

CHAPTER I

INTRODUCTION

1.1 Background of the Study

In present situation, the expenditure of government is increasing very rapidly as compared to increase in their national income. The increasing expenditure of the government is not possible to meet only through revenue collection. The government of a country gets its income from two sources namely; public revenue and public debt. The public debt is considered as effective instrument for the economic development of nation. In most of the developing country, the volume of public debt is increasing.

The phenomenon of public debt was originated in Great Britain in the seventeenth century, when a group of city merchants provided grant and loan to the government. In return, they received the privilege of Royal Charter to fund the Bank of England, which become the country's central bank. After the Second World War, Public debt seemed very important source of development expenditure. Most of the countries started to borrow systematically and still borrowing to assists the development of their economics at a faster pace and sustained way. After the first and second world wars large amounts of loans were borrowed for the reconstruction, rehabilitation and maintenance of devastated economics.

For the economic development of underdeveloped countries, 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 the underdeveloped countries face the shortage of foreign exchange only external borrowing remains the alternative.

Public debt includes internal and external debt of the government. Internal debt refers borrowing through securities such as development bonds, national saving certificates, Treasury bill and other special bonds. Those securities are to be repaid within a specified time, whereas external debt comprises obligation of country to foreign national or international institutions.

In recent years, several techniques of financing development activities are put into operation in the process of economic development of underdeveloped countries. Public debt, both internal and external, as means of financing economic development has come to assume significant role in the context of planned economic development. For this, public borrowing has to be undertaken within the country as well as abroad. The scope of domestic borrowing in these countries is very limited, because internal resources are scarce. At the same time, only external borrowing remains the alternative to be undertaken by these countries.

Nepal is heavily depended upon external as well as internal public debt for economic development. The government, prior to the establishment of the democracy 1950's had no any legislation about the public finance and public debt. After the establishment of 'Nepal Rastra Bank Act 1955s the public debt has increased systematically. Nepal has borrowed internal loan in 1961 through the means of treasury bills under the public debt act of NRB.

Nepal has started to borrow from abroad since 1964/65 it has been borrowing both from bilateral and multilateral sources like grants, loans and other financial and technical supports. It received external loans from the developed countries, international financial institutions as IMF, WB and ADB, etc.

Public debt is widely accepted as a means of deficit financing measures to reduce the BOP deficit, trade deficit or imbalance and resource gap. The role of public debt is increased significantly by the planned economic development. Nepal is facing a serious problem of financial resources gap in one hand and increasing population growth and inflation on the other. But there is no doubt, if the trend of foreign debt goes on like this; Nepal will be in the situation of debt trap. So, public debt has positive as well as negative aspect on the one hand it has been major part of development budget, without which we cannot even imagine the economic development. On the other hand, the country is falling into debt trap causing the increasing trend for debt servicing in the form of interest and principle payment.

1.2 Statement of the Problem

Government expenditure is increasing rapidly as compared to its revenue. Hence, Nepal has been facing the problem of acute financial resources gap on the one hand and increasing inflation pressure on the other.

Debate of public debt as burden depends upon the nature of investments; productive or unproductive. If it is productive, there will not be a burden because of creation of real asset in the economy, which further generates income of the people there by increasing national income. If it is unproductive, the situation will naturally be burdensome on the government.

The magnitude of public debt and interest is increasing rapidly, but the addressing capacity for redemption of the debt is not increasing in the same rate. Government borrowings are increasing and have been used for unproductive sectors. Government borrows the new loan to pay the previous one. So the country is highly indebted and the rate of inflation is rising and debt servicing capacity of the government is decline. Nepal is heavily indebted from external debt burden than internal. This ever increasing trend of debt servicing capacity of the country creates a great problem for debt management than because major challenging issue for Nepal.

Taxation and saving are also not enough for development financing. It is neither desirable nor possible to raise funds through taxation beyond a certain limit. Alternatively, there is no substitute left except public loan or borrowing. Government of Nepal needs about 80 percent of the budgetary deficit is financed by external borrowing in most of the fiscal year. The external public debt accounts large share of the total public debt, this shows Nepal's dependency on foreign debt, which has become a serious problem in the economy.

In recent years, Nepal has been raising Public debt from external and internal sources, which has been increasing very rapidly particularly after 1990 when multiparty democratic system was reinstated in Nepal. It is very natural and common to know the ever-increasing magnitude of Public debt must be accompanied by an increase in the debt servicing capacity. So, that economic may not go under any undue strain on the balances of payments. Owing to outflow of

funds through debt services and there may not be unnecessary increase in the rate of tax for meeting the requirement of internal debt servicing capacity. Though public borrowing as a means of raising fund is applied in a wide perspective, it is necessary to have a careful look on the increasing magnitude of Public debt and proper care must be taken to increase the debt servicing capacity of the country.

1.3 Research Questions

The research questions of this thesis are as follows:

- a) What is the trend and structure of public debt?
- b) How are we analyzing the burden of public debt and debt servicing problems of Nepal?
- c) Is there any resource gap in the financing of development expenditure in Nepal?
- d) What are the policy measures for the appropriate public debt management?

1.4 Objectives of the Study

The general objective of this thesis is to analyze the trend, and structure of public debt in Nepal. The specific objectives are as follows:

- a. To examine the trends and structure of public debt.
- b. To analyze the burden of public debt and debt servicing problems of Nepal.
- c. To find out the resource gap in the financing of development expenditure in Nepal.
- d. To suggest policy measures for the appropriate public debt management.

1.5 Significance of the Study

The process of economic development in Nepal was started with the implementation of the first five years plan in 1956. Since then the magnitude of development outlay has been increasing because of the growing demand for fund. Particularly after 1970 the volume of budgetary deficit has been increasing. For meeting these deficits HMG has been raising funds from both external and internal sources.

In Nepal various objectives are made for the economic development in various planning. To meet such objectives public debt is necessary because of low level of taxable capacity of the people specially, in developing countries needs are

increasing and resources are limited. In such a situation public debt is necessary tools for appropriate mobilization of resources.

This study focused on the existing scenario of public debt, necessity of public borrowing, trend and structure of public debt and the consequences of debt in the overall performance of economy. So, this study is valuable for researcher, policy makers and students. It provides some information related to our budgetary system and contribution of debt on it. This study helps to get knowledge about government borrowing, sources of debt, its present situation and some recommendation of public debt in Nepal.

1.6 Data and Methodology

1.6.1 Research Design

Research design followed in the study are Quantitative technique and qualitative analysis are main techniques for the analysis of the data. This study is based on certain research methodologies consisting of tabular analysis, graphical analysis etc. Secondary data are used for the purpose of analysis.

1.6.2 Selection of Study Period

The study of the trend and structure of public debt in Nepal covers 14 years data from 1999/2000 to 2012/2013. It analyzes the outstanding debt trends which are essential to observe the burden of debt to the citizens.

1.6.3 Nature and Sources of Data

This study is descriptive and analytical in nature and totally depends upon the secondary data which have been published in books, magazines, reports and journals etc. most of the data are taken from different sources such as: Ministry of Finance, Nepal Rastra Bank, Central Bureau of Statistics, National Planning Commission, International Monetary Fund, Nepal Human Development Report, World Development Report, World Bank are follows.

1.6.4 Methods of Data Analysis

The data collected from various sources is processed according to the need of the chapter. The available data from various documents are collected, classified and tabulated according to the needs of the study. Simple statistical tools like ratio, percentage, average annual growth rate and chat etc; are used for analyzing the data.

1.7 Definitions of Terminology

- ❖ **Public Debt**
Public debt refers to loans by a government within the country or outside the country.
- ❖ **Internal Debt**
Internal debt refers to the debt floated within the country.
- ❖ **External Debt**
External debt is the obligation of borrowing the government from international agency or sources through bilateral and multi lateral sources.
- ❖ **Debt Servicing**
Interest payment of loan and repayment of principal after maturity.
- ❖ **Gross National Product(GNP)**
GNP is the measure of the total domestic and foreign output claimed by resident of the economy, less the domestic output claimed by nonresident GNP does not include for deprecation.
- ❖ **Gross Domestic Product(GDP)**
GDP is the final value of goods and services produced in a country in any specific period of time.

- ❖ **Debt Trap**
Debt Trap is the situation when new fresh loans are taken to redeem the previously taken loan.
- ❖ **Burden of Debt**
Burden of debt is the sacrifice of the community through a rise in taxation at the time of payment and for paying the annual interest on the government loans.
- ❖ **Export of Goods and Services(XGS)**
It is the amount of goods and services sold to another country.
- ❖ **Import of Goods and Services(MGS)**
It is the purchase of goods and services from another country.

1.7 Limitations of the Study

- a. This study is based on the secondary data and it has not been examined the reliability of the data.
- b. This study covers only the period of 14 years between 1999/2000 to 2012/13.
- c. This study has not examined the effectiveness of public borrowing on macro-economic variables, such as money supply, price level, employment, income and so on.

1.7 Organization of the Study

This thesis consists of five chapters in total. The chapter one summarizes the introduction and methodology, chapter three describes the trend and structure of public debt. Chapter four covers the burden of public debt in Nepal. And final chapter includes summary of findings, conclusions and policy recommendations. At the end, of it includes a list of bibliography as well.

CHAPTER – II

REVIEW OF LITERATURE

This chapter presents the review of literature of public debt. Moreover, it has presented various reviews of theoretical views and the review of the texts and dissertations of the Public Debt. The theoretical reviews refer to the various views of the debt from the classical economists to that of the modern economists.

2.1 Introduction

The history of Public debt is not old in Nepal. In history text- books there are discrete references to the great king, Prithivi Narayan Shah, raising revenue and even borrowing from the public for the purpose of unifying the Kingdom of Nepal. Even Chandra Shamsheer is reported to have borrowed money from Pashupati Nath Temple to resettle the emancipated slaves around A.D. 1925.

Most of the developing countries consist of the limited opportunities for raising the resources internally in terms of domestic debt. It is because of the low marginal propensity to save. The widespread poverty, low level of productivity, low purchasing power and minimum participation of the people in the development activities are the common characteristics of the developing countries. There is capital scarcity in Nepal. The higher population growth rate and the topographical constraints are the main factors responsible for the capital scarcity. To alleviate the poverty and to uplift the nation with self-sustainable manner huge initial investment is the pre-condition.

On the other hand the government of developing countries like Nepal depends mostly on the external assistances. The external loan contains some criteria while receiving. Through the external debt has no current real burden on the community, it possess the burden to the future generation. The external debt has the question of the benefit and cost, which is determined by the capacity of servicing and utilization of the borrowed amount.

The Public Debt is not the new and keen matter of the students of economic. From the very beginning of classical economists, of 19th century, like J.B. Say, Malthus and Pigou has raised the argument of debt on for and against. In fact, they were against all types of debt but they appreciated the productive use of Public Debt. Then the argument of Public Debt become in favor after the rise of Keynesians.

2.2 Theoretical View

The Classical writers were generally against the public borrowing. They assumed that individual, consumer, and the business firm employs the resources more efficiently. They were against the role of the state and they had the philosophy that the government is the best which governs the least. According to them state has to perform its limited activities; maintenance of law and order, justice and social security. Classical economists like J.B. Say, TR Malthus and CG Basetable have the strong faith that “Debt creates burden in the economy because of its unproductive nature” (Harris, 1974).

The classical Economist Adam Smith opposed any use of Public Debt. He took Public Debt as leads to extravagance, encouraged resort to war and induced generally disadvantageous economic conditions for the nation, which employed it. Similarly, Bastable (1964) observed, a nation can't any more than an individual keep adding continually to its liabilities without at least coming to the end of its resources. They also taken Public Debt is no longer a cake eating feast but rather a careful and efficient brain to handle the management of the Public Debt. In this context Shiras opines, as government must remember that borrowing is not a shortcut to prosperity except for what can reasonably be regarded as productive expenditure (Lekhi, 1995).

In case of public Debt, classical economists were generally against the government borrowing but they accepted the government borrowing only for self-liquidating and return generating projects. They favored minimum Public expenditure.

- i. Deficit financing means an increase in Public Debt. Since it is an easy. Method of obtaining income, government is likely to be extravagant and irresponsible consequently. Public Debt will become a definite burden in the economy.

- ii. Payment of interest as Public Debt and refund of the principle will require additional taxation. It might prove to be difficult since government's power to tax is not unlimited.
- iii. Deficit financing might produce deterioration and price inflation.

In the words of Lerner (1955) viewed that it internal debt may not have direct money burden in a community as a whole, since the payment of interest to meet the debt burden involved simply transfer the purchasing power from one group of person to another. To the extent the creditors and tax payers are the same there may not be an net burden at all on the community but to extent the creditors and tax payers belongs to different income groups the change in the distribution of the income among different section of the community may that place. Generally the government bonds and securities holders are mostly rich people where as the burden of taxation fall both the rich as well as poor section to the community. Another economist Dalton argument that there is always a direct real burden of public debt because public securities are held mainly by the rich classes and progressive taxation is likely to be as sharply progressive as to counter balance the inequalities in the distribution of income.

The classical philosophy propounded by Adam smith and his supporters have viewed laissez-fair equates a sound and balanced budgetary policy that doesn't consider the fiscal deficit and hence public borrowing. The classicist says that Just as private economic units should not run into a persistent deficit. Moreover they state if debts are indispensable and inevitable for a particular period of time. It should be paid off as soon as possible.

2.3 Keynesian View

The Classical economists were against the public borrowing and they favored balanced budget. The economy is always in full employment equilibrium and whatever earned is automatically spent. But during 1930's, Keynes came up with different ideas. In his general theory he did not accept the free enterprise economy and self-equilibrating economy. He advanced the new concept of under employed equilibrium economy. He argued if the government becomes unconscious; the resources of private sector might remain unemployed for relatively longer time. In

such a situation, increasing government expenditure by employing the idle resources and materials is likely to raise the level of aggregate demand and thereby output and hence income, employment. Hence public debt need not necessarily be unproductive, inflationary and burdensome. Therefore Keynes strongly prescribed to increase the public expenditure even by undertaking deficit financing.

Keynes advanced his theory quite against the full employment equilibrium concept of classical economists for Keynesians; there is nothing to worry about the size of the debt. It is because such debt involves merely a series of economic transfer payments. Hence the main concern subject is about level of income, employment and the economic stability. It propounded the concept of the double budget; current budget and the capital budget. But Keynesian view is that the budget deficit should be undertaken during the period of depression. (Singh, 2004)

2.4 Post Keynesian View

Post Keynesian economists think about the developing countries have a very low income, saving and investment. They further say that without increasing the rate of these crucial factors, no country could achieve steady growth. So the overall aim of borrowing is not to equalize income in different countries but to provide every country with an opportunity to achieve steady growth. On the other side, people of the developed countries are enjoying high prosperity; high standard of living, high education facilities etc. population growth problem is not also so serious in these economics. Harrie (1974) maintains, “Public debt assures 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 in to account the income generating aspect in the public debt and reject any possibility of internal debt being burden upon the community.”

Moulton (1943) considers Public debt as a national asset rather than liability and says that it is essential for the prosperity of the country.

Post Keynesian economist Goode (1984) views 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 finance of investment will retard economic growth. A weakness of the argument is that not all outlays classified as investment actually contribute to growth, while some expenditure usually classified as government consumption promotes growth.

Public debt plays significant role in the developing economics. The developing countries have the natural resources but lack the technology for management in developing countries there is the gap between import-export($x-m$), saving-investment($S-I$) and the gap of the income and expenditure. To fulfill this gap, debt is an essential fact. Domestic borrowing sources of these countries are not sufficient to fill up the gap. Borrowing can be undertaken in order to mobilize the technology for the economic development. It has produced a transfer of resources from the richer to the poorer countries. In this context then term “foreign debt” has been a means of reducing this gap.

Public debt play's significant role in the development of the capital market as well. According to Nevin In the early stages of requirement stock exchange the Public debt and the government operation in it will play a fundamental role in the presuppose and adequate flows of capital to the productive enterprises of the country. In this instance, this likely to be done to a large degree through the medium of the Public debt, with the development of trading facilities in securities, the possibility of the issues of private securities directly to local institutional investors becomes a responsible one and the follow of capital will be stimulated and expanded (Nevin, 1963).

2.5 Modern Thinking on Debt

In the modern context the least developed countries borrow in order to fulfill the resource gap. There is wider gap of the import-export, Revenue-Expenditure, and the

gap of saving-investment. The internal resources are not sufficient to meet the government expenditure. Generally, government makes a larger investment for the infrastructure development which is the back bone of the nation. The aim of the government is to develop the money as well as the capital market in the home country. The mobilization of the resources through taxation is not sufficient. The mobilization of the saving through the device of the borrowing in order to meet the financial need of its development program.

Recently the least developed countries report 1999 points out the recent trends in the external indebtedness of LDCs and concludes that most debtors LDCs have not yet reached an exit from neither debt destructing process with the efforts of the global financial crisis on commodity prices, such a goal has in fact moved further out of reach, unless more generous and flexible action to undertaken under the heavily indebted poor countries initiative. The decline in commodity prices which are projected to remain depressed over the next several years is likely to dampen exports prospects for many LDCs thus further weakening their debt servicing capacity.

Domar (1984) has defined the burden of public debt as the ratio of the total debt to the national income. He lays down the condition under which the burden would increase or decrease over time. Let,

$$T = Di \dots \dots \dots (1)$$

$$\text{And } t = T/y \dots \dots \dots (2)$$

Where,

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

I = rate of interest paid on debt

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

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

$$t = T/y = Di/y = I.D/y$$

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

$$T = 1 / (1/i) \cdot (G/b) \\ = i \cdot b / G$$

Where,

G = rate or growth of income.

B = ratio of deficit to income.

This equation shows the burden of debt would increase or decrease. When either ratio of deficit to income rate of interest paid on debt increases then the burden of the debt will also be increased or, the burden of the debt (t) and ratio of deficit to income (b) and the rate of interest paid on debt have positive relationship. Likewise, the burden of debt (t) and the rate of growth of income (G) have negative relation.

The level of government borrowing is function of the ability and willingness of persons and business to lead and government's power and intention to tax. Maximum level of debt can be expressed in terms of the following equation:

$$D = \frac{y_t - 0}{R}$$

Where,

D = maximum sustainable national debt.

0 = constant expenditure for ordinary government operation.

Y_t = maximum ratio of tax receipt national income.

R = contractual interest rate of government debt.

However, the burden controversy depends upon the nature of investments, productive or unproductive. If it is productive, there will not be burden because of

creation of real assets in the economy, which further generates income of the people there by increasing national income. If it is unproductive, the situation will naturally be burdensome on the government (Singh, 2001).

2.6 National Context

In review of literature on Public debt in Nepalese context some of the students of master level specially say, have or university and some writers have preceded to male their dissertation and article on Public debt. Some of these have focused its structure and importance where others have in its burden and impact in inflection, employment and national solvency etc. These thesis papers and articles have also enriched the importance, role, need and scope of Public debt in macro economy.

Acharya (1968), in his master's thesis analyzed about the features, problems and the patterns of the public debt. He concluded that public debt is more popular on these days because of the fact that the repayment of debt on maturity can be adjusted through the issue of fresh public debt. But, the fact is that the habit of purchasing bonds issued by the government should by developed among the people, so that no difficultly may be faced in getting the bonds purchased by the public. He recommended that since wide scope efforts to issue more and more bonds, so that internal saving may be mobilized and best utilized for the economic development to be accelerated.

Singh (1983) in his report analyzed the structure of internal debt and its impact on the economy. He found most inflationary nature of internal borrowing to increase inflection in the economy.

Gurugharana (1996), in his article has presented share of outstanding public debt in GDP at factor cost and of foreign debt servicing in regular expenditure. He pointed out that “Although foreign loan is relatively much softer terms for Nepal compared

India and China, the very low rate of return and increasing share of loan in foreign aid imply that aid slowly pushing Nepal toward a debt crisis in the coming years.

Joshi (1982), in his master's thesis covers the structure of the public debt and the importance of public debt in the financial development. He has presented the poor performance of the nation's topography and the poor performance of the human capital. He concludes the debt is only one source of fulfill the resource gap of the budgetary expenditure of the nations and internal debt is the essential phenomena for the development of the capital as well as the entire money market.

Adhikari, (1996) in her article has analyzed the foreign debt servicing problem in Nepal. She found out substantial increase in foreign debt servicing. She prescribed effective implementation of liberalization policy in all areas of investment. This can bring a great relief to the country by creating capacity for foreign exchange earning which can reduce burden of debt servicing substantially in the years to come.

Thapa, (1997) in his article explained that treasury bill is ways and means advanced debate on their implication for monetary policy” has said, government borrowing from central bank is not considered good for it amounts to printing money.

Sharma, (1998) in his article has, analyzed that the even increasing debt in Nepal and its servicing has really created a situation which leads the country towards debts trap because of following reasons:

- i. Large amount of loan is allocated for meeting development expenditure.
- ii. A good amount of borrowed fund is for debt servicing.
- iii. Volume of borrowed amount exceeds the maximum legal limit of borrowing.

Khatiwada, (1998) in his article has observed basically dealt with monetary implications of the public debt. He has found that public debt as.”

- i. Exerted excess monetary expansion, which has indirectly resulted in high rate of inflection and deterioration of current account situation.
- ii. Pressure of debt servicing to the government resulting in higher budgetary deficit which further contributes to monetary expansion having subsequent repercussion on the interval as well as external sector stability.
- iii. It has crowded out resources available for private sector investment.
- iv. Exerted upward pressure on the market rate of the interest.

He has further analyzed the situation move as foreign loan of the long term nature is Maturing out the faster rate and rate of exchange of the Nepalese rupee is depreciating the debt servicing requirement.

Sigdel (1996) in his article has stated that Aid serves three main objectives political, Economic and humanitarian. The blanket justification of aid is the promotion of Economic, development of recipient countries. Although Nepal is receiving a higher Per capita aid than some of her neighbors, the aid divided GDP ratio and per capita Aid amount are still far below the threshold level which could bring about rapid and Visible changes in the economy. That ratio is 10 percent; the GDP could not go up as per the aid increment. It seems that foreign aid has been playing a substitute role for domestic saving. He suggested the effective and the productive utilization of the foreign debt.

Kunwar (2000) in his master thesis has observed the government borrowing is the financial obligation of the state for which government is committed to pay its interest and principle with stipulated time period. He further added borrowing abroad gives a country provided but entails a further real cost and transfer problems whatever such borrowing should be undertaken is essentially a benefit or cost questions that can be analyzed by reference to the value of debt financing expenditures and the countries debt service capacity. In practice however much

borrowing is unplanned and is promoted by attractive offers of credit or by emergencies, miscalculation or weak fiscal policies.

Koirala (2000) in his article has deal with the debt as a useful resource for economic development, several inverse consequences were found by it's over use. The debt crises 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 (SDRs) to curbs the crises in the third world. He further opines that we have only two options: either mobilizes more foreign debt to invest for economic debt to invest for economic development or put the hand off hand doing nothing. In a nutshell, we should have a debt management plan for its better use and regular servicing. The government debt has a simple relationship with the government deficit over a given year is equal to the budget deficit or a higher economic growth requires a higher level of investment that is not possible simply from taxation so that government seeks public borrowing.

Thapa (2005) in his article has observed that the size of fiscal deficit that affects the size of internal borrowing in Nepal in increasing every year, for the development of the government securities market; and efficient management system should be established. To manage the government borrowing efficiently, development of an efficient government security market is a must. The borrowing should not be for the payment of interest and principle amount. It should be invested in the productive sector so the return form such investment will be sufficient for repayment. He further indicates that the objective of borrowing should not be for making easy money for the government. If the return is less than the borrowing costs, this will result in the gradual deterioration in the paying capacity of government and finally the public will have less confidence on government, the borrowing instruments can be used for maintaining monetary balance as well as for government financing. So, there should be a cordial co-ordination between fiscal and monetary policy maker and debt manna.

Neupane (2007) in his M.A. dissertation entitled A case study on role and burden of public debt in Nepal observed that government borrowing has been increasing unlikely uncertainties, high expenditure, hence, government always lacks of resources then borrows the new loan to previous ones. That's why, the public debt and its interest is mounting rapidly, but addressing capacity for redemption of the debt is not increasing in same pace.

Regmi (2008) in his M.A. dissertation entitled A study on public debt and its impact on Economic growth in Nepal has found out that Nepal is in critical phase of managing public finance because of inadequacy of internal resources fiscal or revenue deficit is widening every year. In order to finance the deficit, the government is borrowing internal and domestic debt. The portion of external debt is too higher as compared to domestic loan.

CHAPTER III

TRENDS AND STRUCTURE OF PUBLIC DEBT

3.1 INTRODUCTION

The debt is useful resource for economic development of underdeveloped countries. To fulfill the objectives of economic development, there is need of heavy investment to build up socio-economic infrastructure such as health, education, transportation, communication etc. Public debt is widely accepted as a means of deficit financing measures to reduce the BOP deficit, imbalance and resource gap. the role of Public debt has been increased significantly due to the planned economic development.

The government debt statistics of Nepal indicates that the country remained debt free nation till 1950's. However, the foreign and domestic borrowing has been alternative means of financing in Nepal then after imitation of planed economic development in Nepal.

Foreign loan is accepted by Nepal since the first five year (1956/57 to 1959/60) and started to raise the internal debt since the year 1961/62 through the means of Treasury bill that amounted Rs 7 million. Since then amount of external borrowing has continued to increase every year. The main source of public debt is multinational sources mainly the IMF, WB and ADB.

The government of Nepal raises the debt in order to fulfill the following objectives:

- i. To recover the deficit budget.
- ii. To tackle the emergency period of crisis.
- iii. To sustain the economic and monetary stability.

Nepal has been borrowing rapidly mainly to balance her budgetary deficit. A large number of infrastructures are essential for the development of the economy. Besides

that the availability of the educated people, reasonable use of natural resources, a technically efficient civil servants and well behaved and dedicated citizens are essential for economic development. At the same time, the capital availability and mobilization of the resources is one of the fundamental causes of the development of any nations. Besides, Physical capital is required but also the human capital is equally essential for development. Endeavor.

Since, Nepal lacks the sufficient internal resources for the economic development. The huge amount of external debt is inevitable. The debt proportion of the budgeting is to be relied upon the GDP of the nation. It is hence necessary to maintain the internal debt with in the limit of 2 percentage of GDP.

3.2 Resource Gap

The limited mobilization of internal resources is the main obstacle of the development program in Nepal. So that resource gap in Nepalese economy has always been a common phenomenon. Nepal is facing serious and growing problem of resource gap. This is because of the growth trend of the total expenditure and its revenue generation capacity. The annual absolute volume of government expenditure has outpaced its revenue collection resulting financial resource gap in budget of the government. On the other hand, a foreign aid cannot be received as expected; export trade tendency is not so encouraging which also leads budgetary deficits.

Nepal is in the grip of an economic crisis between 2.1 to 2.5 percentage of the population growth rate, low public and private saving capacity and high income leakage from the heavy flux of foreign goods and services. Nepal receives 70 percentages in loan and 30 percentages in grants. Currants are received from bilateral sources. The process of shifting from grants to loan has aggravated the situation further in that a sizeable amount of public saving is diverted towards debt servicing. The debt servicing ratio in a country is about a percentage of GDP. (Economic Survey: 2012/13).

It is obvious that capital formation is primary function of the least developed countries. Due to the lack of an appropriate mobilization of internal resource, Nepal is unable to grow up with various development activities. The grants and revenue from home and abroad is not so encouraging. The tax and custom administration is not fair, transparent and fragile to somewhat extent so that government cannot collect the revenue as it predicts.

In Nepal marginal propensity to save is low and tax evasion is widespread. The annual growth rate of the total expenditure and that of its revenue are not keeping in the same face. The annual absolute volume of government has outpaced its revenue collection resulting financial resources gap in budget of the government. Similarly, foreign aid cannot be received and our export trade is not so encouraging, with ultimately leads to the budgetary deficit.

Table 3.1: Different Scenarios of Resource Gap

Fiscal year	Government Revenue(a)	Annual growth rate of GR %	Government expenditure(b)	Annual growth rate of GE %	Scenario (I) fiscal deficit (b-a)	Annual growth of FD	Foreign Grant(c)	Annual growth rate of FG	Scenario (II) budget deficit (I-C)	Annual growth of BD
1997/1998	32937.9	8.44	56118.3	10.64	23180.4	13.91	5402.6	-9.78	17777.8	23.78
1998/99	37251.3	13.10	59579.0	6.17	22327.7	-3.68	4336.6	-19.73	17991.1	1.20
1999/2000	42893.8	15.15	66272.5	11.23	23378.7	4.71	5711.7	31.71	17667.0	-1.80
2000/01	48893.6	13.99	79835.1	20.46	30641.5	32.35	6753.4	18.24	24188.1	36.91
2001/02	50445.5	3.17	80072.1	0.30	29626.6	-4.25	6686.2	-1.00	22940.4	-5.16
2002/03	56229.8	11.47	84006.1	4.91	27776.3	-6.25	11339.1	69.59	16437.2	-28.35
2003/04	62231.0	1.85	89442.6	6.47	27111.6	-2.39	11283.4	-0.49	15828.2	-3.71
2004/05	70122.7	12.50	102560.4	14.67	32437.7	19.65	14391.2	27.54	18046.5	14.01
2005/06	72282.1	3.08	110889.2	8.12	38607.1	19.02	13827.5	-3.92	24779.6	37.31
2006/07	87712.2	21.3	133604.6	20.4	45892.4	18.8	15800.8	14.27	30091.5	21.43
2007/08	107620.5	22.6	161350.0	20.0	53729.6	17.07	20652.8	30.7	33406.7	11.01
2008/09	143474.4	33.3	219660.0	36.14	76185.2	-	26382.9	-	49802.7	-
2009/10	177990.1	27.2	259680.9	13.7	81690.8	-	38546.0	11.3	43144.8	17.3
2010/11	198376.3	12.5	295363.0	14.8	96986.7	10.5	45922.2	19.4	51064.5	20.4
2011/12	244374.9	16.1	339168.3	22.1	94793.4	19.2	40810.3	29.3	53893.1	28.4
2012/13	289604.9	18.5	404825.4	23.8	115220.6	18.9	46989.2	15.1	68251.4	32.1
Average Annual growth rate		15.84		13.92		12.28		14.51		13.83

Note: (A dash denotes not available)

Source: Various Issues of Economic Survey, MOF/GON

The table 3.1 first scenario shows the trends in revenue and expenditure in Nepal. The revenue and expenditure both are continuously increasing each and every year. The increasing trend of total expenditure is higher than total revenue which shows increasing tendency of fiscal deficit. The amount of total expenditure was Rs. 56118.3 million in FY 1997/1998 has gone up to Rs. 404825.4 million in FY 2012/2013, whereas total revenue has increased from Rs. 32937.9 million in FY 1997/1998 to Rs. 289604.9 million in FY 2012/2013. This shows the public expenditure dominated to government revenue.

The total revenue and expenditure are Rs. 32937.9 million and Rs.56118.3 million respectively in FY 1997/1998. So, the revenue gap is Rs.23180.4 million in the same period. The government expenditure is continuously increasing than government revenue. In FY 2012/2013 the total expenditure is Rs. 404825.4 million which is increased from Rs. 56118.3 million in FY 1997/1998. This indicates that the problem of resource gap is serious problem.

In the review year the growth rate of total expenditure has been 13.92 percentages per annual whereas annual growth rate of revenue has been 15.84 percent. It shows that the growth rate of revenue is greater than expenditure but in absolute terms the table shows the horrible increment of resource gap that was increased from Rs. 23180.4 million in fiscal year 1997/98 to Rs. 115220.6 million in fiscal year 2012/13 an the average annual growth rate is 12.28 percent.

The second scenario shows budget deficit by including grants is the most potential sources of foreign currency, which is solid instrument for government to import the capital goods and to pay the interest and principle of external debt. A foreign grant is not increasing in the desirable pace as it predicts where it was Rs.5402.6 million in 1997/98 to Rs.46989.2 million in 2012/13. Budget deficit was Rs. 17777.8 million in 1997/98 and Rs. 68251.4 million in 2012/13. The average annual growth rate is 13.83 percent. It is happened due to the fluctuation of foreign grants.

Table 3.2 Resource gap as percentage of GDP*(Rs in Millions)*

Fiscal Year	Nominal GDP at current Price	Fiscal Deficit	Fiscal Deficit as percentage of GDP	Budget Deficit	Budget Deficit as Percentage of GDP
1997/1998	289798	23180.4	8	17777.8	6.1
1998/99	330018	22327.7	6.8	17991.1	5.5
1999/2000	366251	23378.7	6.4	17667	4.8
2000/01	394052	30941.5	7.9	24188.1	6.1
2001/02	406138	29626.6	7.3	22940.4	5.7
2002/03	437546	27776.3	6.4	16437.2	3.8
2003/04	474919	27111.6	5.5	15828.2	3.2
2004/05	508651	32437.7	6.3	18046.5	3.5
2005/06	557869	38607.1	6.9	24779.6	4.4
2006/07	696989	45892.4	6.5	30091.5	4.3
2007/08	792131	53729.6	6.7	33406.7	4.2
2008/09	909528	419804.6	7.71	49804.5	5
2009/10	1083415	41197.3	6.80	41197.3	3.5
2010/11	1256482	49622.2	3.6	49622.2	3.6
2011/12	1396139	53796.1	3.5	53796.1	3.5
2012/13	1540181	63835.5	3.7	63835.5	3.7
Average Annual Growth Rate			5.89		4.43

Source: Various Issues of Budget Speeches and Economic Survey, MOF/GONs

Table 3.2 reveals that the fiscal deficit as percent of GDP and budget deficit as percent of GDP (GDP at current price, based on the 1997/98)

To analyze the fiscal deficit as percent of GDP is more important as the GDP is the main indicator of the economy, which includes different components of the economy and shows their performance. In this context, fiscal deficit as percent of GDP has decreased from 8 percent in 1997/98 to 3.7 percent in 2012/13. And average annual growth rate is 5.89 percent.

The budget deficit as percent of GDP, which has included grants, is also decreased from 6.1 percent in 1997/98 to 3.7 percent in 2012/13. The inclusion of grants in government in government's revenue may not be appropriate because the amount of grants depends upon political consideration of countries, which may have been

fluctuating character. Because it is determined by the various factor. Even then the amount of grant is included here, as it doesn't require repayment and therefore, it may be taken as good as revenue.

3.3 Deficit Financing:

Public debt has been the main sources for financing fiscal deficit in Nepalese fiscal system. A deficit in fiscal position occurs when the government spends more than its current revenue. The government must borrow from somewhere to meet its fiscal deficit; broadly there are two sources of deficit financing-internal and external. The total public debt has been increasing rapidly since the restoration of multiparty system for meeting the requirement of fiscal deficit.

Table 3.3 Internal and External Debt as percentage of Budget Deficit

(Rs in Millions)

Fiscal Year	Budget Deficit	Total Debt(TD)	Internal Debt(ID)	External Debt(ED)	ID as percentage of BD	ED as percentage of BD
1997/1998	17777.8	14454.6	3400	11054.4	22.7	73.9
1998/99	17991.1	16562.4	4710	11852.4	26.2	65.9
1999/2000	17667	17312.2	5500	11812.2	31.1	66.9
2000/01	24188.1	19044	7000	12044	28.9	49.8
2001/02	22940.4	15698.7	8000	7698.7	34.9	33.6
2002/03	16437.2	13426.8	8880	4546.4	54	27.7
2003/04	15828.2	13236.8	5607	7629	35.4	48.2
2004/05	18046.5	18204.2	8939.1	9266.1	49.5	51.3
2005/06	24779.6	20048.5	11834.2	8214.4	47.8	33.1
2006/07	30091.5	27945.8	17892.3	10053.5	59.4	33.4
2007/08	33406.7	29476.3	20496.4	8979.9	61.3	26.8
2008/09	49804.5	28386.0	18417.1	9968.8	36.98	20.02
2009/10	41197.3	41137	29914	11223.4	72.6	27.2
2010/11	49622.2	54591.4	42515.8	12075.6	85.7	24.3
2011/12	53796.1	4751.8	36418.7	11083.1	67.7	20.6
2012/13	63835.5	63835.5	38000	25835.5	59.5	40.5
Average Annual Growth Rate					46.04	38.95

Source: Various Issues of Economic Survey, MOF/GONs

Table 3.3 shows the increasing trend of public debt from both internal and external sources, which was Rs. 14454.6 million in 1997/98, and has increased to Rs. 63835.5 million in 2012/13. From above table, external debt is increasing rapidly then internal debt.

Internal debt was Rs. 3400 million in fiscal year 1997/98 and gone up to Rs. 38000 million in fiscal year 2012/13, whereas external debt was Rs. 11054.4 million in 1997/98 which has gone up to Rs.25835.5 million in 2012/13. This shows the tremendous increasing trend.

The table also shows that the percentage share of internal and external debt to budget deficit. Contribution of internal and external debt was 22.7 and 73.9 percent in fiscal year 1997/98 respectively, whereas share of internal and external debt is 59.5 percent and 40.5 percent in fiscal year 2012/13. This shows the fluctuation trend of external debt in different years and increasing trend in internal debt.

From above table show government growing reliance on external loan from meeting the ever increasing budget deficit is on decreasing trend and that of internal debt is on increasing trend.

3.4 Growth Trends of Government Borrowing

The expenditure of the government is increasing very rapidly as compare to increase the income resource it is due to the rapid increase in the service of the government. Reliance on Taxation is not sufficient in view of the large amount of financial resources required for growing government expenditure and therefore, there is increasing need for supplementing it by borrowing internally and externally, Nepal is facing large financial resources gap in the government budget. Thus, government has to borrow loans to meet it. This trend is shown in the table 3.4

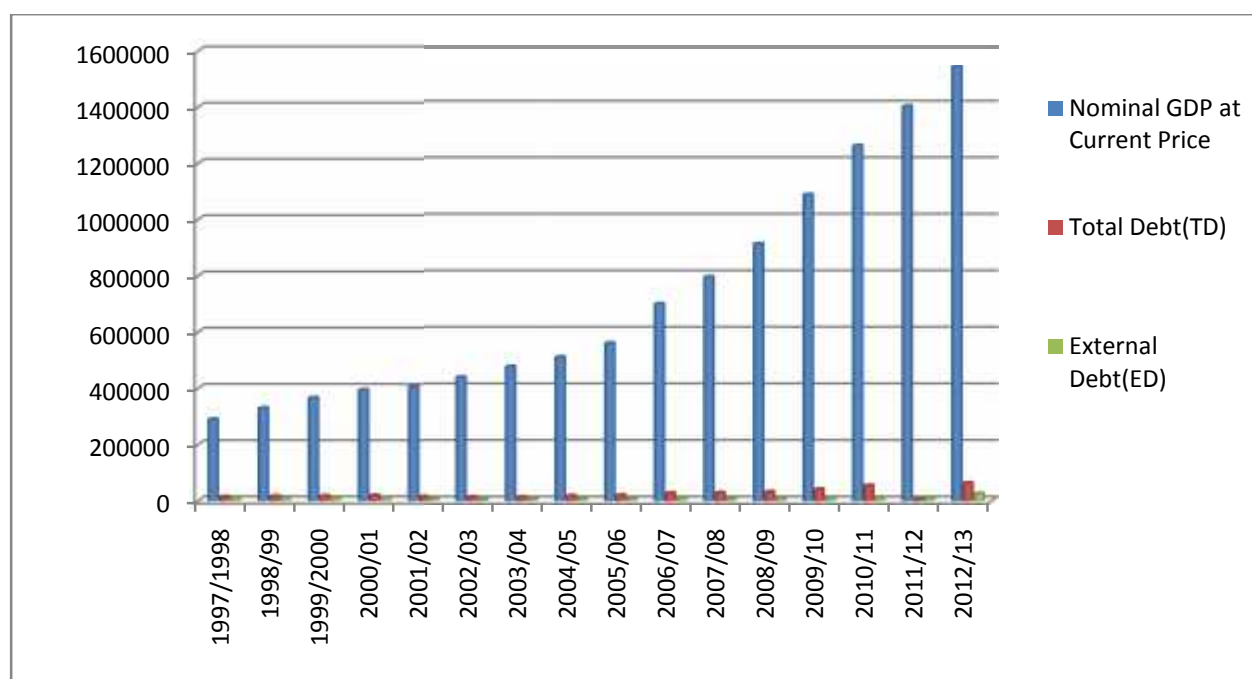
Table 3.4 Public Debt as % of GDP*(Rs in Millions)*

Fiscal Year	Nominal GDP at Current Price	Total Debt(TD)	External Debt(ED)	Internal Debt(ID)	TD as percentage of GDP	ED as percentage of GDP	ID as percentage of GDP
1997/1998	289798	14454.6	11054.4	3400	4.99	3.81	1.17
1998/99	330018	16562.4	11852.4	4710	5.02	3.59	1.43
1999/2000	366251	17312.2	11812.2	5500	4.73	3.23	1.50
2000/01	394052	19044	12044	7000	4.83	3.06	1.78
2001/02	406138	15698.7	7698.7	8000	3.87	1.90	1.97
2002/03	437546	13426.8	4546.4	8880	3.07	1.04	2.03
2003/04	474919	13236.8	7629	5607	2.79	1.61	1.18
2004/05	508651	18204.2	9266.1	8939.1	3.58	1.82	1.76
2005/06	557869	20048.5	8214.4	11834.2	3.50	1.4	2.10
2006/07	696989	27945.8	10053.5	17892.3	4	1.4	2.5
2007/08	792131	29476.3	8979.9	20496.4	3.7	1.1	2.5
2008/09	909528	32537.2	9968.8	18417.1	3.6	1	1.9
2009/10	1083415	41137	11223.4	29914	3.4	0.9	2.5
2010/11	1256482	54591.4	12075.6	42515.8	3.97	0.9	3.1
2011/12	1396139	4751.8	11083.1	36418.7	3.09	0.7	2.4
2012/13	1540181	63835.5	25835.5	38000	3.75	1.5	2.2
Average Annual Growth Rate	11.16	11.19	11.09	10.04	3.71	1.52	2.10

Source: Various Issues of Budget Speeches and Economic survey, MOF/GONs

The table 3.4 shows that the government borrowing and annual growth rate between the periods 1997/98 to 2012/13. As table shows that the under the review period total government borrowing has increased with an average annual growth rate of 11.19 percent from Rs.14454.6 million to Rs.63835.5 million. Similarly external borrowing also increased with an average annual growth rate of 11.09 percent from Rs.11054.4 million to Rs. 25835.5 million under the period of study. And average annual growth rate of internal debt is increasing trend from Rs. 3400 million to Rs. 38000 million. Thus these trends indicate clearly shows that the government borrowing is increasing in both absolute and relative terms.

Figure 3.1 Growth Trends of Government Borrowing in Nepal



Source: Various Issues of Budget Speeches and Economic survey, MOF/GONs

Figure 3.1 shows the External Debt, Total Debt & Nominal GDP at Current Price. The figure shows that External Debt, Total Debt & Nominal GDP at Current Price is increasing in 1997/98 to 2012/13.

3.5 Outstanding Public Debt in Nepal

The trend of ever growing fiscal deficit, the government has to borrow large amount of public debt to meet ever increasing financial resource gap. Usually public debt is used as means of meeting the government budgetary expenditure, but in case in Nepal it is the main and reliable resources of meeting the government expenditure over from the years. So the volume of outstanding public debt has been increasing. The trend of increasing volume in public debt is shown in table 3.5

Table 3.5 External Debt as Percentage of Total Outstanding Debt

(Rs Million)

Fiscal Year	Nominal GDP at Current Price	Total Outstanding Debt(TOD)	External Outstanding Debt(EOD)	Internal Outstanding Debt(IOD)	TOD as percentage of GDP	EOD as percentage of GDP	IOD as percentage of GDP
1997/1998	289798	199614.7	161208	38406.7	68.9	55.6	13.3
1998/99	330018	219135.6	169465.9	49669.7	66.4	51.4	15.1
1999/2000	366251	245048.2	190691.2	54257	66.9	52.1	14.8
2000/01	394052	264474.4	200404.6	60043.8	67.1	50.9	15.2
2001/02	406138	293746.3	220125.6	73620.7	72.3	54.2	18.1
2002/03	437546	308078.5	223433.2	84645.3	70.4	51.1	19.3
2003/04	474919	318913	232779.3	86133.7	67.2	49	18.1
2004/05	508651	307206.1	219641.9	87564.2	60.4	43.2	17.2
2005/06	557869	329516.2	233968.6	94710.6	59	42	17
2006/07	696989	320404.9	216628.9	103776	45.9	31	14.8
2007/08	792131	353299.7	242060.6	111239.1	44.6	30.5	14
2008/09	909528	425100	277000	125700	43	27.9	15
2009/10	1083415	440400	256200	147660	36.9	21.5	15.4
2010/11	1256482	443600	259600	184200	32.3	18.9	13.4
2011/12	1396139	523200	309300	213920	34.1	20.1	13.9
2012/13	1540181	511100	299400	211700	30.1	17.6	12.4
Average Annual Growth Rate	11.16	6.27	4.23	11.59	54.09	38.56	15.44

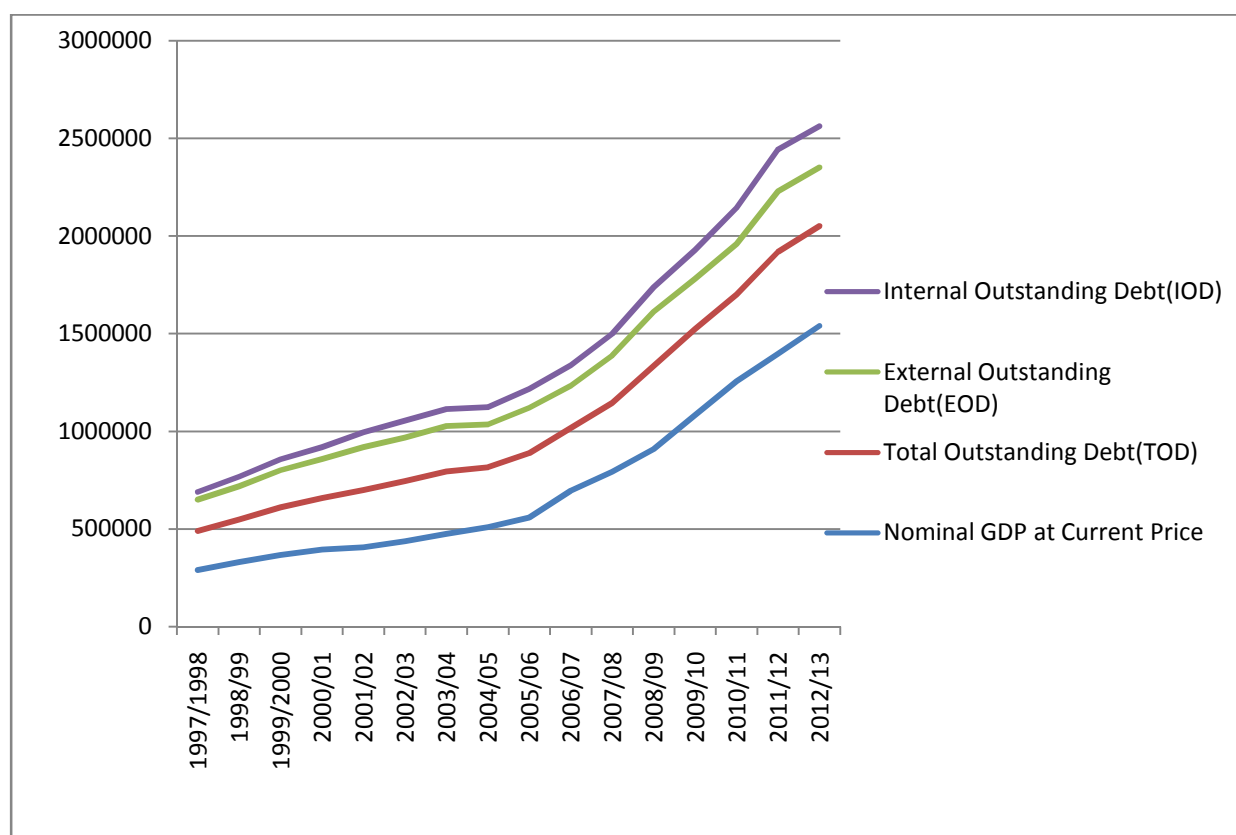
Source: Various Issues of Budget Speeches and Economic Survey.

The table 3.5 seems as an elaboration of debt burden of Nepal in which the total outstanding public debt of government has increased from Rs. 199614.7 million in 1997/98 to Rs. 511100 million in 2012/13 with the growth rate of 6.27 percent annual. The table shows that outstanding external loan has increased from Rs.161208 million in fiscal year 1997/98 to Rs. 299400 million in fiscal year 2012/13 under the review period. It also shows that the average annual growth rate

of outstanding external and internal debt which ate 4.23 to 11.59 percent respectively. This shows the trend of increasing outstanding of external debt is higher than internal.

The average annual shares of total outstanding debt, external outstanding and internal outstanding debt to GDP are 54.09, 38.56 and 15.44 percent respectively under the period of study. This clearly indicates that the increasing reliance on the external borrowing one of the factors responsible for rapid increase in the external debt is depreciating of Nepalese currencies each year. Other attributing factors are the growing needs of foreign currencies to bridge the current account capital deficit and capital deficiency in the economy.

Figure 3.2: Outstanding Public Debt in Nepal.



Source: Various Issues of Budget Speeches and Economic Survey.

Figure 3.2: shows that total outstanding debt, external outstanding debt and internal outstanding debt. Figure 3.2 show the increasing of external outstanding debt is higher than internal outstanding debt.

3.6 Structure of Internal Outstanding Debt in Nepal

Nepal has carried out internal borrowing program since four decades. It is used for to meet the resources gap on the budgetary system and mobilizing financial resources for development. Now the Government mobilizes the internal borrowing by issuing mainly treasury bills, development bonds, national special certificate and special bonds. Treasury bills are short term credit instruments having three to twelve months maturity. It is generally used to absorb the liquidity of banking sector. Similarly, development bonds, National saving certificate and special bonds are long term financial requirement having the maturity of 5 to 7 years. They are used to target financial institution to absorb their liquidity. Table 3.6 shows the structure of internal net outstanding debt in Nepal.

Table 3.6 Structure of Internal Outstanding Debt in Nepal

(Rs Million)

Fiscal Year	Total Outstanding Debt	Treasury Bills	Development Bonds	National Saving Certificate	Special Bonds
1997/1998	38406.9	9182.5	3302.2	9886.4	16035.6
1998/99	49669.6	17586.9	3872	10426.4	17784.1
1999/2000	54357	21027	4262.2	11526.5	17541.3
2000/01	60043.7	27610.8	5962.2	12476.4	13994.3
2001/02	73620.7	41106.5	11090.7	11536.1	9259.3
2002/03	84645.3	48860.7	16059.2	9629.8	9164.5
2003/04	86133.7	49429.6	17549.2	9029.8	8946.2
2004/05	87564.2	51383.1	19999.2	6576.7	8176.3
2005/06	94710.6	62970.3	17959.2	3876.8	8225.6
2006/07	103776	74445.3	19177.1	1516.9	7245.6
2007/08	11239.1	85033	21735.4	1116.9	5139.8
2008/09	125700	86515.1	29478.5	2169.5	5030
2009/10	148100	102043.7	35519.4	1015.6	5369.7
2010/11	184200	120340.7	43519.4	10680	5029.1
2011/12	213900	131624.1	57519.5	15680.1	5028.7
2012/13	211700	131624.1	63019.5	17522.4	5671.1
Average Annual Growth Rate		19.83	21.21	55.60	-5.37

Source: Various issues of Budget Speeches and Economic Survey MOF/GON

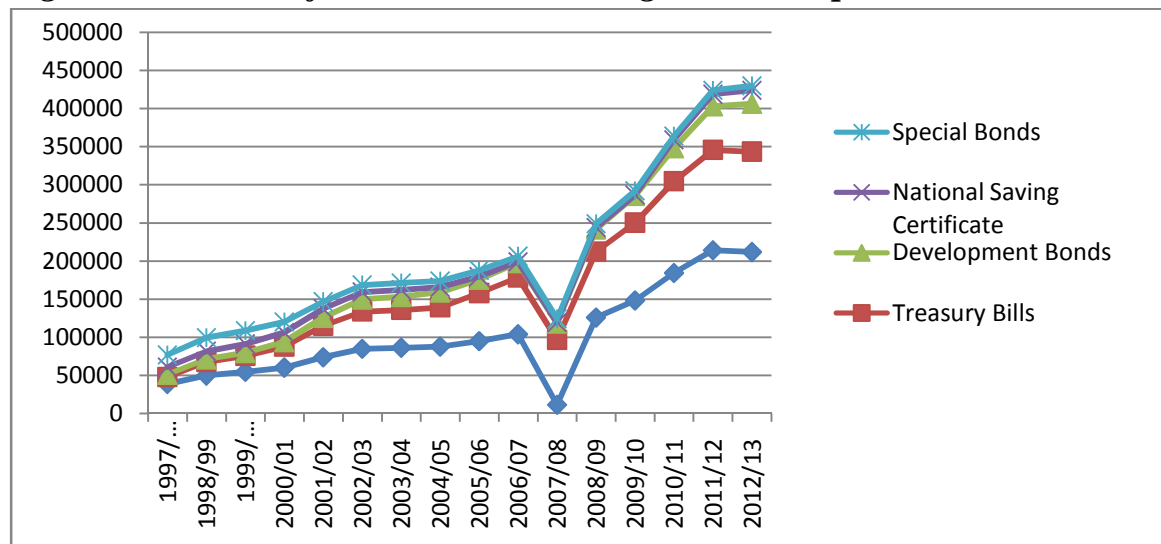
The table 3.6 presents the annual net outstanding of internal public debt. Treasury bill is the short term loan which is raised for the period of less than one year. Normally the duration of Treasury bills is on 91 days; however, sometimes they are floated for 364 days. Through Treasury bills, government, at the first time issue the internal debt amounting Rs. 7 million in 1962. National saving certificates and Government bonds are the long term securities with the maturity of period 3-15 years.

On the table total outstanding debt is Rs.38406.9 million during review period of fiscal year 1097/98. In fiscal year 2012/13 is reached to Rs.211700 million. It reflects the highly indebted economy with low economic standard of citizens.

Treasury bills are increased from Rs.9182.5 million in 1097/98 to Rs.131624.1 million in 2012/13. Development bonds are increased form Rs. 3302.2 million in the fiscal year to Rs.63019.5 million in fiscal year 2012/13. In case of National Saving Certificate it can be seen that it is raised slightly from fiscal year 1997/98 to Rs. 9886.4 million in fiscal year 2012/13 to Rs. 17522.4 million so it increasing.

The special bonds are decreasing form Rs.16035.6 million during review period of fiscal year 1997/98 to Rs.5671.1 million in 2012/13.

Figure 3.3: Trend of Internal Outstanding Debt in Nepal



Source: Various issues of Budget Speeches and Economic Survey MOF/GON

Figure 3.3 shows the total outstanding internal debt, Treasury Bills Development bonds, National Saving Certificate and Special bonds.

3.7 Structure of External Debt in terms of Disbursement by major Sources

Nepal's first experience of foreign economic assistance was heralded by the point-four-program agreement signed on 23rd Jan, 1951. In which the U.S. Governments assistance of Rs. 22 thousands was provided. But Nepal had started to borrow foreign loan since 1064/65. The foreign assistance grants and loans are the major source of foreign currency for Nepal.

Nepal has borrowed the external loan through bilateral and multilateral sources. Bilateral loans are loans form government and their agencies, loans form, autonomous bodies and direct loans from official expert credit agencies. Multilateral loans are loans and credits form multilateral agencies as World Bank, IMF, Regional Development Banks and other multinational and inter-governmental agencies. It is necessary to compare an Analyze the follow of foreign loan and it debt servicing through the earnings of foreign trade. Review period between 1997/98 to 2012/13, the foreign loan disbursement has been shown by Table 3.7.

Table 3.7: Structure of External Debt in terms of Disbursement by major Sources.

(Rs. Millions)

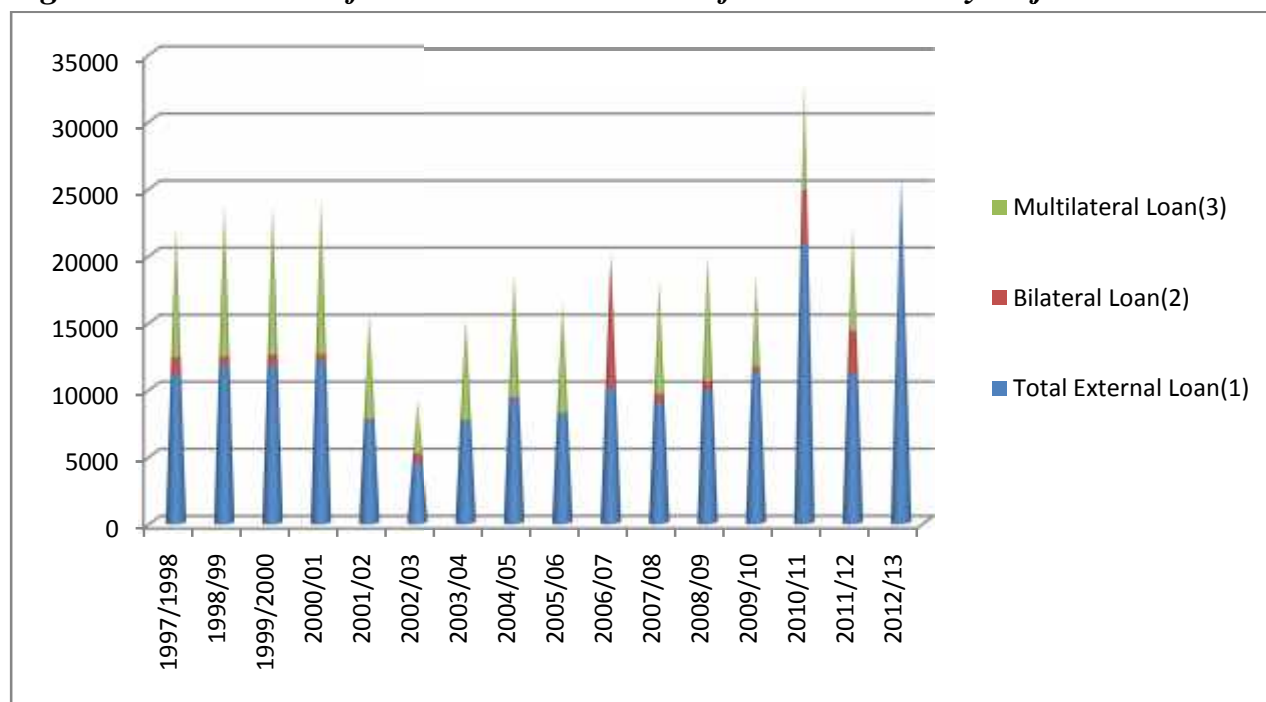
Fiscal Year	Total External Loan(1)	Bilateral Loan(2)	Multilateral Loan(3)	(2)as percent of (1)	(3)as percent of (1)
1997/1998	11054.5	1314.5	9740	11.9	88.1
1998/99	11852.4	584	11268.4	4.9	95.1
1999/2000	11812.2	757.9	11054.3	6.4	93.6
2000/01	12044	586.7	11457.3	4.9	95.1
2001/02	7698.6	87	7611.6	1.1	98.9
2002/03	4546.4	657.2	3889.2	14.5	85.5
2003/04	7629	66	7563	0.9	99.1
2004/05	9266.1	126.5	9139.6	1.3	98.6
2005/06	8214.3	40.6	8173.7	0.4	99.6
2006/07	10053.5	9004.5	1048.9	89.5	10.4
2007/08	8979.8	632.1	8347.7	7	92.9

2008/09	9968.8	612.9	9356.9	6.15	93.8
2009/10	11220.3	455.5	6672.8	4.6	59.5
2010/11	20704.2	4112.4	7963.2	19.9	38.5
2011/12	11080.2	3254.4	7828.7	29.4	70.6
2012/13	25830.5	-	-	-	-
Average Annual Growth Rate				13.52	81.29

Source: Various Issues of Budget Speech and Economic Survey MOF/GON

The above table shows, increasing trend of bilateral loan and decreasing trend of Multilateral Loans during the review period. Bilateral loan is Dominated Multilateral Loans in the structure and composition of external debt in Nepal. In the starting year of review period 1997/98, the percentage share of Bilateral loans on the total external debt was 11.9 percent and Multilateral loan was 88.1 percent similarly, by the end of the study year 2012/13, the percentage share of Bilateral loan has been increasing 29.4 percent whereas Multilateral loan has been decreasing to 70.6 percent. The average annual growth rate of bilateral and multilateral loans to total external loans are 13.52 percent and 81.29 percent respectively under the review period.

Figure 3.4: Structure of External Debt in terms of Disbursement by major Sources.



Source: Various Issues of Budget Speech and Economic Survey MOF/GON

Figure 3.4 shows that external debt, bilateral loan and multilateral loan, bilateral loan and multilateral loan figure 3.4 shows that total external borrowing has grown year by year. The share of multilateral loan to total external loan is higher than bilateral loan, which is shown in the figure.

3.8 Sector-wise Distribution of Public Borrowing

Deficit financing is the most useful method for promoting economic development in developing countries. It means as filling the gap cause by excess of government expenditure over its receipts, finance through public borrowing and creation of new currency. In the other word, deficit financing is excess of expenditure incurred by the government over the receipts they get by the method of taxes, fee and other miscellaneous items including external assistance in the shape of grants and loans. It has been regarded as a means to cover the gap of financial resources for adequate internal and external monetary sources in order to fulfill the physical targets of the plans. Developing countries like Nepal, needs heavy investment to build up Socio-economic infrastructure such as agriculture, transportation, Communication, Industry etc. to fulfill the objectives of economic development. Nepal has use external borrowing in different sectors such as Agriculture, Irrigation and Forestry, Transportation, power and Communication, Industry and Commerce and Social Services which is shown on table 3.8.

Table 3.8 Public Borrowing by Sectors

(Rs in millions)						
Fiscal Year	Total Debt	External Debt	Agriculture Irrigation and Forestry	Transportation power and communication	Industry and commerce	Social Service
1997/1998	14454.6	11054.4	2543.5	5813	167.9	2530.1
1998/99	16562.4	11852.4	2925.1	6179.7	391.6	2312.3
1999/2000	17312.2	11812.2	2693.4	6039.5	283.8	2795.1
2000/01	19044	12044	3242	6012.6	-	2789.4
2001/02	15698.7	7698.7	2560.8	3593.3	49.5	1495
2002/03	13426.4	4546.4	1488.9	1080.5	28.3	1738.4
2003/04	13236.8	7629	1488.9	1080.5	28.3	1738.4

2004/05	18204.2	9266.1	1214.7	2836.8	0.1	5212.5
2005/06	20048.5	8214.4	971.9	2669.5	0	3901.4
2006/07	27945.8	10053.5	1656.8	3740.7	0	4656
2007/08	29476.3	8979.9	2358.4	2006.1	0	4615.4
2008/09	34525.4	9968.9	-	-	-	-
2009/10	4113.7	11222.9	1093.2	1827.3	0.8	116.5
2010/11	5459.1	12074.2	722.5	585	0	134.2
2011/12	4750.2	11082.1	1062.5	1086	0	122.2
2012/13	6383.5	25834.8	1047.8	3290	0	80

Source: Various Issues of Budget Speeches and Economic Survey MOF/GON

Table 3.8 shows that the use of external debt in different sectors of economy. It shows the fluctuation trend of allocation through external debt to the various sectors i.e. Agriculture, Irrigation and Forestry, Transportation power and communication, Industry and commerce and social service. Transportation power and communication sector has not highest amount of loan, where as Agriculture Irrigation and Forestry, Social service and Industry and commerce has got lowest amount of loan respectively. It is sad to note the Industry and commerce sector is neglected by using low amount of loan and no amount of loan in some fiscal years as shown in the table. In this scenario, how can we increase growth without industrialization of a country?

Similarly, the amount share of Agriculture, Irrigation and Forestry; Transportation power and communication, Industry and commerce and social service out of external debt is Rs.2543.5, 5813, 167.9 and 2530.1 respectively in the fiscal year 1997/98 whereas the percentage share in fiscal year 2012/13 is Rs.1047.8, Rs.3290, Rs.0 and Rs.80 respectively.

In conclusion, the government's budget in Nepal has always remained in deficit. The revenue mobilization has not been satisfactory in relation to the increasing trend of government expenditure. The gap between government expenditure and revenue has not been narrowing. The government needs to manage its expenditure effectively and to enhance revenue mobilization capacity in order to reduce such gap. If the present status of revenue mobilization does not improve in recent future, the economy will have to bear highest cost of debt. The capacity of government's revenue mobilization seems to have weakened in recent years. So, the public debt has to play a crucial role to finance deficit. From my review period, the government's source to reduce the budgetary deficits is internal and external borrowing. The trend of external borrowing, especially bilateral and multilateral loan is increasing rapidly than internal borrowing, which has created some sort of constraint in the performance of economy as a whole.

CHAPTER-IV

BURDEN OF PUBLIC DEBT IN NEPAL

4.1 Introduction

Burden of public Debt is increasing very rapidly in our country; it indicates that the sacrifice and effect on the community through a rise in taxation at the time of repayment and for paying the annual interests on the government loans. In other words, it refers every government is bound to repay the public borrowing whether internally or externally with interest may tend to fall either on the obligation of repayment including with interest. Government borrowing has been excessive and the burden of Public debt is increasing day by day according to increase on the outstanding portion of the debt composition. The total burden of Public debt can be classified into two groups; burden of internal debt and burden of external debt.

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

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

In case of Nepal, outstanding Public debt is increasing rapidly each year that which becomes 30.1 percent to GDP in 2012/13. Large scale of Public debts have been incurred in the past for financing development programs, but debt servicing capacity has not been increasing in the same speed. Nepal has been borrowing new fresh loans to repay old loans. This also has alarmed situation of "debt trap" in the future. Hence, proper utilization of debt is necessary to reduce the debt burden.

4.2 National Debts and its share in GDP

The ratio of Public Debt is an important indicator of the manage ability of Public Debt in an economy. The relative magnitudes of the Public Debt of the GDP should be taken into consideration for assessing the burden of growing public indebtedness in an economy. Nepal has to borrow huge amount of loan from external as well as internal sources for meeting deficit budget. Burden of outstanding debt is increasing because of the tax revenue and non-tax revenue is not increasing as its expectation and unutilized of Public Debt and rampant corruption. Here, table 4.1 shows the burden of debt through the method of measure of burden of debt as the ratio of Public Debt to GDP.

Table 4.1 Outstanding Debts and its share in GDP

(Rs in millions)

Fiscal Year	Total Public debt	External Outstanding Debt	internal Outstanding Debt	GDP	Share in Percentage of GDP		
					Total Debt	External Debt	Internal Debt
1997/1998	199614.7	161208	38406.7	289798	68.9	55.6	13.3
1998/99	219135.5	169465.9	49669.7	330018	66.4	51.4	15.1
1999/2000	245048.2	190691.2	54357	366251	66.9	52.1	14.8
2000/01	261594.2	200404.6	60043.8	394052	66.1	50.9	15.2
2001/02	293746.3	220125.6	73620.7	406138	72.3	54.2	18.1
2002/03	308078.5	223433.2	60000	437546	70.4	51.1	19.3
2003/04	318913	232779.3	84645.3	474919	67.2	49	18.1
2004/05	314400	219641.9	86133.7	508651	60.4	43.2	17.2
2005/06	337793	233968.4	94710.6	557869	59.1	42	17
2006/07	332790	216628.9	103776	696989	46	31	14.8
2007/08	375670	242060	11639.1	792131	44.6	30.5	14

2008/09	425100	277000	12570	909528	43	27.9	15
2009/10	440400	256200	14810	1083415	36.9	21.5	15.4
2010/11	443600	259600	18420	1256482	32.3	18.9	13.4
2011/12	523200	309300	21390	1396139	34.1	20.1	13.9
2012/13	511100	299400	21170	1540181	30.1	17.6	12.4

Source: Various Issues of Budget Speeches and Economic Survey and NRB Report

The table 4.1 shows the magnitude of outstanding debt, GDP and their ratio, which also assesses the burden of Public Debt. Total outstanding of Public Debt has increased from Rs. 199614.7 million in 1997/98 to Rs. 511100 million in 2012/13. And its share of GDP has decreased from 68.9 percent to 30.1 percent. The table also shows that the share of external debt has decreased from 55.6 percent to 17.6 percent and share of internal debt has increased from 13.3 percent to 12.4 percent respectively under the review period.

Observing table, the burden of external outstanding debt is greater than internal which may be anger in the future generation. In the table, GDP is also increasing from Rs. 289798 million in 1997/98 to Rs. 1540181 million in 2012/13 its growth rate of GDP is less than growth rate of outstanding debt.

4.3 Debt Servicing Issues in Nepal

Most of development activities, projects depend upon the Public debt especially foreign loan. Nepal is taking huge amount of external and internal loan with the obligation of future repayment. In Nepalese context, foreign loan share is rapidly increasing which increase financial and real burden for the future generation. So the debt servicing is one of the problems of Nepalese economy because most of the portion of revenue has been used to pay the interest of internal debt as well as external debt.

The ratio of internal and external debt servicing to total debt servicing and their percentage share to GDP during the period 1997/98 to 2012/13 has shown in table 4.2

Table 4.2: Share of External and Internal Debt Servicing in Total Debt Servicing.

(Rs Million)

Fiscal Year	Total Debt Servicing(TDS)	Internal Debt Servicing(IDS)	External Debt Servicing(EDS)	IDS as Percentage of TDS	EDS as percentage of TDS
1997/1998	7682.8	3481.6	4201.2	45.32	54.68
1998/99	8723	3977.5	4745.5	45.60	54.40
1999/2000	10032.8	4711.4	5321.4	46.96	53.04
2000/01	10388.4	4187	6201.4	40.30	59.70
2001/02	12205.2	5637.7	6567.5	46.19	53.81
2002/03	16181.3	8662.1	7519.2	53.53	46.47
2003/04	17338.8	9429.9	7908.9	54.39	45.61
2004/05	19751.3	11651.4	8099.9	58.99	41.01
2005/06	20423.5	11272.7	9150.8	55.19	44.81
2006/07	22916.3	13321.8	9594.5	58.13	41.87
2007/08	22760.6	14742.1	10014.7	64.77	44.00
2008/09	26988.3	14494.3	12494	53.71	46.29
2009/10	28413.6	15212.5	13201.1	53.54	46.46
2010/11	29957.6	16417.6	13540.0	54.80	45.20
2011/12	-	-	16363.2	-	-
2012/13	-	-	17013.4	-	-
Average Annual Growth Rate	10.53	12.79	9.35	52.24	48.38

Note: (A dash denotes not available)

Source: Various Issues of Budget Speeches and Economic Survey and NRB Report

The table 4.2 reflects that total debt servicing amount has increased from Rs 7682.8 million to Rs 29957.6 million during the study period of 1997/98 to 2010/2011. It has increased with the rate of 10.53 percent. This indicates an increasing trend of total debt servicing.

Similarly, the internal debt servicing amount has increased from Rs.3481.6 million in fiscal year 1997/98 to Rs 16417.6million in fiscal year 2010/11 with the average annual growth rate by 12.79 percent. The external debt servicing has increased

form Rs 4201.2 million in fiscal year 1997/98 to Rs17013.4million in fiscal year 2012/13 with the average annual growth rate by 9.35 percent.

From the table 4.2, the average annual growth rate of total debt servicing is 10.53 and growths rate of internal debt servicing & external debt servicing is 12.79 and 9.35 percent respectively. This means the burden of internal debt is growing rapidly than burden of external debt. Thus, we find that the share of internal debt servicing in total debt servicing has been greater than that of external debt servicing throughout the study period.

4.4 Analysis of internal Debt Servicing Situation

The burden of Public Debt is measured by the ratio between the debt servicing and aggregate tax revenue and non-tax revenue or total revenue and the ratio between servicing cost and national income (GDP). To analyze the pattern of internal debt servicing situation to total revenue regular expenditure and GDP, this has been shown by table 4.3

Table 4.3 Share of Internal Debt servicing in total revenue, Regular expenditure and GDP

Fiscal Year	Total Revenue (TR)	Regular Expenditure	GDP	Internal Debt Servicing (IDS)	(Rs. in Millions)		
					IDS as % of TR	IDS as % of RE	IDS as % of GDP
1997/1998	32937.9	27174.4	289798	3481.6	10.57	12.81	1.20
1998/99	37251.3	31944.2	330018	3977.5	10.68	12.45	1.21
1999/2000	42893.8	35579.3	366251	4711.4	10.98	13.24	1.29
2000/01	48893.6	45837.3	394052	4187	8.56	9.13	1.06
2001/02	50445.5	48863.9	406138	5637.7	11.18	11.54	1.39
2002/03	56229.8	52090.5	437546	8662.1	15.40	16.63	1.98
2003/04	62231.0	55552.1	474919	9429.9	15.15	16.97	1.99
2004/05	70122.7	61686.4	508651	11651.4	16.62	18.89	2.29
2005/06	72282.1	67017.8	557869	11272.7	15.60	16.82	2.02
2006/07	87712.2	77122.4	696989	13321.8	15.19	17.27	1.91

2007/08	107620.5	91446.9	792131	14742.1	13.70	16.12	1.86
2008/09	143474.4	124425.3	988272	14494.3	10.10	11.65	1.47
2009/10	177990.1	186597.6	1192774	15212.5	8.55	8.15	1.28
2010/11	198376.3	210167.7	1374953	16417.6	8.28	7.81	1.19
2011/12	244374.9	243460.0	1536000	-	-	-	-
2012/13	289604.9	279011.2	1701194	-	-	-	-
Average Annual Growth Rate					12.18	13.54	1.58

Source: Various Issues of Budget Speeches and Economic Survey and NRB Report

The table 4.3 shows the average annual growth rate and volume of total revenue, regular expenditure, GDP and internal debt servicing. It also shows the share of TR, RE and GDP as percentage of internal debt servicing.

Under the study period (fiscal year 1997/98 to 2010/11), the magnitude of total revenue, regular expenditure, GDP and internal debt servicing was Rs 32937.9. Rs.27174.4, Rs.289798 and Rs.3481.6 million at the starting period of review and which has increased to Rs. 198376.3, Rs.210167.7, Rs.1374953 and Rs.16417.6 million at the last period of review respectively.

Observing Table 4.3 the nature of internal debt servicing as percentage of total revenue, regular expenditure, GDP and internal debt servicing has been increasing. The internal debt servicing as percentage of total revenue was 10.57 percent in fiscal year 1997/98 and in middle period it has been fluctuation and 8.28 percent in fiscal year 2010/11 and it has been slightly decreased, regular expenditure was 12.81 percent in fiscal year 1997/98 and has decreased to 7.81 percent in fiscal year 2010/11. Similarly, the internal debt servicing as percentage of GDP was 1.20 percent in fiscal year 1997/98 and has decreased to 1.19 percent in fiscal year 2010/11. It indicates that increasing trend of internal debt servicing as percentage of GDP.

4.5 Public Debt, Development Expenditure and Debt Servicing

The increase in development expenditure is a reflection of the rising development activities of government of the development process. However the growth of development expenditure remained lower than the regular because of weak

implementation of development projects resulting from political instability and lack of commitment. A regular expenditure shows an interesting phenomenon, it has tendency to double in every five year.

The relation of outstanding Public Debt, development expenditure and total debt servicing has been shown in table 4.4

Table 4.4: Development Expenditure, outstanding Public Debt and Total Debt servicing

(Rs. in millions)

Fiscal Year	Total Outstanding Debt (TOD)	Total Debt Servicing (TDS)	Development Expenditure (DE)	TOD as percentage of DE	TDS as percentage of DE
1997/1998	199614.7	7682.8	28943.9	14.50	26.54
1998/99	219135.5	8723	22992.1	10.49	37.94
1999/2000	245048.2	10032.8	25480.7	10.40	39.37
2000/01	261594.2	10388.4	28307.2	10.82	36.70
2001/02	293746.3	12205.2	24773.4	8.43	49.27
2002/03	308078.5	16181.3	22356.1	7.26	72.38
2003/04	318913	17338.8	23095.6	7.24	75.07
2004/05	314400	19751.3	27340.7	8.70	72.24
2005/06	337793	20423.5	29606.6	8.76	68.98
2006/07	332790	22916.3	39729.9	11.94	57.68
2007/08	375670	22760.6	53516.1	14.25	42.53
2008/09	425100	26988.3	47524.4	11.18	56.79
2009/10	440400	28413.6	40509.0	9.20	70.14
2010/11	443600	29957.6	47326.0	10.67	63.30
2011/12	523200	-	51391.0	9.82	-
2012/13	511100	-	66133.0	12.94	-
Average Annual Growth Rate	6.22	10.53	6.63	10.41	54.92

Note: (A dash denotes not available)

Source: Various Issues of Budget Speeches and Economic Survey and NRB Report

Table 4.4 shows that the magnitude of outstanding public debt has increased from Rs.199614.7 million in 1997/98 to Rs 511100 million in the last year of review period 2012/13 with annual average growth rate 6.63 percent. This shows the real burden of debt of Nepal where total outstanding of public debt as percentage of expenditure was 14.50 percent has maintained up to 12.94 percent at the end of study period.

4.6 Annual Internal Borrowing and Internal Debt Servicing

The proportional relationship between annual internal borrowings and internal debt servicing can be taken as important aspects of internal debt analysis. Table 4.5 shows that the aspects of internal debt servicing and proportion of annual borrowing which has spent on debt servicing.

4.5 Annual Internal Debt Servicing as Percentage of Annual Internal Borrowing

Rs. in million

Fiscal Year	Internal Debt (ID)	Internal Debt Servicing (IDS)	IDS as percent of ID
1997/1998	3400	3481.6	102.40
1998/99	4710	3977.5	84.45
1999/2000	5500	4711.4	85.66
2000/01	7000	4187	59.81
2001/02	8000	5637.7	70.47
2002/03	8880	8662.1	97.55
2003/04	5607	9429.9	168.18
2004/05	8939.1	11651.4	130.34
2005/06	11834.2	11272.7	95.26
2006/07	17892.3	13321.8	74.46
2007/08	20496.4	14742.1	71.93
2008/09	24475.3	14494.3	59.22
2009/10	29914	15212.5	50.85
2010/11	42515.8	16417.6	38.62
2011/12	36418.7	-	-
2012/13	38000	-	-
Average Annual Growth rate	18.89	12.79	84.94

Note: (A dash denotes not available)

Source: Various Issues of Budget Speeches and Economy Survey and NRB Report.

The table 4.5 shows the internal debt servicing and its percentage with internal debt. As far as measuring the internal debt burden, it shows internal debt servicing is growing faster than that of internal debt receiving. Observing the data we can find out the volume of internal debt was Rs.3400 million and Rs. 38000 million in fiscal year 1997/98 with 18.89 percent of annual average growth rate. Likewise internal debt servicing is also gone up from Rs.3481.6 million and Rs. 16417.6 million in fiscal year 2012/13 with 12.79 percent of annual average annual growth rate.

4.7 Annual External Debt Servicing as Percentage of Annual External Borrowing

Nepal is bearing heavy burden of external debt. So it leads to rise in debt servicing charge. External debt is growing year to year in high rate. Our domestic resource mobilization is inadequate and insufficient to meet the growing requirement of funds. Here, the attempt has been made to compare annual flow of external debt and its servicing which is shown in table 4.6

Table 4.6 Annual External Debt Servicing as percentage of annual External Borrowing

Fiscal Year	External Debt	External Debt Servicing (EDS)	EDS as Percentage of ED
1997/1998	11054.4	4201.2	38.00
1998/99	11852.4	4745.5	40.04
1999/2000	11812.2	5321.4	45.05
2000/01	12044	6201.4	51.49
2001/02	7698.7	6567.5	85.31
2002/03	4546.4	7519.2	165.39
2003/04	7629	7908.9	103.67
2004/05	9266.1	8099.9	87.41
2005/06	8214.4	9150.8	111.40
2006/07	10053.5	9594.5	95.43
2007/08	8979.9	10014.7	111.52
2008/09	9968.9	12494	125.33
2009/10	11222.9	13201.1	117.63
2010/11	12074.2	13540.0	112.14
2011/12	11082.1	16363.2	147.65
2012/13	25834.8	17013.4	65.85
Average Annual Growth Rate	11.09	9.35	93.96

Source: Various Issues of Budget Speeches and Economy Survey and NRB Report.

Observing Table 4.6, the volume of external debt was Rs.11054.4 million in 1997/98 and due to high increasing rate, external debt was Rs.9266.1million in2004/05 but it was greater than external debt servicing at the end of the review year 2012/13. External debt becomes less than external debt serving and the percentage share to external debt has increased from 38 percent to 65.85 percent.

All these trend shows Nepal's fourth coming days will be change into free of debt burden of these situation is running up continuously.

4.8 Foreign Loan

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

Nepal is facing various problems like poverty, unemployment and Nepal's macroeconomic indicators show very low economic growth and declining economic performance recently. Nepal has to invest huge amount for security, which seems unproductive in present situation. Due to this reason, Nepal's external public indebtedness has increased very much. A rise in external indebtedness should be accompanied by increase in debts seeming capacity so that these may be undue strain in the balance of payment awing to lead to the country to the heavy burden of debt crisis in the future.

Although, foreign loans are main pillars for development process and to breakout vicious circle of insufficient domestic capital formation, it has adverse effect on national economy when its service means that scare foreign exchange resource have to be transferred to creditor's countries.

When external debt service has obvious impact on domestic capital formation and leads to reduction in the domestic standard of living unless the loans are used enough to satisfy creditors' claims for debt servicing. Therefore, the true burden of debt service depends to a substantial extent in how the borrowed fund from external sources can be transformed into productive investment. If the foreign loans are used unto unproductive investment projects that provide present consumption with more goods than being produced in the country then foreign debt servicing if the debt because quite impossible.

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

Samuelson (1964) has suggested for use of foreign capital in the process of development of developing countries. He has said that "if there are many difficulties in the way of domestic financed capital formation, why not rely more heavily on foreign sources. He further said, "Doesn't economic theory tellers that a rich country which has used of all its own high interest investment projects can benefit it and at the same time benefit a poor country abroad." If only it will shift investment to the high internal project not yet exploited abroad."

4.9 External Debt Flow and its Annual Servicing

One of the main features of budgetary system in Nepal is deficit budget in which large proportion of it is fulfilled by external loan. This is also proved by increasing trend of average annual growth rate of external debt by..... Percent under the period of study. Here, the ratio of external outstanding debt to GDP has grown up and creating adverse situation in the economy, which requires serious thinking for its solution.

Here, the attempt has been made to compare the annual flow of external debt with annual debt servicing obligation, which is shown by table 4.7

Table 4.7: External debt flow and its servicing

Rs. in million

Fiscal Year	External Debt (ED)	External Debt Servicing (EDS)	EDS as Percentage of ED
1997/1998	11054.4	4201.2	38.00
1998/99	11852.4	4745.5	40.04
1999/2000	11812.2	5321.4	45.05
2000/01	12044	6201.4	51.49
2001/02	7698.7	6567.5	85.31
2002/03	4546.4	7519.2	165.39
2003/04	7629	7908.9	103.67
2004/05	9266.1	8099.9	87.41
2005/06	8214.4	9150.8	111.40
2006/07	10053.5	9594.5	95.43
2007/08	8979.9	10014.7	111.52
2008/09	9968.9	12494	125.33
2009/10	11222.9	13201.1	117.63
2010/11	12074.2	13540.0	112.14
2011/12	11082.1	16363.2	147.65
2012/13	25834.8	17013.4	65.85
Average Annual Growth Rate	11.09	9.35	93.96

Source: Various Issues of Economic Survey and NRB Report

The table 4.7 shows, the external debt was Rs.11054.4 million in 1997/98 and has increased up to Rs.25834.8 million in 2012/13 million. This is the great improvement in our economic sector. We must accept it being a 11.09 percent of average annual growth rate under the review period. The amount of external debt servicing has increased from Rs.4201.2 million in 1997/98 to Rs 17013.4 million in 2012/13 with 9.35 percent of average annual growth rate under the period of the study.

4.10 External Debt Servicing, Export Earning and GDP Ratio

Here, the attempt has been made to compute the ratio of external debt servicing to export earnings and debt servicing to GDP, In Nepal, the large proportion of GDP and export earning go back to foreign countries while servicing. The table 4.8 shows the external debt burden in terms of export earning, debt servicing and ratio to GDP.

Table 4.8: External Debt Servicing, Export Earning and GDP ratio

Rs. in million					
Fiscal Year	GDP	External Debt Servicing	Export	EDS as percentage of GDP	EDS as percentage of Export
1997/1998	289798	4201.2	27514.5	1.45	15.27
1998/99	330018	4745.5	35676.3	1.44	13.30
1999/2000	366251	5321.4	49822.7	1.45	10.68
2000/01	394052	6201.4	55654.1	1.57	11.14
2001/02	406138	6567.5	46944.8	1.62	13.99
2002/03	437546	7519.2	49930.6	1.72	15.06
2003/04	474919	7908.9	53910.7	1.67	14.67
2004/05	508651	8099.9	58705.7	1.59	13.80
2005/06	557869	9150.8	60234.1	1.64	15.19
2006/07	696989	9594.5	59383.2	1.38	16.16
2007/08	792131	10014.7	59266.7	1.26	16.90
2008/09	988272.0	12494.0	67697.5	1.26	18.46
2009/10	1192774.0	13201.1	60824.0	1.11	21.70
2010/11	1374953.0	13540.0	64338.5	0.98	21.04
2011/12	1536000.0	16363.2	74261.0	1.07	22.03
2012/13	1701194.0	17013.4	78524.4	1.00	21.67
		9.35	7.53	1.38	16.31

Source: Various Issues of Economic Survey and NRB Report

The table 4.8 shows the magnitude of export earning was Rs.27514.5 million in 1997/98 that has increase up to Rs.78524.4 million in 2012/13 with the 7.53 percent of average annual growth rate under the period of review. whereas external debt servicing amount was Rs.4201.2 million in 1997/98 and increased to Rs.17013.4 million in 2012/13 with 9.35 percent of average annual growth rate under the review period.

4.11 Outstanding External Debt and Import

The relationship between external debt burden and import payments on their average annual growth rate and the ratio of imports payments to external debt are shown in table 4.9

Table 4.9: Ratio of External Outstanding Debt and Import Payment

Rs in million

Fiscal Year	External Outstanding Debt (EOD)	Import	Imports as percentage of EOD
1997/1998	161208	89002.0	55.21
1998/99	169465.9	87525.3	51.65
1999/2000	190691.2	108494.9	56.90
2000/01	200404.6	115687.2	57.73
2001/02	220125.6	107389.0	48.79
2002/03	223433.2	124352.1	55.66
2003/04	232779.3	136277.1	58.54
2004/05	219641.9	149473.6	68.05
2005/06	233968.4	173780.3	74.28
2006/07	216628.9	194694.6	89.87
2007/08	242060	221937.8	91.69
2008/09	277040.4	284469.6	102.68
2009/10	256243.3	374335.2	146.09
2010/11	259551.8	396175.5	152.64
2011/12	309287.1	461667.7	149.27
2012/13	379381.8	541423.5	142.71
Average Annual Growth Rate	5.85	12.40	87.61

Source: Various Issues of Economic Survey and NRB Report

The table 4.9 indicates that the increasing trend of external outstanding debt with 5.85 percent of average annual growth rate, which indicates the serious problem in external debt burden of Nepal. On the other hand, the magnitude of import payment was Rs 89002.0 million in 1997/98 and has gone up to Rs 541423.5 million in 2012/13 with the 12.40 percentage of average annual growth rate. This shows the large proportion of foreign exchange transferred to foreign countries for import of goods and services.

Table 4.9 also shows import payments as percentage of external outstanding debt, which was 55.21 percent in 1997/98 to 142.71 percent in 2012/13. This indicators show that purpose of external debt is not going right direction and balance of payments hampered. In 2012/13, imports payments as percentage of external debt is 142.71 percent which indicates more than half of external debt has transferred for import payments showing gradual increase in import of goods and services from abroad, this also the causes of affected balance of payments.

CHAPETR V

SUMMARY OF MAJOR FINDINGS AND RECOMMENDATIONS

5.1 Summary of the Findings

The successive governments that came into existence after the people's agitation in 1990 have superfluously claimed to achieve miraculous development in Nepal. But the truth is just the opposite. The international comparison of macroeconomic indicators shows that Nepal's position is extremely counterpale. Nepal is facing the serious problem of inadequate mobilization of internal resources. And on the one hand, government has to invest in almost all sectors of economy where as on the other hand; there is a challenge to mobilize additional resources for meeting the growing expenditure.

In the context of developing countries, it is playing vital role for socio-economic development because they have limit size of funds which is not sufficient for development financing, In case of Nepal, the landlocked nature and mountains 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 in public expenses.

Basically, the study shows that there is lack of adequate fund for development financing. We have limited resources, small size GDP, lower per capita income, lack of infrastructure, saving investment gap, export import gap, revenue expenditure gap etc. so, the domestic resources are not sufficient to promote the rapid development of the economy. All these factors are major causes to increase external dependency.

Borrowing is taking from two sources internal and external. In the internal sources treasury bills, special bonds, development bonds and national saving certificate are included. Large proportion of internal debt is taken by banking sectors from very beginning of the debt program. Similarly, in external sources Nepal is receiving

borrowing in the form of bilateral and multilateral sources such as ADB, UNDP, WB, WHO, IMF etc.

Nepal is facing the problem of financing due 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 is decreasing, which further increased in debt burden. Such factor helps to raise internal and external borrowing, for the developing countries like Nepal. External borrowing is growing in higher rate than internal borrowing, increasing trend of borrowing also increased debt servicing obligation. In the early stage of development higher resource gap itself would not have been a serious problem because of foreign grants but how the situation is just reverse, amount of grants decrease day another. There are limited source of government revenue such as non-tax revenue, which is not sufficient for growing needs of expenditure, so it is necessary to borrowed fund through the internal and external sources.

The government budgetary deficit is increasing each and every year. So, the trend of continuously increased in borrowing and debt servicing obligation is not good economic indicator for developing country like Nepal. Obviously, there are not any alternative sources for financing budgetary deficit so that the government is unable to reduce social-economic development of nation.

5.2 Summary of Findings is as follows:

-) In the fiscal year 1997/98, Revenue Deficit (TE-TR) was Rs.23180.4 million in which was increased to Rs 115220.6 million in the fiscal year 2012/13. The average annual growth rate of revenue is 12.28 percent. Similarly, government expenditure is increased from Rs 56118.3 million to Rs 404825.4 million in the fiscal year 1997/98 and 2012/13 respectively. The average annual growth rate of revenue is higher than the average annual growth rate of expenditure but the absolute amount of government expenditure is higher than the revenue. This shows the financial resource gap, in which fiscal deficit has been increased from Rs 17777.8 million to Rs 68251.4 million with an average annual growth rate of 13.83 percent under the review period.

-) The total debt has been increasing from Rs 14454.6 million to Rs 63835.5 million where as share of external loan to fiscal deficit has been decreasing form 73.9 percent to 40.5 percent and share of internal loan has been increasing and some years fluctuating from 22.7 percent to 59.5 percent under the review period. Its average annual growth of 38.95 percent and 46.04 percent under the review period.
-) Main sources of financing deficit are loan and grant. In fiscal year 1997/98 share of external borrowing was Rs 11054.4 million where as the share of internal borrowing was Rs.3400 million but in fiscal year 2012/13, the amount of external borrowing was Rs 25835.5 million and internal borrowing was Rs.38000 million. It shows that both sources of borrowing are increasing and average annual growth of internal and external borrowing was 10.04 percent and 11.09 percent decreasing.
-) A foreign grant is not increasing in the desirable pace as it predicts. Foreign grants has been increasing from Rs 5402.6 million in fiscal year 1997/98 to Rs46989.2 million in 2012/13 with 14.51 percent average annual growth rate under the study period.
-) In the study period fiscal year 1997/98 to fiscal year 2012/13 the percentage share of total debt to GDP has been decreasing from 4.99 percent to 3.75 percent with 3.71 percent average annual growth rate. Similarly, internal debt as percent of GDP was 1.5 percent in fiscal year 1997/98 and increased to 2.2 percent in fiscal year 2010/11 with 2.10 percent average annual growth rate and external debt as percentage of GDP was 3.81 percent in fiscal year 1997/98 and decreased to 1.5 in fiscal year 2012/13 with 1.52 percent average annual growth rate.
-) In the study period, the average annual growth rate of outstanding total debt, internal debt and external debt are 6.27 percent, 11.59 percent and 4.23 percent respectively. The share of external debt in GDP fluctuating under the study period from 55.6 percent in 1997/98 to 17.6 percent in 2012/13 similarly, the share of internal debt in GDP also increasing and fluctuating nature from 13.3 percent in 1997/98 to 12.4 in 2012/13. And the share of total

outstanding debt in GDP also increasing and fluctuating 68.9 percent to 30.1 percent over the period.

5.3 Conclusions

Public Debt refers to the obligation to pay money back to the persons, institutions, or country from whom it has obtained. It plays a valuable role in socio-economic development of a nation. Nepal started obtaining internal debt since FY 1961/62 and external debt since FY 1963/64 with the objectives of national development. Nepal's most development activities are depending upon the Public Debt especially external debt.

During the study period, it was found that government borrowing has been increased unlikely and financed mostly on the unproductive sector including uncertainties, high expenditures and hence government always lacks the revenue then borrows the new loan to pay the previous one. That's why, the Public Debt and its interest is growing rapidly. But addressing capacity for redemption the debt is not increasing in the same pace.

It is concluded that the average annual growth rate of GDP, revenue and export earnings are considerably low as compared with that of debt and its servicing obligation and the most of the borrowed funds are using in unproductive sectors. Because of the misuse of borrowed funds, other things remaining the same there are symptoms of steadily falling into the debt trap.

The agile amount of debt and poor servicing capacity of the government compel to think the sinking condition of the economy. It arises several questions about the capacity of debt receiving and existence of the nation. Excessive dependency on foreign assistance makes the balance of payment on the favor of creditors which is horrible situation to get rid of. Any way it can play the useful role for the economic development of every nation and it is widely accepted measure also for financing government expenditure.

6.4 Recommendations

In the Nepalese budgetary system Public Debt has meaningful place. To fulfill the gap between revenue and expenditure debt is using every year heavily. So, to rescue from the debt trap the effective utilization of Public Debt is necessary. After the study of Public Debt in Nepal during the period 1997/98 to 2012/13, the following recommendations are proposed to be a tool for the Public Debt management in Nepal.

-) The size of revenue collection is very low and expenditure is very high which creates fiscal imbalance. To minimize this problem, the government expenditure has to be controlled and allocated the basis of national priority so that productivity may increase within stipulated time period. And for maximizing revenue collection, government should adopt transparent and effective tax policy and improving tax administration which helps to reduce dependency on loans for financing development expenditure.
-) Government should use the 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.
-) Government should move towards fiscal imbalance and strong fiscal discipline through control of unproductive expenditure and maximizing revenue mobilization.
-) The most important issue is increasing excessive dependency upon the foreign assistance to sustain our economy. Thus, such dependency should be minimized by containing foreign aid within the desired limits and mobilizing of internal resources as maximum as possible for development purpose.
-) Maximum efforts should be made to increase revenue from the taxes.
 - i. Government should increase heavy import duty on luxurious goods, harmful goods.
 - ii. Government should impose progressive tax in income, property etc.

-) The government should be active enough to maintain the strong policy of monitoring, evaluation and supervision which help to reduce corruption and to increase accountability, responsibility and implementation.
-) Government should try to minimize borrowing from banking sectors which is highly inflationary and enhance non banking sectors which stimulate domestic saving and investment.
-) Government should adopt the policy of trade but not aid for the economic development.
-) Government should minimize the import tax on necessary goods and capital goods and increase import tax to protect the domestic industries.
-) Government should replace the remittance instead of external debt in different economic activities.
-) Proper attention should be given to maintain macroeconomic stability of the country while taking both external and internal borrowing.
-) The government should try to maintain balance between expenditure and revenue.

The role of government is dominating to private sector in all sectors of the economy in Nepal. Thus the government should adopt 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 economy will be capable to move in a self-sustaining growth path.

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