CHAPTER I

INTRODUCTION

1.1 Background of the Study

Government of a country gets income from two sources namely public borrowing and public revenue. Public debt of a central government express in monetry terms often refer to as national debt. The government represents the people. Government debt can be seen as the indirect debt of the tax payer. Deficit financing means an increase in public debt since it is easy method of obtaining income. Government is likely to be extravagant and irresponsible consequently public debt will become a definite burden on the economy.

A deficit is the difference between government revenue and the accumulation of deficits over time is the total public debt. Deficit finance allows government to smooth tax burden over time and government an important finance policy tool. Government can pay for spending by borrowing. The government borrows for financing the budget deficits. Deficit financing is estimated as a gap between expected revenue plus foreign grant minus expected government expenditure. Government expenditure revenue foreign grant.

Expenditure is estimated for a targated rate of growth saving investments gaps and slow growth of revenue as compared to growth in government expenditure causes this deficit.

Recent thinking that growth in the debt recent cause alarm for two reasons. First, growth in debt ratio might lead to crowing out of private investment. Second, And more important is the assumption that government spending out of borrowed fund might be non-productive. The second agreement is not suitable in fact the part of public debt is burdensome whose servicing falls entirely or mostly on tax revenue.

In Nepalese context, some historical events suggest that public debt is not altogether new practice in the past kings/prime ministers used to take resources of public debt. King Prithvi Narayan Shah had borrowed from the public of financing the war in 1768. The Rana Prime Minister Chandra Shumsher had also borrowed from Pashupati Nath Temple for the Kamaiya Mochan around 1925 with the enforcement of public debt Act 1960. Domestic public debt in form of treasury bills development bonds and

National saving certificate was issued.. This bonds and bills are of regular nature. Some of them are issued as deficit financing while other are issued with view to depend on the money market (Acharya, 1998).

Public debt has been the important source of fund to finance the development plans of the government of Nepal. As the budgetary situation of the government has always deficit. Some portion of deficit is met through the domestic and foreign borrowing as a result the volume, if debt as also increases quite sharply in the recent years. A country like Nepal, Public borrowing helps in achieving of growth rate. It allows for higher level of investment then it's saving can meet. It narrow down the gaps between saving and investment required for a targeted growth rate. The type of bonds and Treasury bills use by the government of Nepal to collect internal debt (Sharma & Bista, 2015). National saving bonds, civil saving certificates and special bonds are issued by Central Bank of Nepal.

The persistent feature of Nepal's public debt both internal and external has been increasing rapidly each year. The trend of external debt is increasing more rapidly in absolute term than internal debt. Since developing countries like Nepal alas razed foreign currencies, to import many capital goods required for development. These countries have to depend more on external borrowing then internal for favorable balance of maintaining in availability of foreign exchange and controlling the inflation. Government of Nepal stetted to collecting fund through public debt to fulfill the deficit and to launch big development projects internally from 1803 and external from 1951.

1.2 Statement of the Problem

Most economists agree that financing the debt is appropriate when revenue sources are not enough to meet current needs or when the tax burden to raise money to carry out a project would be overly burdensome. However, there is debate on such questions as how large the national debts may safely be allowed to grow. How and when public debt should be retired, what effect public borrowing has on the economy and even whether government should borrow at all should finance all expenditures from current revenues.

Nepal is facing the problem of financing ever increasing resource gap because government expenditure is increasing rapidly but government revenue is not increasing at the same pace. In Nepal, both internal and external borrowings have been increasing rapidly each year. The external borrowings is increasing more rapidly than internal borrowings. Increasing trends of public borrowings debts servicing obligations are also increasing rapidly. But debt servicing capacity of the country has not been increasing with the same pace. In this context, Nepal is facing debt crisis in the near future in which debt obligation will become major impediments to the balance management of the economy.

Nepalese economy is characterized by 3 kinds of macro economic imbalances viz. saving investment gap, export gap and revenue expenditure gap. To fill up this gap public debt in the form of either internal or external is inevitable. The Volume of external debt is expressively rising in the recent years under liberalization policy. As globalization concept is widely spreading all over the world. Aid is gradually decreasing and emphasis is going on loan technology transfer and trade which have created which degree of indebtedness and consequently servicing obligations are increasing. In the meanwhile the loan is not self-liquidating that debt repayment capacity is not increasing, in the same pace so ever increasing debt and debt servicing obligations will create a serious problem in the economy like "debt trap" colonization internal public instability, etc. In short, this may appear macro economy imbalances which create excessive dependency upon foreign assistance. For this purpose the study has made attempt to identify the following questions:

1. What are the trend and structure of public debt in Nepal ?
2. Is there any resource gap in the financing of capital expenditure in Nepal?
3. How can the burden of public debt and debt servicing analyze in Nepal?
4. How can the empirical relationship between public debt and GDP examined?

1.3 Objectives of the Study

The general objective of the study is to examine and analyze the structure, trend and burden of public debt in Nepal. The following specific objectives are as follows.

1. To analyze the trend and structure of public debt in Nepal,
2. To find out the resource gap in the financing of capital expenditure,
3. To explore the burden of public debt and debt servicing in Nepal.
4. To examine the empirical relationship between public debt and GDP.

1.4 Significance of the Study

In the past, many researchers have been conducted in order to analyze public debt in Nepal. The most of them have analyzed the trend pattern and burden of debt. However, only a few studies have concentrated about the internal debt.

At present, economic planning is taken as the main tool of economic development. In economic planning various objectives are made due to level taxable capacity of the people. Public debt is essential to meet the objective of development plan in Nepal. Hence, public debt has become a reliable and common instrument for resource mobilization and hence to break vicious circle of poverty in our country. The Government of Nepal has to invest a huge amount in socio-economic sectors as well as in direct productive sector. For this, there is a need of heavy investment due to which this scope and importance of public debt has been increasing day by day. Most of the existing studies are concentrating the examination of structure pattern and burden of external debt in Nepal.

However, this research paper provides updated information for the existing studies. Unlike the past studies, it explores and analyzes the effect of external debt on the output growth of Nepal. The findings of the study will be useful for all those who are interested to know about the Nepalese economy.

1.5 Limitations of the Study

The study has the following limitations:

1. This study has covered only time period of 15 years data from FY 2001/02 to 2016/17.
2. The research has based on secondary data only. So the reliability and validity of this study will depend upon the nature and accuracy of data.

1.6 Definition of Terminologies

- **Public Debt**: Public debt includes both external and internal debt of total debt of a national government.
- **Internal Debt**: Internal debt is the government's borrowing from domestic banking sectors and individuals.

- **External Debt**: External debt is the government's borrowings from external sources through bilateral and multilateral sources.
- **Gross Domestic Product (GDP)**: GDP is the measure of the total domestic output at factor price.
- **Debt Servicing**: Debt servicing refers to the principal and interest payment on loan after maturity period.
- **Burden of Debt**: Burden of debt is the sacrifice of the community through a rise in taxation at the time of repayment and for paying the annual interest on the government loan.
- **Debt Trap**: Debt Trap is the situation when new fresh loans are taken to repay the previously taken loan.
- **Export of Goods (XGs)**: XGs are the total value of goods and all service (including worker's remittance) sold to the rest of the world.
- **Import of Goods (MGs)**: MGs are total value of goods and services purchased from the rest of the world.
- **Gross National Product (GNP)**: GNP is the measure of the total domestic and foreign outcomes.

1.7 Organization of the Study

This thesis is divided into five different chapters. The first chapter is concerned on the introductory part of the study with background, statement of the problem, objectives, significance and limitations of the study. The second chapter reviews some literatures, books, theses, articles and so on. The chapter three describes about the data and methodology. The chapter four is related with the data analysis, presentation and interpretation of the study. The chapter five shows summary of findings, conclusion and recommendations. Finally, references are presented at the end of the thesis.

CHAPTER II

REVIEW OF LITERATURE

2.1 Introduction

Nepal is a small and beautiful country endowed with natural resources. Nepalese economy is passing through the critical phase of low income level, equilibrium trap, and vicious circle of poverty. Agricultural is the main source of Nepalese economy. These problems can be solved not only by the investment in the private sector but also by deliberate actions of government in the field of transaction, communications, power, road and other basic infrastructure and directly productive activities. So, to reduce poverty and economic development, government invests big amount in this field. Government has to depend upon borrowing from both internal and external sources (Bhandari, 2014).

The government of a country gets its income mainly from two sources; public revenue and public debt. But public debt carries with it the obligation to pay money back to person, institutions, or countries from whom it has been obtained so, "The accumulated amount of what the government has been borrowed to finance past deficits is called public debt". An internal debt is owed by a nation to foreigners and it is burdensome (Samuelsson, 1992, p.628).

The history of public debt is not new in Nepal. Nepal's experience in public debt in an ongoing and documented basic is fairly recent. In the process of obtaining public debt (1962) by a year, the first foreign creditors being USSR and the UK public debt transaction in Nepal fall under the domain Public Debt Act 1960, and Public Debt by law 1963. After the enforcement of Public Debt Act 1960, Public Debt for the first time was issued in Nepal in 1962 through Treasury Bills amounting to Rs. 7 millions. The next instrument of public debt, Development Bond, was first issued in fiscal year 1963/64, amounting to Rs. 250 million. Beginning from January 1992, NRB bond was issued with the sole objectives of mapping of excess liquidity. It however has been suspended since April 1996 (Banjade, 2008).

The 19th century economist have been arguing and discussing for and against the public debt. Particularly, the classical economist such as Pigou and Bastable visualized the views against the public debt saying "Nation once begins to borrow would be resist until it reached the point bankrupt" whereas post Keynesian and the modern economist including J.M. Keynes, Harries, Hansen, Buchannan, Musgrave, Davis, Kopt, and others have challenged the version of classical economists and hold opposite opinion on the subject of public debt, it‟s size and use.

The governments of the underdeveloped countries have to borrow due to low saving. This is resulted from the low level of investment. This justifies that capital deficiency in the developing countries are facing the deficiency of the capital in relation to their population and natural resources. Most of the developing countries are characterize by deficiency of capital. To break vicious circle of poverty and uplift a country with a self-sustain growth, a large amount of initial investment is necessary. Thus, under develop countries shows emphasized to stimulated and accelerate capital formation. Public debt particularly in developing countries has assumed great importance in view of the increasing magnitude of budgetary deficits. In Nepal, firstly the public debt was raised in 1961withthe means of Treasury Bills and such other instrument to raise the debt internally and externally.

2.2 Theoretical Context

2.2.1 Classical View

The classical economists were generally against the public borrowing and favored the minimum role of government. They assumed that individual, consumer and business firm employ resources more efficiently. According to them, economic activities are best in private sector because they have the greed of profit, through which allocation of resources would be more efficient. On the other hand, government does not have such greed. Due to this, they are in favor of limit size of public sector and reduce the function of government to the minimum possible extent .They further believed that any government intervention into the economic results into rigidity and disrupt the smooth functioning. This would help to bring about the optimum allocation of resources and the achievement of full employment and maximum output. Under a fully employed economy, therefore government can acquire resources by borrowing only at the cost of private sector where they are more fruitfully engaged. The classicists were not against any form of government expenditure. What they favored was minimum public expenditure (Harris, 1974). In between taxation and borrowing, classicists favored taxation for the following reasons:

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

However, the classical economists were not against all types of public debt. They favored public debt for self- liquidating projects.

Musgrave (1959) defined that self-liquidating projects are narrowly investment in public enterprises that provide the fee or sales income sufficient to service that debt incurred in their financing or they may be defined broadly as servicing of the debt incurred in their financing without requiring an increase in the future level of tax rates.

2.2.2 Keynesian View

Unlike the classical economists, Keynes did not accept the notion of free enterprises economy, which is self- equilibrium at full employment level. He advanced the concept of under employment equilibrium. He argued that resources in the private sector might remain unemployed for relatively longer time period if the government became unconscious. In such situation when resources are unemployed on large scale, government employment of these resources does not necessarily deprive the private sector of anything. On the contrary increasing government spending by using idle men and materials is likely to raise the level of aggregate demand and there by aggregate output and income. Due to this, Keynesian strongly prescribed to increase the public expenditure even by undertaking deficit financing or borrowing. For Keynesian, if debts are internally held, there is nothing to worry about their size. It is because such debt involves merely a series of transfer payments and they cancel out for the economy as a whole. Hence the only concern was on a high level of income and employment. This has emerged the concept of double budget. But Keynesian viewed that deficit budget even by undertaking public debt, would be a powerful tool during the time period of stagnation/ depression.

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 there by output and hence income, employment. Hence, public debt need not necessary unproductive, inflationary and burdensome. Therefore, Keynes strongly prescribed to increase the public expenditure even by undertaking deficit financing (Acharya, 2015).

Keynes rejected the classical notion of a free enterprise economy, which is self-equilibrating at full employment level and emphasized the existence of underemployment equilibrium. He advances the concept of underemployed for relatively long periods if corrective or compensating action is not taken by the government. On the other hand, increased government expenditure by using idle man and materials is likely to raise the level of aggregate output and income. Hence, public borrowing need not necessary be unproductive inflationary and burdensome. Many Keynesian carried the analysis to the other extreme and hold the view that if debts are internally held, there is nothing to worry their size. Such a debt involves merely a serious of transform payments and they rejectthe economy as a whole. Hence, the only concern should be about economic stability at the high level of income and employment (Singh, 2004).

2.2.3 Post- Keynesian View

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

The Post- Keynesian economist like Learner also shared the view that internal debt inflicts no burden simply because it is a transfer of fund from one pocket on the other from the left hand to the right hand. He further mentioned that international loan yields the borrower a real benefit and it enabled him to consume or invest more than he is earning or producing. And when he pays interest or repays the load he must tighten his belt, reducing his consumption or his investment. In the case of national debt, which had neither the benefit nor the burden, the belt cannot be let out when borrowing need not be tightened when repaying (Poudel, 2015).

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

i. According to them, public borrowing does not always deprive the private sector from the use of resources. As for example during the time period of wide spread unemployment, it may be productive.

ii. Besides, it is not accepted now that borrowing in the period of full employment must be inflationary. If the borrowing taps the funds otherwise used of consumption, it is not more inflationary.

iii. A large public debt if internally held poses many problems for the economy. It complicates the monetary policy and creates difficulties of management and so on.

iv. In resorting to borrowing, government should be guided by macro economic considerations its effects on macro-economic variables.

Moulton (1943) considered public debt as a national assert rather than liability and says that it is essential for the prosperity of the country.

Goode (1984) viewed that borrowed money when used to finance public investment causes no such reduction, all that 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 classifieds investment actually contributes to growth, while some expenditure usually classified as government consumption promotes growth.

Public debt plays significant role in the developing countries. The developing country have the natural resources but lack the technology for management in developing countries there is the gap between imports-exports, saving-investment and the gap of 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 under taken 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.

The post-Keynesian position accepted a large part of the modifications of the classical debt theory has brought about by Keynesian economists. It emphasizes, however, on the transfer and management aspects as well as the interrelationships between public debt and money supply.

Many economists have argued that borrowing today constitutes burden for future. Public borrowing does not always deprive the private economy of resources and instance in a period of widespread unemployment. It is also not accepted now that borrowing in a period of full employment must be inflationary. It depends on the circumstances. If borrowing taps funds otherwise spent on consumption, it is not more inflation any than taxation. A long public debt, if internally hold, poses many problems for the economy (Singh, 2004).

In a developing country for economic growth, development of industries, infrastructures and for social welfare, government may choose external borrowing. The marginal productivity of borrowed funds may be as high in relation to the rate of interest on loans available in more matured nations as to compensate for future to transfer difficulties and income drainage. The under developed country may thus supplement its own saving with command over foreign resources and the increase in the real income that this makes possible to justify the admitted complications (present and future) of foreign borrowing (http://amazon.com/books).

2.2.4 Recent View

Jalan (1996) opined that heavy growth of the borrowing is dangerous for the economy for two reasons: Firstly growth of debt ratio may lead crowding of public investment; Secondly, government spending out of borrowed funds might be unproductive. They observed that the part of public debt which is burdensome and that servicing falls entirely or mostly on tax revenue. If its servicing does not fall entirely on tax revenue, it is not burdensome rather it is productive. Because it itself generate resources for its debt service besides income, employment and output. Therefore all debt are not burdensome.

Chelliah (1961) observed that if revenue will meet subsides, other transfers, interest payments and the greater the part of current expenditure: debt finance will be used for meeting the government's non- remunerative capital formation: and the total domestic borrowing will be determined in such a way that given the rate of domestic saving, the non- government sector will be able to obtain a due share of saving and that there will be no need to borrow from the central bank more that the correct amount of seignior age, it is the ideal situation for borrowing. It can be presented in another ways also:

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

$$D = \frac{Yt - O}{r}$$

Where,

D = maximum sustainable national debt

O = Constant expenditure of ordinary government operation

t = maximum rate of tax receipts to national income (Y) and

r = contractual interest rate of government debt. However, the burden of debt 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 thereby increasing national income. If it is unproductive, the situation will naturally be burden to the government.

Especially in underdeveloped countries, as a fiscal instrument, to raise the effective demand which is ultimately leads to accelerate pace of economic development. It also acts as an effective instrument of inflation generated in the process of growth and ensures growth with stability. It also acts as a balancing wheel that controls the tempo of the business cycle. In the period of depression when aggregate demand is not enough to accelerate the level of production and employment, compensatory fiscal policy suggests to increase in public expenditure and public works by mobilizing idle saving in the hands of people through public borrowing to create effective demand and promote an economic recovery(Barman,1986,p.12).

Growth in the debt ratio causes alarm for two reasons. First, growth is debt ratio might lead to crowding out of private investment. Second and more important is the assumption that government spending out of the borrowed funds might be unproductive (Michael & Posher, 1992, p.204).

Chelliah (2004) observed that the ideal situation is on which first, revenues will meet subsidies, other transfers, interest payment and the greater part of current expenditure, debt finance will be used for meeting the government non remunerative capital formation, a proportion of current expenditure designed to increase social capital and productivity the governments of financial investments and second, the total domestic borrowing will be determined in such way that given the rate of domestic saving, the nongovernment sector will be able to obtain a due share of saving and that there will be no need to borrow from the central bank more than the correct amount of seignior age.

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IMF (2006) presented that a new database on government debt in 19 emerging market countries including Brazil, China, India, Malaysia, Korea and Thailand since 1980. The data set focuses on the structure of debt in terms of jurisdiction of insurance, maturity, currency, composition, and indexation. It also presents stylized facts on debt structure and preliminary evidences on their determinants.

2.3 Empirical Review

2.3.1 In Nepalese Context

In review of literature on public debt in Nepalese context some of the student of master level and some writers have preceded to male their dissertation and article on public debt. Some of these have focused its structure and important whereas others have focused on its burden and impact in inflation, 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. The students of economics try to make a thesis on such context but it emphasizes the Nepalese system and practice on public debt of Nepal.

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

Sharma (1998) discovered that ever increasing debt in Nepal and it's servicing has really created a situation, which is driving the country towards debt trap because of the following reasons:

- A good amount of borrowed fund is used for debt servicing.
- Large amount of loan is allocated for meeting current expenses within the development expenditure.
- Volume of borrowed amount exceeds the maximum legal limit of borrowings.

The most important aim of public debt raised by government i to fill the gap between the revenue received by government and proposed expenditure during the year. The government may borrow money from internal and external sources whenever the income of the government falls short of its expenditure. This income of the state is over and above all taxes and other revenue resources. However, the debt incurred is the income of the state for the year along. Hence, it will have to be rapid through taxation and other resources. The government borrows money from internal as well as from external sources in order to meet gap between their revenue and expenditure.

Guru Gharana (2006) analyzed the burden of public debt as debt servicing cost in Nepal and has come to the view that the long-term upward trend of increasing debt burden inflicts greater burden. He concludes that through loan component of foreign aid. Nepal is suffered more than other countries India, China through the rate of return is very low and rapidly increase volume debt slowly brings the Nepalese economy towards crisis of debt trap.

Debt sustainability is an essential condition for macro-economic stability and sustained economic growth. Most often high public debt level creates repayment flow that can crowed out much needed public spending and can generate adverse incentives for private investors to engage in activities that support long term growth. An excessive level of public debt can make the nation venerable to interruption in aid flow or to sudden shift in domestic financial market sentiments. A narrow export and production based and various structure political and institutional factors that reduce return on investment agreed this problem (ADB, 2016).

Khatiwada (2008) basically discussed the monetary implication of public debt which debt with following points:

- Public debt has exerted upward pressure on the market rate of interest
- Debts servicing resulting to higher budgetary deficit which further contribute to monetary expansion.
- Public debt has crowded out resources available for private sector investment.
- Exerted excess monetary expansion which has indirectly resulted in high rate of inflation and determination of current account situation.
- Heavy bank borrowing by the government contributed significantly for the expansion of money supply in 1990.

According to him the situation is more alarming as foreign loan in the long term nature is Maturing out faster and exchange rate of Nepalese rupees is depreciated very fast multiplying the debt obligation as well as debt servicing requirements.

Based on this analysis he has recommended debt management policy for Nepal as follows:

- Rescheduling of some of the matured foreign debt for the next 10 to 20 years will an alternative

- Nepal should make her economic diplomacy to set foreign loans written off on a case by case basis.

Public debt is a term for all of the money owned at any given time by any branches of the government. It is the amount of money that government has borrowed for inside the country and or outside the country for its spending. Public debt is very important sources in developing country like Nepal.

Hence, Nepal is heavily indebted with internal and external borrowing. Public debt includes internal or external borrowing of the government. It also covers loan received b%' public enterprises against government guarantees. Deficit financing or the utilization of cash balances made available Nepal Rastra Bank is also recorded as part of public debt. Internal debt consists of borrowing through securities such as development bonds. National saving certificates, treasury bill and other special bonds. These securities are to be rapid within specified time. External debt comprises loan and credits made available on concessional. Semi-concessional or commercial term for bilateral and multilateral sources.

If all the public debt used properly- it enhances the economic growth rate and also improve living standard of people. If' properly not used we fall in debt trap. The concept of public debt has been changed according to time to time. They are various views about it.

Koirala (2002) viewed that, if debt is not handled properly our generation to generation may be tired of paying back ancestral earnings. In this perspective, he prescribed some policies to mitigate the pain and adverse effects of ever increasing trend of public debt in Nepal. Loan assistance should be utilized selectively after careful scrutiny at the proposed. Cost and benefits of such projects and programs should be carefully analyzed in order to reduce burden of external debt while contributing to accelerating growth meeting socio-economic objectives.

- Increase the share of tax and reduced the dependency on foreign debt for the financial resources mobilization.
- Unproductive expenditure should not be made out of foreign grant or loan.
- Proper attention should be given to the macro-economic stability of the country while, accepting short term and long terms loans.

- Proper attention should be given to cost benefit analysis when using public debt.

Neupane (2007) observed that government borrowing has been increasing unlikely and financed mostly on the unproductive sectors including uncertainties high expenditure, hence, government always lacks of resources that borrows the new loan to previous ones. That"s why, the public debt and its interest is mounting rapidly, but addressing capacity for redemption for the debt is not increasing in same pace.

Ghimire (2008) concluded that the average annual growth rate of GDP, revenue and export earnings are considerably low as compared with rate of debt and its servicing obligation and 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 stability falling into the debt trap. The angle amount of the 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 servicing and existing 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 measured also for financing government expenditure.

Regmi (2008) 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 external debt. The portion of external debt is too higher as compared to internal debt.

Adhikari (2006) tried to study the debt situation in Nepal. He finds that Nepal is heavily indebted and it will fall on debt crisis if the strong obligation and commitments are not made. The burden of interest payment is higher than the burden of principle payment in Nepal. Growth rate of external debt in Nepal is faster than the growth rate of export earnings. Finally he has concludes that due to the depreciation of Nepalese currency vis-à-vis the convertible foreign currency, the burden of debt servicing has been increasing year by year.

Joshi (1982) presented the poor performance of the nation"s topography and the poor performance of the human capital. He concludes the debt is only one sources of fulfilled 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.

Subedi (2057) started that Aid serves three main objectives political, economic and humanitarian. The blanket justification of aid is 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.

Bhattarai (2007) examined that the trend and structure of public debt, the practice and legal framework of Nepal and other countries regarding fiscal rules on public debt. He also examined that the indebt ness, debt servicing capacity and debt sustainability of Nepal. CEID Nepal (2012) analyzed the study of overall situation of public debt in Nepal. It examined that the high stock of debt, slow growth rate of economy and outflow of considerable amount of resources in the form of debt servicing have raised questions of debt sustainability and also whether foreign or domestic borrowing on current terms is beneficial for our economy or not. This study purposed to analyze current debt situation, analyzed the trend of public debt, analyzed impact of debt on macroeconomic performance & so on. The methodological approach used in this study is based on: inductive inquiry, reviewing of secondary sources of information, which includes published status reports, audit reports and financial records, and consultation and interactions with the officials of key stakeholders this study was carried out for a quick assessment of the situation, as per the call made from Financial Comptroller General Office. The study has examined and identified the key issues in the overall debt situation of Nepal and has made recommendation for its improvement.

The classical economists were against the public borrowing and favored the minimum expenditure from the government side. However, they were not against all types of public debt. They like to approve public debt only for productive purpose and believed that debt servicing did not necessitate additional taxation. The classical economists preferred self-liquidating project the generated required income to serve the incurred debt. J.M. Keynes argued against free market economy, which is self-equilibrating at full employing level propounded by the classical economists pledged in favor of an active government that invests a large amount of budget to correct market-driven shocks and fluctuation to meet the deficit budget of government. They argued about public borrowing which need not necessary be unproductive, inflationary and burdensome.

Hence, Nepal is heavily indebted with internal and external borrowing Nepal's budgetary deficit is fulfilled by loan which is inflationary. But there is no any way to avoid borrowing because the people are so poor, wide saving-investment gap, revenue - expenditure gap and export-import gap. To cover these entire deficits, there is need of borrowing. If it is used properly we can enhance the growth rate, otherwise, may lead towards debt trap.

2.3.2 International Context

Generally, classical economists were against public borrowings and favored the minimum expenditure from the government of side. Classical economists like JB say, JS Mill and TR Malthus have given their argument that "debt creates burden in economy because of its productive nature" (Singh, 1982, pp. 312-314).

Classical views are criticized because government not every expenditure is always unproductive. Therefore, that public debt may not be always burden on the economy and their views regarding the shifting of the debt burden is not correct. The real burden of public debt must be born in the initial period of debt creation when government borrows for meeting development requirements. Hence, government attract resources from prix ate user and put into the public project in the initial period. (Joshi, 1982).

However, modern economists considered public borrowing as an important technique of public finance. Public loans in modern times are necessary to meet financially unfavorable situations. The deficit in budget flood and famine was expenditure etc. Many economists like Keynes has advocated increase public expenditure finance through borrowings and not through taxation as means to remove depression and unemployment. Public borrowings are considered as vary useful for the development of natural resources of developing country (Tyagi, 1976, p. 21).

Since the past times, many individual and institutions have studies and express their views on Public debt regarding its burden Structure, importance, trends etc. Some of them may be outlined as follows:

Lerner (1995) as post second world war economist and one of the pro founder of functional financial approaches, view that public debt maintains that the government should borrow only when it want to make people hold more bonds in place of money. He perceived that if debts are internally hold and then there is nothing to worry about their size.

Goode (1984) examined that domestic borrowings is a use of national saving. The act of burrowing by the government makes it unavailable to private sector for investment. So, Lancing of composition by internal borrowings will causes a curtailment of the national saving and investment. In other hand, borrowed money when used to finance public investment causes no such reduction; all that will happen is the change in the consumption of the capital formation.

Romer (2003) viewed that budget deficit and its financing in many developing countries are very important parameters for analyzing, monetary effects as well as fiscal effect. In the countries overall economic development. Many industrialized countries face similar long term budgetary challenges like developing countries and have run persistently large budget deficit in recent decades. These large and persistent budget deficits have generated considerable concern. There is a wide spread perception that they reduce growth, and could lead to a crisis if they continue for long and become too large. Thus, it is important to examine the resources and effect of budget deficit.

Goode (1984) viewed 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 arguments I that not all outlays classified as investment actually contributed to growth, while some expenditure usually classified as government consumption promote growth.

Musgrave (1959) concluded that the existence of external debt involves a burden for the group as a while since resources must be surrendered in servicing it. Taxpayer as a group would be better if the debt was forgiven. At the same time, the present generation might be better after allowance for debt service than it would have been without past borrowing.

Conscious people, a reasonable of natural resources, a spirit of enterprises, a technically trained labor force and dedicated civil servants are the essential requirements for achieving rapid economic development, but capital formation or mobilization of financial resources is fundamental to the whole problem of economic development. It is true that a large supply of capital is not a sufficient condition for economic development, but increase capital is obviously a necessary concomitant of it. To insure and adequate supply of capital without which economic progress cannot be achieved, appropriate methods of mobilizing financial resources have to be adopted. Using the wrong method can wreck even the best plan (Hicks, 1954, p.37).

Taylor (1971) discussed that the debt is the form of promises by the treasury to pay to the holders of these promises a principle sum and in most instances interest on that principle. Borrowing is restored to order to provide funds for financing a current deficit.

Public debt, an instrument of fiscal policy, has assumed great importance to meet the budgetary deficits. Public debt is the accumulate amount of what government has borrowed from finance deficit. An internal debt is owed by a nation to foreigners and it's burdensome (Samuelson, 1964).

Barman reviewed that public debt is defined as a kind of tax thought which public enjoys the advantage of public expenditure since it becomes greater than current revenue collection; it refers to that obligation of the state promises to pay the amount borrowed by the lender with the interest after a given period of time.

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

Munla (1992) analyzed and explained the origin of debt problems. The debt crisis has its origin with the substantial rise in the external liabilities of the developing countries during the second half of 1970s and early 1980s in an environment of large-scale recycling of the oil exporter s surplus, rising world inflation, and negative real interest rate . At that time many critics viewed this recycling of funds as a positive development: creditors were able to identify new investment out less and deters could acquire funds needs for development purpose.

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

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

He contributed towards principle of the debt strategy and pointed three fundamental principles which are:

- Debtor countries need to pursue strong adjustment programs, supported by determined structural reforms, aimed at increasing domestic resources mobilization. Attracting non debt creating flows, and reducing impediments to growth.
- Creditor and donors need to ensure to provision of adequate external financing in support of such programs on a case-by-case basis.
- The international economic environment must be conductive to the sources of these efforts.

2.4 Research Gap

In context of Nepal, there are a few studies which focus on debt growth nexus. Past studies have also suffered from conflicting results. The past studies have open the way to future research stating that the application of relevant methodology would provide time outcomes. Further, the objectives and methodologies of the present study are different from those of aforementioned reviewed studies and articles. So, this study intends to link and fill gaps in the literature of the past at academic level covering large span of time series annual data.

Above research worked mainly concerned with the public debt of Nepal. Issues of public debt are not a new phenomenon. Earlier thesis also has studied the different aspect of public debt like trend, pattern, financial resource gap and relationship between public debt and GDP. However issues of public debt changes with the changes in time. Therefore, this earlier research study may not be grasping the current issues of public debt because these studies have used old data and information. As a result, these earlier research may not be relevant for the understanding of the different contemporary issues of public debt. In this context, this research study has tried to find out the trend, pattern, financial resource gap and GDP in Nepal by using latest data and information.

Further, in the changed socio- economic structure of the economy, the past studies may not provide sound guidelines for present policy prescription. Therefore, an in-depth study on relationship between government debt and economic growth is utmost important and it is expected that it will contribute extra knowledge in the existing field.

CHAPTER III

RESEARCH METHODOLOGY

3.1 Research Design

The design of the research study is based on historical, descriptive as well as analytical approaches. The research study is designed to show the role, structure and trend of public debt in Nepal. The research study is designed to show the role, structure and trend of public debt in our country.

3.2 Nature and Sources of Data

The research study is descriptive as well as analytical in nature. This study is based on secondary sources of data and information. The required data were collected from various sources as

- Theses and Dissertations
- Economic Reports of Nepal Rastra Bank (NRB)
- Economy surveys and budget speech (MoF)
- Publications of Central Bureau of Statistics (CBS) as well as National Planning Commission (NPC).
- Published articles on different journals and magazines.

3.3 Tools and Techniques of Data Analysis

Data from various sources is processed according to the need of the research study. The available data from various documents were gathered, processed and tabulated to meet the need of the research study. Percentage distribution, average annual growth rate, regression and trend analysis were used for analyzing the data.

3.4 Analysis and Presentation of Data

Analysis and presentation of the collected data is the core of the research work. In the process of data analysis, data are presented with the help of tables, bar diagram and pie-charts and analyzed in the descriptive manner according to the requirement of the study.

3.4.1 Simple Linear Regression Model

The simple linear regression analysis indicates the regression equation with only one independent variable .If two variables say, X and Y are linearly related and further if Y is a linear function of X, then the regression equation Y on X can be expressed as:

$$Y = a + b X$$

Where, X = independent variable

Y = dependent variable

a, b = regression parameters

Here, to explain the role of public debt on economic growth, a simple ordinary least square linear regression model is used. Gross Domestic Product (GDP) depends upon the Internal Debt and the External Debt .

It shows the Relationship between GDP and public debt.

1. $GDP = a_0 + a_1 TD$
2. $GDP = a_0 + a_1 ED$
3. $GDP = a_0 + a_1 ID$

Where, GDP = Gross Domestic Product

ID = Internal Debt

ED = External Debt

TD = Total Debt

a_0, a_1 and a_2 are the parameters.

CHAPTER IV

ANALYSIS, PRESENTATION AND INTERPRETATION OF DATA

4.1 Introduction

Public debt plays a vital role in underdeveloped countries like Nepal. It also helps in the financing of economic development through the mobilization of resources. In Nepal, sources of revenue are inadequate and insufficient for the economic development due to the low level of income and saving capacity of people. In spite of these problems expenditure of the government is going on rapidly in order to achieve rapid economic development mobilization unutilized resources.

The underdeveloped countries like Nepal always face the problem of fund which is reflected in a large extent and as ever increasing financial resource gap in the government budget. Therefore, the selection of appropriate method for financing development plan, various method to be adopted mobilizing for the economy are among the leading issues in economics development.

Public borrowing has major sources, external and internal sources. Internally, a government can borrow for individual's financial institution, non-banking financial intuitions, commercial banks and central bank. Similarly the main sources of external borrowing are IMF, WORLD BANK. IDA and ADB, etc. These institutions give loan to the member countries for a short term for covering the temporary balance of payment difficulties and for along term for the development.

Fiscal policy must be designed to maintain or achieve the goal of high employment, a reasonable degree of price level stability, balance in the foreign accounts and an acceptable rate of economic growth. Public borrowing is needed for stabilization since full employment and price stability do not come about automatically in a market economy but require public policy guidance. Without it the economy trends to be subjects to unemployment or inflation (Musgrave and Musgrave, 1989).

Public borrowing is regarded as a prime mover for economic development. Along with this reasonable abundance of natural resource a spirit of enterprise, a technically trained labour force and dedicated civil servant are the essential requirement for achieving rapid economic development. For this increased capital is needed which seems the fundamental problems of economic development in under developed countries like Nepal due to low label of income and saving capacity of people. In such condition government can take loan from internal as well as external sources. The scope of domestic borrowing is very limited because of scare of internal resources. All the same time the shortage of foreign exchange so only external borrowing remains alternative.

Since Nepal lacks the sufficient internal resources for the economic development. The huge amount of 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.

4.2 Public Borrowing and Deficit Financing

Deficit financing is used to mean any public expenditure that is in excess of current public revenue. It has been used for acquiring resources for economic development. When the government cannot raise the enough revenue through taxation and other sources, expenditure meet through public borrowing know as deficit financing. To fulfill such deficit, the government can adopt the following solution, loan form central bank, loan from people external loan and issuing paper.

Government debt is the debt owned by a central government. In federal states,' government debt may also refer to the debt of a state or provincial, municipal or local government) by contrast, the annual "government deficit refers to the difference between government receipts and spending in a single year, that is, the increase of debt over particular year.

Government usually borrows by issuing securities, government bonds and bills. Less creditworthy countries sometime borrow directly from a supranational organization (e.g. the World Bank) or international financial institutions.

As the government draws it's income from much of the population, government debt is an indirect debt of the taxpayers. Government debt can be categorized as internal debt (owned to learners with in the country) and external debt (owed to foreign lenders). Another common division of government debt is by duration until repayment is due. Short term debt is generally considered to be for one year or less. Long term is for more than ten years. Medium term debt falls between these two boundaries.

A broader definition of government debt may consider all government liabilities, including future pension payment and payment for goods and services the government has a contracted but yet paid.

Public borrowing plays a vital role in under-developed countries like Nepal. It also helps in the financing of economic development through the mobilization of resources. In Nepal, sources of revenue are inadequate and insufficient for the economic development due to low level of income and saving capacity of people. In spite of these problems expenditure of the government is going on rapidly in order to achieve rapid economic development, mobilize unutilized resources. Government receives revenue through internal sources which are not enough in maximization of resources available to the government. Since internal borrowing is very low because of poor tax payable capacity of external borrowing remains alternative sources for development economics. Under developed countries like Nepal is suffering from vicious circle of poverty. To escape out of such circle, capital formation is regarded as a prime mover of development which is necessary in Nepal. But in Nepal, the available stock of capital goods is not sufficient to employ the available labor force on the basis of modern techniques of production. This condition is rapid because it has low rate of saving, investment, income, low living standard due to low per capita income and poverty, dualistic economy, unutilized natural resources, lower health and education condition of people, deficiency of capital etc. in comparison to developed countries in which development is financed by the automatic forces of capital formation under free market economy. But Nepal has market imperfection. In such market resources are not mobilized properly due to lack of capital. So that public debt is only one solution to fulfill the lack of capital deficiency.

Fiscal policy must be designed to maintain or achieve the goals of high employment, a reasonable degree of price level stability, balance in the foreign accounts and an acceptable rate of economic growth. Public borrowing is needed for stabilization, since full employment and price stability do not come about automatically in a market economy but require public policy guidance. Without it the economy tends to be subjected to unemployment or inflation. Under-developed countries like Nepal have low income whereby it is very difficult for mobilization of resource. Nepal has so vague areas where resources are abundant but those are not monetized. These sectors make the mobilization of financial resources more complex. People have no incentives to save. The government policy to promote development is less effective. Thus the rigorous fiscal policy must be adopted to maximize domestic saving for requires investment. The availability of capital fund can be increased through compulsory saving by the help of various fiscal instruments like borrowing, deficit financing and import restriction. There is no doubt public debt is one of the major sources for development financing in developing countries. Public borrowing is regarded as a prime mover for economic development. Along with this reasonable abundance of natural resources, a spirit of enterprise, a technically trained labor force and dedicated civil servant are the essential requirement for achieving rapid economic development. For this increased capital is needed which seems the fundamental problem of economic development in under developed countries like Nepal due to low level of income and saving capacity of people. In such condition government can take loan from internal as well as external sources.

The scope of domestic borrowing is very limited because of scarce of internal resources. At the same time, most of the under-developed countries face the shortage of foreign exchange so only external borrowing remains alternative. Thus, there is no doubt that public debt is a useful instrument for economic development of Nepal. Government is bounded to borrow for financing economic development due to low level of capital formation, which leads to low level of income and wide spread poverty. So to fulfill the lack of capital deficiency public debt plays a prominent role in under developed countries like Nepal either internal or external sources (Krishna, 1998).

Deficit financing is used to mean any public expenditure that is in excess of current public revenue. It has been used for acquiring resources for economic development. When the government cannot raise the enough revenue through taxation and other sources, expenditure meet through public borrowing known as deficit financing. To fulfill such deficit, government can adopt the following solutions:

- Loan from Central Bank
- Loan from people
- Issuing paper money
- External loan

Deficit financing cannot create real resources, which do not exist in the economy. It is only a device that helps to transfer resources to government. The real resources require for economic development must exist in the form of material equipment, labor and skill. Printing money or issuing bank credit cannot create these things. Deficit financing only can put the funds at the disposal of government which can be used for acquiring the real resources provided they are available in the economy.

Deficit financing is the most useful method of promoting economic development of under-developed countries and may be used for the development of economy and social over head capital such as construction of roads, railway, power projects, school, hospitals etc. By providing socially useful capital, deficit financing is able to break bottlenecks such as lack of capital, technical skill and monetary stability etc. of development and thereby increase productivity. Deficit financing as an instrument of economic development, has been given an important place in Nepal’s development plans. It has been regarded as a means to cover the gap in financial resources for want of adequate internal and external monetary sources in order to fulfill the physical targets in the plans. Deficit financing is restored mainly to enable the government to obtain necessary resources for plan. The level of outlay local down by government cannot meet only by taxation and other resources. The gap in resources some extent is made up partly by external assistance but when external assistance is not enough to fill the gap, deficit financing has to be undertaken when the target of production and employment cannot be achieved by the level of expenditure with resources obtained through taxation and other sources, additional resources have to found. How much deficit financing must be done is decided by lacking into consideration a number of other important factors and careful limits. A policy of deficit financing is an important and most fruitful instrument for capital formation in under-developed countries like Nepal. However, deficit financing always does not provide available long term solution. The Nepalese experience has clearly established the fact that heavy dose of deficit financing are advisable because heavy dose of money infected economy and also creates the problem of monetary of monetary stability which make the fruits of development meaningless. It may also lead to inflationary pressure and loss of confidence in the currency. Thus, the effects of deficit financing may be dangerous to economy if its limits are exceeded. So, greater stress needs to be placed on the mobilization of domestic resource for financing of development programs in Nepal. In this context, public borrowing can be taken as effective instruments for mobilization of economic resources for development in Nepal.

4.3 Resource Gap in Nepalese Economy

Public expenditure is the expenditure made by the government for the welfare of the people through the fund collected through tax and revenue, internal and external borro«-in foreign grants and all other receipts by the government. The main motive of the public expenditure is the overall welfare of the people and the nation.

Government borrowing is interrelated with the basic government fiscal flows of taxation and expenditure. When the volume of government expenditure exceeds that of the government revenue, the deficit budget arises. Thus, a deficit budget provides the fundamental pre-condition for debt creation. Such created debt needs interest payment to maintain the debt and refinancing operations of the debt.

Nepal is a least developed country has been facing the problem of funds where the level of government revenue is very low became of low tax payable capacity of people but the level of government expenditure is increasing rapidly. The government needs heavy investment for infrastructure development and socioeconomic development. Since. government revenue is not sufficient for such development, public borrowing plays a prominent role to bridge the fiscal deficit of a country to meet such investment.

The main reasons for raising the government borrowing can be categorized as:

- collect necessary fund,
- recover budgetary fund,
- import knowledge and technology,
- collect fund for infrastructure development and economic development,
- increase production,
- create employment opportunity,
- meet the emergency and special expenses
- sustain the economic and monetary stability,

A country like Nepal public debt help in achieving a growth rate not permitted by it's saving level for investment it allows for higher level of investment than it's saving can meet. It narrows down the gap between saving and investment.

In Nepal, first experience of foreign aid was that of the US government in 23rd January, 1951 with that of the US government of "point four program". In the First Five Year Plan (1956/57-1960/61) of Nepal the development expenditure was fulfilled by foreign loan/grants. But from Second Three Year Plan (1962/63-1964/65), Nepal started to obtain the external debt from 1963/64 and internal debt from FY 1962/63.

Nepal has been borrowing rapidly mainly to balance her budgetary deficit. A large number of infrastructures are essential for the development of the economy. Since Nepal lacks the sufficient internal resources for the economic development the huge amount of 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 within the limit of 2 % of GDP.

Resource in Nepalese economy has always been common phenomenon since the starting of the systematic budgeting system in Nepal. Nepal is facing the serious and growing problem of resource gap. This is because of the growth of the growth rate of the total expenditure and it's revenue generation is not increasing at the same rate. Every individual as well as government needs fund to maintain their expenditure but importance of fund is much essential for government due to the concept of national development to finance for the development works government must be collect funds through the taxation and other source of revenue. However government revenue is inadequate to meet the expenditure because of limited sources of revenue generation. To collect needy funds government must be increased in the tax and fees, which is unjustified for the point of view of social welfare. On the other side the tax and custom administration is not fair transparent and agile 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 total expenditure and that of it's revenue are not keeping in the same pace.

Table 4.1

Different Scenario of Resource Gap

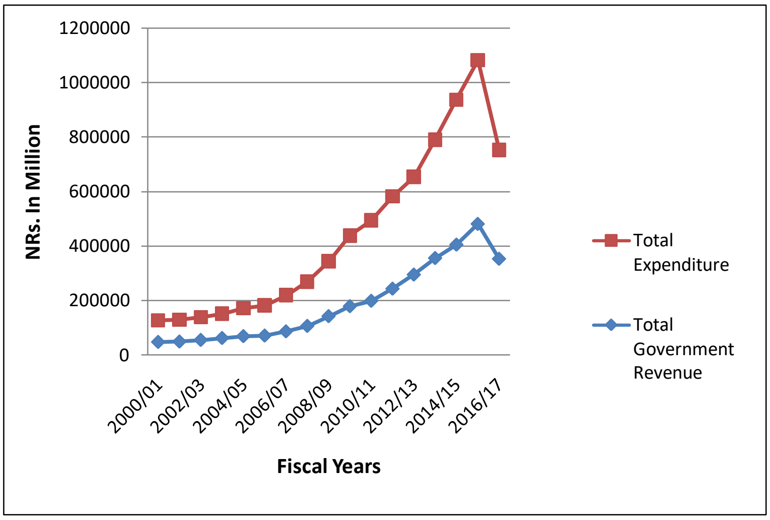
(NRs. In Million)

F/Y	Total Government Revenue	Annual Growth rate of Govt. Revenue	Total Expenditure	Annual Growth Rate of Government Expenditure	Revenue Expenditure Gap	GDP	Revenue as Percent of GDP	Expenditure as Percent of GDP	Revenue Expenditure Gap as Percent of GDP
2000/01	48893.6	14	79835.1	20.5	30941.5	394052	12.4	20.3	7.9
2001/02	50445.5	3.2	80072.2	0.3	29626.5	425454	11.9	18.8	7
2002/03	56229.8	11.5	84006.1	4.9	27776.3	444052	12.7	18.9	6.3
2003/04	63331	10.9	89442.6	6.5	27111.6	473545	13.2	18.9	507
2004/05	70122.7	12.5	102560	14.7	32437.7	517993	13.5	19.8	6.3
2005/06	72282.7	3.1	110889	8.1	38607.1	630300	11.5	17.6	6.1
2006/07	87712.1	21.3	133605	20.5	45892.5	696989	12.6	19.2	6.6
2007/08	107623	22.7	163000	22	55377.3	781262	13.7	20.8	7
2008/09	143475	33.3	201966	34.7	76187.5	938671	15.3	23.4	8.1
2009/10	179946	25.4	259689	18.2	79743.3	1096038	16.4	23.7	7.3
2010/11	199819	11.1	295363	13.7	95544.4	1369431	14.5	21.5	6.9
2011/12	244374	22.3	339168	14.83	94794	1527344	15.91	22.2	6.2
2012/13	296021	21.1	358638	5.74	62617	1692643	17.48	21.18	3.69
2013/14	356620	20.5	435050	21.3	78430	1941624	18.36	22.4	4.03
2014/15	405866	13.80	531558	22.18	125692	2130150	19.05	24.95	5.90
2015/16	481962	18.74	601016	13.07	119054	2247422	21.44	26.74	5.29
2016/17	353910	20.50	400163		46253	2599234	13.4	15.39	1.77
Average Annual Growth Rate		16.59		15.07			14.99	21.27	16.27

Source: Economic Surveys and NRB Reports of Nepal, (F/Y 2000/01- 2016/17)

Figure 4.1

Different Scenario of Resource Gap



Source: Based on Table 4.1

In the above Table 4.1 the second column and the fourth column shows the trend in revenue and expenditure. The sixth column shows the revenue expenditure gap in which it can be seen the increasing tendency mainly because of increasing volume of total expenditure than revenue.

The amount of total expenditure was NRs. 79,835.1 million in F/Y 2000/01 has gone up to NRs. 601016 million in F/Y 2015/16 ; whereas total revenue has increased from NRs.48,893.6 million in F/Y 2000/01 to NRs. 481962 million in F/Y 2015/16. This shows the public expenditure has dominated to government revenue. Thus, the revenue- expenditure gap is NRs. 30,941.5 million in F/Y 2000/01. Present research show that gap is increasing continuously increasing in each FY. In F/Y 2015/16 this gap has been NRs. 119054 million. This phenomenon tends to express that the resource gap is serious and perplexing issues in our country. It is one of the central issues as well as thread in Nepal.

The annual growth rate of government revenue and total expenditure is 14 percent and 20.5 percent in F/Y 2000/01 respectively but the annual growth rate of government revenue and total expenditure is 18.74 percent and 13.07 percent respectively in F/Y 2015/16. This indicates that there is considerable improvement in the allocation of government revenue as compared to F/Y 2000/01.

GDP has been increasing continuously from F/Y 2000/01 to F/Y 2015/16. GDP is the main indicator of the economic development that is why analysis of resource gap as percentage of GDP is more important. The revenue expenditure gap has been decreased from 7.9 percent in F/Y 2000/01 to 5.29 percent in F/Y 2015/16. Average annual growth rate of revenue expenditure gap as percentage of GDP is 6.27 percent.

4.4 Public Debt for Financing Fiscal Deficit

Public debt is the main source for financing fiscal deficit in Nepalese fiscal system and both internal and external sources of borrowing have been adopted in any underdeveloped economy for financing fiscal deficit, which is a common phenomenon in any underdeveloped economy. The total public debt has been increasing rapidly since the restoration of multiparty system.

Due to the rapid increasing in the government expenditure, public debt has become imperative in bridging the resource gap. The government has been unable to raise the revenue to meet the expenditure needed. Government of Nepal (GoN) collects revenue from two sources, namely tax revenue and non-tax revenue. Tax revenue stems from income tax on employees‟ salaries, profit of proprietorship firms and trade industries, house rent, capital gains, and other sources of income where as non-tax revenue stems from custom duties, land tax, fees and commission and so on. The state has not been able to collect tax revenue as expected due to several reasons; some of which are unstable political situation including week and frequently changing government on-going conflicts, weaker performance of economy, weak management of particularly state owned enterprises and resources and rampant corruption in the bureaucracy etc. moreover, GoN has tried to please the general mass including trades, framers, employers and others by resorting to populist economic majors. We have noticed that government’s words are louder than its actions. All these factors have contributed to the government’s failure in collecting required revenue. This leaves with the government no other option than borrowing to need the revenue shortfall and the borrowing has taken place either within the country or from abroad.

The government meets the budgetary deficits by the following means:

- Issuing money
- Borrowing from home country and abroad
- Grants
- Drawing down on foreign exchange reserves

To meet the budgetary deficit, borrowing from home country and abroad is a better option than issuing money. Most of the governments do not want to finance the budgetary deficit by issuing money because it creates inflationary problem in the economy.

4.5 Growth Trend in Public Debt

Nepal is facing large and growing financial resource gap in the budgetary resource. In this context, the government borrowing both external and internal is needed for supplementing the resource gap.

Table 4.2

Trend of Government Debt and Annual Growth Rate

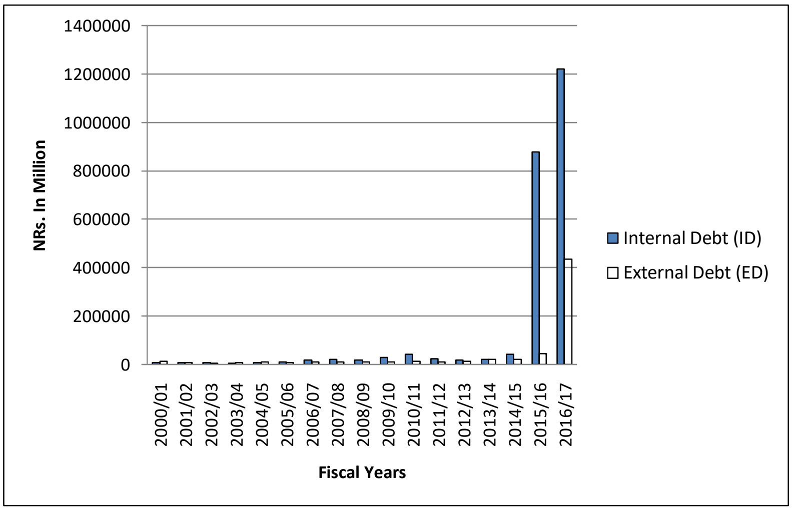
(NRs. In Million)

F/Y	Internal Debt (ID)	External Debt (ED)	Total Debt (TD)	% share of ID in TD	% share of ED in TD	GDP	ID as % of GDP	ED as % of GDP	TD as % of GDP
2000/01	7000	12044	19044	36.8	63.2	394052	1.78	3.06	4.83
2001/02	8000	7698.7	15698.7	51	49	425454	1.81	1.81	3.69
2002/03	8880	4546.4	13426.4	66.1	33.9	444052	2	1.02	3.02
2003/04	5607.8	7629	13236	42.4	57.6	473545	1.18	1.61	2.8
2004/05	8938.1	9266	18204.1	49.1	50.9	517993	1.73	1.79	3.51
2005/06	11834.2	8214.4	20048.6	59	41	630300	1.88	1.3	3.18
2006/07	17892.3	10053.5	27945.8	64	36	696989	2.57	1.44	4.01
2007/08	20500	11325.5	31825.5	64.4	35.6	781262	2.62	1.45	4.07
2008/09	18417.1	9968.9	28386	64.8	35.1	938671	1.96	1.06	3.02
2009/10	29914	11223.5	41137.4	72.7	27.3	1096038	2.72	1.02	3.75
2010/11	42515.8	12075.6	54591.6	77.8	22.1	1369431	3.1	1.1	3.9
2011/12	23419	11083	47502	76.66	23.33	1527344	2.38	0.73	3.11
2012/13	19043	11969	31012	61.4	38.6	1692643	1.12	0.71	1.83
2013/14	19980	21130	41110	48.6	51.4	1941624	1.02	1.08	2.11
2014/15	42368	20432	62800	67.46	32.53	2130150	1.988	0.96	2.948
2015/16	877755	43774	131549	66.72	33.27	2247422	3.90	3.90	5.85
2016/17	1221017	435054	1656071	7374	26.4	2599234	2.107	1.38	3.47
Average Annual Growth Rate							46.69	16.73	63.38

Source: Economic Surveys and NRB Reports of Nepal (CBS), (F/Y 2000/01-2016/17)

Figure 4.2

Trend of Government Debt and Annual Growth Rate



Source: Based on Table 4.2

The government borrowing and annual growth rate from the period 2000/01 to 2015/16. Contribution of both external and internal debt to the total debt has been in the pace of increasing trend. The average annual growth rate as percentage share of internal debt and external debt to total debt is 56.5 percent and 42.92 percent respectively. The total debt has been increased from NRs. 19,044 million in F/Y 2000/01 to NRs.131549 million in F/Y 2015/16.

The share increased of internal debt and external debt as percentage of GDP is 1.78 percent and 3.06 percent respectively in F/Y 2000/01.This has been decreased to 3.9 and 1.94 respectively in F/Y 2013/14. The contribution of external debt has been decreased compared to internal debt in the study period from F/Y 2000/01 to 2015/16.

4.6 Pattern of Internal Net Outstanding Debt in Nepal

Nepal has started internal borrowing since F/Y 1961/62. Internal debt plays an significant role on cash flow management and to support the expenditure for betterment of the nation. Government is receiving internal debt from various sources by means of treasury bills, national saving certificates, development bonds and special bonds.

Table 4.3

Ownership Pattern of Government Bond and Treasury Bills

(NRs. In Million)

F/Y	Treasury Bills	Development Bonds	National Saving Certificate	Special Bonds	Total Outstanding Internal Debt	Percent Share of Treasury Bills	Percent Share of Development Bond	Percent Share of National Saving Certificate	Percent Share of Special Bond
2000/01	21026.9	4262.2	11526.5	17541.4	54357	46	9.9	20.8	29.2
2001/02	27610.8	5962.2	12476.4	13994.3	60043.7	56.3	15.2	15.8	19.2
2002/03	48860.7	16059.2	9629.8	9164.5	83714.2	58.3	19.2	11.5	11.1
2003/04	49429.6	17549.2	9029.8	8946.2	84954.8	58.2	20.7	10.6	10.8
2004/05	51383.1	19999.2	6576.7	8176.3	86135.3	59.7	23.2	7.6	10.4
2005/06	62970.3	17959.2	3876.8	8225.6	93031.9	67.7	19.3	4.2	8.8
2006/07	74445.3	19177.1	1516.9	7245.7	102385	71.7	18.7	1.5	8.1
2007/08	85033.1	21735.4	1116.9	5139.8	113025	72.2	19.8	0.9	4.2
2008/09	86515.1	29478.5	216.9	5030	121241	71.3	24.3	0.1	4.1
2009/10	102044	35519.4	0	5369.7	142933	71.4	24.9	0	3.7
2010/11	120341	43519.4	10680	5029.1	179569	67	24.2	5.9	3.7
2011/12	131624	57519.5	15680.1	502.87	214000	61.5	26.9	7.3	2.4
2012/13	136468	51610.9	15680	1334.5	211900	64.4	24.5	7.4	0.6
2013/14	136468	47110.9	16586.5	0	206700	66.02	22.8	8.02	0
2014/15	1198581	57070.0	4871.1	4871.1	1983857	60.41	28.78	8.36	2.45
2015/16	1150591	108900	4871.1	22973.7	229736.7	50.08	47.40	0.39	2.12
2016/17	1030093	115900	16586.5	4871.1	240366.9	42.81	48.21	6.91	2.03
Average Annual Growth Rate						62.63	23.11	6.89	7.54

Source: Economic Surveys and NRB Reports of Nepal (CBS), (F/Y 2000/01 – 2016/17)

The pattern of internal net outstanding internal debt in Nepal during the period F/Y 2000/01 to F/Y 2015/16 in which the government mainly mobilizes the internal resources by four sources. The contribution of treasury bills is larger because its average annual growth rate is 62.65 percent which is larger than others.

The percentage share of treasury bills, development bonds, national saving certificate and special bonds are 46 percent, 9.9 percent, 20.8 percent and 29.2 percent respectively in F/Y 2000/01. Present research shows that the share of treasury bills has dominated in the mobilization of internal debt. But the average annual growth rate of treasury bills, development bonds, national saving and special bonds are 62.63 percent, 23.11 percent, 6.89 percent and 8.9 percent which shows that the share of treasury bills has dominated in the mobilization of internal debt.

4.7 Pattern of External Debt in Nepal

The need of external borrowing is growing due to the revenue deficit. Internal debt is not sufficient to government for development activities. Due to the low resource mobilization the fund collection is inadequate. So, external debt is the most essential source of revenue to the government.

Table 4.4

Pattern of External Debt in Terms of Disbursement by Major Sources

(NRs. In Million)

F/Y	Bilateral Debt	Multilateral Debt	Total external Debt	Percent Share of Bilateral Debt	Percent Share of Multilateral Debt	GDP	Bilateral Debt as percent of GDP	Multilateral Debt as Percent of GDP	External Debt as Percent of GDP
2000/01	586.7	11457.3	12044	4.9	95.1	394052	0.15	2.91	3.06
2001/02	87	7611.3	7698.6	1.1	98.9	425454	0.02	1.79	1.81
2002/03	657.2	3889.2	4546.4	14.5	85.5	444052	0.15	0.88	1.02
2003/04	66	7563.2	7629	0.9	99.1	473545	0.01	1.6	1.61
2004/05	126.5	9139.6	9266.1	1.4	98.6	517993	0.02	1.76	1.79
2005/06	40.6	8173.7	8214.3	0.5	99.5	630300	0.01	1.3	1.3
2006/07	9004.6	1048.9	10053.5	89.6	10.4	696989	1.29	0.15	1.44
2007/08	632.1	8347.8	8979.9	7	92.9	781262	0.08	1.71	1.14
2008/09	612.9	9356	9968.9	6.1	93.9	938671	0.07	0.99	1.06
2009/10	4550.6	6672.8	11223.4	40.5	59.5	1096038	0.4	0.6	1.02
2010/11	4823.7	7251.9	12075.6	39.9	60.6	1369431	0.3	0.5	1.01
2011/12	3254.4	7828.7	11083	29.4	70.6	1527344	0.21	0.51	0.72
2012/13	2574.4	9394.9	11969	21.5	78.5	1692643	0.15	0.56	0.71
2013/14	1573.7	19556.9	21130	7.4	92.6	1928517	0.08	1.01	1.1
2014/15	3427.6	22188.0	25615.60	13.38	86.64	2130150	0.16	1.16	1.20
2015/16	3201.5	30026.8	33228.3	9.6	90.36	2247422	0.14	1.33	1.47
2016/17	94905.0	71526.4	166431.4	57.02	42.98	2599234	3.65	2.70	6.403
Average Annual Growth Rate				18.91	81.12		0.21	1.16	1.34

Source: Economic Surveys of Nepal (MoF), (F/Y 2000/01 – 2016/17)

The pattern of external debt in terms of disbursement by significance sources. Bilateral loan is in decreasing trend and multilateral loan is in increasing trend and it also reflects that the total external debt is increasing.

External debt is NRs. 12,044 million in F/Y 2000/01 which is increased to NRs. 33228.3 million in F/Y 2015/16. The average annual growth rate of bilateral debt and multilateral debt is 17.98 percent and 82.04 percent respectively.

4.8 Net Outstanding Debt

Net outstanding total debt means both internal and external debt after deducting repayment of principal and interest. Nepalese government has to borrow large amount of loans to meet the financial resource gap. There is increasing trend of total net outstanding public debt in each year.

Table 4.5

Net Outstanding Public Debt to GDP Ratio

(NRs. In Million)

F/Y	Outstanding ID	Outstanding ED	Total Outstanding Debt	GDP	ID as % of GDP	ED as % of GDP	Total Debt as % of GDP
2000/01	54357	200404	255908	394052	13.8	50.9	64.9
2001/02	60043.7	220126	280169	425454	14.1	51.7	65.9
2002/03	73620.7	223433	297054	444052	16.6	50.3	66.9
2003/04	84645.3	232779	317425	473545	17.9	49.2	67.1
2004/05	86133.7	219642	305776	517993	16.6	42.4	59
2005/06	87564.2	233969	321533	630300	13.9	37.1	51
2006/07	93031.9	216201	309233	696989	13.3	31	44.4
2007/08	111239	242061	353300	781262	14.2	30.9	45.1
2008/09	121241	277040	398281	938671	12.9	29.5	42.4
2009/10	142933	256243	399176	1096038	13	23.4	36.4
2010/11	179569	262252	441821	1369431	13.1	19.1	32.2
2011/12	214000	309300	523200	1527344	14	20.2	34.3
2012/13	211900	333400	545300	1692643	12.5	19.7	32.2
2013/14	206700	346800	553500	1928517	10.5	17.9	28.5
2014/15	201657	343262	544919	2130150	9.47	16.11	25.58
2015/16	239029	348760	627789	2247422	10.63	17.29	27.93
2016/17	233226	391280	624510	2599234	8.97	15.05	24.02
Average Annual Growth Rate					13.53	32.06	45.23

Source: Economic Surveys of Nepal (MoF), (F/Y 2000/01- 2016/17)

The net outstanding public debt. Both net outstanding internal and external public debt are increasing in each FY. In F/Y 2000/01, net outstanding internal and external debt is NRs. 54,337 million and NRs.200,404.4 million respectively. In F/Y 2013/14, net outstanding internal and external debt has been increased to NRs. 206,700 million and NRs. 346,800 million respectively.

The average annual growth rate of internal and external debt as percentage of GDP is 14.01 percent and 33.81 percent respectively. The net outstanding debt share of external source is larger than internal sources. Hence, this shows that external debt dependency is increasing each year.

4.9 Public Debt as Percentage of Fiscal Deficit

In Fiscal system of Nepal, the fiscal deficit is financed through both internal and external borrowing. Since the government expenditure is rapidly increasing which is unable to raise revenue accordingly. Thus, accumulation of debt is mainly for financing the deficit. The internal and external debt a percentage of fiscal deficit is shown in Table 4.6 and Figure 4.4.

Table 4.6

Percentage of Debt in Fiscal Deficit

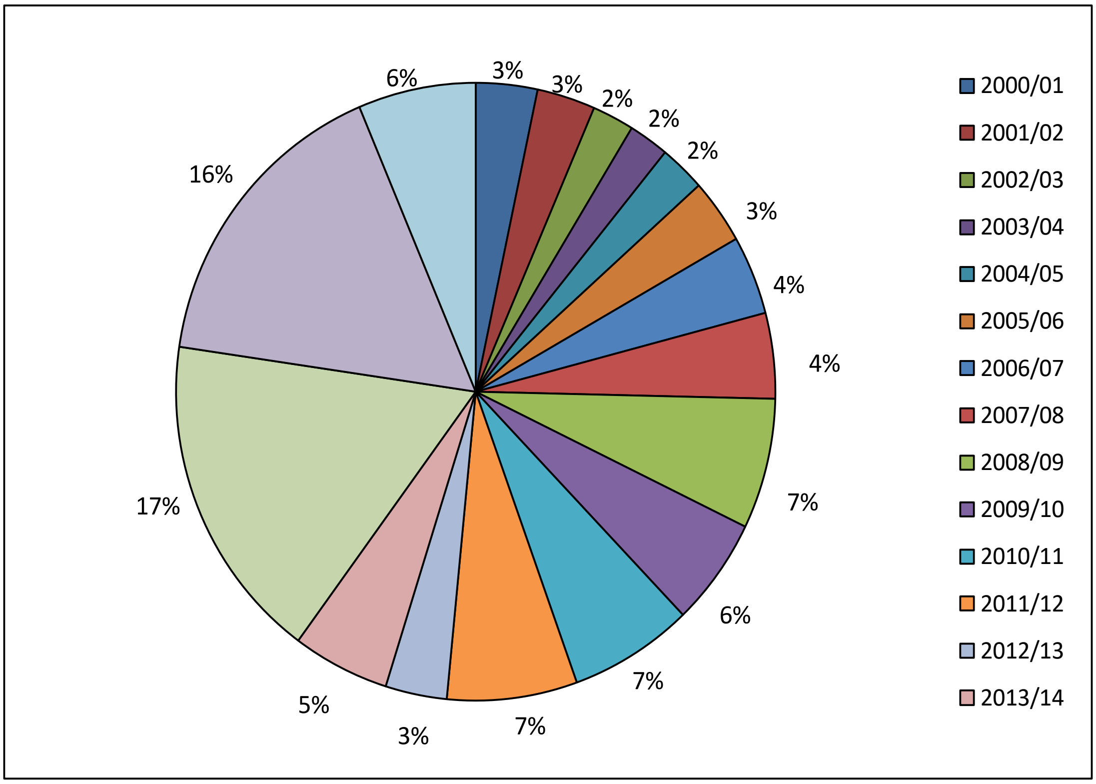
(NRs. In Million)

F/Y	Internal Debt(ID)	External Debt(ED)	Total Debt	Fiscal Deficit	Foreign Grants	Annual growth rate of Deficit	ID as Percent of Deficit	ED as Percent of Deficit
2000/01	7000	12044	19044	24188.1	6753.4	32.3	22.6	38.9
2001/02	8000	7698.7	15698.7	22940.6	6686.2	-4.2	27	26
2002/03	8880	4546.4	13426.4	16437.1	11339.1	-6.2	32	16.4
2003/04	5607	7629	13236	15828.2	11283.4	-2.4	20.7	28.1
2004/05	8938.1	9266	18204.1	18046.5	14391.2	19.6	27.6	28.6
2005/06	11834.2	8214.4	20048.6	24779.6	13827.5	19	30.7	21.3
2006/07	17892.3	10053.5	27945.8	30091.7	15800.8	21.4	39	21.9
2007/08	20500	11325.5	31825.5	32642	20735.3	8.47	62.8	34.7
2008/09	18417.1	9968.9	28386	49804.7	26382.8	52.6	36.9	20
2009/10	29914	11223.4	41137.4	41197.4	38546	-17.3	72.6	27.2
2010/11	42515.8	12075.6	54591.4	48669.1	57997.8	10.1	87.3	24.8
2011/12	36419	11083	47502	51184	40812	5.16	71.2	21.7
2012/13	19043	11969	31012	24170	35229	-51.72	77.1	48.4
2013/14	19980	21130	41110	38150	33960	54.39	52.4	55.4
2014/15	42368	20432	62800	125692	36374	299.0	33.70	16.25
2015/16	87775	43774	131549	119054	32478	5.28	73.72	36.76
2016/17	2332226	166431.4	399657	46253	10298	203.8	50.42	35.982
Average Annual Growth Rate						27.89	47.95	2917

Source: Economic Surveys of Nepal (MoF), (F/Y 2000/01- 2016/17)

Figure 4.3

Percentage of Debt in Fiscal Deficit



Source: Based on Table 4.6

Total public debt in F/Y2000/01 is NRs.19, 044 million which has been increased to NRs. 41,110 million in F/Y 2013/14. In F/Y 2013/14 both internal and external debt are increased to NRs. 19,980 million and NRs. 21,130 million respectively. The fiscal deficit has been increased to NRs. 38,150 million from NRs. 24,188.1 million.

The internal debt has occupied 22.6 percent of deficit whereas the external debt has occupied 38.9 percent of fiscal deficit in F/Y 2000/01. But in F/Y 2013/14 the internal debt has occupied 52.4 percent of fiscal deficit whereas the external debt has occupied 55.4 percent of fiscal deficit

4.10 Share of External and Internal Debt Servicing as Percentage of GDP

Debt servicing of foreign loan entails double burden First, debt servicing has the primary claim upon the allocation of national budget. To that extent priority for economic activities such as drinking water, health, irrigation, road, education, and electricity are deprived of resources. On the other hand, debt servicing of external debt involves the scarcest resource, the foreign exchange. It curbs the capacity to import capital goods needed for the country. 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 and external debt.

Ratio of internal and external debt servicing to total debt servicing and their percentage share to GDP during the period from F/Y 2000/01 to F/Y 2013/14.

Table 4.7

Internal and External Debt Servicing in Nepal

(NRs. In Million)

F/Y	Internal Debt Servicing (IDS)	External Debt Servicing (EDS)	Total Debt Servicing (TDS)	GDP	IDS as % of GDP	EDS as % of GDP	TDS as % of GD
2000/01	4193.2	6201.4	10394.6	394052	1.1	1.6	2.6
2001/02	5637.8	6567.5	12205.3	425454	1.3	1.5	2.9
2002/03	8663.4	7519.2	16182.6	444052	2	1.7	3.6
2003/04	9424.9	7908.9	17338.8	473545	2	1.7	3.7
2004/05	11651.4	8099.9	19751.3	517993	2.3	1.6	3.8
2005/06	11271.7	9150.8	20423.5	630300	1.8	1.5	3.3
2006/07	13321.8	9594.5	22916.3	696989	1.9	1.4	3.3
2007/08	15900.7	10014.7	25915.4	781262	2	1.3	3.3
2008/09	8713.8	12494	21207.8	938671	0.9	1.3	2.3
2009/10	7689.3	13201.1	20890.4	1096038	0.7	1.2	1.9
2010/11	5574.1	13481.1	19055.2	1369431	0.4	0.9	1.3
2011/12	6626.8	13532.4	20159.2	1527344	0.4	0.9	1.3
2012/13	20940.1	14190.1	35130.2	1692643	1.2	0.8	2.1
2013/14	25152.5	16724.6	41877	1941624	1.3	0.9	2.2
2014/15	47429.9	17041.8	64471.7	2130150	2.22	0.80	3.02
2015/16	50334.9	17795.0	68129.9	2247422	2.23	0.79	3.03
2016/17	17975	9803	27777	2599234	0.69	0.37	1.06
Average Annual Growth Rate					1.48	1.24	2.72

Source: Economic Surveys of Nepal (MoF), (F/Y 2000/01 – 2016/17)

Table 4.7 shows the ratio of internal and external debt servicing to total debt servicing and their percentage share to GDP during the period from F/Y 2000/01 to F/Y 2015/16. Table 4.7 shows that the total debt servicing is increasing rapidly. In the F/Y 2000/01, total debt servicing was NRs. 10,394.6 million which has increased to NRs. 68129.9 million in F/Y 2015/16.

The increasing trend of internal debt servicing is greater than external debt servicing. The average annual growth rate of internal debt servicing as percentage of GDP is 41.48 percent, external debt servicing as percentage of GDP is 41.48 percent and total debt servicing as percentage of GDP is 2.72 percent which shows that the burden of internal debt servicing is growing rapidly than the burden of external debt servicing. Thus to remove this problem of burden proper debt management is necessary in Nepal.

Note: External Debt Servicing= Repayment + Interest Payment

Internal Debt Servicing= Total Debt Servicing – External Debt Servicing

Total Debt Servicing= Interest Payment + Principal Repayment

4.11 Trend of Regular Expenditure and Debt Servicing

In annual budgetary process the total debt servicing is a part of regular expenditure. The process of debt servicing has burden on the regular expenditure. The effect is on the head of people of Nepal. Total debt servicing and total external debt servicing and their percentage share in regular expenditure.

Table 4.8

Regular Expenditure and Debt Servicing

(NRs. in Million)

F/Y	Regular Expenditure(R.E.)	Annual Growth Rate of R.E.	Total Debt Servicing	External Debt Servicing	Total Debt Servicing as percent of R.E.	External Debt Servicing as percent of R.E.
2000/01	42769.2	23.9	10394.6	6201.4	24.3	14.5
2001/02	48590	13.6	12205.3	6567.5	25	13.5
2002/03	54973	13.2	16182.6	7519.2	29.4	13.7
2003/04	55552.1	1.1	17338.8	7908.9	31.2	17.3
2004/05	61686.4	11.1	19751.3	8099.9	25.4	13.1
2005/06	67017.8	8.6	20423.5	9150.8	23.1	8.2
2006/07	77122.4	15.1	22916.3	9594.5	29.7	12.4
2007/08	98172.5	27.3	25915.4	10014.7	26.4	10.2
2008/09	127738.9	30.1	21207.8	12494	16.6	9.8
2009/10	151019.1	18.2	20890.4	13201.1	13.8	8.7
2010/11	168824.2	11.7	19055.2	13481.1	11.2	7.9
2011/12	243460	15.8	20159.2	13532.4	8.28	5.6
2012/13	247455.5	1.6	35130.2	14190.1	14.2	5.7
2013/14	303531.8	22.7	41877	16724.6	13.8	5.5
2014/15	244985.6	19.288	64471.7	17041.8	26.31	6.95
2015/16	257259.4	5.01	68129.9	17795.0	26.78	6.91
2016/17	212624.2	17.33	27777	9803	13.06	4.61
Average Annual Growth Rate		14.89			21.57	9.9975

Source: Economic Surveys of Nepal (MoF), (F/Y 2000/01- 2016/17)

In the F/Y 2000/01 total debt servicing was NRs. 10,394.6 million which was 24.3 percent of regular expenditure of that year. Total debt servicing was increased and reached 26.48 percent of regular expenditure in F/Y 2015/16. The average annual growth rate of regular expenditure is 14.89 percent which is greater than the average annual growth rate of external debt servicing as percentage of regular expenditure.

4.12 Trend of Foreign Aid in Development Plan

The contribution of public debt in the public sector development expenditures of the different plan periods. The trend of foreign aid in different development planning.

Table 4.9

Share of Foreign Aid in Development Expenditures in Economic Plans

(NRs. In Million)

Periodic Plans	Development Expenditure	Foreign Aid	Foreign Aid as percent of Dev. Exp.
First Plan (1956-61)	382.9	382.9	100
Second Plan(1962-65)	614.7	478.3	77.8
Third Plan(1965-70)	1639.1	919.8	56.1
Forth Plan(1970-75)	3356.9	1509.1	45
Fifth Plan(1975-80)	8870.6	4264.1	48.1
Sixth Plan(1980-85)	21750	13260	60.1
Seventh Plan(1985-90)	29000	20480	70.6
Eighth Plan(1992-97)	113519.1	74355	65.5
Ninth Plan(1997-2002)	189580	111548	58.8
Tenth Plan (2002-2007)	234029	127311.7	54.4
Three Year Interim Plan (2007/08- 2009/10)	178990	140660	78.6
Three Year Plan (2010/11- 2012/13)	364340	249280	68.42

Source: Periodic Plans of Nepal (NPC (1956-2013)

The contribution of aid as percentage of development expenditure has gradually declined from 100 percent in the First Plan to 45 percent in the Forth plan. It increased gradually then reached 65.5 percent and 58.8 percent in the Eight Plan and Ninth Plan respectively. Then it is decreased to 54.4 percent in the Tenth plan. The portion of foreign aid in the development expenditure in the Three Year Interim Plan estimated to be 78.6 percent.

4.13 Internal Debt Instruments of Nepalese Government

At present, there are five types of domestic borrowing instruments, which are development bonds, National saving s certificates, Citizen saving certificates, Special bonds, Treasury bill.

(i) Treasury Bills

Treasury bills are short term obligations of up to one year. The government has issued 28 days, 91 days, 182 days and 364 days treasury bills. They are issued on the auction as specified in the issue calendar. NRB prepares public debt calendar including the schedule of servicing amount of previously raised loan and the additional amount of accorded by government. The treasury bill most of the time purchased by Commercial banks as a competitive bidders. At least 15 percent of offered amount has to be separated for non-competitive bidders and they should purchase the bill at average discount rate. It should be noted that commercial banks are not allowed to take part as non-competitors.

Treasury bills are issued on every Tuesday. Before one week of issuing Treasury Bills, the notice of auction would be published in the national daily newspaper mentioning the necessary terms like series number, offered amount, taxable/non-taxable, maturity period, earnest money, issue date, bidding time and other conditions. The information would also provide by website by NRB (www.nrb.org.com).

The lender form can be obtained at any branches of NRB and it is to be submitted to the department in the valley and to the branches of NRB in out of the valley within Monday. Investor can apply for minimum Rs. 25000. Investor should enclose original credit voucher as for "earnest money" amounting 2.5 percent of required amount to an auction deposit "sundry creditors main account". Deposit can be made at any banking branches of NRB. The succeeded competitor will be notice to deposit the cash instantly and rejected person get back their respective earnest money. Treasury bills are issued at the discount rate declared by the auction system and redeemed at par (value) that is offered amount would be paid off by the maturity of the bill (Paudel, 2016).

(ii) Development Bonds

It was started to publish from 1963. Initially it was issued in face value at the pre-determined interest rate. After 2005 it was starts to issue on auction. It is divided into competitive and non-competitive categories dividing at least 15 percent for non-competitive bidders. The notice would be public in newspaper with special features and also put in NRB website. Development bond can be purchase by minimum Rs. 25000 and up to rupees exactly divisible by Rs. 25000.

(iii) National Saving Certificate and Citizen Saving Certificate

The main aim of these saving certificates is to mobilize small savings. These are generally non-marketable and tax exempted debt instruments for the public. However, in Nepal these two saving certificate are marketable and taxable securities at the moment. These certificates are sold in face value with pre-determined interest rate. For the issuance, notice with necessary terms and condition would be published in newspaper. There are some differences between these two saving certificates. Citizen Saving Certificates can only be purchase by people where as National Saving Certificate can be can be purchased by both people and banking and non-banking institution. Both saving certificates are issued in form of promissory notes and stock. Ownership of promissory type certificate can be transferred by simple process of signature endorsement between buyers and sellers.

These certificates are recorded in NRB‟s (issuing authority) to their signature verification. On the other hand, stock type's certificate can't be sold by holders simply by endorsement process as they are registered in issue offices. Saving certificate holder has to come to the issue office with buyer for the signature verification. This signature verification is done by NRB, public debt management development department, which is the debt manager of the government.

These saving certificates can be purchase by minimum amount of Rs. 1000 and of maximum amount exactly divisible by Rs. 1000 but not more than stipulated amount. Annual interest of these saving certificates can be received on fixed interest rate in each 6/6 month from NRB, commercial banks, banking branches of agriculture development bank and fixed interest rate and market price.

4.14 Situation of Debt Trap in Nepal

The condition of debt trap is the great challenge for developing countries like Nepal. When the country loses principal payment capacity and interest payment capacity there raises a situation that whole-borrowed money will be used for debt obligation payment. Nepal faces the problem of fiscal deficit.

Nepal is facing over increasing problem of resources gap. It has such situation because:

- Productivity very low
- Less contribution by annually ever growing labor force
- Low quality of human resource available
- A traditional nature in tax administration
- The inflow of easy money through various channels
- Sluggish change in the traditional economic structure
- Extreme capital deficiency

Now a day's foreign assistance is seen so essential that each sector of the economy is wholly dependent on it in Nepal. Above tables shows the trend of average internal public debt is 19 percent of GDP, but external public debt is 48.42 percent of GDP. It has the great place as a source of financing trade deficit, fiscal deficit as development expenditure is increasing day by day.

Present scenario shows that the outstanding public debt is nearly 26.89 percent of GDP in one hand, and debt servicing to GDP ratio is nearly 1.63 percent. This shows that debt is mounted in very high amount in each year. Corruption and use of low quality manpower misuse the high amount of aid. Aid projects are implemented on the donor priorities.

There are neither scientific systems of aid are effective nor productive. Due to such weakness, the government of Nepal would fall into debt trap. This happens when:

a) Borrowed money is used for repayment of principal and payment of interest.

b) Large amount of loan is allocated for regular expenses.

c) The borrowed amount exceeds the debt bearing capacity of the country or the maximum legal limit (1-2 percent of GDP for internal debt).

d) High portion of loan is set-aside for meeting current expenditure.

From the above analysis we can also find that growth rate of GDP is more than growth rate of external debt. Also, we do not only look on large volume of external debt. We have to relatively analyze about what is the impact of external debt on altogether development of economy. To analyze the debt trap, we have to give sharp sight on national income, growth of production level, infrastructure development, foreign exchange earnings, and BOP situation, effect on internal public revenue, capital formation, human development, poverty elevation, sustainable development, industrialization, and exchange rate. From relative analysis we can see positive trends on these sectors. So, external debt has positive impact on these sectors. Most of the foreign debt received by Nepal was of average 1 percent yearly interest rate and of long run maturity. This provide sufficient period for debt servicing. Also 36 countries of the world were fallen in to the category of heavily indebted countries as classified by IMF and WB. But Nepal is not included in that list by IMF and WB. This also shows that Nepal has not fallen in debt trap.

Also, up to this period, Nepal has paid matured principal and interest on the time. Still, it had not taken new loan to pay previous one. All these shows Nepal has not fall in debt trap still. But, there also exist many problems in external debt management in Nepal. The leakages, corruption, inefficient and less productive use of public debt are problems exist in external debt management, hence, we are also in critical situation and if we do not improve it, we may fall in debt trap in near feature (paudel, 2016).

The condition of debt trap is the great challenge for developing countries like Nepal. When the country loses principal payment capacity and interest payment capacity, there arise a situation that whole- borrowed money will be used for debt obligation payment. Nepal faces the problem of fiscal deficit. Nepal is facing over increasing problem of resource gap. It has such situation due to following situation:

- Less contribution by annually ever growing labor force
- Low quality of human resource available
- Productivity is very low
- Sluggish change in the traditional economic structure
- A traditional nature in tax administration

4.15 Burden of Public Debt in Nepal

Underdeveloped countries like Nepal lack the formation of adequate domestic capital to funds development needs. Moreover, these countries are facing the shortage of foreign exchange for importation of capital goods, thereby requiring such countries to resort to public debts from internal as well as external sources such as bilateral and multilateral agencies to break the vicious circle of insufficient capital formation and development bottlenecks. The scope for domestic borrowing in these countries is very limited, because internal resources are scare. Therefore, only external borrowing remains the viable alternative to be undertaken by these countries. Nepal is facing various problems such as poverty, unemployment, internal conflict, political uncertainty and breakdown of law and order etc. and Nepal's macroeconomic indicators show negative/marginal growth and declining economic performance. Nepal's human development index 0.558 as per Nepal Human Development Report 2017, UNDP. This index highlights acute level of human development in Nepal. Recently, Nepal has been incurring huge amount of expenditure for security, which is unproductive from development perspective. There is deficit in our current year's budget and revenue is not increasing. Due to this reason, Nepal will have to depend upon foreign assistance and external loans.

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 governments loan. 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. The total burden of public debt can be classified into two groups, burden of internal debt and external debt.

Internal debt refers to the debt held internally by the persons or institutions with in the area controlled by the public authority. Classical economists were against all types of public debt. They were of the view that if debt is inevitable, they should be paid off as soon as possible it is sometime argued that there is some upper limit to the public debt, beyond which the debt becomes so burdensome that the economy may be open to the risk of bankruptcy. They viewed if the borrowed fund is spent on the productive purpose, it will generate the income and the rate of capital formation will increase.

The external debt is quite different from that of the internal debt. It refers to the money borrowed from foreign countries. External debt poses real burden on the economy by losing the economic welfare of the debater community. The process goes for a long time until the loan is cleared because the debater country has to pay not only the loan but also the interest charge on it. The debt will be less burdensome to the community if it is used for productive purpose so that the balance of payment of the nation will be on its favor. If the debt is used ineffectively, it will certainly create the problem like "debt trap" and problem of the balance of payments.

There is always debate among the economists in case of the shifted burden of public debt to the future generation. Some of the economists have viewed, if the present generations reduce their saving in order to meet the debt finance and leave a smaller amount of capital resource for the future, this will reduce the productive capacity of the coming generation and they will accordingly lose. In this way, burden of debt may push on to the future generation. But some economists have challenged the above version and opposite opinion on the subject of burden of public debt. They submit that there is no shift of the basic burden to the future generation because the state posterity which pays the additional taxes will be benefited from the repayment of the debt.

In case of Nepal, outstanding of public debt is increasing rapidly each year. Large scale of public debts have been incurred in the past for financing development programs, but debt servicing capacity has not increased in the same pace so that there may be undue strain in the balance of payment owing to out flow of funds through debt services. 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.

4.16 Relation between GDP and Public Debt in Nepal

Regression equation is used to analyze the cause and effect relationship between GDP and internal debt (ID) and external debt (ED). To identify the validity of regression estimates and the value of the parameters, various statistical tests have been used. On the basis of the values of the parameters, we have analyzed the structure, trend and burden external and internal debt on the economic development of Nepal.

- **Relation between GDP and Internal Debt in Nepal**

This analysis shows the relationship between GDP and Internal Debt bu=y using the regression equation Y on X_1 which is as:

$Y= a_0 + a_1 X_1$

Where, Y= GDP (Dependent Variables)

X_1 = Internal Debt (Independent Variable)

a_0, a_1 = Regression parameters

The result of this regression model is :

$Y = 98.61+46.63 X_1$

$R^2 = 0.708$ F- test = 16.92

- **Interpretation of the Results**

The fitted equation above shows that there is positive relationship between GDP (Y) and Internal Debt (ID) which means when Internal Debt increases the GDP increases. The coefficient of determination R^2 is 0.688 which means 70.8 percent of variation of GDP (Y) is determined by the explanatory variable i.e. Internal Debt. This means that 29.2 percent of the variation in GDP cannot be explained by Internal Debt alone. Therefore, there must be other variables that have an influence . Similarly, the calculated F- value is 28.5 at 5 percent level of significant which is greater than tabulated F- value 4.75 which implies that the model is statistically significant.

- **Relationship between GDP and External Debt in Nepal**

This analysis shows the relationship between GDP and External Debt by using the regression equation Y on X_2 which is as:

$Y= a_0 + a_1 X_2$

Where, Y= GDP (Dependent Variable)

X_2 = External Debt (Independent Variable)

a_0, a_1 = Regression Parameters

The result of this regression model is:

$Y= - 200.0+110.74 X^2$

$R^2 = 0.673$ F- test = 16.92

- **Interpretation of the Results**

The estimated coefficients of the above equation have expected sign. Both the coefficients are statistically significant at 5 percent level. The coefficient of determination is 0.673 which shows that 67.3 percent of variation of GDP is determined by External Debt. Hence, the growth in External Debt have positive impact in the growth of output., this relationship is statistically significant as the calculated value F- value is 16.92 at 5 percent level of significance which is slightly greater than the tabulated F- value .

- **Relation between GDP and Total Debt in Nepal**

This analysis shows that the relationship between GDP and Total Debt by using the following regression equation:

Regression equation Y on X is

$Y = a_0 + a_1 X$

Where, Y= GDP (Dependent Variable)

X= Total Debt (Independent Variable)

The result of this equation is

$Y = 15.82 + 35.69 X$

$R^2 = 0.749$ F- test = 24.88

- **Interpretation of the Results**

The fitted equation shows that there is positive relation between GDP and Total Debt which means when Total Debt increases then GDP also increases. The coefficient of determination is 0.749 which means that 74.9 percent of variation of GDP is determined by Total Debt. Similarly, the calculated F- value is 24.28 which is greater than tabulated F- value which implies that the model is statistically significant.

The analysis of this chapter reveals that there exist significant positive relationship between External Debt, Internal Debt and total Debt with GDP

CHAPTER V

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.1 Summary of Findings

Public debt in Nepal: An analysis of trend its structure, trend and burden is representative vision of the reality. The main thrust of the study is to analyze the structure and pattern of public debt in Nepal and to show the relationship. Nepal is in critical phase of managing public finance because of inadequacy of internal resources. The Fiscal deficit has been increasing in every fiscal year. The government borrows for financing the budgetary deficit and helps to achieve a higher growth rate of the economy. The government expenditure mainly regular expenditure is increasing rapidly but revenue is not increasing in the same rate. The landlocked nature and mountainous topography are the major constraints for development of Nepal. Economically, Nepal is backward and its economic performance is not satisfactory. Nepalese government is facing an acute resource gap problem which is also being expected to grow in coming years. Nepal is demanding more and more financial resources through public debt to bridge the growing resource gap in the budget.

Borrowing is taking from two sources internal and external. In the internal source treasury bills, development bonds, special bonds and national saving certificate are included. Similarly, in external sources Nepal is receiving borrowing in the form of bilateral and multilateral sources as ADB, UNDP, WB, WHO, IMF etc. For Nepal, both internal and external debt plays a significant role as a means of financing economic development. Public borrowing has to be undertaken within the country as well as abroad. Only through internal sources, it is not sufficient to promote the rapid development of the Nepalese economy. Thus, external debt financing contributes significantly to the external development of Nepal.

Data shows that internal and external debt has been increasing rapidly but external borrowing is more vigorous than internal borrowing. The share of outstanding external debt in total outstanding debt is more than the internal debt. It seems that government could not raise enough internal borrowing due to its limited sources and the presence of non- monetized sectors.

Government should be responsible to utilize the public debt in productive sector rather than unproductive sectors. The government regulates the better fiscal policy and concern in the proper implementation.

Major findings are as follows:

- In the study period from F/Y 2000/01 to F/Y 2016/17, the government revenue has increased from NRs. 48,893.6 million to NRs. 353,910 million with the average annual growth rate of 16.64 percent in revenue. In the same period, the expenditure has increased from NRs. 79,835.1 million to NRs. 400163 million the average annual growth rate of 15.07 percent. But the growth rate of revenue is not sufficient for financing the increased government expenditure..
- The economic growth of country depends on the amount invested in the development activities. If the budget analyzed of Nepal it is found that the share of development expenditure is increasing while the share of regular expenditure is increasing.
- The amount of internal debt was NRs. 7,000 million in F/Y 2000/01 and it has increased to NRs. 1221017 million in F/Y 2016/17. Similarly, the amount of external debt was NRs. 12,044 million in F/Y 2000/01 and it has increased to NRs. 435054 million in F/Y 2016/17. Percentage share of internal debt and total debt in F/Y 2000/01 was 36.8 and 73.74 percent respectively. The share of internal debt and external debt has reached to 56.5 and 42.92 percent respectively. But the average annual growth rate of internal debt and external debt during the study period is 56.5 and 42.92 percent. Thus the portion of internal debt has been increasing in average.
- Average annual growth rate of total external debt as a percentage of GDP is 1.34 percent where as the percentage hare of bilateral and multilateral debt is 0.21 and 1.16 percent respectively. This shows that the external debt is heavily dependent upon multilateral sources.
- In the study period from F/Y 2000/01 to F/Y 2016/17, the gap between revenue and expenditure has increased from NRs. 30,941.5 million to NRs. 46253 million. The resource gap has been increasing in each year that shows

there is excessive increase in government expenditure than government revenue which leads the resource gap

- Total external debt was NRs.12, 044 million in F/Y 2000/01 in which NRs. 586.7 million was taken from bilateral and NRs. 11,457.3 million from multilateral sources. It has gone up to NRs. 435054 million where NRs. 94905 million from bilateral and NRs. 71526.4 million from multilateral sources. In the study period the share of bilateral debt is 18.91 percent and the share of multilateral debt is 81.12 percent.
- The outstanding internal and external debt in F/Y 2000/01 was NRs. 4,357 million and NRs. 200,404.4 million respectively. But in F/Y 2016/17 both outstanding internal and external debt is NRs. 233226 million and NRs. 391280 million respectively. The average annual growth rate of internal and external debt as percentage of GDP is 13.53 and 32.06 percent respectively.
- Development expenditure has been increasing in each plan period. In the First Plan development expenditure was NRs. 382.9 million which is increased to NRs. 364,340 million in the Twelfth Three Year Plan. Foreign Aid is also increasing from NRs. 382.9 million in the First Plan to NRs. 249,280 million in the Twelfth Three Year Plan which is 68.42 percent of development expenditure.
- In F/Y 2000/01, fiscal deficit was NRs. 24188.1 million which is increased to NRs. 46253 million in F/Y 2016/17. The fiscal deficit is increasing in each fiscal year. The average annual growth rate of fiscal deficit is 27.89 percent.
- The total debt servicing was NRs. 10,394.6 million in F/Y 2000/01 which has increased to NRs. 27777 million in F/Y 2016/17. During the period between F/Y 2000/01 to F/Y 2016/17, the average annual growth rate of total debt servicing as percentage of GDP is 2.69 percent. In that period the average annual share of internal debt servicing is more than external debt servicing.

5.2 Conclusion

Public debt in Nepal: An analysis of trend its structure, trend and burden is representative vision of the reality. The main concern of the study is to analyze the structure and pattern of public debt in Nepal and to show the relationship.

The condition of indebtedness of the external debt has increased, due to the poor-mobilization of internal resources, widening investment saving gap, export import gap, revenue expenditure gap and large amount of fiscal deficit. So there has been excessive flow of foreign loans to bridge up these gaps. Consequently, burden of debt and debt servicing obligation are increasing rapidly in each year but debt servicing capacity of the economy is not increasing the same pace.

Present research has analyzed the role, structure and trend of public debt on the economic development of Nepal. The government expenditure has increased more rapidly than government revenue. So the government has borrowed from internal and external sources. The growing trend of borrowing creates a great problem for debt management and becoming a major challenge issue for the country. The borrowing money is unlikely financed on the non-monetized and unproductive sectors of the economy which in turn has the burden for the economy.

Present research has found that government borrowing has increased unlikely and financed mostly on the unproductive sectors and hence government always lacks resources then takes the new loan to pay the previous ones. That's why the public debt and it interest is mounting rapidly but addressing capacity for redemption the debt is not increasing in the same pace.

Present research clearly shows that the average annual share of outstanding debt as a percentage of GDP is almost 47.88 percent. It concluded that we are entrapped in the debt net. If debt management is not set effectively and effective programs for debt financing are not carried out we shall not escape from the situation of debt trap.

The empirical results confirm that stock of internal, external and total debt has not caused negative impacts on GDP growth of Nepal. It is better to take the loan for the economic development but it should be properly utilized on productive sectors otherwise debt-trap will drag us to the path of difficult situation from where we cannot escape from it.

5.3 Recommendations

On the basis of above findings, the following are the purpose recommendations which can be helpful to address the problems of public debt financing in Nepal.

- Government should maintain fiscal balance by applying strong fiscal and monetary policy.

The size of revenue collection is very low and expenditure is very high which creates fiscal imbalance. This has lead to heavy borrowing from internal and the volume of borrowing and maximizing revenue collection government should adopt transparent and effective tax policy by improving tax administration. Government should maintain the strong fiscal discipline. It must set and implements the effective legal system to control the ever- increasing corruption, unnecessary expenses and improper allocation of resources. This might contribute to control growing unproductive and useless expenses in one side and increased revenue on the other side. Government efforts should be directed towards mobilizing internal resources and thus to reduce dependency on loans for financing development expenditure.

- Government should try to receive more grants rather loans.

The government should try to get the rants more and more as far as possible. There is more domination on bilateral grants. The government should maintain such external policy so that more grants should be received rather than the loans.

- Government should increase the debt servicing capacity of the country.

To increase the Debt servicing capacity, Government should increase GDP growth, revenue growth and export earnings growth in sustainable path so that country will not trapped on the debt servicing problem Government should be conscious about falling the country into debt trap. To prevent from debt trap, government should create new debt servicing capacity. The inflowing loan should be utilized as possible as in productive and currency earning areas.

- Proper attention should be given to the macro- economic stability of the country

Nepal has so many under-developed areas, where the role of government is dominating. Government should maintain the balance between urban and rural areas, agricultural and industrial sectors, trades and non- traded sector. The maintenance of such various imbalanced sectors of the economy should be done through control of unproductive expenditure, big push through capital and proper utilization of resources of the under-developed areas. And Government should reduce foreign dependency, various measures must be applied such as export promotion, tourist attraction and import substitution policy should be emphasized and import of capital goods should be increased for the productive purpose.

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