

# CHAPTER I INTRODUCTION

## 1.1 General Background

Though pro-liberal economists advocate for minimum role of Government in recent years. The government expenditure is increasing day by day. The role of the Government, least to 'supply public goods and services' and 'manage public debts', is increasing. At the same time, the government of the developing countries like Nepal has to finance for growth promoting economic activities seeking huge investment. But the level of income and saving capacity of such economy is inadequate to generate sufficient internal revenue. Moreover, internal borrowing is very low because of poor tax payment capacity of the people. Hence, external borrowing is one of the instruments for development financing for the developing economies like Nepal.

In developing countries, public debt is taken as balancing item for increasing trends of fiscal deficit. It is a source of resource mobilization for financing ever-increasing development outlay. The present level of capital formation of developing countries is very low and any substantial increase in saving is not possible, due to extreme low level of income and wide spread poverty. Since tax base is very low which limits the possibility of mobilizing the tax revenue. To escape from the complex situation, the government can utilize borrowing as the alternative method.

Public debt is not so different with private debt, both have obligation of repayment. It is the major source of development activities basically in developing countries. Now it is widely accepted as a means of deficit financing measures to reduce the Balance of Payment (BOP) deficit, trade deficit and resource gap. The role of public debt is increased significantly by adopting the planned economic development.

Classical economists were against borrowing and they favored the minimum role of the government. They were in the favor of the productive type of borrowing. After the great depression of 1930s, the intervention of the government in the economy became an important tool. The government has to play the role to push the economy upward and it must contribute a large amount of budget. Prof John Maynard Keynes introduced the concept of deficit budget. To meet the deficit budget government needs to under-take the public debt, which need not necessarily unproductive and inflationary.

Public debt includes internal and external debt of the government. Internal debt refers borrowing through securities such as development bonds, national saving certificates, and treasury bills and offers special bonds. Those securities are to be repaid within a specified time.

It has been argued that public debt and economic development are complementary in an economy. Since the scope of domestic borrowing in underdeveloped countries is very limited, external borrowing has become alternative for development. Although the use of external borrowing for development through bilateral and multilateral sources has been a matter of controversy where often the practical diplomatic and economic issues are mixed upon the reliance of developing economies on external borrowing. This links to their balance of payments and to the problem of inflation.

Developing countries like Nepal use borrowing as a medium to address the gap between the government revenue and its investment and export import gap. Such borrowing adds to the total resource available to the government, over a given period and enables the government to make higher expenditure than would otherwise be possible. If properly utilized

such resources, can benefit for the borrowings countries and contribute to economic growth and poverty reduction. However, when debt is efficiently allocated the cost of borrowed external resources can contribute to macroeconomic management problem in the form of high or even unsuitable levels of external debt servicing obligations.

Public debt plays an important role in developed as well as developing countries to meet the budgetary deficit. But it has positive as well as negative aspects. On the one hand, it has been major part of development budget, without budget we cannot even imagine development. On the other hand the country is falling into debt trap causing the increasing trend for debt servicing in the form interest and principle payment.

Public debt is the total debt of internal as well as external. Nepal is heavily depending on internal as well as external public debt for economic development. In internal sources, financial sectors dominate others and in external debt, it is received from both bilateral and multilateral sources. The trend of borrowing through external source is very high in Nepal as compared to internal source. Hence in both developed as developing countries area making public debt as a main source of resource mobilization to meet budgetary deficit. Now it is widely accepted means for financing deficit. The role of public debt is increased signification by the planned economic development. Nepal is facing a serious problem of financial resource gap in one hand and increasing population growth and inflation in another. It is sure that, if the trend of foreign debt goes on same speed Nepal will be in debt trap in the near future.

## **1.2 Statement of the Problem**

In Nepal, effective management of public financing is a challenging job. Government expenditure is increasing rapidly each year, but government revenue is not growing at the same time. Hence, the deficit is widening each year so that Nepal is facing the serious problem in this regards.

In developing countries, generally private sector is reluctant to involve in long term investment for building infrastructure, such as telecommunication, road and power and development of social sector such as education, health and drinking water because return on such investment would be in the long period of time. Government collects public debt for such investment. So, public debt helps to increase the growth rate of the economy, generating more employment opportunities, reducing inequalities in income and wealth and bringing regional balance in the economy. Not only high public debt raises the risk of a fiscal crisis in Nepal but also imposes costs on the economy by keeping borrowing costs high, discouraging private investment and constraining the flexibility of fiscal policy. Historically, Nepal has not generated enough primary budget surpluses to ensure the sustainability to their public debt. The inability to generate adequate primary surpluses appears to stem from the characteristic of the fiscal system; weak revenue bases and less elective at controlling expenditures.

In recent year, it seems that Nepalese economy has lost its productive capacity due to present condition of political instability. Large and persistent level of public debt push up interest rates, reduce investment and create a burden of indebtedness which is difficult for the government and tax payers to bear it. So,an idea in favor of contra-dictionary fiscal policy instead of expansionary fiscal policy is raised. But, in developing countries like Nepal where infrastructures are not well developed, public

debt is necessary. That is why; present increasing size of Nepal's Public debt is a matter of great concern for all.

The composition of budgetary expenditure has also undergone a dramatic change. In 1990, regular expenditure contributed around one third of total expenditure which has increased to nearly half of the budget. These days, the government is talking foreign aid, not only for development expenditure but also for regular expenditure.

Hence, Nepal has become an aid dependent country. Foreign aid has become a main source of financing budgetary deficit. It is not only facing the problems of revenue-expenditure gap, but also export-import gap and saving-investment gap which all are taken as major macroeconomic indicators. So, to break the vicious circle of poverty and improve the socio-economic condition of the people, public borrowing is inevitable. The government borrowing itself is not medicine if it is not utilized properly. In such condition, the government borrowing may be the unnecessary evil for developing countries like Nepal.

### **1.3 Objectives of the Study**

The specific objectives of the study are:

- ) To assess the public debt in Nepal and,
- ) To analyze the trend and structure of public debt.

### **1.4 Importance of the Study**

For economic development of Nepal, government must invest on various sectors such as education, health, transport communication etc. To build up such overhead capital is needed a heavy investment. The regular as well as development expenditure is necessary for the increasing population and concept of modern welfare nation.

In recent time, public debt is an economic issue of a country. On the one hand the role of public debt is increase the growing concept of globalization and liberalization and on the other hand to increase volume of debt servicing. That pulls the country into debt trap. So, the analysis of role, trend structure and burden of public debt become matter of concerned, especially after the restoration of democracy.

Public debt is concerned maintain high level of employment, a reasonable degree of price level stability, balance in foreign accounts and an acceptable rate of economic growth. So, debt is need for economic development but id concerns with appropriate utilization.

## **CHAPTER II LITERATURE REVIEW**

### **2.1. Introduction:**

Public debt refers the obligation to pay money back to person, institution or countries from whom it has been obtained. Public debt as an instrument of fiscal policy, has assumed great importance to meet the budgetary deficits. Public debt is accumulated amount of what government has borrowed to finance for deficit. An internal debt is owed by a nation to its citizen and it possess only internal burden. And external debt is owed by a nation to foreign country or other internal agencies, then it possess burden.

The objective of public debt in developing countries is an instrument to mobilized saving of the people which would otherwise have gone to wasteful consumption. To meet such objective and use as an instrument, public debt have to use productively. If it is not so, than many problems will be created and it will be destructive and devastative for the future generation on monetary impact. The effect will not affect to the tax payer only but also decrease productivity, demand for goods and commodities will be decreased due to increasing amount of taxation. The economy may in to phase of recession.

There are different views about public debt. Some economists are favors of public debt and some are against. Especially, classicists had generally negative attitude towards borrowing and they want to minimize to role to government. They opined that "let the money fructify in the pocket of the people" according to them state has to perform its limited activities maintenance, law and order, justice and social security. Classical economist like J.B. Say, J.S. Mill, T.R. Malthus, C.F. Bitable have given their arguments that public debt creates debt creates burden on the

economy because of its unproductive nature. But Keynesian and modern economist including J.M. Keynes, Harries, Hansen, Buchanan, Musgrave and other have challenged the version of classical economist and hold opposite opinion on the subject of public debt, its size and use. In their view, public debt is required for economic stabilization, to operate monetary and fiscal measurement.

## **2.2. Theoretical Review**

### **Review of Classical Thought**

The classical economist was generally against the public borrowing and favored the minimum role of government into economic activities. They further believed that, any government intervention to the economic activities result into rigidity and disrupt the smooth functioning of market mechanism. The optimum allocation of resources, the achievement of full employment and maximum output are best without government intervention. Classical economical economists like J.B. Say, J.S. Mill, T.R. Malthus and C.F. Bitable have the strong faith that "Debt creates burden in the economy because of its unproductive nature". (Harris, 1974).

The classical theory is criticized mainly on two grounds. Firstly, every government expenditure is not always unproductive. Hence, public borrowing may not always burden upon the economy. Secondly, the traditional view regarding the shifting of the debt burden is not correct. The real burden of public debt must be borne in the initial period debt creation when government borrows for meeting development requirement. Hence, government attracts resources for private use and put in to the public project in the initial period (Joshi 1982).



The classicists were not against any form of government expenditure. What they favored was minimum public expenditure. In between taxation and borrowing, classicists favored taxation for the following reasons:

- 1) Deficit financing means an increase in public debt. Since it is an easy method to obtain income, government is likely to be extravagant and irresponsible. Consequently, public debt will definitely become a burden to the economy.
- 2) Payment of interest on public debt and refunding of the principle will require additional taxation. It might prove to be difficult since government's power to tax is not unlimited.
- 3) Deficit financing might produce currency deterioration and price inflation.

However the classical economists were not against all type of public debt. They favored public debt for self – liquidation projects. In the words of R.A. Musgrave, "Self liquidation projects may be define narrowly investment in public enterprises that provide the 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 rates." (Musgrave, 1959)

### **Review of Keynesian Thought**

Unlike the classical economists, Keynes did not accept the notion of free enterprises economy, which is self-equilibrium at full employment level. He advanced the concept of underemployment equilibrium. He argued that resources in the private sector might remain unemployed for relatively longer time period if the government becomes unconscious. In

such situation when resources are unemployed on large scale, government employment of these resources does not necessarily deprive the private sector of anything. On the contrary, increasing government spending by using idle men and materials is likely to raise the level of aggregate demand and there by aggregate output and income. Hence public borrowing/debt need not necessarily be unproductive, and burdensome. Due to this, Keynesian strongly prescribed to increase the public expenditure even by undertaking deficit financing or borrowing.

For Keynesian, if debts are internally held, there is nothing to worry about their size. It is because such debt involves merely a series of transfer payments and they cancel out for economy as a whole. Hence the only concern was on high level of income and employment. This has emerged the concept of double budget. But Keynesian view is that deficit budget even by undertaking public debt, would be a powerful tool during the time period of stagnation/depression.

### **Review of Post Keynesian Thought**

During the Second World War II and post-World War period, the size of public debt and servicing increased enormously. This has made the economist to make revision on the aspect of public debt. The post Keynesian development was that it emphasizes the transfer and management aspect as well as interrelationship between public debt and money supply.

The post Keynesian economist like Learner shares the view that "internal debt inflicts no burden simply because it is a transfer of found from one pocket in the other from the left hand to the tight hand". He further maintains, "An inter-personal of international loan yields the borrower a real benefit, it enables him to consume or incest more than he is earning

or producing. And when he pays interest or repays the loan he must tighten his belt, reducing his consumption or his investment. In the case of national debt we have neither the benefit nor the burden, the belt cannot be let out when borrowing need not be tightened when repaying. (Poudel, 2005).

It cannot be denied that internally held public debt involves a series of transfer payments in the form of taxes and debt service payment and for the economy as a whole, they cancel out. But the volume of public debt cannot be dismissed as of no consequences. This is because heavy debt constitutes a burden for future generation. The post Keynesian did not reject the entirely classical notion regarding to public debt rather put it in better perspectives:

- a) According to them, public borrowing does not always deprive the private sector from the use of resources. As for example during the time period of widespread unemployment. It may be productive.
- b) Besides, it is not accepted now that borrowing in the period of full employment must be inflationary. If the borrowing taps the funds otherwise used of consumption. It is not more inflationary.
- c) A large public debt if internally held poses many problems for the economy. It complicates the monetary policy and creates difficulties of management and so on.
- d) In resorting to borrowing, government should be guided by macro-economic considerations- its effects on macro- economic variables.

### **Recent Thought**

Recent thinking opined that heavy growth of the borrowing is dangerous for the economy for two reasons:

Firstly, growth of debt ratio may lead crowding out of private investment: secondly, government spending out of borrowed fund might be unproductive. (Poser;1992)

They observed that, part of public debt is burdensome servicing galls entirely or mostly on tax revenue. If it's surviving does not fall entirely on tax revenue, it is not burdensome rather it is productive. Because it itself generates for its debt service besides income, employment and output. Therefore all debts are not burdensome.

According to modern economist Raja J. Challah observed that. " if revenue will meet subsidies, other transfers, interest payments and the greater the part of current expenditure; debt finance will be used for meeting the government's non-remunerative capital formation; and the total domestic borrowing will be determined in such a way that, given the rate of domestic saving, the non-government sector will be able to obtain a due share of saving and that there will be no need to borrow from the central bank more than the correct amount of saving and the three will be no need to borrow from the central bank more than the correct amount of seignior age, it is the ideal situation for borrowing.

### **2.3. International Review**

Taylor Philip et al. (1968), in his book entitled "The Economics of Public Finance" has analyzed the nature and the burden of public debt upon the economy one of the upon which fiscal policy must stand, without it the financing of public emergencies would be impossible. Public debt is desirable, no matter what its burden when incurred for the purpose of securing benefits which outweigh the burden. In this sense debt is a necessary evil, like cost of production; if the benefits could be secured with fewer burdens the alternative would be preferable.

The burden of public debt is represented but the economic hardship which it imposes. This hardship may take the form of waste of productive efficiency for the economy as a whole or undesirable economic burdens imposed upon particular classes. The possibility of inflation resulting from the form of borrowing constitutes other elements of burden. The urge given by Taylor to reduce debt principle may involve three kinds of burden.

- ) The raising of taxes for debt retirement by a regressive tax system will take funds from those less able to pay and transfer these funds to bond holders who gain relatively little benefit from their receipt.
- ) Reduction of expenditure on useful government function will impose burden upon prior beneficiaries of those function.
- ) Taxes to repay debt held by the bank may result in net destruction of a part of the circulating median.

Certainly the most important single determinant of debt burden is the level of national income. The existing high level of public debt makes this the overriding consideration in minimizing debt burden. Sensible approach to the analysis of debt burdens requires that the size of debt principle be de-emphasized. For as we have seen, not only are the transfers of income which contribute debt burden principally those which relate to interest and not principle payments, but the size of principle is inaccurate measurement of the magnitude of these transfers. The principle determinants of debt burden pointed by Taylor are:

- ) The magnitude of annual transfers for debt service.
- ) The pattern of debt ownership within the economy.

- ) The type of tax system.
- ) The level of national income.

Post Keynesian economists Richard Goode view that borrowed money when used to finance public investment causes no such reduction. All that will happen is the change in the consumption of capital formation. "The inference is that failure to restrict borrowing to the investment will retard economic growth. A weakness of the argument is that not all outlays classified as investment actually contribute to growth, while some expenditure usually as government consumption promote growth" (Goode, 1984: 198)

According to new Palgrave dictionary of economic 1088, "Public debt is a legal obligation on the part of government to make interest or amortization of payment to holder of designated claims in accordance with a defined temporal schedule. It is created through the government borrowing from individual corporation's institutions and other government. It refers to loan raise by government within the country or outside the country. Every government like individual has to borrow when its expenditure exceeds revenue. The receipts from the sale of financial instruments by government to individual or firms, in the private sector to induced the private sector, to release manpower and real resource and to finance the purchase of those resources or to make welfare payment or subsidies".

Nadim (1992), in his article entitled "External debt policy" has analyzed the origin of debt problems. The debt crisis had its origin in the substantial rise in the external liabilities of the developing countries during the second half of the 1970 and early 1980s, in an environment of large scale recycling of the oil exporter's surpluses rising world inflation

and negative real interest rate. At the time many viewed this that recycling of funds as a positive development; creditor were able to identify now investment out less and debtors explained that an external debt crisis was due to:

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

According to Gurley and Shaw, it is applied for the maintenance of balance between the expenditure and revenue for financing economic development, since developed or developing and revenue for financing economic development, since developed or developing countries always face the problem of fund, which is reflected in a large extent and as ever increasing financial resource gap in government budgetary. Therefore the selection of appropriate method for financing development is very important for the success of a development plan. Various methods to be adopted mobilizing financial resources and their implication for the economy are among the leading issues in economic development. Finance aspects are as important as the other aspect of economic development and their study should be received proper attention (Gurley and Shaw, 1995: 575)

Buiter(2001), observes, "The government borrows only to finance public sector formation cannot be easily rationalized in terms of generally accepted economic principles. At worst it could become a straight ticket on the fiscal and financial strategy. It also risks inducing a misplaced

sense of complacency about the accumulation of public investment related to public debt. Debt must be serviced through future higher current revenues of lower public spending regardless of what motivated its issuance."

#### **2.4. Nepalese Context**

Acharya in his M.A. thesis entitled "A case study of public Debt in Nepal" states public debt is most popular in these days because of payment of debt on maturity can be adjusted through the interest issued by the government should be developed among the people so that no difficulty may be faced in getting the bond purchased by the people. (Acharya, 1968).

The dissertations entitled "Structure of public Debt in Nepal" (1982) by Mahesh Raj Joshi in his M.A. dissertation has analyzed the structure of public debt in Nepal and the importance of public debt and financial development. Birju Prashad Sharma, in his dissertation paper entitled "Public Debt in Nepal" in 1987, has tried to show the relationship between public borrowing development expenditure and budgetary deficit.

An article entitled "The role of foreign aid and Economic development and poverty alleviation" by Gurugharana in 1996 analyzed the burden of public debt as debt servicing cost in Nepal has come to the conclusion that the long term upward trend of increasing debt burden inflict greater burden. He finally said that through the loan component of foreign aid, Nepal is softer than other countries like India and China, yet the very low rate of return and rapidly increasing volume of debt is slowly bring in Nepalese economy towards crises of debt trap. (Gurugharana, 1996)



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

An article o "Debt Management" by Annathakrishan (1998), opines, "If a country borrows from abroad, it has repay the principle and interest the capacity to pay the debt service cost should be realized by investing the borrowed funds into increased production activity. The increase production consumption but would also increase exports. Only then can a country find funds to pay the debt service cost. He emphasized mostly on productively used of available public debt then only it helps to raised national income and GDP. Hence borrowing can increase economic welfare in both lending and borrowing countries.

Koirala(2002), in his article entitled "Effective public Debt Management in Nepalese perspective" states that debt is a useful resource for economic development, several inverse consequences were found by it's over use. The debt crisis of nineties eighties is widely known as the result of over use. The World Bank has established multilateral insurance Guarantee Agency (MIGA) and the international monetary fund has minted special drawing right (SDR) to cubs the crisis in the third world. His further opines that we have only two options; either mobilize more foreign debt to invest for economic development plan for its better use and regularly servicing. The government debt over a given year is equal to the budget deficit, the increase in the government debt over a given year so, equal to the budget deficit of a higher economic growth requires

a higher level of investment that is not possible simply from taxation so that government seeks public borrowing (Koirala, 2001)

Poudyal(2003) has submitted a dissertation paper titled "Trend and structure of public debt in Nepal" has analyzed borrowing fund from external resources product expectable item and three should be construed a committee to supervise and narrator and control unnecessary foreign borrowing. The role of government in dominating private sector in all sectors of the economy in Nepal. Thus the government should adept appropriate economic policy. The government should give attention in all sectors of the economy with high economic growth rate by reducing excessive external dependency and internal resource mobilization for the development purpose and the economic will the capable to move in a self- sustaining growth path.

Subedi, (2004), in his thesis "A case study of Public Debt in Nepal" has tried to study the debt situation with following objections.

- ) To analyzed the trend and structure of Debt in Nepal.
- ) To identify the debt servicing problem.
- ) To measure the burden of debt in Nepal.

He found that Nepal is going on indebted and it will fall debt crisis of the strong obligation and commitments are not made. The burden of interest payment is higher than the burden of principle payment in Nepal. Growth rate of external debt in Nepal is faster than the growth rate of export earnings. Finally he has concluded that due to the depreciation of Nepalese currency vis –a vis the convertible foreign currency, the burden of debt servicing has been increasing year by year.

Thapa(2005), observes that, "Although Nepal's debt burden and its servicing should not be called as excessive, on the basis of its level of

development, it is quite burdensome. Debt burden has reached this level even to achieve such meager development. Nepal has not taken high growth path so far and once it takes it will require enormous of investment and that investment will have to be made through borrowing from both domestic as well as the external sources. At that time Nepal will have to borrow an unlimited amount of financial resources from both the source. Therefore, until growth rate takes momentum, we should be extremely judicious while borrowing to finance the budget deficits".

Ghimire(2005), in his article entitled, "Foreign capital in Nepal Rastra Bank Samachar, has analyzed the role of foreign capital for the acceleration of the economic growth and to fulfill the deficiency of the domestic capital. He has opined that the rationale of the foreign assistance is to promote domestic growth and long term economic development and transformation so that the recipient country eventually needs no such assistance in future. But in case in Nepal, this is quite opposite. It further increases the dependence of economy on foreign capital or assistance instead of reducing it. The foreign capital has not brought any positive change in terms of macro-economic indicators. He says that the contribution of revenue surplus to the development expenditure is being financed by foreign capital. Similarly, the use of foreign capital also increases the ratio of outstanding foreign loan capital. Similarly, the use of foreign capital also increases the ration of outstanding foreign loan in terms of GDP. He expresses that some achievements have been made in terms of physical indicators such as length of the roads, number of telephone lines, number of service providers, etc. have increased significantly. Number of schools and students has increased. The country has made some progress in the field of health increasing in number of hospital.

Khanal(2006), in his M.A. thesis entitled, "Government Borrowing System and Practice in Nepal." concludes that the magnitude of public debt and its interest is increasing rapidly, but the neither addressing capacity for redemption is nor increasing in the same pace. He further adds that the obligation of internal debt may raise the question on the capacity of government. An internal resource mobilization and excessive dependency upon external loan may push the nation into a debt trap if the term of trade is not moved in favor of debtor country. That is why extra care should be taken in procuring such loan.

K.C. (2007), in his thesis entitled, "Public debt of Nepal: trend and pattern of public borrowing from 1984/85 to 2000/01" analyzes the trend and structure of public debt in Nepal. In the work, he has expressed his view that the increased government borrowing has been in financing mostly on the unproductive sectors with uncertainties, lack of a well-trained civil service, corruption, high current expenditure and hence government always lacks the resources than borrows ones. The average annual growth rate of GDP of revenue is considerably low as compared with that of debt of GDP of revenue is considerably low as compared with that of debt and its servicing obligation. So, if effective program is not set with time to carry out for debt financing, the economy would be entrapped into vicious circle of debt trap.

Banjade(2008). "Public Debt in Nepal: An analysis of its structure and Burden." has dealt the positive role of government borrowing for the stand economic growth and prosperity on a hand and on the other hand he has alarmed the state not to disburse the debt unproductively.

The objective taken by him is as follows:

- ) To study the burden of public debt and the problem of debt servicing.
- ) To examine the impact of public debt on GDP.
- ) To fulfill the above maintained objective has used secondary data from various publications. For analysis purpose he has taken simple mathematical tools like ratio, percentage, average etc.

The major findings of his study are:

Nepal has been passing through a critical stage of inadequate financial resource. While its duties and responsibilities are widening day by day but public funds available for the administration and development are limited. The government therefore adopts the policy of borrowing internally and externally.

Internally raised funds are to be spent on the construction of particular projects which may provide benefits for longer period of time. Time will reduce the burden of debt in the long run.

Because of increasing volume of expenditure the amount of deficit has been persistently increasing which has necessitated the growing need of public debt in Nepal.

Nepal is facing the debt servicing problem; the government must allocate certain amount for it in its annual budget. The most remediable facts are that the servicing amount is also increasing year by year.

The rate of interest on bonds and securities should be somewhat equal to the rate of interest faced by the commercial banks on fixed deposits, so that people may be tempted to invest in government bonds and securities.

Public debt is to be utilized effectively so as to increase productivity in the economy and the increasing rate of national income is to be greater than the rate of increase on national debt.

After giving some finding, he concludes the excessive dependency upon external loan that may lead the nation into a debt trap, if the terms of trade are not moved in favor of the debt country. That is why extra care should be exercised in procuring such loan.

The study the topic is "A Study on Trend and Structure of Public debt in Nepal". From 1991/1992 to 2010/2011 seeks to explore some new aspects on role, trend and structure of public debt.

## **CHAPTER III RESEARCH METHODOLOGY**

### **3.1 Introduction**

Research Methodology is a very much essential component which helps to systematically solve the research problem. It may be understood as a science of studying how research is done scientifically. In it we study the various steps that are generally adopted by a researcher in studying his research problem along with the logic behind them. It is necessary for the researcher to know not only the research methods/techniques but also the methodology. Researchers also need to understand the assumptions underlying various techniques and they need to know the criteria by which they can decide that certain techniques and procedures will be applicable to certain problems and others will not. All this means that it is necessary for the researcher to design the research methodology for solving problem as the same way differ from problem to problem. So, it is an essential part of a research work. This form is the framework for obtaining all necessary inputs for the study period. Hence, following methodologies have been adopted to complete the study.

### **3.2 Research Design**

The research design of the study is descriptive in nature. It is to see the stand objective of his study, have to supplement some important and relevant information through secondary sources.

### **3.3 Study Period**

This study covers the time period between 199/22 to 2010/11.

### **3.4 Nature and Sources of Data**

This study totally based on secondary data which were collected from Ministry of Finance, Ministry of Industry Commerce and Supply, National Planning Commission, Nepal Rastra Bank, Central Bureau of Statistic and published and unpublished books, reports, thesis, journals, papers, records etc for required quantitative and qualitative information.

### **3.5 Analysis of Data**

The study is based on qualitative analysis such as descriptive and analytical. Some statistical tools such as percentage distribution, average annual growth rate and trend analysis etc. have been employed. Likewise, , some ratios of debt servicing capacity have been estimated.

### **3.6 Limitations of the Study**

This study has the following limitations:

- ) This study based on the secondary data, but the reliability of those data is not examined.
- ) The data analysis is based on simple statistical techniques. The sophisticated statistical tools and technique have not been adopted for the generalization of the study. Hence the finding of this study may not be generally conclusive.
- ) This study concerns only with the particular problem entitled “A Study on Trend and Structure of Public Debt” as aforesaid objectives.
- ) This study is submitted in the partial fulfillment of the requirement for master’s degree in Economics. Therefore, it is not able to find out the sufficient result in debt.



### **3.7 Organization of the Study**

This study is divided into six parts. In the introduction part, background, statement of the problem, objectives of the study, importance of the study are included. In the second chapter, review of literature is mentioned. The third chapter includes research methodology. Under this heading introduction, research design, nature of data, analysis of data, limitation of the study, organization of the study of have been revealed. Likewise, in the fourth chapter, Trend and Structure of Public Depth is given. Fifth chapter covers Role of Public Depth. And summary, major findings and conclusion is explained in the last sixth chapter.

## **CHAPTER IV**

### **ROLE OF PUBLIC DEBT IN NEPAL**

#### **4.1 Introduction**

In Nepal, public borrowing plays a prominent role it helps in the mobilization of resources for the economic development. To fulfill the objective of economic development, there is need of heavy investment to build up socio infrastructure such as health, education, transportation, communication etc. For this, there is no other means to possible the government revenue i.e. tax and non-tax. So, public debt is a must for it. Public debt is widely accepted as a means of deficit financing measure to reduce the BOP deficit, imbalance and resource gap. The role public debt has been increase significantly by the planned economic development.

In underdeveloped countries one of the foremost tasks of the state is to stimulate the growth of the economy with stability. In most of them is to escape from "vicious circle of poverty". There is small capacity to low productivity, which is usually due to the lack of appropriate technology of capital equipment of the capacity to use them to the best advantage (Barman, 1986). So, public debt is necessary to remove such conditions.

For the economic development of Nepal, public borrowing is a useful instrument. A government can take loan from internal as well as external sources. The scope of domestic borrowing is very limited because of scarce of internal resources. At the same time, Nepal faces the shortage of foreign exchange show only external borrowing remains the alternatives.

According to R.K. Lekhi, "Foreign borrowing should be used to secure capital and technology which is very essential for the economic development of a developing country. So it needs greater care in the matter of securing foreign loan. It is but natural that certain internal basis

requirements are to be fulfilled to as to justify foreign loan. In undeveloped countries these loans should be used to stimulate economic growth it hold balance is such a feature. If the productive resources of the country are sufficient to have a planned rate of growth than the foreign loan will be justified and it would carry the favorable effect of the economy.

Nepal is dependent upon foreign assistance and external borrowing. Domestic resource like taxation and borrowing has their own constraints and under such circumstances deficit financing cannot also be recommended because of its inflationary effects. So, foreign loan can act as an important instrument for raising additional finance within a short period of time. This assistance can help in achieving the objective of developing economy such as economic stability and growth, if the funds are properly utilized on productive purposes. There is no doubt public debt is one of the major sources for development financing in Nepal. Hence, public debt borrowing is useful instrument for Nepal.

#### **4.2 Public Debt and Deficit Financing**

In Nepal, government cannot manage or run its development and regular expenditure without more or adequate resources, which lack development activities. The revenue resources like taxation and other non-taxation are required amount for the revenue to the economic development but it is not enough. So, the government obtains the public debt which is must. Thus in Nepal, the development activities are higher than its revenue, this is the main economic problem of the Nepal. This resource gap is fulfilled by public debt.

Deficit financing is the most useful method for promoting economic development in Nepal. It means as filling the gap caused by the excess of

government expenditure over its receipts, finance through public borrowing and creation of new currency. In other words, deficit financing takes place even when a budget gap is covered by loan. In fact any expenditure beyond its current income is known as deficit financing.

Deficit financing is that financing, which lies in financing, needs of the government, especially in the wartime than normal period. At that time it is not possible to mobilize the internal resources adequately. Keynes gave his views first time that the deficit financing as instrument of economic policy in the depression time to raise the output and employment (Tripathy, 1978).

According to Indian Planning Commission, "the term deficit financing is used to denote the direct addition to gross national expenditure through budget deficit whether deficit is on current revenue or of capital account. The essence of such a policy lays therefore the government spending in excess of the revenue; it receives in the shape of taxes, earning of taxes enterprises, of state enterprises, loan from public, deposit funds and other miscellaneous sources. The government may cover either by running down its accumulated balance or by borrowing from banking system mainly from the central bank of the country and this creating new money".

Deficit financing in the context of LDCs have different connotation. It is the most useful method of promoting economic development in LDCS. The nature of an LDC is such that sufficient private investment is not forthcoming due to various social, economic and institutional factors. Deficit financing may be used for the development of economic and social overheads such as construction of roads, railways, power projects, schools, hospital etc. By providing socially useful capital, deficit

financing is able to break bottleneck and structure rigidities and thereby increases productivity. Deficit financing is an important and most fruitful instrument for capital formation in under developed countries.

We can conclude that public borrowing is the means form to meet deficit financing for the economy. It has very close relation with borrowing both internal and external. Borrowing is easy source to finance deficit in Nepal.

### **4.3 Public Debt and Economic Development**

Economic development is the main goal of Nepal to provide employment opportunities, to eliminate poverty and it accelerates the economy. So, economic development helps to transform the traditional society in to modern society. But due to the lack of financial resources, it cannot be easily achieved. To minimize the lack of financial resources public debt can play a vital role.

Public borrowing is important to economic development in so far as it stimulates creates appropriate milieu in the economy. In underdeveloped country, both money and capital market unorganized and are in primitive stage of their development. But the proper development of the public borrowing programmed helps to develop both the money and capital market. With the expansion of treasury bills, the money market develops. Similarly, with the expansions of bond the capital market develops. In this regards, the government may be interested merely in borrowing at minimum possible cost but it may also endeavors to create such as atmosphere, with might encourage the growth of money and capital market in the economy (Shree Kathharadhya, 1972).

Underdeveloped countries are facing the deficiency of capital in relation to their production and nature resources. Most of the countries are

characterized by deficiency of capital. To break vicious circle and uplift a country with a self-sustaining growth a large amount of initial investment is necessary. This, underdevelopment countries should emphasize to stimulate and accelerate capital formation (Rostow, 1952).

Lack of capital is resulted largely from the small potentiality of saving. This in turn is resulted from the low level of investment. Hence, poverty sequence moves like inadequate capitals low productivity, low real income level and low purchasing power, inadequate, inducement to save and to invest and adequate capital gain (Nurkse, 1962). This Justify that capital deficiency in the developing countries is serious bottleneck for the development.

Due to that market imperfection and low saving capacity mobilization of adequate financial resources is difficult in Nepal. However, further strengthening of the financial institutions of money and capital market government must facilitate by making appropriate policy measures. Then only domestic for the process mobilization will be strengthened which helps to finance for the process of economic development. Borrowing from the market the market may increase capital accumulation where borrowing from central bank may have inflationary pressure in the economy. So, it is desirable to increase market borrowing so as to increase the pace of development.

In conclusion, public borrowing is widely accepted as a means for development of a country. Without public debt, the adequate mobilization of internal resources could not have been made in order to accelerate the rate of economic development. Public borrowing provides regular channel for investment and also helps development of money and capital market. Ultimately, it helps to develop financial sector of the economy, which ate

allocated for the mobilization of resources. Public borrowing is revenue to the government. The urgent need of Nepal is not augmentation of effective demand but expansion of the productive capacity. So, borrowing as a method of financing for development is quite suitable as it has less expansionary effect on the money supply than deficit financing.

#### **4.4 Public Debt and Resource Mobilization**

For economic development of Nepal, public borrowing is a means of mobilizing financial resources. Though classical economists were against the use of public debt, they are not fully restricted the use of public debt on "self-liquidating projects". Bank Keynesian views were fully devoted on the use of public debt, which brought a change in the growth. He advocates that increase the employment and national income.

The public debt should be used as an instrument to mobilize saving of people, which would otherwise, have gone to ideal or wastefully consumption. Public debt should be advocated creating additional capacity and producing capital equipment's. Generally, government borrows for the creation of infrastructure in the economy. Since it requires huge investment initially this cannot meet only through revenue collection. The aim of public debt policy should be help I strengthening the money and capital market which in turns accelerate development and price stability. The government of Nepal rise to mobilize saving of the community party through the device of public borrowing in order to meet the financial needs of its development programs. Nepal has limited sources of revenue and excess need of development expenditure. There in mismatch between revenue and expenditure is one hand and in another investment on infrastructure development is needed due to this reason abundant resources are can play major role of resource for development funding.

The economic effect of financing a deficit by loan may be more nearly like form taxation. We will latter shown loan financing may not cause of significant curtailment of individual consumption and a subsequent release of resources for government (Samuelsson, 1958). So, public debt is very essential for the economic development of a Nepal but depends upon the mobilization of resources.

Public borrowing is an effective instrument for mobilization of resources since; heavy taxation is against the public willingness. There is cardinal limit to which to taxation can be used to cover up the deficit in the budget without having adverse effect on the economy. When private saving is not possible because of lower profitability, public debt is helpful to mobilize resources.



## **CHAPTER V**

# **TREND AND STRUCTURE OF PUBLIC DEBT IN NEPAL**

### **5.1 Introduction**

The phenomenon of public debt was originated in Great Britain in 17th century where city merchants provided grants and loans to the government. In return, they received the privileges of a royal charter to found the Bank of England. Concepts and needs of public debt arose simultaneously with take loan by the public for war financing. After the end of 2nd world war many countries made free from colonial rule then there is need of funds, which pushed forward on the needs of debt.

Public debt is the result of mismatch between revenue and expenditure over time period. The gap is growing due to limited sources of fund, where level of government revenue is very low because of low tax payable capacity of people but the level of government expenditure is in the form of regular and development expenditure is increasing rapidly. Since government revenue is increasing slowly and government expenditure is increasing rapidly, public borrowing expenditure is increasing rapidly; public borrowing becomes important to bridge the fiscal deficit of a country.

Nepal started to collect external debt from 1963/64 and internal debt from 1964. In fiscal year 1963/64, the government for the first time floated securities for mobilizing saving to finance the country's economic development. Especially "After the enforcement of public act 1960, public debt for the first time was issued in Nepal in 1962 through treasury bills amounting to Rs. 7 million. The next instrument of public debt, development bond, was first issued in fiscal year 1963 1963/64,

amounting to Rs. 131.0 million. National saving certificate is being issued since 1984, which was Rs. 250 million" (Acharya, 1998).

"Nepal has been incurring fiscal deficit with the evolution of budgetary development in the first budget of the country in 2008 LB.LS. Revenue was Rs. 30.5 million incurring thus the fiscal deficit of Rs. 22 million" (Thapa, 2005). This trend has continued uninterruptedly until it was accepted by Nepal since the first five year plan (1956/57-1959/60) and started to raise the debt since the year 1961/62 through the means treasury bill that amounted of million and carried one percentage of interest rate. In the FY 2064/65 the government issued public debt regulations and partial is still managed with the regulation. Since the amount of external borrowing of Nepal are the government of developed countries, international financial institutions, mainly IMF, WB and ADB.

There are mainly four reasons for the rise in government borrowing.

- a) To recover the deficit budget.
- b) To recover emergency expenses
- c) To sustain the economic and monetary system.
- d) To accelerate the economic and monetary stability.

## **5.2 Resource Gap**

A common phenomenon, resource gap has always been seen in Nepalese economy due to limited mobilization of internal resource of the development program in Nepal. Nepal is facing serious and growing problem of resource gap, since the starting of systematic budgeting system in Nepal. This is because of the growth trend of the total expenditure and its revenue generation capacity. Every individual as well as government needs fund to maintain their daily expenditure but importance of fund is much more essential for government due to the concept of national development. To finance for the development works government must be collect fund through the taxation and other sources of revenue. However, government revenue is inadequate to meet the expenditure because of limited source of revenue generation. To collect needy funds, government must be increased in the tax rates and fees which are unjustifiable for the point of social welfare. In Nepalese economy, resource gap has been always a common phenomenon, since the start of the systematic budgeting system in Nepal. Nepal is experiencing a serious and growing problem of resource gap. This is because the trend of revenue collecting is increasing in lower rate than the rate of expenditure, which is growing rapidly year to year. Thus revenue expenditure gap is growing rapidly year to year. Thus revenue foreign gap is growing is very fiscal year. On the other hand, a so encouraging which also leads budgetary deficits. The extent of financial resource gap in the context of Nepal has shown in the table 5.1.

**Table 5.1**  
**Different Scenario of Resource Gap (Rs. in Millions)**

<b>Fiscal Year</b>	<b>Total Revenue (1)</b>	<b>% Change in Revenue (2)</b>	<b>Total Expenditure (3)</b>	<b>% Change in Expenditure (4)</b>	<b>Revenue Gap (5) = (1-3)</b>	<b>Foreign Grants (6)</b>	<b>Fiscal 3-(1+6)</b>
1991/92	13512.7	-	26418.2	-	12905.5	1643.8	11264.7
1992/93	15148.4	12.10	30897.7	16.69	14549.3	3793.3	1195.6
1993/94	19580.8	29.29	33597.4	8.74	14016.6	2393.6	11623.3
1994/95	24575.2	25.51	39060.0	16.26	14484.8	3937.1	10547.2
1995/96	27893.1	13.50	46542.4	8.95	18649.3	4825.1	13824.2
1996/97	30373.5	8.89	50723.7	10.64	20350.2	5988.3	14361.9
1997/98	32937.9	8.44	56118.3	10.64	23180.4	5402.6	17777.8
1998/98	57251.0	13.99	59579.0	6.17	22328.0	4336.6	17991.4
1999/00	472893.8	15.15	66272.5	11.29	22378.7	5711.7	17667.0
2000/01	48893.6	13.99	79835.1	20.49	30941.5	6753.4	24188.1
2001/02	50445.5	3.17	80072.2	0.30	29626.7	6686.1	22940.6
2002/03	56229.8	15.04	84006.1	4.91	2776.3	11339.1	14637.2
2003/04	62331.0	10.85	89442.6	6.47	2711.6	11283.4	15828.2
2004/05	70122.8	12.5	102560.4	14.7	32437.6	14391.2	18046.5
2005/06	72282.1	3.1	110889.2	8.1	38607.1	13827.5	24779.6
2006/07	87717	21.35	133604.4	20.48	45887.4	15800.8	30086.6
2007/08	107622.5	22.69	161349.9	20.76	73632.9	20320.7	33406.7
2008/09	143474.5	33.31	219662	36.14	76187.5	26382.8	49804.7
2009/10	179945.8	25.42	25689.1	18.22	79743.3	38545.9	41197.4
2010/11	199818.7	11.04	294197.9	30.29	94379.2	45922.2	48427

Source: Various Issues of Economic Survey, MOF, GON

Table 5.1 presents the trend of revenue gap and fiscal deficit. The revenue gap is increasing regularly because of increasing volume of total expenditure. This situation shows that present change in revenue is higher than expenditure, but the quantum of total expenditure is greater than total revenue and incurs revenue gap. In FY 1991/92, Rs. 26418.23 million was the total expenditure but total revenue was only Rs. 13512 million, there was gap of Rs. 12905.5 million which is 2010/11 to amount Rs. 294197.9 million of total expenditure, Rs. 199818.7 million revenue and revenue gap is Rs. 94379.2 million. This indicates that revenue gap is increasing year to year and very high in recent years.

The total revenue and expenditure are Rs. 13512.7 million and Rs. 26418.2 million respectively in FY 1991/92. So the revenue gap is 1205.5 million in the same period. The government expenditure is continuously increasing than government revenue. In FY 2006/07, total expenditure is LR. 133604.4. The total revenue and expenditure are 199818.7 million and 45922.2 million respectively in FY 2010/11. This indicates that the problem of resource gap is a serious problem.

Foreign grant plays important role to meet the fiscal deficit but that cannot cover resource gap totally. There for, there is fiscal deficit of Rs. 1126.7 in fiscal year 1991/92 and of Rs. 30086.6 million in FY 21006/07 which shows that trend of fiscal deficit is increasing in every year. The trend of grant in table 4.1 shows increasing and decreasing tendency. In fiscal year 1991/92, there was Rs. 1643.8 million grants which is Rs. 38545.9 million in fiscal years 2010/11. The table also presents that the quantum of fiscal deficit which shows upswing and down-swing tendency.

So, table indicates that trend of revenue and expenditure is increasing in review year, but quantum of expenditure is more than revenue. Which really forced to collect debt in order to meet resource gap in the country? Though foreign grant plays vital role to fulfill the resource gap but that cannot fully remove the gap and nation goes to collect public debt.

### **5.3 Export-Import Gap**

Nepal is a least developed country with limited export goods and without specialization such as food, grains, garments products, carpet etc. We are exporting low quality goods in low price which reduce the competitiveness of the product. Due to such scenario, there is not any possibility for current account balance. Major exports goods are raw materials and goods grains but import goods are final as well as capital goods so that year by year the gap is growing rapidly. The trends of export and import of Nepal is shown on the table 5.2 below.

**Table 5.2**  
**Trend of Export and Import**

<b>Fiscal Year</b>	<b>Export</b>	<b>Import</b>	<b>Export Import Gap</b>	<b>Growth Rate of Export Import Gap</b>
1991/92	13706.5	31940.0	18233.5	-
1992/93	17266.5	39205.6	21939.1	20.32
1993/94	19293.4	51570.8	3227.4	47.12
1994/95	19639.2	63679	46040.3	42.63
1995/96	19881.1	74454.5	54573.4	18.63
1996/97	22636.5	93553.4	70916.9	29.94
1997/98	27531.5	89002.0	61488.5	-13.29
1998/98	35676.3	87525.3	51849.0	-15.67
1999/00	9822.7	108504.3	58682.2	13.17
2000/01	55654.1	115687.2	60033.1	2.3
2001/02	46944.8	107389.0	60444.1	6.8
2002/03	49930.6	124352.1	74421.5	23.12
2003/04	53910.7	136277.1	82366.4	10.67
2004/05	58705.7	149473.6	90767.9	10.2
2005/06	60234.1	173780.3	113546.2	25.09
2006/07	59383.1	194694.6	135311.5	19.16
2007/08	5926.65	221937.7	216011.05	59.63
2008/09	67697.5	284469.6	277700.1	28.55
2009/10	60824	374335.2	313511.2	12.89
2010/11	64338.5	396175.5	33187	5.84

Source: Various Issues of Economy Survey, MOF, GON

Table 5.2 presents that, the total amount of export was Rs. 13706.5 million in 1991/92 which increases to amount Rs. 64338.58 million in

2010/11. On the another side, the total amount of import was Rs. 31940.0 million in 1991/92 which increase to amount Rs. 39617.5 million in 2010/11. The rate of growth of import is lower than export but the gap amounted to Rs. 331837 million in 2010/11, which was 18233.5 million in 1991/92. In export side there is fluctuating trend year by year, but in import side, the trend is increasing mostly. This condition states that larger amount of revenue is going to match the export-Import gap which pushes the economy for further internal and external debt. The figure of export and import shows that in the fiscal year 2000/01 the gap is decreasing due to cause by terrorism not by the export diversification.

Nepal is accelerating the process of trade liberalization that had commented in the mid-eights. This is reflected in membership of W: TO, agreement of a framework for a free trade area (FIA) in south Asian an interning of FAT with BIMST-EC. The trade liberalization in Nepal will have likely impact on import duties, which presently are an important source of government revenue contributing about one quarter of total tax revenue.

#### **5.4 Public Debt as Percentage of Fiscal Deficit**

Public debt is the valuable sources for financing the fiscal deficit in Nepal. Since the government expenditure is rapidly increasing which is unable to raise the revenue accordingly. Although for financing the government annual budgetary deficit both internal and external sources borrowing have been adopted. The government should borrow the internal debt within the limit of 1-2 percent of GDP for economic betterment. The external borrowing contains no such restrictions. However, it must keep within limit of GDP. The higher amount of debt makes the economy totally dependent on foreign assistance and the debtor country becomes a short of the colony of debated country. The



internal and external debt as percentage of fiscal deficit has been shown in the table 5.3

**Table 5.3**  
**Percentage of Debt in Fiscal Deficit**

Fiscal Year	Internal Debt (ID)	External Debt (ED)	Govt. Revenue (GR)	Govt. Exp. (GE)	Total Debt	Deficit	Annual Growth Rate of Deficit	ID as % of Deficit	ED as % of Deficit	TD as % of Deficit
1991/92	2078.8	6816.9	13512.7	26418.2	88957	12905.5	0.0	16.1	52.8	68.9
1992/93	1620.0	6920.9	15148.4	30897.7	8540.9	15749.3	22.0	10.3	43.9	54.2
1993/94	1820.0	9163.6	19580.8	33597.4	10984.4	14016.6	-11.0	13.0	65.4	78.4
1994/95	1900.0	7312.3	24578.2	39060.0	92123	14484.8	3.3	13.1	50.5	63.6
1995/96	2200.0	9463.9	27893.1	4652.4	11663.9	18649.3	28.8	11.8	50.7	62.5
1996/97	3000.0	9043.6	30373.5	50723.7	12043.6	20350.2	9.1	14.7	44.4	59.2
1997/98	3400.0	11054.4	32937.9	56118.3	1445.4	23180.4	13.9	14.7	47.7	62.4
1998/98	4710.0	11852.4	37251.0	59579.0	165624	22328.0	-3.7	21.1	53.1	74.2
1999/00	5500.0	11812.2	42893.8	66272.5	17312.2	23378.7	4.7	23.5	50.5	74.1
2000/01	7000.0	12044.0	48893.6	79835.1	19044.0	30941.5	32.3	22.6	38.9	61.5
2001/02	8000.0	7698.7	50445.5	80072.2	15698.7	29626.7	-4.2	27.0	26.0	53.0
2002/03	8880.0	4564.4	56229.8	84006.1	13426.4	27776.3	-6.2	32.0	16.4	48.3
2003/04	5607.0	7629.0	62331.0	89442.6	13236.0	27116.6	-2.4	20.7	28.1	48.8
2004/05	8938.1	9266.0	70122.7	102560.4	18204.1	32437.7	19.6	27.6	28.6	56.1
2005/06	11834.2	8214.4	72282.1	110889.2	20048.6	38607.1	19.0	30.7	21.3	51.9
2006/07	17892.3	10053.5	87717	133604.4	27945.8	45887.4	18.9	39	21.9	60.9
2007/08	20496.4	8979.9	107622.5	161349.9	29476.3	53727.4	19.07	38.14	16.7	54.8
2008/09	18417.1	9969.9	143474.5	219662	28386	76187.5	41.80	24.17	13.08	37.2
2009/10	29914	1123.4	179945.8	25989.1	310374	79743.3	4.61	37.5	14.08	38.9
2010/11	42515.8	12075.6	199818.7	294197.9	54591.4	94379.2	18.35	45.04	12.79	57.84
							10479	21.88	34.203	55.44

Source: Various Issues of Economy Survey, MOF, GON

In FY 1991/92, internal debt and external debt were Rs. 2078.8 million and Rs 6816.9 million respectively which went up to Rs. million and Rs. 12075.6 million respectively in FY 2010/11. This shows the tremendous increasing trend of public debt by both internal and external

The average annual percentage of total debt to fiscal deficit is 8.4 percentages. Lest of budgetary deficit has been fulfilled by grants and cash-balance. Above table shows that the internal debt had occupied 16.1 percent of deficit whereas external debt has occupied 52.8 percentages in FY 1991/92. In overall, external debt has occupied 40 percentage of share out of total deficit whereas internal debt has occupied 21.88 percentages of shares out of total deficit whereas internal debt has occupied 21.88 percentages of shares out of total deficit during the study period of FY 1991/92 to 2010/11.

### 5.5 Trend of total External Borrowing in Nepal

In this section a snapshot of total External Borrowing made by Nepal including direct and indirect in different fiscal year has been shown in the following figure in Rs Million from fiscal year 2001/02 to 2011/12.

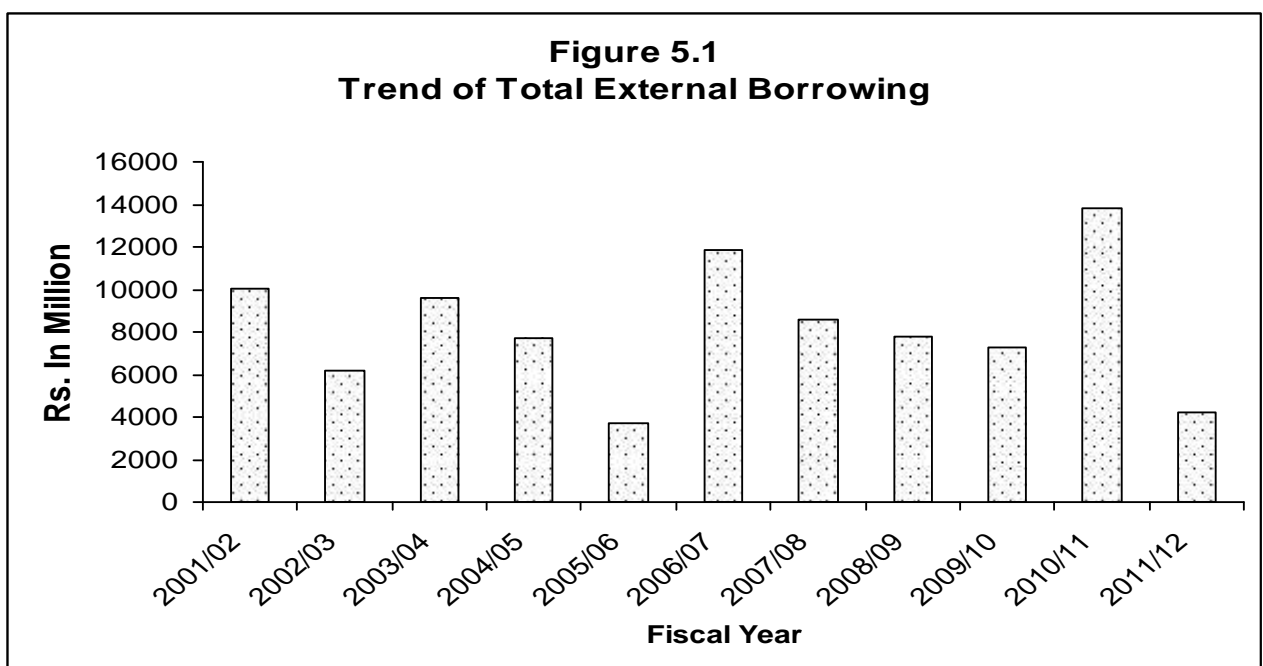


Figure 5.1 shows the trend of External borrowing to Nepal from Fiscal Year 2001/02 to 2011/12. By seeing the bar diagram it can be said the though the trend is increasing and decreasing in different fiscal year but on an average it has been increasing with uneven rate.

### **5.6 Trend of Internal Borrowing in Nepal**

Internal borrowing is started to carry from fiscal year 1961/62. Nepal is borrowing the internal debt to meet the resource gap and to mobilize the internal fiscal resource for development from various sources such as Treasury bill, Development Bond, National Saving Certificate and Special Bond. Internal public debt have important role in cash flow management and to support the expenditure for development activities. Now a day, government is also receiving internal borrowing from citizen saving certificates. The trend and structure of internal borrowing is shown in table 5.4.

**Table 5.4**  
**Trend and Structure of Internal Borrowing**

<b>Fiscal Year</b>	<b>Total Outstanding Internal Debt</b>	<b>Treasury Bills</b>	<b>Percent</b>	<b>Development Bonds</b>	<b>Percent</b>	<b>National Saving Certificates</b>	<b>Citizen Saving Certificates</b>	<b>Special Bonds</b>
1991/92	23234.9	3483.2	14.99	5132.2	22.09	4546.3	-	10073.2
1992/93	25456.1	4403.2	17.30	5132.2	20.16	4901.5	-	11019.2
1993/94	30631.2	5216.3	17.03	4732.2	15.45	5691.5	-	14991.2
1994/95	32057.8	6392.5	19.94	4122.2	12.86	6076.4	-	15466.7
1995/96	34241.9	7142.5	20.86	3672.2	10.72	7376.5	-	16050.7
1996/97	35895.9	8097.5	22.56	3042.2	8.48	8736.5	-	16019.7
1997/98	38406.7	9182.5	23.90	3302.2	8.60	9886.4	-	16035.6
1998/98	49939.7	17856.9	35.76	3872.2	7.75	10426.4	-	17784.2
1999/00	54357	21026.9	38.68	4262.2	7.84	11526.5	-	17541.4
2000/01	60043.8	27610.8	45.98	5962.3	9.93	12476.4	-	13994.3
2001/02	73621.1	41106.6	55.84	11090.7	15.06	11536.3	628.1	9259.4
2002/03	84645.3	48860.7	57.72	16059.2	18.97	9629.8	931.1	9164.5
2003/04	86133.7	49429.6	57.38	17549.2	20.37	9029.8	1178.9	8946.2
2004/05	87564.2	51383.1	58.68	19999.2	22.84	6576.7	1428.9	8176.3
2005/06	94710.9	62970.3	66.49	17959.3	18.96	3876.8	1678.9	8225.6
2006/07	36756	7445.3	20.26	19177.1	52.17	1516.9	1391.0	7225.7
2007/08	116039.5	85033	73.28	21735.4	18.73	1116.9	3014.4	5139.8
2008/09	125674.1	86515.1	68.84	29478.5	23.46	216.9	4433.6	5030
2009/10	148059.7	102043.7	68.92	35519.4	23.99	0.0	5126.9	5369.7
2010/11	178016.1	120340.7	67.60	43519.4	24.49	4000.0	5126.9	5029.1

Source: Various Issues of Economic Survey, MOF, GON

The above table shows that net outstanding internal debt and its variation in treasury bills, development bonds, national saving certificates and special bonds. In table total outstanding internal debt was Rs. 20855.9 million in FY 1991, which is increasing gradually and expected by Rs. 184205.7 in FY 2010/11.

Treasury bills are short term loan as these raised for the period of less than one year. In above table, Amount of Treasury bill is increased to Rs. 120340.7 million in fiscal year 2011 from Rs. 2350.0 million in fiscal years 1991.

The other remaining securities are called long-term securities as they are issued for the period of more than one year. Government bonds and national saving certificates have 3 to 15 years period of maturity according these are identified as long-term securities. In the above table development bonds, national saving certificate and special bonds are upswing and downswing trend. It is concluded that the role of domestic upswing and downswing trend. It is conducted that the role of domestic borrowing for resource mobilization is increasing by the absence of growth in revenue collection as the proportion of growth in expenditure.

### **5.7 Trend of External Borrowing in Nepal**

Nepal has not international before 1950's with rest of the world intimately which is changed after the 2007 B.S. revolution. Then foreigners are attracted to provide financial assistance for the socio-economic development of Nepal. Nepal has started to borrow from external sources from 1994/95. Internal debt is not to low resource mobilization, the fund collection is inadequate. So, external debt is the most essential source of revenue to government. Basically, external borrowing can be divided in

Bilateral and multilateral source. The friend and structure of external debt is shown in the following table.

**Table 5.5**  
**Pattern of External Debt in Term of Disbursement by Major Source**  
**(Rs. in Millions)**

<b>Fiscal Year</b>	<b>Total External Debt</b>	<b>Bilateral Debt</b>	<b>Multilateral Debt</b>	<b>% of Bilateral External Debt</b>	<b>%of Multilateral External Debt</b>
1991/92	6269.41	2389.80	3879.67	38.12	61.88
1992/93	5961.78	1307.62	4654.14	21.93	78.07
1993/94	9163.67	582.91	8580.71	6.36	93.64
1994/95	7312.37	717.30	6595.02	9.81	40.19
1995/96	9463.91	460.00	9003.97	4.86	95.14
1996/97	9043.66	850.75	8192.95	9.41	90.59
1997/98	11054.55	1314.56	9740.06	11.89	88.11
1998/98	1182.47	584.00	1268.44	4.93	95.07
1999/00	11812.29	757.91	11054.39	6.42	93.58
2000/01	12044.05	586.74	11457.35	4.87	95.13
2001/02	7698.63	87.06	7611.61	1.13	98.87
2002/03	4546.46	657.28	3889.24	14.45	85.55
2003/04	7629.04	66.02	7563.09	8.65	91.35
2004/05	9266.11	126.54	9139.64	1.36	98.63
2005/06	8214.32	40.66	8173.75	0.49	99.5
2006/07	10053.53	9004.61	1048.92	89.57	10.43
2007/08	8979.97	632.15	8347.84	7.03	92.96
2008/09	9969.90	612.96	9356.00	6.14	93.38
2009/10	11223.40	4550.61	6672.81	40.54	95.454
2010/11	12075.67	4112.43	7963.28	34.05	65.95

Source: Various Issues of Economic Survey, MOF, GON

Table 5.5 shows that external debt has grown from FY 1991/92 to FY 2000/01. After FY 2001/02 foreign loan shows upswing and downswing trend. The total external debt was Rs. 62694.4 million in FY 1991/92 which increased and reached at Rs. 12075.6 in FY 2010/11. In table multilateral debt has dominated the bilateral debt up to 05/06.

In 1991/92, Rs. 2389.8 million from bilateral source and Rs. 3879.6 million from multilateral, where share is 38.12 and 61.898 percent respectively.

The table also shows that the share of bilateral debt is decreasing and the share of multilateral debt is increasing up to FY 2005/06 and again decreasing and start to rise on 2011/11. But in FY 2010/11 data has totally changed, where share of bilateral loan is 35.05 percent and multilateral loan is 65.94 percent.

These shows that now a days, the debt circular countries are satisfied from the return of Nepal, what they had expected.

### **5.8 Net Outstanding Debt**

A prime feature of Nepalese fiscal policy is the budget deficit due to revenue surplus cannot meet the development expenditure. The government has to borrow large amount of loans to meet ever increasing financial resource gap which needs large amount of loan and on the other hand there is low amount of repayment as compared with the total borrowing each year.

Thus, there is increasing total net public outstanding debt each year. Net outstanding total debt means both internal and external debt after deducting repayment of principal and interest. The total debt stock of Nepal is shown in table below.

**Table 5.6**  
**Trend of Nepal's Total Debt Stock (Rs. in Million)**

<b>Fiscal Year</b>	<b>External Loan</b>	<b>Percent</b>	<b>Internal Loan</b>	<b>Percent</b>	<b>Total Debt</b>	<b>GDP</b>	<b>Total Debt as % of GDP</b>
1991/92	70923.6	75.32	23234.9	24.68	94158.5	144933.0	64.97
1992/93	87420.8	77.45	25456.1	22.55	112876.9	165350.5	68.27
1993/94	101966.8	76.90	30631.2	23.10	132598.0	191596.0	69.21
1994/95	113000.9	77.90	32057.8	22.10	145058.7	209974.0	69.08
1995/96	128044.4	78.90	34241.5	21.10	162286.3	239388.0	67.79
1996/97	132086.8	78.63	35890.9	21.37	167977.7	269570.0	62.31
1997/98	161208.0	80.76	38406.7	19.24	199614.7	289798.0	68.88
1998/98	169465.9	77.33	49669.6	22.67	219135.5	330018.0	66.40
1999/00	190691.2	77.82	54357.0	22.18	245048.2	366251.0	66.91
2000/01	200404.4	76.95	60043.7	23.05	261594.3	413428.0	63.00
2001/02	220125.6	74.94	73620.7	25.06	293746.3	430396.0	68.25
2002/03	223433.2	72.52	84645.3	27.48	308078.5	460325	66.93
2003/04	245211.4	96.72	8320.9	3.28	328232.3	500699	50.64
2004/05	219641.9	71.50	87564.2	28.50	307206.1	548485	56.01
2005/06	234805.6	71.26	94710.6	28.74	329516.2	611118	53.92
2006/07	216628.9	67.61	103776.0	32.39	320404.9	675859	47.41
2007/08	249965.4	68.30	116039.5	31.70	366004.9	755257	48.46
2008/09	277040.4	68.79	125674.1	31.21	402714.5	909309	44.29
2009/10	256243.3	63.38	148059.7	36.62	404303	1060881	38.11
2010/11	259551.8	58.49	184205.7	41.51	443757.5	1246423	35.60

Source: Various Issues of Economic Survey, MOF, GON



Table 5.6 presents the total outstanding debt of Nepal from FY 1991/92 to 2010/11 which shows that Nepal's total outstanding has reached a little more than two third of the national income of the country. In view of the level of the development and the per capital income of the country, this level of outstanding public debt should be taken as burdensome.

The table also shows that both internal and external net outstanding public debt is increasing trend. In fiscal year 1991/92, internal and external outstanding debt is Rs. 23234.9 million and Rs. 70923.6 million respectively, which reached Rs. 184205.7 million and Rs. 259551.8 million in FY 2010/11. Growing trend of external debt is greater than internal debt. From above table, we conclude that net outstanding debt is growing due to the growing needs of socio-economic development and lower debt servicing trend.

## **CHAPTER VI**

### **SUMMARY, FINDING AND RECOMMENDATIONS**

#### **6.1 Summary**

The concept of public debt grew after the end of world war-II because of independence of Asian and African countries from the colonial rule of centre. Most of classicists were against borrowing because they thought individual can effectively use resource than government. They were not totally against the borrowing, they prefer effective utilization of loan or borrowing must be used on productive activities. Later on, after the great depression of 1930s role of government on the economy increased which leads to increase in debt also.

In the context of developing countries, it is playing vital role for socio-economic development because they have limited size of funds which is not sufficient for development financing. In case of Nepal, the land locked nature and mountain topography are the major constrains for development of Nepal. Nepal is economically backward and also its economic performance is not satisfactory. Nepal is demanding more and more financial resources to bridge the growing resources in budget. So, public debt is playing crucial role for development and fulfill the gap between income and expenditure. The study shows that the government borrowing is growing year by year along with the rise is pubic expenses of bilateral and multilateral sources such as ADB, UNDO, WB, WHO, IMF etc.

Internal debt playing important role to fulfill deficit financing and to promote monetary policy but domestic resources are not deficient to meet such fiscal imbalance and government have to depend upon external borrowing.

Nepal is also implementing periodic plan for smooth development of a county. Such plan demands heavy fund for infrastructure development as well as fulfilling various objectives of the plan. Since internal sources are not sufficient, government collects needy fund from external sources are not sufficient, government collects needy fund from external source. The trend and structure of internal and external borrowing is increasing due to increasing trend of fiscal deficit.

Nepal is facing the problems of financing to ever increasing resource gap. The widening resource gap in the recent year has been cumulative effect on the deficiency of investment.

Budgetary deficit is growing rapidly in every fiscal year and trend of grants in decreasing which further increased in debt burden. Such factor helps to raise internal and external debt. Although, the trend of continuous increase in public debt is not good economic indicator for Nepal, public debt is an important source to mobilize resources as well as socio-economic development of the country.

## **6.2 Major Findings**

There is excessive increase in revenue gap which leads to increase fiscal deficit. The revenue gap has increased fiscal deficit. The revenue gap has increased from Rs. 12905.5 million in starting year of review period 1991/92 to Rs. 94379.2 million in last year of review period 2010/11. Thus fiscal deficit [TE- (TR + Grant)] has increased from Rs. 11261.7 million in starting year of review period 1991/92 to Rs. 42922.2 million in final year of review period 2010/11.

The trend of percent change in revenue is greater than the trend of percentage change in expenditure but the quantum of expenditure is

greater than quantum of revenue. So higher rate of growth in revenue is not sufficient for financing increased government expenditure.

In FY 1991/92, import-export gap Rs. 18233.5 million and in FY 2010/11, it is Rs. 33187 million. Whereas the amount of export was Rs. 13706.5 million and import was Rs. 31940.5 million in LFY 1991/92 and in FY 2006/07 export is 60824 million and import is Rs. 374335.2 million.

The sources of financing deficit are loan and grants, in loan share of external debt is higher than internal debt. In fiscal year 1991/92 debt was Rs. 6186.9 million. In fiscal year 2010/11, the amount of external debt is Rs. 12075.6 million and amount of internal debt is Rs. 42515.8 million.

Foreign grant also plays important role to meet fiscal deficit. In fiscal year 1991/92, the total amount of grant was Rs. 1643.8 million which is increased to Rs. 45922.2 million in 2010/11.

In FY 1991/92, government received internal debt of Rs. 3483.2 million from Treasury Bills, Rs. 5132.2 million from development bonds, Rs. 4546.3 million from National Saving Certificates and Rs. 120340.7 million from special bonds. But in FY 2010/11, it is Rs. 120340.7 million from Treasury Bills, Rs. 43519.4 million from Development Bonds, Rs. 4000.0 million from National Saving Certificates, Rs. 5126.9 million from citizen saving certificate and Rs. 5029.1 million from special bonds. This shows that the trend of internal debt is rising in all those sources.

The total debt amount is increasing from Rs. 144933.0 million in FY 1991/92 to Rs. 1246423 in FY 2010/11. The total as percentage of GDP was 65.0 percent in FY 1991/92 and in FY 2010/11, it is 35.60. In the

study period, total debt as percentage of GDP lies between 30 to 70 percent.

### **6.3 Recommendations**

The size of borrowing is increasing year by year due to the size of fiscal deficit is increasing every. So that proper utilization and minimization of public debt is necessary. The following recommendations are purposed to address the problem of public debt in Nepal.

- Government should use both external and internal debt on highly productive sectors which can contribute to pay back of the principle and interest and to help to generate the capital formation.
- Borrowing should not be used to the payment of interest and principal amount. It should be invested in the productive sector so that return from such investment will be sufficient for repayment.
- Government should try to collect foreign instead of foreign debt.
- Borrowing should be invested according to people's desire and needs so that return from such investment would be high.
- Appropriate environment and policy should be made to attract foreign investment.
- Tax collection system should be made effective and sources of revenue should be developed to substitute public debt.
- The government should be active enough to maintain the strong policy of monitoring, evaluation and supervision which help to reduce corruption and to increase to accountability, responsibility and implementation.

- Poor attention should be given to macro-economic stability of the country while taking both internal and external debt.
- Government should adopt the policy of trade but aid for the economic development.
- Government should replace the remittance instead of external debt in different economic activities.