrowing is very high. Making domestic debt servicing, taxing affair, most of the domestic debt is of short term mature but there is less like hood of an improved budgetary if the government in the future.

A study done by **Mr. Shree Bhadra Khanal** (2008) entitled *" Public Debt in Nepal: A Study of its Structure and Burden "*. He analyzed the trend and structure of public debt in Nepal, the role of public debt in financing development and burden of public debt in Nepal. He described that the external borrowing is increasing more rapidly than internal borrowing in the developing countries, like Nepal. Increasing trend of public borrowing, debt servicing obligation are also increased with the same pace. He again revealed that internal 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 facilities the effective implementation of monetary policy. He reached on the conclusion that the system of public debt is one of the best ways of financing development expenditure of the government, which helps to control inflation and to mobilize the internal financial resources in the productive sector of the country's economy.

CHAPTER THREE
RESEARCH METHODOLOGY

3.1 Research Design

This study is based on primary as well as secondary data and descriptive, analytical as well as quantitative approaches are developed to examine the issues. The primary data has been collected to examine internal debt amount use for capital expenditure or not. The study is an examination and evaluation on the deficit budgetary policies as incorporated in the budget documents. The government has been borrowing huge money to recover deficit budgetary system of Nepal. The data, information and polices exacted from the budget documents and economic bulletin from NRB have been presented in meaningful order. Different statistical models such as second degree of trend and other model have been applied to interpret the data.

3.2 Size of Sample

In order to show trend and structure of government debt in Nepal, Eight year data (F.Y. 2001 to 2009) have been taken in to account and the sample for the examines of internal debt amount use for capital expenditure or not only 2 persons select for questioner.

3.3 Source of Data

This study is based on secondary data as well as primary data. Besides, a detailed review of literature has been conducted in order to collect relevant data and information. The review materials are mainly collected from government of Nepal, Ministry of finance, central Library of T.U., Kirtipur, Library of Shanker Dev Campus, Ramshaha path, Library of Nepal Commerce Campus, New Baneshwor, web site of NRB, NEPSE, and other public libraries. Apart from this some useful data, facts and figures are also obtained from investors and experts.

Secondary data : Ministry Of finance
Nepal Rastra Bank
Respective web site
Published books, magazines and journals

3.4 Data Collection Instrument

This study based on primary and secondary data. Besides, a detailed review of literature has been conducted in order to collect relevant data and information. The review materials are mainly collected from central Library of T.U. Kirtipur, Library of Nepal Commerce Campus, New Baneswor and other public libraries. Apart from this, some useful data, facts and figures are also obtained from investors and experts.

3.5 Data Analysis Tools

Financial tools and statistical tools will be used for data analysis.

<u>Financial Tools</u>

For the valuation of short term maturity government securities, following formula will use:

$$\mathbf{V_0 = \frac{MV}{(1+k)^n}}$$

Where,

V_0 = Intrinsic value of bond/security today

MV = Redemption price of bond at maturity date

K = Current market interest rate (YTM)

n = Life remaining for maturity of bond.

In order to find the Bank discount rate (DR) of short term maturity bond the following formula will use:

$$DR = \frac{\text{Par Value of bond} - \text{Purchase Price of bond}}{\text{Par Value of bond}} * 360/n$$

For the valuation of long term maturity government securities, following formula will use:

$$V_0 = INT\ (PVIF_A, k\%, n\ year) + MV\ (PVIF, k\%, n\ year)$$

Where,

V_0 = Intrinsic value of bond/security today

INT = Coupon interest amount received from bond

MV = Redemption price of bond at maturity date

K = Current market interest rate (YTM)

n = Life remaining for maturity of bond

Statistical Tools

1. Regression equation line will use to forecast the amount of government internal debt in 2009 AD.

Let, X and Y are two variable, among which X is independent (known) and Y is dependent (unknown) variable. That is, by the help of known variable X, we have to forecast the value of unknown variable Y. Then

Regression equation of Y on X is given by,

$$Y = a + bX$$

Where,

a = Constant value

b/b_{YX} = Regression coefficient of Y on X

And its two normal equations are,

$$\Sigma Y = Na + b\Sigma X$$

$$\Sigma XY = a\Sigma X + b\Sigma X^2$$

2. In order to present the final result of thesis in simple manner, different diagram, graph and chart will be use.

3.6 Methods of Analysis and Presentations

To analyze the data eight years data every sources of internal debt will be taken. And in each and every year, relative Wight of various sources with comparison to each other will be shown by Pie-Chart. Also the increment in debt amount in current year with comparison to previous year will be shown by mathematical calculation method. The formula which is used to find out the percentage increased or decreased is given by:

% increased/decreased in amount of debt collected this year =

$$\frac{\textbf{Current year amount - previous year amount}}{\textbf{Previous year amount}}$$

(Positive value suggests that there is increment in debt collection with comparison to previous year. And Negative value suggests that this year debt collection has been decreased with the comparison of previous year)

CHAPTER-FOUR

DATA PRESENTATION AND ANALYSIS

This chapter deals with the presentation, analysis and interpretation of statistical data carryout the research work. Here, the study presents the collected data carryout the research work. Here, the study presents the collected data of various purpose of analysis. The data are analyzed by using various statistical and financial tools. The analyses data and results are presented in each topics and subtopics and. this chapter includes five subchapters, they are following.

a) Trend and structure of Government securities in Nepal.

b) Internal debt amount use for capital expenditure or not.

c) System and practice of government securities in Nepal.

d) Major Finding.

4.1 Trend and Structure of Government Debt in Nepal

4.1.1 Introduction

The government of Nepal has been raising public debt since the first budget speech of Nepal. The analysis is made on the basis of amount raised in term of treasury bills, national saving bonds, special bonds and citizen saving certificates. Overdraft is also taken as internal debt for the analysis of the structure of the taken as internal debt for the analysis of the structure of the debt.

Internal debt is interrelated with the basic government fiscal flows of revenue and expenditures. If the volume of the government expenditure exceed the volume of government revenue, fundamental precondition for creating public debt. Debt creation should be viewed as one of several alternatives financial managements. And "Debt is merely a means of meeting a particular budgetary situation, namely a deficit budget caused by excess of government spending over receipt".[5]

Internal borrowing is one of the appropriate sources of public borrowings. It is applied as means of mobilizing internal resources in the development process of the country in a wider prospective. The collected funds through public debt should be used in the social welfare sectors, like as; to develop infrastructure, to build school, hospital, drinking water etc. these are the main principle of public debt. Because of these sectors, private investors are not willing to invest due to lack of sufficient return in short term however these are the very important for the people. During the period of the world war, the government of concerned countries borrowing policy helped to transfer the ownership of resources to the hands of government from the hands of people scattering all over the country" [6]. In the "Investment strategy in Nepal; published by the World Bank, it is suggested to keep the internal debt with in 2 percent of GDP of nations." [7] Government borrows the amount that equal to the gap between aggregate expenditure and current revenue.

The expenditure and revenue generation are not same pace in the Nepalese economy so, Nepal has been suffering from shortage of capital since the first budget speech. The main source of revenue generation is custom duty. Due to frequently changes in political situation, the government has not been able to implement efficient and effective policy to collect revenues in Nepal.

Generally, Public borrowing is for following reasons;

a) To recover the deficit budget.

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5 Herber,B.P., **A modern public finance, fifth edition**, Laxman Chand Arya publication, Krishna Nagar,delhi, India

[6] Mahesh, Ram Joshi (1982), **Structure of public debt in Nepal**, Master Thesis, T.U., Kirtipur

[7] Visma Upreti (1999), **Public debt in Nepal (samachar)**, Kathmandu, the annual publication of NRB, p.117

b) To maintain the welfare state and economic development

c) To maintain peace and law and order

d) To maintain economic and monetary stability

4.1.2 Trend and Structure of Government Securities in Nepal

Every Year, the government has adopted a deficit budgetary system in the name of development functions. The government of Nepal has been issuing four types of securities. Therefore, government issues various bonds to recover the deficit budget of Nepal. The treasury bills, development bonds, National saving bonds, special bonds, Citizen saving certificates and overdraft are the debt-borrowing instrument in Nepal. Now, there are treasuries bill, Development bonds, National saving certificates and special bonds are the main sources of internal borrowing. The types and amount of government securities under the review period 2001-2009 is tabulated below.

Table 4.1

Trend and Amount of Government Securities Issued in Nepal (2001-2009)

(Rs. in Million)

Year	Treasury Bill	Development Bond	National Saving Bond	Citizen saving certificate	Special bonds	overdraft	Total debt
2001	21026.9	4262.2	11526.5	0.0	17541.4	522.7	54879.7
2002	27610.8	5962.2	12476.4	0.0	13994.3	6546.7	66590.5
2003	41106.6	11090.7	11536.3	628.1	9259.4	5897.2	79518.3
2004	48860.7	16059.2	9629.8	931.1	9164.5	0.0	84645.3
2005	49429.6	17549.2	9029.8	1178.9	8946.2	0.0	86133.7
2006	51383.1	19999.2	6576.8	1429.9	8176.3	0.0	87565.3
2007	62970.3	17959.2	3876.8	1678.9	3469.8	391.0	89564.9
2008	74445.3	19177.1	1516.9	1391.0	2773.5	0.0	99303.8
2009	82568.0	19565.4	1516.9	2388.0	1191.2	0.0	107229.5

Source: Quarterly Economic Bulletin, Nepal Rastra Bank (from 2001 to Mid –April 2009)

In Above Table, the net outstanding internal public debt has been presented in its terms of types such as treasury bills, development bonds, national saving bonds, citizen saving certificates, Special bonds and overdraft. This study has covered also for the analysis of the total internal public debt.

The Five types of government securities are not insignificant. Government has been collecting huge amount by issuing these securities. Treasury bills are short term loan. They are issued for the period of less than one year. Treasury bills are normally floated for the period of 91 days however; sometimes government issues bills for 364 days. Development bonds, national saving bon, citizen saving certificates and special bonds are the long term government securities.

In the above table, Treasury bills in 2001 is Rs. 21026.9 million Which trend growing and reached to Rs.82568.0 Million in 2009. The government has been collected large amount of internal debt from Treasury bills. the loan has been growing sharply from 2001 to 2009.

Similarly, the development bonds have also increased from 2001-2009 The total bond issued is Rs.4262.2 million in 2006 and Rs.19565.4 Million on the years 2009. Such bonds have not increased in comparison to Treasury bills. The trend shows fluctuating during the period of 8 years. Government has been selling huge amount of Treasury bills in the market. Most of the individual and Institutional investors purchase short-term securities. it may be due to maturity of short period. In the 2009, the development bond was issued Rs.19565.4 million. The National Saving bonds have been decreased in the year from 2001 – 2009.

The Citizen saving certificate have been listed in Zero in above table up to 2003. The issue trend of citizen saving certificate have been increasing from first issue. In the year 2003 the government was issued 628.1 million and Rs.

2388.0 million in 2009. In the case of Special bonds, the trend is same as the case of citizen saving certificate it also decreasing trend from 2001-2009. But the overdraft is not like other government securities. It is loan for Government from NRB. In 2005, 2006,2007,2008,2009 governments have surplus funds in NRB account. But in 2001,2002,2003,2004 governments has deficit budget and receive loan from NRB. Thus the above table shows debt policy of Nepalese Government. The Government of Nepal has been borrowing huge amount by issuing various government securities at different times. The various securities are issued for the purpose of fulfilling of problem of the country.

Figure 4.1

Trend Line of Five Government Securities and Overdraft from 2001 – 2009

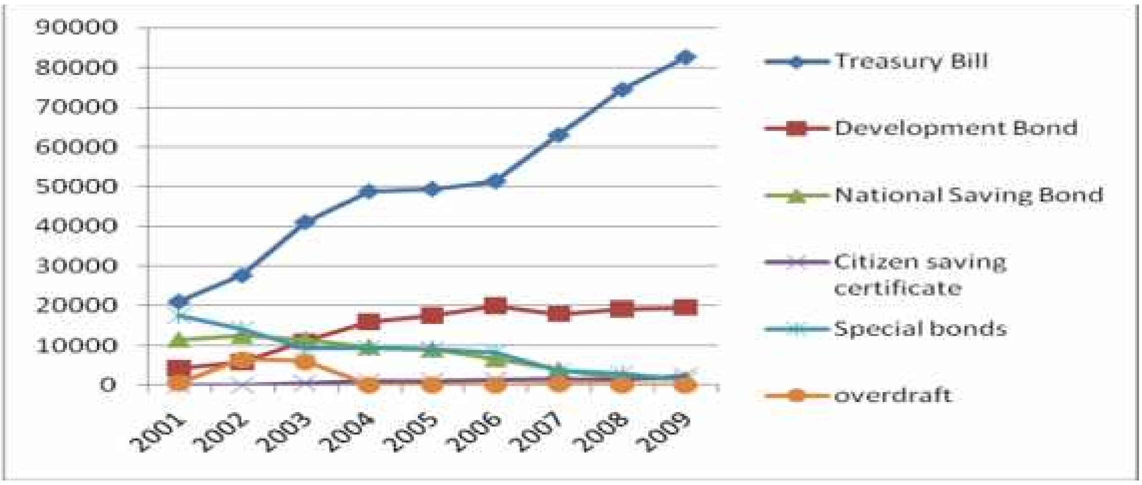
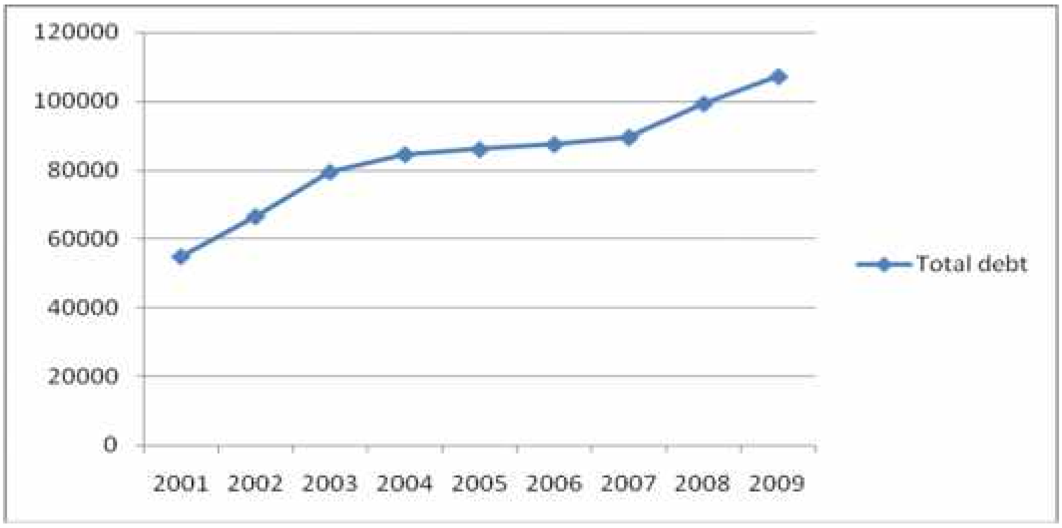


Figure 4. 2

Trend Line of Total Debt from 2001-2009



The trend of treasury bill, Development bonds, National saving bonds, citizen saving bonds and overdraft is fluctuating of total internal debt is upward slopping. The above curve clearly shows the debt collection policy of Nepal government. The government has been selling the five types of securities. They are issued to recover the deficit budget of Nepal.

4.1.3 Fitting Regression Equation

The Figure 4.1.2 shows the debt collection policy of Government. This is gradually increasing. The curve is upward slopping. The straight line trend does not give result according to the nature of data. Here, Regression trend has been used. The equation regression is

$$\mathbf{Y = a + bX + CX^2}$$

Table 4.2
Data Fitted in Regression Equation

(in Rs. Million)

Year(X)	X = X-1997	TID (y)	Xy	x^2	x^3	X4	x^2Y
1989	-10	9042.1	-90421.0	100	-1000	10000	904210
1990	-9	11636.0	-104724.0	81	-729	6561	942516
1991	-8	14929.1	-119432.8	64	-512	4096	955462.4
1992	-7	15079.2	-105554.4	49	-343	2401	738880.8
1993	-6	20855.0	-125130.00	36	-216	1296	750780.0
1994	-5	23857.2	-119286.00	25	-125	625	596430.0
1995	-4	28730.3	-114921.20	16	-64	256	459684.8
1996	-3	31315.9	-93947.70	9	-27	81	281843.1
1997	-2	32800.9	-65601.80	4	-8	16	131203.6
1998	-1	30530.1	-30530.10	1	-1	1	30530.1
1999	0	36839.9	0	0	0	0	0
2000	1	43630.6	43630.60	1	1	1	43630.6
2001	2	50512.0	101024.00	4	8	16	202048
2002	3	54879.7	164639.10	9	27	81	493917.3
2003	4	66590.5	266362.00	16	64	256	1065448
2004	5	79518.3	397591.5	25	125	625	1587957.5
2005	6	84645.3	507874.8	36	216	1296	3047230.8
2006	7	86133.7	602935.9	49	343	2401	4220551.3
2007	8	87565.3	700522.4	64	512	4096	5604179.2
2008	9	89564.9	806084.1	81	729	6561	7254756.9
2009	10	99303.8	993038.00	100	1000	10000	9930380.0
Total	0	997959.8	3614150.4	770	0	50666	39241640.4

Where $N = 21$ $\Sigma X^2 = 770$

$\Sigma Y = 997959.8$ $\Sigma x^3 = 0$

$\Sigma X = 0$ $\Sigma X4 = 50666$

$\Sigma XY = 3614150.4$ $\Sigma\ x^2Y = 39241640.4$

Required solution,

$\Sigma Y = Na + c\Sigma X^2$ ……………………………………………1

i.e. $997959.80 = 21\ a + 770\ c$

$\Sigma XY = b\Sigma X^2$…………………………………………………2

i.e. $3614150.4 = 770\ b$

$b = 3614150.4 / 770 = 4693.7$

$\Sigma\ X^2Y = a\Sigma X^2 + c\Sigma X4$……………………….…………3

i.e. $39241640.4 = 770a + 50666c$

Now solving the equation 1 and 3 by multiplying 770 and 21 respectively

$16170a + 592900c = 768429046$

$16170a + 1063896c = 824074448.4$

- - - ,

$- 471086c = -55645402.4$

$c = 55645402.4 / 471086 = 118.12$

$a = (392416404 – 50666 * 118.12) / 770 = 43190.77$

$\check{Y} = a + bx + cx^2$

$\check{Y} = 43190.77 + 4693.70X + 118.12x^2$

The estimated equation is used to forecast the total of total internal debt for the year 2010, 2011, 2012, 2013, 2014, 2015, 2016. here the internal debt for the 7 years has been estimated below using regression equation. to forecast the total internal debt for these years, the values of x2010, x2011,x2012, x2013, x2014, x2015, x2016 are calculated bellow.

$x2010 = 2010 - 1999 = 11$

$x2011 = 2011 – 1999 = 12$

$x2012 = 2012– 1999 = 13$

$x2013 = 2013 – 1999 = 14$

$x2014 = 2014 – 1999 = 15$

$x2015 = 2015 – 1999 = 16$

$x2016 = 2016 – 1999 = 17$

<u>The forecast internal debt for 20010</u>

$\check{Y} = 2010 = 43190.77 + 4693.7*11 + 118.12*11^2$

$= 109113.99$million

<u>The forecast internal debt for 2011</u>

$\check{Y} = 2011 = 43190.77 + 4693.7*12 + 118.12*12^2$

$= 116524.38$million

<u>The forecast internal debt for 2012</u>

$\check{Y} = 2012 = 43190.77 + 4693.7*13 + 118.12*13^2$

$= 124171.15$ million

<u>The forecast internal debt for 2013</u>

$\check{Y} = 2013 = 43190.77 + 4693.7*14 + 118.12*14^2$

$= 132054.02$ million

<u>The forecast internal debt for 2014</u>

$\check{Y} = 2014 = 43190.77 + 4693.7*15 + 118.12*15^2$

$= 140173.20$ million

<u>The forecast internal debt for 2015</u>

$\check{Y} = 2015 = 43190.77 + 4693.7*16 + 118.12*16^2$

$= 148528.62$ million

<u>The forecast internal debt for 2016</u>

$\check{Y} = 2016= 43190.77 + 4693.7*17 + 118.12*17^2$

$= 157120.35$ million

Table 4. 3

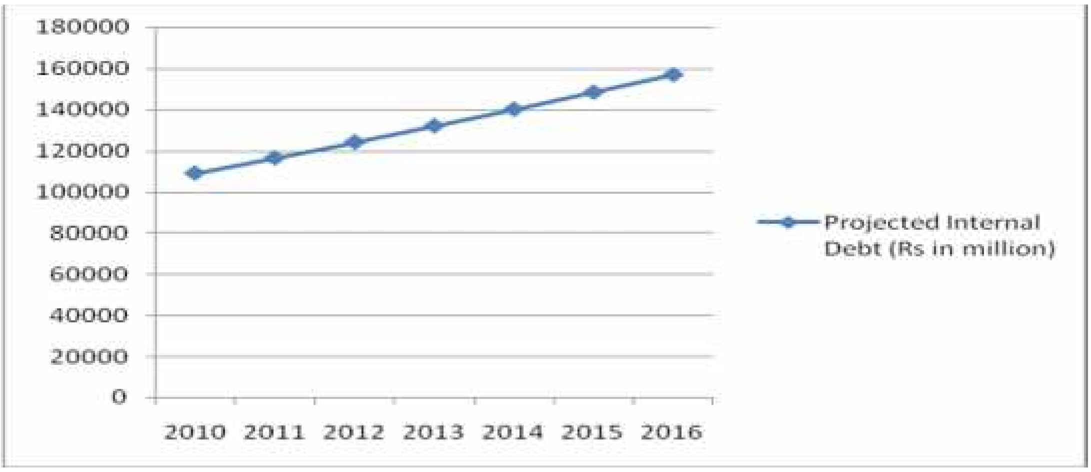
Trend and Amount of Projected Internal Debt from 2010 to 2016

Year	Projected Internal Debt (Rs in million)
2010	109113.99
2011	116524.38
2012	124171.15
2013	132054.02
2014	140173.2
2015	148528.62
2016	157120.35

The estimated internal debt for the years 2010, 2011, 2012, 2013, 2014, 2015, 2016 are Rs. 109113.99million, 116524.38 million, 124171.15 million, 132054.02 million, 140173.2 million, 148528.62 million, 157120.35 million. It is estimated internal debt using regression. The total internal debt has been increasing in every year the projected value can be in the diagram as below.

Figure 4.3

Trend Line of Projected total Debt from 2010-2016



The trend line is gradually upward, which is fitted y regression line. The government's internal borrowing should increase at shown in the above figure.

4.1.4 Percentage Change of Yearly Internal Debt with Total Internal Debt (2001-2009)

The percentage change calculation by using following formula:

Percentage of debt in ….. Years with respect to total internal debt

$$= \frac{\text{total debt in …. year}}{\text{Total internal debt}} * 100$$

So, percentage of debt in 2001 with respect to total internal debt

$$= \frac{54879.7}{55431.00} * 100$$

= 7.3%

Percentage of debt in 2002 with respect to total internal debt

$$= \frac{66590.5}{755431.00} * 100$$

= 8.9%

Percentage of debt in 2003 with respect to total internal debt

$$= \frac{79518.3}{755431.00} * 100$$

= 10.6%

Percentage of debt in 2004 with respect to total internal debt

$$= \frac{84645.3}{755431.00} * 100$$

= 11.2%

Percentage of debt in 2005 with respect to total internal debt

$$= \frac{86133.7}{755431.00} * 100$$

= 11.4%

Percentage of debt in 2006 with respect to total internal debt

$$= \frac{87565.3}{755431.00} * 100$$

= 11.6%

Percentage of debt in 2007 with respect to total internal debt

$$= \frac{89564.9}{755431.00} * 100$$

= 11.9%

Percentage of debt in 2008 with respect to total internal debt

$$= \frac{99303.8}{755431.00} * 100$$

= 13.2%

Percentage of debt in 2009 with respect to total internal debt

$$= \frac{107229.5}{755431.00} * 100$$

= 14.2%

In 2001, the percentage change on total internal debt is 7.3% where as the proportions of percentage have increased to 14.2% in the year 2009. It shows that the percentage of debt has been increasing gradually from the F.Y. 2001 - 2009.

4.2 Use of Internal Public Debt in Capital Expenditure

4.2.1 Some Facts, Commonly Related with Foreign Debt

Mostly the foreign debt or grant comes in form of technical support. That is the donor countries are willing to give the loan as technical form (like technical manpower, equipments, software etc.) but not in cash form. So we could not use this type of loan in any sectors as our necessity. Due to the limited use of this type of loan, most of the grants/loan is being productiveness.

And the loans which are in cash also in American Dolor but not in Naples rupees. While the repayment of loan is made after its maturity we have to greater amount of principle, beside the interest amount. This is why, the value of US dollars is always fluctuating in international market and its trend is generally found in increasing trend. So there is always a huge amount of loss has to be bewared by the home country.

Other form of international loan is the home country is being compelled to invest in investor's interest sector. But not as the required of own.

The donor country makes a promise to give certain amount of loan after certain time interval. After this the home country includes this amount of loan on their coming development programmers through the annual budget or master plan. But when, time gets laps, the promise will not be fulfilled properly. These types of action seriously affect to other plans and policy. Besides this the interference of donor country is often realized. These all drawbacks do not remain in internal debt.

Internal Public Debt

To fulfill the gap of deficit budget, Government Issue (through NRB) different long term and short term securities in domestic capital market primarily. These securities will be held by individual, Financial Institutions and different organizations. That means the Government collect required fund locally or internally (That is by the use of internal resource only).That is why it is called internal public debt, commonly known as "Public Debt" only.

4.2.2 Some other Benefit of Collecting Public Debt

-Small amount of saving which was initially hold by individuals or by organizations is collected and transferred into huge single amount. By investing this amount in capital building or infrastructure building, the massive utilization of local resources takes place which results positive impact on economy, employment national income and saving etc. Beside this there is no other better utilization and movement of internal resources.

-Collecting and not collecting internal debt: These two actions also can be used as the tools of monetary policy.

- While economy passes through serious problem of inflation, at that time Government may collect huge amount of internal debt to stabilize the economy.
- Now the condition is just opposite, economy is passing through recession problem. At that time government make repayment of internal loan.

-Any development programmer, which is established by internal debt means, people are being involved in development programmer. And obliviously "development is, For people by people" is a sustainable action.

4.2.3 Use of Internal Debt as Capital Expenditure

Expenditure can be categorized into two forms:

1. Regular Expenditure

Expenses which are made to fulfill the regular and daily expenses. These expenses are called non-productive expenses. Example: Security and administrative expenditure are regular expenditure.

2. Capital Expenditure

Which increase the level of total national capital stock. For example primarily issue of security and expenses made on making of building and infrastructure. These expenses are called productive expenses. It gives the positive contribution to economy movement. Also to increase employment level and per capita income, this expenditure plays vital role.

Economist J. M. Kenysis said “Almost portion of Internal Public Debt must be used for Capital Expenditure only". So our this study mainly focused on the usage of internal debt.

Conclusion of Study

Government fund is like a vessel, where all revenues of government (Tax, Loan and Foreign grants) are poured. All regular and capital expenditure of Government is made from the vessel. It is hard to find out the sources of any capital expenditure from the overall government revenue. Government revenue is a totality/composite form, different title of usage are made from there. So it is quite tough to make a clear separation of regular and capital expenditure of government revenue/fund.

But we could make a aggregate concept or portion of governmnet fund. For example we take an *Annual Budget of Fiscal year 2064/065.(Source: International Forum-july/august-2009)*

Total Budget (revenue) Amount = 1 kharba 69 arba

Source of annual Budget:

Govn. Internal revenue (tax)	=	61%	= 1.03 Kharba
Foreign grants/loan	=	26%	= 0.44 Kharba
Internal loan	=	13%	= o.22 Kharba

Usage of Annual Budget:

Regular Expenditure (Army+Police+Admin. +repayment of loan) =67%

Capital Expenditure (Education+Health+Agricalture+Road) =33%

Representation in Pie-Chart

Figure 4.4

Sources of Annual Budget

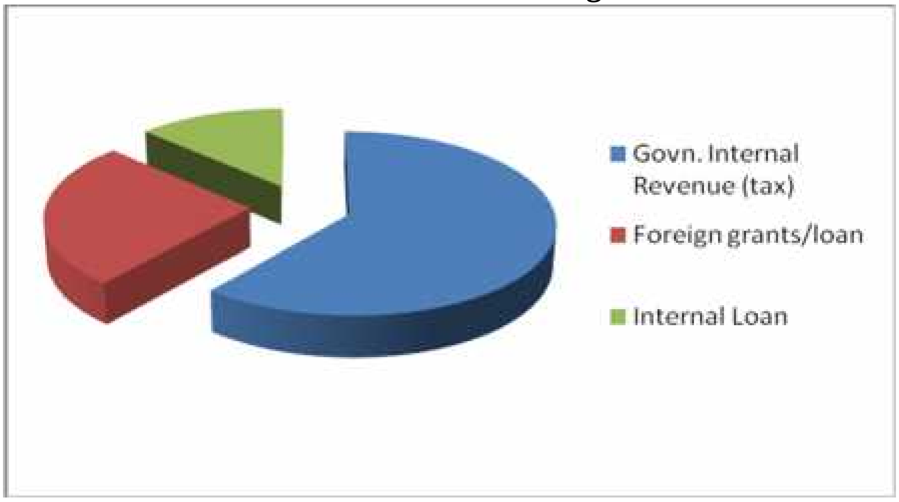
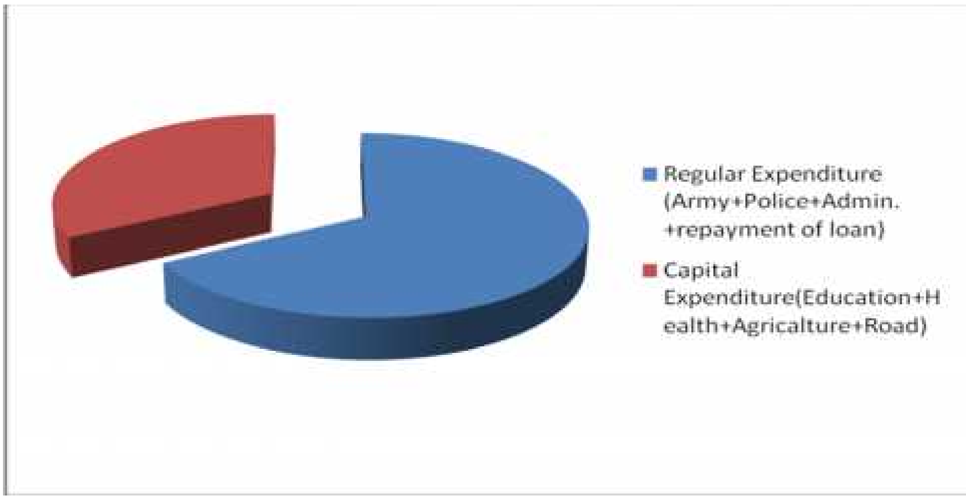


Figure 4.5

Usage of Annual Budget



Internal Public Debt has 13% Weight in total revenue. And this whole amount is supposed to use for making Capital Expenditure, which as 67% Weight in total usage made by Government. And remaining amount (i.e. 67-13= 54%) will be maintained by from foreign grants/loan and from government revenue (tax) respectively.

Hence we could conclude that the total amount of internal debt is used for making capital expenditure as far as possible.

4.3 The System and Practice of Government securities in Nepal

4.3.1 Introduction

Government in every country works with the objective of improving the welfare of the people. Large percentage of people in the country has small income while some people in the country Introduction:

Government in every country works with the objective of improving the welfare of the people. Large percentage of people in the country has small income while some people in the country have high income. People with different income may be different opinion regarding the investment in various investment alternatives. Therefore, government need encourage bonds. There are commercial banks, financial institutions and other reputed private companies in the country that can be used for mobilization of small funds. People in the country invest their saving funds in different investment alternatives. Such investment should be used with the concept of utilization of small funds in the production sectors.

If the person keeps money in the house, it is called idle funds. Such fund does not create earning. Therefore, it should be invested in the productive sectors. The person, who has traditional or conservative behavior, keeps money in the less risky investment as far as possible. They do not intend to bear risk so they search risk-less investment. The empirical test had been conducted in USA and it was found that the investors are risk averters. They prefer risk less investments.

Revenue generation is required for the better functioning of the government activities. But the collected revenues alone do not meet the requirements of government expenditure. Therefore, the government had to issue bonds to meet the deficit financing in the country. Government issues different types of internal debt to fulfill the different desire of the people. Most of the economists and financial analysts have focused that the internal debt is the process of transferring fund from one person to another person. It helps for better implementation of monetary policy of the country.

If country collects funds from external debt, the country's obligation will be high. In addition to this, the country has to follow their rules and regulations.
Securities can be classified either debt-type or ownership type. The government and private companies can issue debt securities, if the securities are not traded in the secondary market, they are called non-marketable securities. Special bonds issued by Nepal Rastra Bank (NRB) are such type of debt securities. Non-marketable securities are also common in economically advanced countries. Such securities contribute 30 percent to total public debt in United States. Government issues only debt securities, based on their capital structure. Holders of debt securities receive interest payment at predetermined rates and principal payment at the maturity of the debt instruments. Thus, periodical interest payment and capital gains are the incentives in bond instruments."Debt securities market in Nepal is highly dominated by government debt securities. Corporate debt securities market in Nepal is extremely limited." [8] Government in less developed countries usually borrow at lower rate than the market rate of interest on one hand on the other, such securities are exchanged in the face value if their value has appreciated in the market.

4.3.1.1 Pricing of Debt Securities

The values of bonds are determined by coupon rate and maturity period of debt securities. It is inversely related to the maturity period and the market rate of interest. The higher the coupon rate, the higher the value of the bond. The

[8] Shree Prasad Poudel (2059), **Nepal Rastra Bank Samachar**, Kathmandu: NRB annual publication

present value of the bond is calculated by summing all discounted coupons and principal payments with the discount rate being the market rate of interest of corresponding years as modeled below. [9]

Bo = C1 / (1+k1) + c2 / (1+k1)(1+k2) + c3 / (1+k1)(1+k2)(1+k3) +………………..+Cn / (1+k1)(1+k2)(1+Kn) + P /(1+k1)(1+K2)+(1+k3)(1+Kn)

Where, Bo is the present value of the bond and p, the principal. similarly K1, K2, K3, Kn and C1, C2, C3, Cn are market interest rates or going interest rates or discounted rates and coupon rates respectively. When market rate goes down, the price of previously issued bonds at higher coupon rate goes up and investors receive capital gains.

Financial repression is a common phenomenon where economies are not liberalized. The government directed system is such repressed market fails to competitively determine interest rate on deposit and lending. While government borrows at rate lower than market rate of interest, the government coupon rates sometimes provide loan return on government debt security in negative at a time when the coupon rate is lower than inflation rate. Risk associated with bond invested reduces the value of the bond. The longer the period of maturity, the higher would be the default risk. Through, the default risk of government bonds is assumed zero, changes in inflation rate, tax rate, market rate of interest and depreciation of domestic currency affect the value of government bond. Thus, pricing of bonds is determined by the relevant macro economic variables as well.

Treasury bills, national saving certificates, Development bonds and special bonds are the government debt securities; they are issued to recover the deficit

[9] Samachar, Kathmandu: **NRB annual publication**

budget. Treasury bills are short-term money market instrument having low return and low risk. Commercial banks mainly hold treasury bills to manage their cash balances. National saving certificate and development bonds are two long-term marketable securities; both are specially sold to NRB and Commercial banks. Coupon Bonds constitute 40% of the total internal debt; have the longest maturity period of about 20 to 25 years and highest risks associated with uncertainly of the longer term.

National saving certificates and Development bonds are the long-term marketable securities available in the exchange market. Market makers facilitate the secondary market transactions of marketable government securities. Settlements of payments are made through NRB. Nepal Stock Exchange Securities ltd. has not yet started transacting government securities in the floor. Buying and selling orders cannot be placed through electronic means exchange of government securities.

Government loan has the all-financial obligations of the nation including its currency or government borrowing. In many cases, the currency is not included in government debt. Moreover, some of them do not include even the overdraft amount from NRB, which must be refunded by the government to the bank within a time limitation.

Government securities classified as two types in terms of internal public debt. They are explained below:

1. **Short-term government debt:** Short-term loan is collected by issuing the short-term government securities such as, Treasury Bills. They mature less than one year. In Nepal, Treasury Bills are sold at discount and pay no interest with the appreciate in value to maturity, which represent investors return. The NRB (on behalf of government) offers various parties for the sale of government securities, for example,

commercial banks, Development Banks, Government and non-government financial institutions, Group of investors, etc. Treasury bills mature after 91 days. Sometimes they are issued 364 days with maturity. Such securities are understood auction system. The party who submits the higher amount of cash can purchase the treasury bills floated by the NRB.

2. **Long-Term Government Debt:** The floating debts are divided in to the bonds and notes. They are issued to provide the funds for sustainable development of the nations, to make the people contemplative to the pride of participation in nation's development and welfare, to draw the liquidity from the market for s long run. Government issues Development bonds and National saving bonds with a long-term maturity period. The government also issues Special bonds, which are in practice today.

4.3.2 Objectives of government Debt

There are various objectives in issuing government securities." in the past, the way of living was very simple and the borrowing was not very significant. The government budgets were very small. The governments also follow the policy of non-intervention in economic system. But in modern times, especially after the world depression of 1930's, the public authorities have started to taken interest in the economic development of their respective countries" [10]

The objectives of government securities are summarized below on the following headings.

[10] L.K. lekhi (1995), **Public Finance**, Kalkotta, India, Kalyani publishers

a) To recover the deficit budget

The most important aim of public borrowing is to fill the gap between the revenue received by the government and proposed expenditure during the year. Modern governments do not have piles of cash or treasure to meet any budget deficit. But because of many unexpected, unplanned revenue, the yield from the taxation and other sources may not be equal to actual expenditure. This is why the government raises funds through the issue of securities.

b) To restrain inflation

It is a condition that we are suffering from the pain of the gradually increasing prices in the market. In other words, we are surrounded by the phenomenon where too much money chases too few goods. In these conditions the government can withdraw a large volume of money from the public to check prices from increasing. Thus the best way to curb private spending is to borrow from the hyper-inflation and maintain the economic stability.

c) To know unpopularity of taxation

Most of the people are not interested to pay the taxes to the government. The tax will be presented by the people whether it may be old or new. People always opposed the enhancement of old rate of tax and the announcement of the new ones. The government through this device can protect itself from the critics of people in regard of levying the tax but it may lead the nation to grim predicament in long run.

d) To maintain economic growth

The state should conduct the general administrative functions and development programmed simultaneously. The government should implement the construction of public works like roads, railway lines, irrigations, powerhouses, etc. for accelerating its economic and social progress. Underdeveloped countries on the hand cannot use their natural resources due to the various constraints and on the other hand theses cannot levy heavy taxation upon their people due to the low rate of real saving of their people. In this situation, borrowing from the people and abroad would be the main and only device of getting financial resources in the nation.

e) To meet unexpected expenses

Sometimes the government borrows from the people to meet the unexpected expenses due to floods, famines, earthquakes, major accidents, epidemics, etc. Such terrible incidents lead the nation to a sudden spurt of the government expenses. On the other hand, there are a great tussles and enmities among the powerful countries for their economic and political supremacy and many other interests. And relatively powerless countries are also bearing the incessant tensions among their neighbors for their respective interests. In this very tense situation, war is the most probable at any time. Now a day, war is becoming very expensive. Of course, a country needs a large amount to maintain its defense service and up to date equipment if it wants to protect itself from its internal enemies or terrorism and foreign aggression and attack. These all cause the nation to be indebted.

f) To allocate resources properly

Specially, the country having the capitalism economic system is not directly liable for its resources allocation. In this and similar other conditions, the country on one hand adopts the progressive tax system and on the other borrows huge amount of money from the capitalists so that the borrowed amount be redistributed towards the poor people in the country. so the borrowing is justifiable in terms of better allocation of resources.

Apart from these all-public loans in modern times are necessary to remedy the business depression, to check the cyclical fluctuations, to finance public enterprises for welfare to create the infrastructures, for establishment of socialistic state and even for meeting the current and regular expenses. It should be noted that different types of loans would be raised for different types of objectives.

4.3.3 Impact of Government Debt

The government debts as well as taxation transfer the purchasing power of people to the government. But in due cause of time cash collected though the taxes and debts are transferred to the people when the state launches the development programmers in the society. In the way, people's property reaches to the people's in another form. However, the cyclical transfer leaves some impacts in macroeconomic situation of the nation and also common public behavior, such as effects consumption, investment, distribution of income, production, etc.

It will be appropriate to examine the impacts of public debt under the following two bases.

4.3.3.1 Advantageous Impact of Government Debt

The classical economists were generally against the government debt. They advocated for the advanced for the balanced budget so that the government would not unnecessarily bear the burden of deficit. Keynes was the first economist who took the position of deficit budget submitting the various theories for deficit budget and Keynesian theory on public finance brought the revolution in economic policy approaches. After the Keynesian theory was set up, most of the countries in the world have been adopting the deficit budget. Most of the modern economists do not deny the need of the government borrowing for following reasons, which can be dealt as the advantageous impacts of government borrowing.

a) Proper use of idle capital

Government raises the loan from the people who save the money for no specific purpose. Most of the lenders are the permanent employees of an institution, civil servant and retired employees. Those sorts of people neither have the sufficient time to utilize the money properly not the inclination for the good entrepreneurship. In this condition government borrows the scattered money from them and use that accumulated fund on the productive projects like irrigation, hydropower, railway, etc.

b) Retraction of over floated cash

The price of commodities and services are growing day by day. One of the factors of increasing the price is the overflow of cash in the market. It is therefore necessary to withdraw the cash from the market. Government borrowing retracts the overflowed money from the rich people in the country so that they cannot spend more cash for their luxurious living. on the other hand, the government invests the borrowed fund in the fruit bearing programmes and here most of the unemployed people get the employment and improve their respective life standard.

c) People's pride in their contribution to nation welfare

it is perhaps the most important advantage of the public debt. It promotes patriotic feeling among citizens. The investors get satisfaction for their contribution to the nation. It makes the people feel that they are also involved in national development in programmes. Moreover, they get the interest income regularly for their properly lent to the nation. Moreover, the interest rates in public debts (mostly in internal debt) will be and it slightly greater than in market and they are considered risk free.

d) Encouragement in Saving

Government securities are purchased by both poor and rich people. The government securities are bonds and promissory notes, which are available at minimum rate of Rs. 100 and dividable by Rs. 100 for furthermore. It indicates the government's desire of borrowing the loan from each sector of society. The government never adopts the policy of charging the tax on the amount purchase of securities. And it generally does not charge the tax upon the interest of government securities. It encourages each type of people to save the money even at small scale.

4.3.3.2 Disadvantageous Impacts of Government Debt

a) Extraordinary spending

There is no restriction for the government in internal borrowing. In case of external public debt most of the proposals from abroad are accepted and they are rarely refused. Due to the various internal factors, the government, for instance, had rejected the loan that was allocated from Arun Third, which was at very concessionary at interest rate. Anyway Nepal has been indebted both internally and externally. But in this thesis, only internal loan has been taken for the analysis.

There is unhealthy completion among the political parties in Nepal. The party (or parties) in power of governance does not hesitate to rise the debt huge internally and externally. Moreover the shameful thing is that the government prides itself for getting the external loan in large volume. The government spends unnecessarily even on unproductive schemes, which brings inflation in the country. Rich people get richer while the poor people are without resource during inflation.

b) Probability of falling into a debt trap

(i) A debt trap simply means the inability to return the amount borrowed from home and abroad.

(ii) If the government raises enormous loans and finances funds on unproductive programmes, naturally the state would be badly indebted unless it considers for economic salvation by removing its considerably increased debt. In case of domestic loan it is not a serious matter. Firstly, the country issues the securities to collect the required fund from the people. If it forfeits the confidence of the people, secondly it may loosen the trap either through levying the heavy taxes or through printing the money. But in case of external debt the situations quite different than in internal loan. The external loan must be paid off either in US dollar or in respective currency of lender country or in gold. The poor and heavily indebted country cannot refund the in foreign currency amount in either from mentioned above. Consequently it falls in to a debt trap. In this situation either it can request for postponement or repudiate the external loan. But these types of measures are the extreme measures, since through theses, the country loses its credit worthiness and it becomes unable to borrow the foreign loan forever.

- ✓ **Private sector may be harassed:** Excepting the case of Nepal, public debt is mostly raised for generating the capital goods. It means that the accumulated fund, which is collected through the public debt, is financed on the industry, trade and many of developmental infrastructures.
- ✓ **Burden to future generation:** Economists like HG Brown Pigu, Leaner, Samuelson and other have expressed the view that public debt carries the burden to the future generation. Modern economists deny this concept submitting the logics for public debt is raised only for financing on return giving projects, which provides many economics and social benefits to people in the

nation. According to them, the productive schemes do not bear the cost forever; rather they start to draw the inflow of return after a certain period of time. In contrast, the traditional economists submit the logics that all of the public debt might not be disturbed only on productive projects. Thus when the state does not use the debt without any benefit.

In conclusion, government loan would be burdensome for future generation under the following conditions:

- If the present generation generates and disburses the great proportion financial resources (it includes all kind of revenue and debt) mainly to operate their regular administration.
- If the government does not add to the capital stock and productive capacity of the country.

In case of Nepal, the above conditions are true ever since we started to borrow. We are, therefore, being squeezed by the public debt raised and consumed by previous generation and similarly coming generation will be squeezed by our irresponsible performance.

4.3.4 Sequential Practice of Government Debt

The government of Nepal has been adopting systematic practice of internal debt. They have been issuing various government securities to finance the deficit budgetary system of Nepal.

4.3.4.1 Practice of Internal Debt

"The phenomenon of public debt was originated in Great Britain in the 17th century where a group of city merchant provided grants and loans to the government. In return they received the privilege of a royal charter to fund the bank of England which became the country's central bank"[11]

The internal debt has been developed with the need of state's development works. In the previous time, the state had to maintain only the internal peace and protect the nation from the external attacks. But with the passage of time the state has the responsibility of maintain the justice, provide the various facilities to the people and work for public welfare. The wide-ranging duties and responsibilities led the nation to be enriched by the various sources of assets, where the state neither had the sufficient sources not it could generate the income and revenue instantly. This is why the state began to borrow the money from the public.

After the world wars, large amount of loan was taken for maintaining the rehabilitation and reconstruction. The state beside these had to pay their expensively hired armies who were alive till the post war period and provide sufficient compensation to afflicted families who lost their members during the war. Truly speaking after this, most of the countries in the world started to borrow systematically and still borrowing to develop their economies at a faster pace.

In case of Nepal, under the Lichhavi dynasty ruling people took the help of people in terms of providing the human labor and ideas or thoughts in regard of maintaining the state's welfare and prosperity. In return people used to get some sort of honor and incumbency on behalf of the state.

In course of unification of the country Great King Prithibi Narayan Shah had also borrowed some money from the local merchant and redeemed the loan by

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[11] Mahesh Ram Joshi(1982), **Structure of public debt in Nepal**, Kathmandu MA thesis T.U. kirtipur

giving them job and land. According to Nepalese economic history written by MC Regmi, King Rana Bahadur Shah had borrowed the money amounting to Rs.600000 from Indian merchant to meet the government expenses[12]. Prime Minister Chandra Samser Rana borrowed the money from the trust of Pashupati temple for abolition of slavery in 1924.

But all those were not borrowed systematically rather were collected by proclamations of rulers who were in power (on the throne) during that time.
After the restoration of democracy in 1950 various development programs were launched. The government started to present and publicize it's annual budget among the people. In the meantime most of the countries in the world had been practicing the deficit budget. This is perhaps, why Nepal also incurred the deficit amount of Rs. 22.0113 million while it presented the first budget in 1951. This volume of deficit was supported only by foreign aid and grants and cash reserve. Most of the deficit amount incurred in the budgets prior to 1961 was supported mainly by foreign aid and grants. But it was not good to relay entirely up on the foreigners. At any cost we had to mobilize our internal resources for our smooth economic betterment.

The government floated the prize bond of Rs. 0.9 million only for individuals in 1967 with 0 percent of interest rate but certain rate prizes were given randomly selected holders twice a year. In the same period Nepal Government issued the special bond of Rs. 0.1 million. Due to lack of required data regarding this part and on details from the concerned bodies Nepal Government and NRB, the interest rate and maturity period of issued special bond cannot be dealt here.

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[12] Shreebhadra Khanal (2000), **Public Debt in Nepal** : a study of system and burden, Kathmandu, M.A.,Thesis. T.U. Kirtipur

The formally issued development bonds were mostly purchased by the organized bodies and institutions. One of the objectives of floating the development bond is to draw the wide spread liquidity throughout the country the country and to make involve the people in nation's development. That is why the government started issuing the mew sort of security with terms and conditions similar to described development bond named "National saving Certificate" in 1984 which provided the privilege of purchasing the certificate to individuals at first. Banking sector and even organized body and institution may apply for the certificate for only remaining amount, which is not purchased by the individuals. The National Saving Certificate was firstly issued in fiscal year 1984/85 amounting Rs. 500 million that year. It has been issuing the certificates with the interest rate ranging for 8% to 15.5%.

Nowadays the national taxes being charged on the interest gained from a few National Saving certificates, otherwise most of them are free of taxes.

Similarly, "The Government started to borrow by issuing CB pass bond in 1986 which amounted to Rs. 187.7 million that year." after this NRB has issued the NRB bond to draw the over flowed liquidity in 1991. It was the effective measure to curb the inflation. But it was not the instrument of raising the public debt since the accumulated fund by this process would be used only by NRB. Currently, treasury bills, development bonds, national saving certificates and special bonds are the main instruments of internal borrowing.

4.3.5 System of the Government Bond

With the inclination and inflation of mobilizing the available capital resources the government has maintained some sort of approach in relation to public debt initially by promulgating financial act and Nepal Rasta Bank act 1955. The act at section 20.2 sanctioning the responsibility and authority of raising the internal debt to Nepal Rasta Bank further clears the "the entire responsibility in relation to the management of public debt shall be entrusted to the bank (NRB) on such terms as may be agreed up on between. Majesty's Government and the bank". After five years the government issued the public debt act 1960 having the main objective to encourage the saving from economic development of the nation.

Similarly public debt regulation 1963 has been formulated by Nepal government which sets the details of systematic process and procedure for borrowing, servicing and redemption of public debt. Apart from this, the regulation includes the system for transference of ownership of bonds, conversion of type and form of securities, provision of losing the bills and certificates and so on.

In Nepal, the task of co-ordination in all this aspects in achieved through NRB and or the agencies of NRB. Nepal Rasta Bank advices the agencies as per necessities, regarding the timing, terms and the amount loan that can be raised in market without undue difficulties.

4.3.5.1 Theoretical Aspect of Issuing the Government Securities

This is not a debate on the necessity of public debt for sound economic development and stabilization. No one violates the power and authority of government for borrowing on public purpose. But it is not expect to borrow for including in 'wasteful' expenditure of any kind of or to suit the personal whims of individuals (particularly of PM and FM) running the government. There are in contrast some theoretical aspects of raising the loan from the market on which the government should conceive thoroughly before floating its securities.

(i) No one should be imposed for lending the loan to the government.

(ii) The management should keep its interest cost to the minimum possible. The government, therefore, should issue the securities with minimum interest rate as far as possible and practicable.

(iii) It should not impact adversely upon the target of sustainable economic development of the nation. Rather, the all practice regarding to public borrowing should assist the state's economic welfare as a whole.

(iv) The securities should not be floated at the time of deflation as well as increasing the interest rate in the market. And the state ought to be able to raise the loan at the period of decreasing or increasing the interest rate in the market.

(v) The state should pay the proper attention towards the legal and ethical restrictions on public borrowing.

(vi) However the government may change the terms and conditions of payment of debt at any time it likes for public welfare, but it is expected everywhere that the government would abide by a self imposed and indulged limitations so that it does not lose the confidence of people in regard to refunding the loan in or on time set previously.

4.3.5.2 System for Government Borrowing

The public debt act 1960, regarding to public borrowing contains the definition of government securities and some related legal terms, authority of borrowing provision for the security which is purchased by the governmental office, an organization and by a registered trust, provision for the case of death of penalty in case of contravention of this law, provision for no responsibility of Nepal Government and NRB, etc. but the system for borrowing and lending is set in Public Debt act 1960. The system for borrowing through the bonds and treasury bills is arranged differently in the regulation.

The borrowing system through the short-term security (Treasury bill)

1. The public debt Department of NRB prepares the schedule of borrowing through the Treasury bills for the fiscal year consisting the servicing amount of preciously raised debt and the additional amount accorded by Nepal Government.

2. The department calls the sealed tender for offered amount mentioning the operation date, life of the bill and so on by issuing notice in renowned national daily news papers on every Thursday and Friday.
3. The tender form can be obtained at any branches of NRB and it is to be submitted to the department in the valley and to the branch of NRB out of the valley within the Monday of next week, otherwise the application will be invalidated. The investor can apply for Rs. 25000.00 minimum.
4. The party (lender/investor) should enclose the original credit voucher as for earnest money amounting 2.5% of required amount for an auction deposited in 'sundry creditors main account'. The deposits can be made at any (banking) ranches of NRB.
5. The accepted competitive tenders, which are under the rule, are presented in the meeting of BOD on Monday afternoon. BOD accepts the selected tenders as per necessities and this notice will be published next morning. the selected party will be noticed to deposit the cash instantly while on the other hand rejected parties would get their respective earnest money which was deposited in the bank in course of applying.
6. 15 percent of offered amount is allocated for non-competitors; They should purchase the bill at average discount rate. It should be noted that the commercial banks are not allowed to take parts non-competitors.
7. Treasury bills are issued at the discount rate declared by the auction system and redeemed at par (value) that is the offered amount would be paid off a the maturity of the bill.

The discount rate can be calculates as:

DR = 100 – Bid price / (Bid price X Maturity period in year)

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

The borrowing system through the long-term security

Every year the Financial Minister presents the budget in the parliament in which is clearly mentioned the amount to be borrowed from the banking and non-banking sector. Different instruments such as treasury bills are used to borrow the loan for the period of less than one year. The funds borrowed through the treasury bills are financed on supporting the current expenditure of government and that sort of borrowing is made with only the banking sector. Long Term securities, on the other hand, are floated for non-banking sector and more significantly say, for the individuals in the country. However, NRB should purchase the remaining portion of stocks and bonds in case of under sales of stipulated quantity of bonds in the market. The system of long-term securities is listed below:

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

1. Firstly the Finance Minister presents the budget in the parliament including the proposal of borrowing from banking sector and non-banking sector in the country. After getting the consent from the legislative bodies (parliament) the government schedules for borrowing from non banking sector through the long-term securities. If forwards the program to NRB for further functioning. The interest rate for the bonds is determined by Nepal Government in general, but it may be maneuvered to some extent on the recommendation of NRB.
2. Public debt department of NRB publishers the notice in reputed national dailies containing the principal features, terms and conditions related to the bonds to be floated generally providing 15 days time duration of the submission of application. If whole of the bonds are sold before the due date, the sales would be stopped.

3. If the could not be sold during the stipulated period of time. NRB will purchase the whole or remaining portion. The issuance of security thereby is stopped exactly at previously scheduled date.
4. In case of both National saving certificate and Development Bonds, the holder is provided the securities in the form of either the promissory notes or the stocks as per the request by the holder, whereas the special bonds are issued in the form of stock only.
5. People may apply for the bonds at any branches and agencies of NRB. Similarly the certificates would be dispatched through the same body involved having the application for bonds.
6. Only the individuals may apply for the bonds at its initial floatation but in case of bonds owned by NRB, that is, under the provision aforementioned at no. 3, might be sold both to individuals and institutions.
7. The ownership of bonds may be registered in to the account of minors with the reference of their guardians.
8. The bonds are issued in the amount of Rs. 100 at minimum and divisible by Rs. 100 thereafter.

The salient feature of government bond is that no one claims upon the bond unless the holder endorses him/her. This kind of protective provision is set for either alive or dead holders.

4.3.5.3 System for Serving of the Debt

The term 'servicing' in economics apply means the payment in interest of periodic basis to the investors for their investment. As, the private firm pays the interest to the investors for their lender either at a single installment or at multiple installments as per compromise, the government in the same way, makes the payment of interest mostly on periodic basis on it's borrowing so that the compromise between the lender and it's borrowing so that the compromise between the lender and it self would be renewed timely and it does not involve the tremendous burden of interest, occurring in case if it is to be paid in as single installment. The periodical payment of interest is quite beneficial than the single payment. The term 'servicing' refers the regular payment of interest on borrowing. The economic survey which is the catalytic tool of dissemination of Nepalese economic inflation, data and indices, has included both periodic interest payment on initial and external borrowing and partial payment of principal of that borrowing.

The procedures of borrowing are listed below

1. Firstly, the government, in its annual budget that is presented in the parliament, allocates the certain amount of principal and interest of borrowing under the distribution of regular expenditure.
2. In case of internal debt servicing NRB is responsible to maintain the entire process and procedure as accorded in NRB Act 1955, at section 20 and in Public Debt 1960.

Treasury Bill was also issued at par value and carried a determined percentage of interest before the fiscal year 1991/92. During this year the 'open market system' change in to use and NRB started to float the Treasury bill at discount rate basis and redeemed at par value.

3. The state can make people to purchase the government securities with no interest at all. by enacting the rules. But to date Nepal government has never borrowed from the people without paying interest, through once it had issued the prize Bond with no compulsion to purchase the bond, it has provided attractive prize to some randomly selected luckier holders. Thus, Nepal government has been providing the interest on borrowing ranging from 1% - 15%. In this system, the holders are paid the interest twice a year from any branches of NRB and commercial banks they want. To receive the interest payments, the holders had to submit the interest payment slip along with the certificate.

4. As previously mentioned all government security holders re provided the facility to collect their interest amount from any branches of NRB and commercial banks charge commission at prescribed rate for operating the transaction concerned with the public debt. NRB receives interest and commission from Nepal Government, Financial Controller General Office and makes the realization for formerly paid cash. It credits its account when with realizing the cheque from Nepal Government and makes the deposits upon their respective account, on transaction connected to the public debt and advice them immediately.
5. NRB obtains 0.2% of total transacted amount while other commercial banks get 0.25% of total transaction related to public borrowing and redemption. They further get the sales commission at prescribed rate for the transaction they made in relation to selling the government securities.
6. In case of external loan, the maturity period is generally longer than we expect and it carries the nominal interest rate which is lesser than on internal debt. Furthermore the buyers are being provided the grace period for maturity and interest rebate. In spite of all these incentives, due to improper financing and use of foreign debt and gradual depreciation of NC with the convertible currencies over the past years, the servicing burden has increased significantly every year.

The interest rate servicing system and training is fixed by mutual consent or as per the negotiation mad between Nepal Government and lender country or agency. The servicing amount and partial and periodic payment of principal of foreign debt should be justified and approved by the parliament.

4.3.5.4 System for Redemption of the Debt

Debt once borrowed has to be redeemed within stipulated maturity period of the debt. The government mostly pays the interest rate at periodic (half annuity/annuity) basis and redeems the principal either on the partial payment basis or payment at maturity or at it's will on a single installment. Nepal government has been redeeming the loans at maturity in case of internal debt. It has already been explained that Treasury Bills implies the funds rise at discount rate and redeemed at face value. And in case of Treasury bill, the transaction of servicing and redemption would be made at once by a single transaction.

On the other hand, the government may employ the various methods like serial bond redemption, conversion of loan, sinking fund, buying up and buying off loans, capital levy up on borrowed amount and finally it may simply employ the repudiation method for redemption of long term debt. Nepal Government has been redeeming it debt by applying the serial bond redemption method mostly and conversion of loan method alternatively. The Nepalese government has never repudiated it's debt till now.

a. System for redemption of short term Debt

Short term loan, in Nepal presents only the treasury bill (however, advancers from NRB should also be taken as the short term loan). None of the securities were issued under one year of maturity except the Treasury Bills. So it is also started that the Treasury bill and the short-term loan are considered as the same in this study. The process of repayment of the bill is discussed below:

1. Being a bank of the government, NRB is fully empowered to handle the system and practice of redemption of debt. Accordingly it receives the par amount of Treasury bill from Nepal government at just the maturity of the bill.
2. NRB redeems the debt by creating the concerned account for those who get the par value prescribed in the bill and bank with it (NRB). The investors who do not bank with NRB get the amount in cash.
3. The amount prescribed in the Treasury bill would be cashed at any branches of NRB after the maturity of the bill. But no

commercial banks and other financial bodies are consented to transact about the redemption of treasury bills.

The investor should pay the income tax at stipulated rate according to his income received from the Treasury bills.

b. System of redemption of long-term debt

Long-term security has life more than one year. In Nepal, generally it represents the special bonds, compensation bonds, Prize bonds, National saving Certificates etc. Most of them are repayable in a long period, In 15 years or more. These bear higher rate of interest in comparison with the short term debt.

The redemption process of long-term debt as practiced in Nepal is given below:

1. The government allocates the amount in its annual budget for redemption of a small portion of total debt every year. The floatation of long-term securities is arranged so systematically that, loans to be paid every year are staggered well.
2. NRB receives the amount from Nepal Government, financial controller general office and provides the principal and also the outstanding interest (if any) after verifying the signature of security holder.
3. There can be claim for principal and also the accumulated interest, till the five years maturity. The government would be transferred to government's revenue account. It the investor claims his principal later than it will be paid as per the decision made by the government.
4. The stockholders are provided the facility to collect their interest and principal from any ranch of NRB and commercial banks. NRB and its agencies get the commission at prescribed rate for the transaction works done.

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

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

4.4 Major Findings

Major the analysis of that following facts are found.

1. The government has adopted a deficit budgetary system in the name of development functions. Treasury bills, development bonds, national saving bonds, citizen saving certificates and special bonds are the debt borrowing instrument in Nepal. In Nepal. Government has been taking overdraft every year except in 2004, 2005, 2006, 2007 and 2009. Treasury bills are normally floated for the period of 91 days and others securities are long-term securities. In the year 2009, the treasury bills, development bonds, national saving bonds, citizen saving certificates and special bonds was issued Rs. 82568 million, Rs. 19565.4 million, Rs. 1516.9 million, Rs. 2388.0 million and Rs. 1191.2 million respectively. The various securities are issues for the purpose of fulfilling varieties of problem of the country.
2. The percentage change in total internal debt has been increasing gradually which has been indicated by upward sloping curve. in 2001,

7.3% , in 2002, 8.9%, in 2003, 10.6%, in 2004, 11.2%, in 2005, 11.4%, in 2006, 11.6%, in 2007, 11.9%, in 2008,13.2%,in 2009, 14.2%.

3. The projected internal debt has been forecasted from the F.Y. 2009 to 2014. The forecasted borrowing is Rs.109113.99 million in 2009, Rs. 116524.38 million in 2010, Rs. 124171.15 million in 2011, Rs. 132054.02 million in 2012, Rs. 140173.2 million in 2013, Rs. 148528.62 million in 2014, Rs. 157120.35 million in 2015.
4. Nepal has been suffering capital shortage since the first budget speech of Nepal. So it has been going through a critical phase of in adequate financial resources, while its duties and responsibilities are widening day by day but the public funds available for the administration and development are limited. The government therefore, adopts the policy of borrowing internally and externally.
5. The government has been following liberal policy in the matter of collecting funds. The main objective from people. This increasing trend borrowing has created insignificant impacts on economy for future generation. It has led country to be considered as a levered country. Borrowing is good borrowed fund is used in productive sectors only.
6. The enormously increasing magnitude of public debt is becoming a great challenge of the nation. The government had borrowed a total amount of Rs. 9042.1 million in 1987 and the amount borrower reached to Rs. 997959.8 million in 2009.
7. All the amount of internal debt being used not in capital expenditure. I can declare it according to our budget and speech of NRB and MOF staff.

CHAPTER – FIVE

SUMMARY, CONCLUSION & RECOMMENDATIONS

5.1 Summary

The government statement of income and expenditure was not in fixed schedule up to 1950's. The budget preparation was only for requirements certain class of the country. The budget was used to facilitate the requirement of such a class only. After restoration of democracy in 1951, the process of maintaining income and expenditure was set as per the house of democratic government. Thus, they were aimed at maintain the statement of lives of the people rather than specific class. Accordingly, the government was completed to present a deficit budget. Till the 1960's decade, the deficit was by bilateral grants.

Nepal stared to raise the internal loans in fiscal year 1961/62 by issuing the treasury bills. People started to purchase government securities, as it constituted the risk less investment.

The government debt is neither worse nor it impairs the economy. The government has been borrowing funds people to maintain smooth and sound economic condition of the country. Government debt is issued to meet short-term and long-term financial requirement. The government expenditure through public debt is quite beneficial to the nation if used productively. Thus, the government has been collecting huge amount of fund through sale of securities every year to fulfill the deficit budgetary system of Nepal.

The government of Nepal has been borrowing overdraft from NRB as well. the government must have pay the amount of overdraft with it's interest to NRB within the stipulated period. This is why it is also considered as a kind of internal debt.

The debt financing of Nepal has also bad side as government has been borrowing according to it's whim and it has pouring the borrowed fund in to unproductive sectors. However, expenditure made on sectors likes health, education, road, bridge, irrigation, drinking water etc have benefited Nepalese people. The nation as a whole gets positive returns such kinds of projects in the long run. The necessity to invest on such projects has been the main cause for deficit and hence public debt.

In fiscal year 2009, the total internal debt was Rs. 107229.5 million. The same debt was Rs. 9042.1 million in 1991. The debt raised by government has been increasing from the year 1987 to 2009. This may generate serious problems for future generations. The innocent children have to bear loan taken before their birth. Therefore, the increasing trend has to be managed soon. The country must have fair bureaucracy, sustainable economic growth, investment in productive sector, etc.

Government sells various securities to collect funds from people. Such as treasury bills, development bonds, National saving bonds, Special bonds and citizen saving certificates. Treasury bills are issued every week. In 2008, the government has borrowed huge amount by issuing treasury bills. It is a short term government they are issued for 91 days maturity period. Others are long term securities they are issued to collect long term capital. But in case of special bonds, it has special provisions while issuing securities. Thus, government issues various types of securities both internally and externally. Many economists believe that borrowing internally is better than borrowing externally. The internal investors of the government are the people of the country.

It is obvious that the issuance of government bond is the cause of deficit budgetary system. Every year the finance presents the budget in the parliament in which it is clearly mentioned the amount to be borrowed from various sectors. The Nepal Rastra Bank the central bank of Nepal issues various government securities on behalf of the government. The bank changes the government 0.25 percent commission on the transacted amount.

Borrowing provides an opportunity to get interest earning to those who have idle saving. Most economists agree that- "borrowing is better than currency inflation." On the other hand, most economists that borrowing today constitutes burden for future. A large public debt may create problem in the economy in future.

5.2 Conclusion

The internal borrowing is the process of involving domestic people in the development programmed launched by the nation. This study shows that Nepalese investors are attracted to government securities in comparison to other investment sectors. Most of investors in Nepal are risk averter and they search less risky investment. Different people are participating in government securities such as rich, poor, educated, uneducated, etc. This has supported general assumption that only requires persons, civil servants are interested in government securities.

Government fund is like a vessel, where all revenues of government (Tax, Loan and Foreign grants) are poured. All regular and capital expenditure of Government is made from the vessel. It is hard to find out the sources of any capital expenditure from the overall government revenue. Government revenue is a totality/composite form, different title of usage are made from there. So it is quite tough to make a clear separation of regular and capital expenditure of government revenue/fund.

5.3 Recommendations

On the basis of the analysis and finding of this study, following recommendations are suggested, which are required to be to solve the problem of debt finance economy of Nepal.

1. The government should maintain the fiscal balance and strong fiscal and monetary discipline by controlling the unproductive expenditure so that budgetary expenses would not increase immensely than the annual revenue income government's effort should be directed towards mobilizing internal revenue in order to reduce dependency on loans for financing development expenditure.
2. Since Nepal is still backward in terms of developmental infrastructure, there is no alternative except from external source to industrialize the nation. Besides, the capital is need of formulating the long term plan for export promotion and coordinating the various export related activities such as product development, market promotion all over the various functions in the country. Therefore, the government should develop various methods to influences the business and private individuals to buy more and more government securities.
3. The government should maintain the strong fiscal discipline in all sectors of the economy which government itself must follow initially. The government must set and implement the effective legal system to control the ever-increasing corruption, unnecessary expenses, improper allocation of resources and the like. Likewise the suggestions by auditor general office must be adopted instantly. Thus, maximum effort should be exercised to maintain the fiscal discipline so that budgetary deficit would be minimized without impairing existing development programs.
4. Borrowing from banking sectors must be minimized since it is most inflationary source of internal borrowing. The government should influence individuals to use their idle money on government security

because this stimulates the investment. At the sometime this sort of borrowing is non inflationary.

5. The most common problem of undeveloped countries like Nepal is the loose monitoring and inspection of the progress of newly launched projects. Regular reviewing must be made on the return of the projects so that they help improve the rate of future projects.
6. The government should not unnecessary interface NRB. If so, the bank, being an advisor of the government can be recommended the salutary measures independently which help the government to tackle the fiscal and monetary problem in the nation.
7. The government may borrow the overdraft from NRB with the stipulated limitation but the bank should not be completed to provide the overdraft as per the government's decision
8. To attract people towards government security it is essential that some special bonds might be issued for development work for a particular locality. When such development work for a particular locality. When such development work as bridge, road, irrigation, communication etc. would be built with the funds from the special bonds at a place, people of the other localities might be encouraged to purchase such bonds. On the other hand, NRB should strongly direct all the commercial bonds that they must pay the interest of the government's bond of their respective customers timely and claim the amount with NRB afterwards. It is because a few government payment at some of commercial banks in Nepal, thought investors are provided the facility that they can collect their interest from any commercial banks in Nepal.
9. The debt management to control and regulate the economic activity is an instrument in the hands of the monetary authorities like ministry of finance and Nepal Rastra Bank in the nation. All the decision regarding the public debt from borrowing to redemption of loan influence the general economic phenomena in country. All possible efforts therefore,

are needed to be made by the monetary authorities to direct economy in the desired way through the technique of debt management.

10. Along with the strong fiscal discipline the government should finance the public borrowing on productive programs, which can provide the return most efficiently as short. If this can be done the national revenue will increase faster and inevitably that debt servicing ability will also increase in the same pace. and the question of debt trap won't at all
11. About the principle all internal debt should use on capital expenditure but in here budget cannot separate it and where utilize. For follow the principle it should separate from the budget.